FAIRMARKET INC
Form 10-Q
August 14, 2002

QuickLinks -- Click here to rapidly navigate through this document

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

ý **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Quarterly Period Ended June 30, 2002

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 000-29423

FAIRMARKET, INC.

(Exact name of registrant as specified in its charter)

Delaware	**04-3351937**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

500 Unicorn Park Drive, Woburn, MA 01801-3341
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: **(781) 376-5600**

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 ý No o

The number of shares outstanding of the registrant's common stock as of August 9, 2002 was 26,239,682.

FAIRMARKET, INC.

FORM 10-Q

For the Quarter Ended June 30, 2002

INDEX

				Page
Part I.	**Financial Information**			
	Item 1.	Financial Statements (Unaudited)		
		a)	Condensed Consolidated Balance Sheets as of June 30, 2002 and December 31, 2001	3
		b)	Condensed Consolidated Statements of Operations for the Three- and Six-Month Periods Ended June 30, 2002 and 2001	4
		c)	Condensed Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2002 and 2001	5
		d)	Notes to Condensed Consolidated Financial Statements	6
	Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations		12
	Item 3.	Quantitative and Qualitative Disclosures About Market Risk		32
Part II.	**Other Information**			
	Item 1.	Legal Proceedings		33
	Item 2.	Changes in Securities and Use of Proceeds		33
	Item 3.	Defaults upon Senior Securities		33
	Item 4.	Submission of Matters to a Vote of Security Holders		33
	Item 5.	Other Information		34
	Item 6.	Exhibits and Reports on Form 8-K		34
Signature				35

FAIRMARKET is a registered service mark, and FairMarket Network, MarketSelect and the FairMarket logo are service marks, of FairMarket, Inc. The names of other companies and products mentioned in this Report may be the trademarks of their respective owners.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

FAIRMARKET, INC.

Condensed Consolidated Balance Sheets

(Unaudited)

	June 30, 2002	December 31, 2001

	(In thousands)	
Assets		
Current assets:		
Cash and cash equivalents	$ 25,092	$ 20,329
Marketable securities	17,928	19,977
Restricted cash	481	481
Accounts receivable, net of allowance for doubtful accounts of $448 and $563 at June 30, 2002 and December 31, 2001, respectively	936	639
Prepaid expenses and other current assets	1,727	1,240
Total current assets	46,164	42,666
Long-term marketable securities	18,022	23,066
Property and equipment, net	2,921	5,718
Total assets	$ 67,107	$ 71,450
Liabilities, Redeemable Convertible Preferred Stock and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 336	$ 383
Accrued expenses	2,241	1,489
Deferred revenue	579	238
Current portion of accrual for unutilized office space	1,092	
Current portion of long-term lease obligation	51	145
Total current liabilities	4,299	2,255
Long-term portion of accrual for unutilized office space	1,999	
Other long-term liabilities	254	338
Total liabilities	6,552	2,593
Redeemable convertible preferred stock (liquidation preference of $2,000)	1,934	
Stockholders' equity:		
Preferred stock		
Common stock	29	29
Additional paid-in capital	188,940	189,370
Deferred compensation and equity-related charges	(1,351)	(10,580)
Accumulated other comprehensive loss, net	(19)	(13)
Accumulated deficit	(128,978)	(109,949)
Total stockholders' equity	58,621	68,857
Total liabilities, redeemable convertible preferred stock and stockholders' equity	$ 67,107	$ 71,450

See accompanying notes to condensed consolidated financial statements.

FAIRMARKET, INC.

Condensed Consolidated Statements of Operations

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2002	**2001**	**2002**	**2001**
	(In thousands, except per share amounts)			
Revenue	$ 1,346	$ 2,773	$ 2,657	$ 5,225
Operating expenses:				
Cost of revenue (exclusive of $6 and $45 in 2002 and $51 and $115 in 2001, for the three- and six-month periods, respectively, reported below as equity-related charges)	1,018	1,259	2,042	2,615
Sales and marketing (exclusive of $4,242 and $8,564 in 2002 and $5,917 and $11,544 in 2001, for the three- and six-month periods, respectively, reported below as equity-related charges)	674	2,662	1,308	6,113
Development and engineering (exclusive of $35 and $107 in 2002 and $105 and $235 in 2001, for the three- and six-month periods, respectively, reported below as equity-related charges)	675	1,382	1,469	3,102
General and administrative (exclusive of $12 and $58 in 2002 and $171 and $259 in 2001, for the three- and six-month periods, respectively, reported below as equity-related charges)	1,722	3,075	3,847	6,023
Unutilized office space charge			4,500	
Equity-related charges	4,295	6,244	8,774	12,153
Restructuring charge	530	1,650	530	1,650
Total operating expenses	8,914	16,272	22,470	31,656
Loss from operations	(7,568)	(13,499)	(19,813)	(26,431)
Other income, net	379	788	784	1,921
Net loss	(7,189)	(12,711)	(19,029)	(24,510)
Dividends on redeemable convertible preferred stock	(16)		(16)	
Net loss attributable to common shareholders	$ (7,205)	$ (12,711)	$ (19,045)	$ (24,510)
Basic and diluted net loss per common share	$ (0.25)	$ (0.44)	$ (0.65)	$ (0.85)
Shares used to compute basic and diluted net loss per common share	29,312	28,780	29,235	28,760

See accompanying notes to condensed consolidated financial statements.

FAIRMARKET, INC.

Condensed Consolidated Statements of Cash Flows

(Unaudited)

	Six Months Ended June 30,	
	2002	2001
	(In thousands)	
Cash flows from operating activities:		
Net loss	$ (19,029)	$ (24,510)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	1,672	1,777
Reserve for uncollectible accounts		37
Amortization of email marketing database		3,032
Amortization of deferred compensation and equity-related charges	8,774	12,616
Loss on disposal of property and equipment	1,169	
Current portion of accrual for unutilized office space	1,092	
Long-term portion of accrual for unutilized office space	2,247	
Redeemable convertible preferred stock issued to customer below fair value	114	
Changes in operating assets and liabilities:		
Accounts receivable	(276)	850
Prepaid expenses and other current assets	(457)	(330)
Accounts payable	(53)	(580)
Accrued expenses	742	(596)
Deferred revenue	333	(613)
Other non-current liabilities	(333)	(85)
Net cash used in operating activities	(4,005)	(8,402)
Cash flows from investing activities:		
Additions to property and equipment	(9)	(724)
Purchase of marketable securities	(101,117)	(14,898)
Proceeds from maturity of marketable securities	108,165	14,978
Net cash provided by (used in) investing activities	7,039	(644)
Cash flows from financing activities:		
Proceeds from issuance of common stock, net of issuance costs	65	46
Proceeds from issuance of redeemable convertible preferred stock, net of issuance costs	1,796	
Repayment of capital lease	(95)	(105)
Net cash provided by (used in) financing activities	1,766	(59)
Effect of foreign exchange rates on cash and cash equivalents	(37)	(63)
Net increase (decrease) in cash and cash equivalents	4,763	(9,168)
Cash and cash equivalents, beginning of period	20,329	61,126
Cash and cash equivalents, end of period	$ 25,092	$ 51,958

See accompanying notes to condensed consolidated financial statements.

FAIRMARKET, INC.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

1. Nature of Business

FairMarket, Inc. ("FairMarket" or the "Company") provides private-label, Internet-based marketing and commerce solutions that incorporate dynamic pricing. The Company offers a range of services, technology and expertise to help large merchants maximize yield on clearance, excess and off-lease inventory and to realize process efficiencies. FairMarket's solutions enable merchants to sell to consumers or wholesale buyers on the merchants' own sites or to buyers on eBay. FairMarket's technology is designed to enable our customers to leverage their existing inventory, transaction and fulfillment infrastructures by integrating seamlessly with those systems.

2. Basis of Presentation

The accompanying consolidated interim financial statements of FairMarket are unaudited and have been prepared on a basis substantially consistent with the Company's audited financial statements for the year ended December 31, 2001. The consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information. Consequently, these statements do not include all disclosures normally required by generally accepted accounting principles for annual financial statements. These consolidated interim financial statements should be read in conjunction with the Company's audited consolidated financial statements for the year ended December 31, 2001, which are contained in FairMarket's Annual Report on Form 10-K, as amended, for the year ended December 31, 2001 filed with the Securities and Exchange Commission. The consolidated interim financial statements, in the opinion of management, reflect all adjustments (including all normal recurring accruals) necessary for a fair presentation of the results of operations and cash flows for the interim periods ended June 30, 2002 and 2001. The results of operations for the interim periods are not necessarily indicative of the results of operations to be expected for the fiscal year. The consolidated interim financial statements include the accounts of FairMarket, Inc. and its wholly owned subsidiaries, FairMarket UK Limited, The FairMarket Network Pty Ltd, FairMarket GmbH and FairMarket Securities Corporation. All intercompany transactions and balances have been eliminated in consolidation.

3. Equity-related and Unutilized Space Charges

Equity-related charges consist of the amortization of (i) deferred stock compensation resulting from the grant of stock options to employees at exercise prices subsequently deemed to be less than the fair value of the common stock on the grant date and (ii) the fair value of warrants issued to strategic customers and shares of Series D convertible preferred stock issued to strategic customers at prices below their fair value. At June 30, 2002, deferred stock compensation was $475,000, net of amortization of $6.2 million and canceled stock options valued at $6.6 million. This amount is being amortized ratably over the vesting periods of the applicable stock options, typically four years, with 25% vesting on the first anniversary of the grant date and the balance vesting 6.25% quarterly thereafter. For the three and six months ended June 30, 2002 and 2001, related expense recognized was $60,000 and $236,000, and $747,000 and $1.2 million, respectively.

At June 30, 2002, other deferred equity-related charges, which is a component of deferred compensation and equity-related charges in stockholders' equity, totaled $875,000, net of amortization of $46.8 million. Included in other deferred equity-related charges is the value of shares of Series D convertible preferred stock issued to Excite, Inc. (now known as At Home Corporation), which

converted into shares of the Company's common stock upon the Company's initial public offering. The Company recorded the shares at fair value for a total of $15.0 million at December 31, 1999. The value of the shares was remeasured at the date of the Company's initial public offering and the Company recorded an additional $10.5 million in the first quarter of 2000 as a deferred charge to be amortized over the remaining term of the Company's original auction services agreement with Excite. As a result of the termination of the original Excite agreement in December 2000, the remaining term of that agreement was modified to the initial 18-month term of the new auction services agreement

entered into by the Company and At Home at that time. During the second quarter of 2002, the Company expensed the remaining $3.3 million of unamortized value of the stock issued to Excite.

Other deferred equity-related charges are being amortized ratably over the terms of the related agreements, from 18 months to three years (ending in September 2002) for the three and six months ended June 30, 2002 and from 18 months to five years for the three and six months ended June 30, 2001. For the three and six months ended June 30, 2002 and 2001, related expense recognized was $4.2 million and $8.5 million, and $5.7 million and $11.5 million, respectively. At June 30, 2002, the unamortized value of deferred charges on the Company's balance sheet was $875,000, which will be expensed in the third quarter of 2002.

In the first quarter of 2002, the Company recorded a one-time charge of $4.5 million for unutilized office space at the Company's Woburn, Massachusetts headquarters. This charge includes rent payments and other related costs for a significant portion of the Company's leased space which has been vacated for the remaining lease term and the write-down of related leasehold improvements and furniture and fixtures.

4. Net Loss per Share

Basic net loss per common share is computed using the weighted average number of common shares outstanding during the period. Diluted net loss per common share is computed using the weighted average number of common shares outstanding during the period plus the effect of any dilutive potential common shares. Dilutive potential common equivalent shares consist of the assumed exercise of stock options, the proceeds of which are then assumed to have been used to repurchase outstanding stock using the treasury stock method, and the assumed conversion of convertible preferred stock and warrants. Potential common shares were excluded from the calculation of net loss per common share for the periods presented since their inclusion would be anti-dilutive. For the three and six months ended June 30, 2002 and 2001, basic and diluted net loss per common share is computed based on the weighted-average number of common shares outstanding during the period because the effect of common equivalent shares would be anti-dilutive.

Certain securities were not included in the computation of diluted net loss per share for the quarters ended June 30, 2002 and 2001, because they would have had an anti-dilutive effect due to net losses for such periods. These securities include: (i) options to purchase 4,646,162 shares of common stock with exercise prices of $0.10 to $9.66 per share at June 30, 2002 and options to purchase 5,338,000 shares of common stock with exercise prices of $0.10 to $9.66 per share at June 30, 2001; and (ii) 952,380 shares of Series B preferred stock convertible into common stock on a one-for-one basis, subject to adjustment, at June 30, 2002.

5. Comprehensive Loss

For the three and six months ended June 30, 2002 and 2001, total comprehensive loss was as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2002	**2001**	**2002**	**2001**
Net loss	$ (7,189)	$ (12,711)	$ (19,029)	$ (24,510)
Changes in other comprehensive loss:				
Foreign currency translation adjustments	60	(24)	39	(44)
Unrealized gain (loss) on marketable securities	97		(45)	(19)
Total comprehensive loss	$ (7,032)	$ (12,735)	$ (19,035)	$ (24,573)

6. Stock Option Exchange

On January 16, 2001, the Company implemented a one-time employee incentive program under which employees had the opportunity to exchange, on a one-for-one basis, their outstanding employee stock options with exercise prices of $3.00 or more for new options with an exercise price of $2.1875, the closing price of the Company's common stock on the January 16, 2001 exchange date. Options held by executive officers and directors were not included in the exchange. Under this program, options covering approximately 1,155,000 shares of the Company's common stock were exchanged for options covering an equal number of shares. Options granted under this program have special

terms, with the options vesting quarterly over two years, beginning on the three-month anniversary of the grant date, if the option exchanged was unvested, or vesting on the six-month anniversary of the grant date, if the option exchanged was vested, and having a term of two and one-half years. For accounting purposes, the exchange constituted a repricing of the existing options and will require variable accounting for the new options granted in the exchange. As a result, the Company (i) will recognize a non-cash compensation charge each quarter with respect to vested options if and to the extent that the per share fair market value of the Company's common stock at the end of the quarter exceeds $2.1875, the per share exercise price of the new options, and (ii) will adjust deferred compensation each quarter for unvested options. There is a potential for such a variable non-cash charge in each quarter until all of the new options are exercised or until the date the options expire (July 16, 2003) or otherwise terminate. The closing price of the Company's common stock on June 30, 2002 was below $2.1875, therefore no related charge was recognized for the three and six months ended June 30, 2002.

7. Revenues and Long-lived Assets by Geographic Region

The table below presents revenues by principal geographic region for the three and six months ended June 30, 2002 and 2001 (in thousands)*:*

	Three Months Ended June 30,		Six Months Ended June 30,	
	2002	**2001**	**2002**	**2001**
United States	$ 971	$ 2,159	$ 1,921	$ 4,025
United Kingdom	353	297	690	727
All other	22	317	46	473
Total	$ 1,346	$ 2,773	$ 2,657	$ 5,225

The table below presents long-lived assets by principal geographic region as of June 30, 2002 and December 31, 2001 (in thousands):

	June 30, 2002	December 31, 2001
United States	$ 2,387	$ 5,021
United Kingdom	534	697
All other		
Total	$ 2,921	$ 5,718

8. Accounting for Consideration Given by a Vendor to a Customer

Effective January 1, 2002, the Company adopted Emerging Issues Task Force ("EITF") Issue No. 01-09, "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)" ("EITF 01-09"). EITF 01-09 addresses whether a vendor should recognize consideration, including equity instruments, given to a customer as an expense or as an offset to revenue being recognized from that same customer. Consideration given to a customer is presumed to be a reduction of revenue unless both the following conditions are met:

(a) the vendor receives an identifiable benefit in exchange for the consideration, and the benefit is sufficiently separable from the customer's purchase of the vendor's products and services such that the customer could have purchased the products from another third party; and

(b) the vendor can reasonably estimate the fair value of the benefit received.

If both criteria are met, consideration paid to the customer may be recognized as an expense. If consideration, including equity instruments, does not meet the above criteria, the vendor must characterize the recognition of such consideration as a reduction of revenue, to the extent there is cumulative revenue from such customer. Any recognition in excess of cumulative revenue for such consideration is recorded as an expense.

During the second quarter of 2002, the Company recorded a one-time charge of $114,200 against revenue to reflect the amount by which the estimated fair value of the shares of the Company's Series B redeemable convertible preferred stock issued to eBay Inc. in May 2002 exceeded the amount paid by eBay (see Note 11).

During the three and six months ended June 30, 2001, the Company recognized amortization of equity-related charges for Excite and Microsoft Corporation as sales and marketing expense. In those same periods, the Company recognized revenue of $231,000 and $463,000, respectively, from Excite and Microsoft. As a result of the adoption of EITF 01-09, the Company has reclassified $231,000 and $463,000 of equity-related charges for the three and six months ended June 30, 2001 as a reduction of revenue since it did not meet both of the above criteria. There was no impact to net loss. The Company will reclassify $5,000 of equity-related charges for the quarter ended September 30, 2001 as a reduction of revenue for comparative purposes when it reports its financial results for the third quarter of 2002.

9. Commitments and Contingencies

FairMarket has been named as a defendant in certain purported class action lawsuits filed by individual shareholders in the U.S. District Court for the Southern District of New York against FairMarket, Scott Randall (former President, Chief Executive Officer and Chairman of the Board of FairMarket), John Belchers (former Chief Financial Officer of FairMarket), U.S. Bancorp Piper Jaffray Inc., Deutsche Bank Securities Inc. and FleetBoston Robertson Stephens, Inc. The lawsuits have been filed by individual shareholders who purport to seek class action status on behalf of all other similarly situated persons who purchased the common stock of FairMarket between March 14, 2000 and December 6, 2000. The lawsuits allege that certain underwriters of FairMarket's initial public offering solicited and received excessive and undisclosed fees and commissions in connection with that offering. The lawsuits further allege that the defendants violated the federal securities laws by issuing a registration statement and prospectus in connection with FairMarket's initial public offering which failed to accurately disclose the amount and nature of the commissions and fees paid to the underwriter defendants. FairMarket intends to defend the lawsuits vigorously.

10. Restructuring Charge

In late June 2002, as part of the Company's plan to continue to implement cost-cutting measures, the Company eliminated 18 positions worldwide, representing approximately 31% of its total employee base. In addition, the Company relocated its U.K. data center to the U.S. The Company recognized a charge of $530,000 in the second quarter of 2002 for the costs related to these initiatives, of which $200,000 relates to non-cash costs. At June 30, 2002, $200,000 of the total charge remained unpaid, primarily related to severance payments to certain employees. The Company expects to pay substantially all of these remaining expenses by the end of the third quarter of 2002.

11. Redeemable Convertible Preferred Stock

On May 17, 2002, the Company completed a private placement of 952,380 shares of its Series B redeemable convertible preferred stock, par value $0.001 per share, to eBay Inc. for an aggregate purchase price of $2.0 million. The Series B preferred stock is entitled to cash dividends payable quarterly at the rate of 6.5% per annum in preference to any dividend on any other series of preferred stock or common stock. The dividends are cumulative and are entitled to participate on a pro rata basis in any dividend paid on the common stock on an as if converted basis. At June 30, 2002, the Company accrued $16,000 for dividends payable. The Series B preferred stock is convertible into shares of common stock on a one-for-one basis, subject to certain adjustment mechanisms including a weighted average anti-dilution mechanism. In the event of any liquidation, dissolution or winding up of the Company (a "Liquidation"), the holders of the Series B preferred stock are entitled to receive, in

preference to the holders of certain junior securities, as defined, a per share amount equal to $2.10 plus all accrued and unpaid dividends (the "Liquidation Preference"). In the event of a Liquidation, after payment of the Liquidation Preference and any other liquidation preference on any other series of stock, the Series B preferred stock is entitled to participate on a pro rata basis with the common stock in the distribution of the remaining assets of the Company on as if converted basis. The holders of the Series B preferred stock have the right to require the Company to redeem the Series B preferred stock at any time after the earlier of (a) May 17, 2003, and (b) the happening of a material adverse effect on the

Company's business, as defined. The Company has the right, at any time after May 17, 2004, to redeem the outstanding Series B preferred stock at $2.10 per share plus all accrued and unpaid dividends. The net proceeds from this offering, after issuance costs, totaled $1.8 million. At the issuance date, the Company estimated the fair value of the Series B preferred stock to be in excess of the amount paid by eBay by $114,200. As a result, the Company recorded an $114,200 adjustment to increase the carrying value of this investment and decrease revenue in accordance with EITF 01-09 (see Note 8.) The Company is accreting the carrying value of the Series B preferred stock up to $2.0 million through May 2003 in accordance with the redemption feature described above. The Company recorded $24,000 in accretion during the second quarter of 2002. At June 30, 2002, the carrying value of the Series B preferred stock was $1.9 million.

12. Recent Accounting Pronouncements

In July 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 requires that all business combinations be accounted for under the purchase method and that certain acquired intangible assets in a business combination be recognized as assets apart from goodwill. SFAS No. 142 requires that ratable amortization of goodwill and certain intangible assets be replaced with periodic tests of the goodwill's impairment and that other intangible assets be amortized over their useful lives. SFAS No. 141 is effective for all business combinations initiated after June 30, 2001 and for all business combinations accounted for by the purchase method for which the date of acquisition is after June 30, 2001. The provisions of SFAS No. 142 are effective for fiscal years beginning after December 15, 2001, and thus were adopted by the Company on January 1, 2002. However, for goodwill and intangible assets acquired after June 30, 2001, certain provisions of SFAS No. 142 are effective from the date of acquisition. The adoption of SFAS No. 141 and 142 had no impact on the Company's financial statements and related disclosures.

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of." SFAS No. 144 further refines the requirements of SFAS No. 121 that companies (i) recognize an impairment loss only if the carrying amount of the long-lived asset is not recoverable based on its undiscounted future cash flows and (ii) measure an impairment loss as the difference between the carrying amount and the fair value of the asset. In addition, SFAS No. 144 provides guidance on accounting and disclosure issues surrounding long-lived assets to be disposed of by sale. The Company adopted SFAS No. 144 on January 1, 2002 and the adoption had no impact on its financial statements and related disclosures.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." This statement addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)" ("EITF 94-3"). SFAS No. 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. EITF 94-3 allowed for an exit cost liability to be recognized at the date of an entity's commitment to an exit plan. SFAS No. 146 also requires that liabilities recorded in connection with exit plans be initially measured at fair value. The provisions of SFAS No. 146 are effective for exit or disposal activities that are initiated after December 31, 2002, with early adoption encouraged. The Company does not expect the adoption of SFAS No. 146 to have a material impact on its financial position or results of operations.

13. Subsequent Event

On August 8, 2002, the Company repurchased the 3,181,000 shares of its common stock, par value $.001 per share, held by Scott Randall, the original founder of FairMarket, at a price of $1.27 per share. These shares represented 10.8% of the Company's outstanding common stock. After giving effect to this repurchase, there were 26,239,682 shares of common stock outstanding.

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

This Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. You can identify forward-looking statements by the use of the words "believe," "expect," "anticipate," "intend," "estimate," "assume" and other similar expressions which predict or indicate future events and trends and which do not relate to historical matters. You should not rely on forward-looking statements, because they involve known and unknown risks, uncertainties and other factors, some of which are beyond our control. Our actual results could differ materially from those set forth in the forward-looking statements. Certain factors that might cause such a difference include the following: market acceptance of our online auction and other e-commerce services; growth of the market for dynamic e-commerce services; the competitive nature of the online markets in which we operate; economic

conditions; our ability to generate significant revenue to reach profitability; our ability to retain existing customers and to obtain new customers; our ability to attract and retain qualified personnel; our ability to expand or maintain our operations in our geographic markets and the currency, regulatory and other risks associated with doing business in international markets; the operation and capacity of our network system infrastructure; our limited operating history; and the other risks and uncertainties discussed under the heading "Factors that May Affect Results of Operations and Financial Condition" on page 19 of this Form 10-Q. You should not place undue reliance on our forward-looking statements, and we assume no obligation to update any forward-looking statements.

The following discussion of our financial condition and results of operations should be read in conjunction with our financial statements and the notes to those statements included elsewhere in this Report and in our Annual Report on Form 10-K, as amended, for the year ended December 31, 2001 and in other reports filed by us with the Securities and Exchange Commission.

Overview

FairMarket provides private-label, Internet-based marketing and commerce solutions that incorporate dynamic pricing. We offer a range of services, technology and expertise to help large merchants maximize yield on clearance, excess and off-lease inventory and to realize process efficiencies. Our solutions enable merchants to sell to consumers or wholesale buyers on the merchants' own sites or to buyers on eBay. Our technology is designed to enable our customers to leverage their existing inventory, transaction and fulfillment infrastructures by integrating seamlessly with those systems.

Our services are used in four primary areas: (1) retail and discount clearance; (2) promotions and interactive marketing; (3) business-to-business surplus; and (4) outsourced auctions and e-commerce to portals and other web communities. We provide a broad suite of dynamic pricing formats, including auctions, our primary format, as well as fixed and falling price formats.

We offer our customers the ability to distribute their listings to other sites through two methods. First, through our MarketSelect[sm] service, we enable customers (with or without their own FairMarket-hosted site) to list, manage and transact sales on eBay. Second, because we host our customer's dynamic pricing sites on our central systems, we have the ability to aggregate listings of goods and services available for sale on our customers' commerce sites and make those listings available for display and sale on other FairMarket-hosted customer sites.

Beginning in the second half of 2001, we began to experience a shift in the nature of our revenue, from the fixed monthly fees we traditionally charge for hosting and maintaining customers' sites, to transaction-based fees. We believe that this revenue shift is partly a result of recent economic conditions and pricing competition, and partly a result of an increasing portion of our customers using our MarketSelect service (which we launched during the second quarter of 2001), the fees for which are primarily transaction-based.

We believe our success is dependent in large part on increasing our customer base and further developing the breadth and functionality of our service offerings, as well as on the volume of our customers' sales on their FairMarket-hosted sites and through our MarketSelect service. We intend to continue to invest in the further development of our service offerings and technology and in the promotion of our service offerings.

Because of our limited operating history, there is limited operating and financial data about our business upon which to base an evaluation of our performance. Period-to-period comparisons of operating results should not be relied upon as an indicator of future operating results.

Recent Developments

On August 8, 2002, we repurchased the 3,181,000 shares of our common stock, par value $.001 per share, held by Scott Randall, the original founder of FairMarket, at a price of $1.27 per share. These shares represented 10.8% of our outstanding common stock. After giving effect to this repurchase, there were 26,239,682 shares of common stock outstanding.

In late June 2002, as part of our plan to continue to implement cost-cutting measures, we eliminated 18 positions worldwide, representing approximately 31% of our total employee base. In addition, we relocated our U.K. data center to the U.S. We recognized a charge of $530,000 in the second quarter of 2002 for the costs related to these initiatives, of which $200,000 relates to non-cash costs. At June 30, 2002, $200,000 of the total charge remained unpaid, primarily related to severance payments to certain employees. We expect to pay substantially all of these remaining expenses by the end of the third quarter of 2002.

In May 2002, we sold 952,380 shares of our Series B convertible preferred stock to eBay Inc. for net proceeds of $1.8 million.

Critical Accounting Policies

We identified critical accounting policies in our Annual Report on Form 10-K for the year ended December 31, 2001. These critical accounting policies relate to revenue recognition and allowance for doubtful accounts. No changes to these critical policies have taken place in the three- and six-month periods ended June 30, 2002.

New Accounting Pronouncements

Effective January 1, 2002, we adopted Emerging Issues Task Force ("EITF") Issue 01-09, "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)" ("EITF 01-09"). EITF 01-09 requires that companies report cash and non-cash stock compensation to customers as a reduction in revenue, rather than as equity-related charges expense, for all periods presented. During the second quarter of 2002, we recorded a one-time charge of $114,200 against revenue to reflect the amount by which the fair value of the shares of our Series B preferred stock issued to eBay in May 2002 exceeded the amount paid by eBay.

During the three and six months ended June 30, 2001, we recognized amortization of equity-related charges for Excite, Inc. (now known as At Home Corporation) and Microsoft Corporation as sales and marketing expense. In those same periods, we recognized revenue of $231,000 and $463,000, respectively, from Excite and Microsoft. As a result of the adoption of EITF 01-09, we have reclassified $231,000 and $463,000 of equity-related charges for the three and six months ended June 30, 2001, respectively, as a reduction of revenue. There was no impact to net loss. We will reclassify $5,000 of equity-related charges for the quarter ended September 30, 2001 as a reduction of revenue for comparative purposes when we report our financial results for the third quarter of 2002.

In July 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 requires that all business combinations be accounted for under the purchase method and that certain acquired intangible assets in a business combination be recognized as assets apart from goodwill. SFAS No. 142 requires that ratable amortization of goodwill and certain intangible assets be replaced with periodic tests of the goodwill's impairment and that other intangible assets be amortized over their useful lives. SFAS No. 141 is effective for all business combinations initiated after June 30, 2001 and for all business combinations accounted for by the purchase method for which the date of acquisition is after June 30, 2001. The provisions of SFAS No. 142 are effective for fiscal years beginning after December 15, 2001, and thus were adopted by us on January 1, 2002. However, for goodwill and intangible assets acquired after June 30, 2001, certain provisions of SFAS No. 142 are effective from the date of acquisition. The adoption of SFAS No. 141 and 142 had no impact on our financial statements and related disclosures.

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of." SFAS No. 144 further refines the requirements of SFAS No. 121 that companies (i) recognize an impairment loss only if the carrying amount of the long-lived asset is not recoverable based on its undiscounted future cash flows and (ii) measure an impairment loss as the difference between the carrying amount and the fair value of the asset. In addition, SFAS No. 144 provides guidance on accounting and disclosure issues surrounding long-lived assets to be disposed of by sale. We adopted SFAS No. 144 on January 1, 2002 and the adoption had no impact on our financial statements and related disclosures.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." This statement addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)" ("EITF 94-3"). SFAS No. 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. EITF 94-3 allowed for an exit cost liability to be recognized at the date of an entity's commitment to an exit plan. SFAS No. 146 also requires that liabilities recorded in connection with exit plans be initially measured at fair value. The provisions of SFAS No. 146 are effective for exit or disposal activities that are initiated after

December 31, 2002, with early adoption encouraged. We do not expect the adoption of SFAS No. 146 to have a material impact on our financial position or results of operations.

Results of Operations for the Three and Six Months Ended June 30, 2002 and 2001

For the three and six months ended June 30, 2002, our net loss was $7.2 million, or $(0.25) per share, and $19.0 million, or $(0.65) per share, respectively. This represented an improvement of $5.5 million, or 43.2% on a per share basis, compared to our net loss of $12.7 million, or $(0.44) per share, for the three months ended June 30, 2001 and an improvement of $5.5 million, or 23.5% on a per share basis, compared to our net loss of $24.5 million, or $(0.85) per share, for the six months ended June 30, 2001. Excluding the restructuring charge of $530,000 in the second quarter of 2002, our net loss was $6.7 million, or $(0.23) per share, for the three months ended June 30, 2002, an improvement of $4.4 million, or 39.5% on a per share basis, compared to $11.1 million, or $(0.38) per share, for the same period of last year, excluding a restructuring charge of $1.6 million recorded in the second quarter of 2001. Excluding the charge of $4.5 for unutilized office space that we recorded in the first quarter of 2002 and the $530,000 restructuring charge in the second quarter of 2002, our net loss for the six months ended June 30, 2002 was $14.0 million, or $(0.48) per share, an improvement of $8.9 million, or 39.2% on a per share basis, compared to a net loss of $22.9 million, or $($0.79) per share, for the same period of last year, excluding the restructuring charge of $1.6 million recorded in the second quarter of 2001.

The improvement in net loss for the three months ended June 30, 2002 compared to the same period of last year is primarily due to a decrease in total operating expenses of $6.2 million (excluding the restructuring charge in each period), partially offset by decreases in revenue of $1.4 million and other income, net, of $409,000. The decrease in net loss for the six months ended June 30, 2002 compared to the same period of last year is primarily due to a decrease in total operating expenses of $12.6 million (excluding the restructuring charge in each period and the unutilized office space charge in 2002), partially offset by decreases in revenue of $2.6 million and other income, net, of $1.1 million. We expect our operating losses and negative operating cash flows to improve as we continue in our effort to achieve operating cash flow breakeven during the first half of 2003.

Revenue

Total revenue was $1.3 million and $2.7 million for the three and six months ended June 30, 2002, respectively, a decrease of $1.4 million, or 51.5%, and $2.6 million, or 49.2%, compared to total revenue of $2.8 million and $5.2 million for the three and six months ended June 30, 2001, respectively, which reflects the reclassification of revenue under EITF 01-09 described above. The decreases in revenue for the three and the six months ended June 30, 2002 compared to the same periods of last year is primarily due to the decrease in the number of our customers described below. Also contributing to the decreases in total revenue was a decrease in professional services fees, which represented approximately 5% and 4% of total revenue for the three and six months ended June 30, 2002, respectively, compared to approximately 13% of total revenue for the same periods in 2001. Also reflected in these decreases is the effect of the revenue shift we began to experience in the second half of 2001 as described above, from fixed monthly fees for hosting and maintaining customers' sites to transaction-based fees, and the percentage increase in the number of our customers that use our MarketSelect service, the fees for which are primarily transaction-based. Revenue for the three months ended June 30, 2001 also included hosting, professional service and other revenue from a short-term interactive marketing promotional auction for one customer which represented 14.1% of our revenue for that period; substantially all revenue under this contract was recognized as of June 30, 2001.

International revenue for the three and six months ended June 30, 2002 was $374,000 and $736,000, respectively (primarily from customers in the U.K.), representing 27.8% and 27.7% of total revenue for those periods, respectively. International revenue for the three and six months ended

June 30, 2001 was $614,000 and $1.2 million, respectively (also primarily from customers in the U.K.), representing 22.1% and 23.0% of total revenue for those periods, respectively. There are risks inherent in doing business internationally, including, among others, fluctuating currency exchange rates, differing legal and regulatory requirements and differing accounting practices. We price, invoice and collect fees for our international services primarily in the local currency. To date, currency fluctuations have not had a material effect on our results of operations and financial condition.

We generally charge a one-time set-up fee for the design, development and implementation of our customers' dynamic pricing sites or our MarketSelect service. Implementation also frequently entails customization and other professional services, for which we charge a professional service fee. The set-up fee and implementation-related professional services fees vary depending on the nature and the anticipated complexity of the service being implemented. These fees are generally payable upon the execution of the contract, recorded as deferred revenue and recognized as revenue, ratably, over the contract period. At June 30, 2002 and 2001, there was $579,000 and $393,000, respectively, of deferred revenue primarily relating to set-up and professional services fees.

During 2001, approximately 56 customer contracts were terminated, either by us or by the customer, primarily as a result of economic conditions resulting in many of our customers suffering significant adverse financial consequences that led in some cases to the customer ceasing operations and in other cases to the customer refocusing on other areas of their business. During the six months ended June 30, 2002, an additional 14 customer contracts were terminated. We ended the second quarter of 2002 with 52 customers, compared to 56 customers at March 31, 2002 and 61 customers at June 30, 2001.

For the second quarter of 2002, three of our customers accounted for approximately 40% of our quarterly revenue, without giving effect to the one-time charge of $114,200 against revenue that we were required to record in the second quarter of 2002 under EITF 01-09 as described above.

Average revenue per customer decreased to $24,900 for the second quarter of 2002 from $49,300 for the second quarter of 2001. Average revenue per customer for future periods will depend on a number of factors such as our customer mix, the mix of our service offerings, technological changes, our pricing strategies and pricing competition.

We believe that total revenue for the third quarter of 2002 will not change materially from the second quarter of 2002.

Operating Expenses

Cost of revenue consists of costs for direct customer support, end-user customer service, depreciation of network equipment, fees paid to network providers for bandwidth and monthly fees paid to third-party network providers. Cost of revenue was $1.0 million and $2.0 million for the three and six months ended June 30, 2002, a decrease of $241,000 and $573,000, respectively, compared to $1.3 million and $2.6 million for the three and six months ended June 30, 2001, respectively. As a percentage of revenue, cost of revenue increased to 75.6% and 76.9% for the three and six months ended June 30, 2002, respectively, compared to 45.4% and 50.0% for the three and six months ended June 30, 2001, respectively. The dollar decrease in each period compared to the same period last year is primarily due to a reduction in salaries and related expenses resulting from headcount reductions in the second and third quarters of 2001.

Gross profit decreased to 24.4% for the three months ended June 30, 2002 compared to 54.6% for the three months ended June 30, 2001. Gross profit decreased to 23.1% for the six months ended June 30, 2002 compared to 50.0% for the six months ended June 30, 2001. The decrease in gross profit is primarily attributable to the decrease in revenue described above. The gross profits reported above are not necessarily indicative of gross profits for future periods. Actual gross profits may vary

significantly depending on, among other things, customer mix, product mix, price competition, technological changes and extraordinary costs. Our cost of revenue components have historically been highly fixed in nature and we believe that they will continue to be fixed in the short term, as a result of which gross profit is expected to be largely based on unpredictable revenue trends.

Sales and marketing expenses were $674,000 and $1.3 million for the three and six months ended June 30, 2002, a decrease of $2.0 million, or 74.7%, and $4.8 million, or 78.6%, compared to sales and marketing expenses of $2.7 million and $6.1 million for the three and six months ended June 30, 2001, respectively. These decreases are primarily due to the absence in the three- and six-month periods in 2002 of amortization of $1.1 million and $3.0 million, respectively, of an email marketing database which we purchased from At Home Corporation (formerly known as Excite, Inc.) in the fourth quarter of 2000 for cash in connection with the termination of our original auction services agreement with Excite and which was amortized over its useful life in 2001. Also contributing to the decreases in sales and marketing expenses was a reduction in salaries and related expenses of $506,000 and $1.3 million in the three- and six-month periods ended June 30, 2002, respectively, resulting from lower headcount, and a reduction in marketing expenses of $282,000 and $441,000, respectively.

Development and engineering expenses were $675,000 and $1.5 million for the three and six months ended June 30, 2002, respectively, a decrease of $707,000, or 51.2%, and $1.6 million, or 52.6%, compared to development and engineering expenses of $1.4 million and $3.1 million for the three and six months ended June 30, 2001, respectively. The decrease in each period is primarily due to a reduction in salaries and related expenses resulting from lower headcount.

General and administrative expenses were $1.7 million and $3.8 million for the three and six months ended June 30, 2002, respectively, a decrease of $1.4 million, or 44.0%, and $2.2 million, or 36.1%, compared to general and administrative expenses of $3.1 million and $6.0 million for the three and six months ended June 30, 2001, respectively. The decrease for the three months ended June 30, 2002 is attributable to lower depreciation and rent expense of $503,000 resulting from the one-time charge for unutilized space in the first quarter of 2002, a reduction in salary and related expenses of $451,000 resulting from lower headcount, a decrease in bad debt expense of $247,000, and other general and administrative operating expense reductions of $152,000. The decrease for the six months ended June 30, 2002 is attributable

to a reduction in salary and related expenses of $926,000 resulting from lower headcount, lower depreciation and rent expense of $577,000 resulting from the one-time charge for unutilized office space, a decrease in bad debt expense of $391,000, and other general and administrative operating expense reductions of $282,000.

Unutilized office space charge. In the first quarter of 2002, we recorded a one-time charge of $4.5 million for unutilized office space at our Woburn, Massachusetts headquarters. This charge includes rent and other related costs for a significant portion of our leased space which has been vacated for the remaining lease term and the write-down of related leasehold improvements and furniture and fixtures.

Equity-related charges consist of the amortization of (i) deferred stock compensation resulting from the grant of stock options to employees at exercise prices subsequently deemed to be less than the fair value of our common stock on the grant date and (ii) the fair value of warrants issued to certain strategic customers and shares of our Series D convertible preferred stock issued to certain strategic customers at prices below fair value.

At June 30, 2002, deferred stock compensation, which is a component of deferred compensation and equity-related charges in stockholders' equity, totaled $475,000, net of amortization of $6.2 million and canceled stock option grants valued at $6.6 million. This amount is being amortized ratably over the vesting periods of the applicable stock options, typically four years, with 25% vesting on the first anniversary of the grant date and the balance vesting 6.25% quarterly thereafter.

At June 30, 2002, other deferred equity-related charges, which is a component of deferred compensation and equity-related charges in stockholders' equity, totaled $875,000, net of amortization of $46.8 million. Included in other deferred equity-related charges is the value of shares of Series D convertible preferred stock issued to Excite, which converted into shares of our common stock upon our initial public offering. We recorded the shares at fair value for a total of $15.0 million at December 31, 1999. The value of the shares was remeasured at the date of our initial public offering and we recorded an additional $10.5 million in the first quarter of 2000 as a deferred charge to be amortized over the remaining term of our original auction services agreement with Excite. As a result of the termination of the original Excite agreement in December 2000, the remaining term of that agreement was modified to the initial 18-month term of the new auction services agreement that we entered into with At Home at that time. During the second quarter of 2002, we expensed the remaining $3.3 million of unamortized value of the stock issued to Excite.

Other Income, net

Other income, net, was $379,000 for the three months ended June 30, 2002, a decrease of $409,000 compared to other income, net, of $788,000 for the three months ended June 30, 2001. Other income, net, was $784,000 for the six months ended June 30, 2002, an increase of $1.1 million compared to other income, net, of $1.9 million for the six months ended June 30, 2001. The decreases in other income, net for the three and six months ended June 30, 2002 is primarily the result of lower interest income from lower average balances of cash, cash equivalents and investments and lower interest rates compared to the same periods of last year.

Liquidity and Capital Resources

At June 30, 2002, cash and cash equivalents, marketable securities and restricted cash (related to a lease deposit) totaled $61.5 million.

Cash used in operating activities was $4.0 million for the six months ended June 30, 2002 and $8.4 million for the six months ended June 30, 2001. Net cash flows from operating activities for the six months ended June 30, 2002 reflect a net loss for that period of $19.0 million combined with an increase in prepaid expenses and other current assets, partially offset by depreciation expense, amortization of deferred compensation and equity-related charges, loss on disposal of property and equipment, short-and long-term liabilities related to the unutilized space charge and an increase in accrued expenses.

Cash provided by investing activities was $7.0 million for the six months ended June 30, 2002. Net cash provided by investing activities for the six months ended June 30, 2002 is primarily attributable to proceeds from the maturity of marketable securities. For the six months ended June 30, 2001, net cash used in investing activities was $644,000, primarily from the purchase of marketable securities and the purchase of property and equipment offset by the proceeds from the maturity of marketable securities.

Cash provided by financing activities was $1.8 million for the six months ended June 30, 2002, resulting primarily from the issuance of 952,380 shares of our Series B preferred stock to eBay in May 2002 as described above. For the six months ended June 30, 2001, cash used in financing activities was $59,000.

We expect to fund our operating expenses primarily from available cash. In addition, we may utilize our cash resources to fund acquisitions or investments in complementary businesses or technologies. We believe, based on our present business plan, that our current cash, cash equivalents and marketable securities and our cash flows from operations will be sufficient to meet our working capital and operating resource expenditure requirements for both the short-term and long-term. If the assumptions underlying our business plan regarding future revenue and expenditures change or if unexpected opportunities or needs arise, we may find it necessary to obtain additional equity or debt financing. If additional financing is required, we may not be able to raise it on acceptable terms or at all.

Factors that May Affect Results of Operations and Financial Condition

This Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. You can identify forward-looking statements by the use of the words "believe," "expect," "anticipate," "intend," "estimate," "assume" and other similar expressions which predict or indicate future events and trends and which do not relate to historical matters. You should not rely on forward-looking statements, because they involve known and unknown risks, uncertainties and other factors, some of which are beyond our control. Our actual results could differ materially from those set forth in the forward-looking statements.

Some of the factors that might cause these differences include those set forth below. You should carefully review all of these factors, and you should be aware that there may be other factors that could cause these differences. These forward-looking statements were based on information, plans and estimates at the date of this Form 10-Q, and we do not promise to update any forward-looking statements to reflect changes in underlying assumptions or factors, new information, future events or other changes.

Risks Related to Our Business

Our business is difficult to evaluate, our business strategy may not successfully address risks we face and your basis for evaluating us is limited.

We were formed in February 1997 and we began to execute our current business model involving the offering of outsourced, private-label auction solutions in December 1998, which we have since expanded to include additional transaction pricing and extended marketing and distribution capabilities. While a high percentage of our operating expenses have historically been, and are expected to continue to be, fixed in the short term, our operating expenses are largely based on unpredictable revenue trends. Because of our limited operating history, our business strategy may not successfully address all of the risks we face, and you have limited operating and financial data about our business upon which to base an evaluation of our performance.

We face the following risks, expenses and difficulties as a company seeking to develop a new Internet-based service:

- if we fail to attract and retain quality customers we may be unable to generate sufficient revenue to support our business;
- if we fail to attract and retain qualified sales, engineering and other personnel we may be unable to maintain and expand our business;
- if we fail to maintain and upgrade our service offerings and technology to keep pace with the rapidly growing Internet market we serve we may be unable to compete effectively; and
- if we fail to raise additional capital if and when we need it we may be unable to develop or sustain our business.

We expect to continue to incur substantial operating losses in the near future.

For the quarter ended June 30, 2002, we incurred a net loss of approximately $7.2 million, which represented approximately 534.1% of our revenue for the same period. As of June 30, 2002, we had an accumulated deficit of approximately $129.0 million. We have not achieved profitability and we will continue to incur net losses until we can produce sufficient revenues to cover our costs, which may not occur. While it is our goal to achieve operating cash flow breakeven during the first half of 2003, even if we achieve profitability, we may be unable to sustain or increase our profitability in the future because we intend to continue to invest in the further development of our service offerings and technology and in the promotion of our service offerings. Any such investment will depend on the availability of funds.

We expect to continue to have negative operating cash flow in the near future which may require us to seek additional financing, which could be difficult to obtain.

We expect to continue to experience negative operating cash flows for the foreseeable future because we intend to continue to invest in the further development of our service offerings and technology and in the promotion of our service offerings. We expect that we will fund these expenditures primarily from available cash.

We believe, based on our present business plan, that our current cash, cash equivalents and marketable securities and our cash flows from operations will be sufficient to meet our working capital and operating resource expenditure requirements for both the short-term and long-term. If the assumptions underlying our business plan regarding future revenue and expenditures change or if unexpected opportunities or needs arise, we may find it necessary to obtain additional equity or debt financing. If additional financing is required, we may not be able to raise it on acceptable terms or at all.

We may not be able to continue to attract new customers or retain existing customers.

The success of our business model depends in large part on our ability to increase our number of customers and to retain existing customers. The market for our services may grow more slowly than anticipated or become saturated with competitors, many of which may offer lower prices or broader distribution. In addition, the sales cycle for larger brand companies, retailers and manufacturers, where we currently focus our sales efforts, is generally longer than for the smaller companies and e-commerce companies that made up a larger part of our customer base in prior years. We also believe that uncertain economic conditions during 2001 and 2002 have resulted in a longer decision-making and implementation process with customers and during 2001 led in many cases to customer contract terminations as a result of the customer ceasing operations or focusing on other areas of their business. If we cannot continue to attract new customers on a timely basis or at all, or if we cannot maintain our existing customer base, our business and revenues would be adversely affected.

A loss of any client that accounts for a large portion of our revenues could cause our revenues to decline.

For the second quarter of 2002, three of our customers accounted for approximately 40% of our quarterly revenue, without giving effect to the one-time charge of $114,200 against revenue that we were required to record in the second quarter of 2002 under the Emerging Issues Task Force Issue 01-09, "Accounting for Consideration Given by a Vendor to a Customer or Reseller of the Vendor's Product." If any one of these contracts is not renewed or otherwise terminates, and if we are unable to replace it with other client agreements, our revenues would decline and our losses would likely increase.

Because our industry is highly competitive and has low barriers to entry, we may not be able to effectively compete.

The U.S. market for e-commerce services is extremely competitive. We expect competition to intensify as current competitors expand their product offerings and new competitors enter the market. In the surplus online auction market, in addition to competition from internally-developed solutions by individual organizations, we face competition for customers from third party providers in the following areas:

- destination auction and auction aggregation sites such as: Dovebid, Liquidation.com (a division of Liquidity Services), Amazon.com, eBay and Yahoo! Auctions;

- third party online auction enablers, such as ChannelAdvisor, MoonBuzz, ReturnBuy and Auctionworks, that facilitate the distribution of listings to third party auction sites such as eBay and Yahoo! Auctions; and

- e-commerce vendors such as ATG, Broadvision, IBM and divine/OpenMarket who either have or may extend their offerings to incorporate capabilities similar to those offered by our services.

In the online loyalty program market, in addition to competition from internally-developed solutions by individual organizations, we face competition from third party providers in the following areas:

destination sites with loyalty auction programs, such as Yahoo! Auctions; and

third party loyalty program enablers such as SoftCoin and Frequency Marketing who may extend their offerings to incorporate capabilities similar to those offered by our loyalty program service.

The principal competitive factors include price, quality and breadth of services provided and potential for successful transaction activity. E-commerce and marketing technology markets are characterized by rapidly changing technologies, changing requirements of customers and frequent new product and service introductions. We may fail to introduce new online pricing formats and features on a timely basis or at all. If we fail to introduce new service offerings or to improve our existing service offerings in response to industry developments, or if our prices are not competitive, we could lose customers, which could lead to a loss of revenues.

Because there are relatively low barriers to entry in the e-commerce market, competition from other established and emerging companies may develop in the future. Many of our competitors may also have well-established relationships with our existing and prospective customers. Increased competition is likely to result, and in some cases has resulted, in fee reductions, reduced margins, longer sales cycles for our services and a decrease or loss of our market share, any of which could harm our business, operating results or financial condition.

Many of our competitors have, and new potential competitors may have, more experience developing Internet-based software applications and integrated purchasing solutions, larger technical staffs, larger customer bases, more and longer-standing distribution channels, greater brand recognition and greater financial, marketing and other resources than we have. In addition, competitors may be able to develop products and services that are superior to ours or that achieve greater customer acceptance. We cannot assure you that the e-commerce solutions offered by our competitors now or in the future will not be perceived as superior to ours by either businesses or consumers.

Our customers may not successfully increase transactions on their dynamic pricing sites.

Beginning in the second half of 2001, we began to experience a shift in the nature of our revenue, from the fixed monthly fees we traditionally charge for hosting and maintaining customers' sites, to transaction-based fees. We believe that this revenue shift is partly a result of recent economic conditions and pricing competition, and partly a result of an increasing portion of our customers using our MarketSelect service (which we launched during the second quarter of 2001), the fees for which are primarily transaction-based. To the extent this revenue shift continues, our success will increasingly depend on increases in the amount of user traffic and the number of transactions on our customers' FairMarket-hosted sites or on eBay through our MarketSelect service. For this to occur, our existing customers must drive sufficient numbers of users to their FairMarket-hosted sites, they must devote sufficient resources to making their sites attractive to buyers and sellers and there must be demand for the products being offered on those sites and on eBay through our MarketSelect service. We cannot assure you that our customers will be successful in accomplishing any of these objectives and their failure to do so could impede our growth and adversely affect our business and revenues.

Our workforce reductions may impact our ability to attract or retain key personnel.

Our future success will depend, in part, on attracting and retaining qualified personnel. In late June 2002, we eliminated 18 positions worldwide, representing approximately 31% of our total employee base. Previously, in 2001, we implemented two workforce reductions in which we eliminated 78 positions, and in 2000 we implemented a workforce reduction in which we eliminated 35 positions. We also experienced a number of management changes in the first half of 2001 and the first half of 2002. Management changes during the first half of 2002 included the election of Nanda Krish as full-time President and Chief Executive Officer, the appointment of three new directors to our Board of Directors, the resignation of one director from the Board, and the resignations of our Vice President of Sales and Marketing and our Vice President of Engineering. We experienced some attrition in personnel prior to and following these workforce reductions and believe that we may experience additional attrition in the future.

We cannot assure you that we will be successful in hiring or retaining qualified personnel. Our inability to attract and retain qualified personnel on a timely basis, or the departure of key employees, could harm our existing business and ability to expand or maintain our operations.

We may not be successful in international markets.

A component of our strategy has been to attract customers outside the U.S. For the three and six months ended June 30, 2002, revenue under contracts with customers outside the U.S. (primarily in the United Kingdom) represented approximately 27.8% and 27.7% of our total

revenue, respectively. During 2000, we opened offices in England, Australia and Germany. We completed the closing of our office in Germany during the third quarter of 2001 and the closing of our office in Australia during the first quarter of 2002. We continue to service our Australian customers out of our U.S. operations. We believe that significant opportunities exist in international markets, and we continue to evaluate our international strategy. Doing business in international markets requires significant management, financial, development, sales, marketing and other resources. We have limited experience in localizing our services, and some of our competitors have expanded or are undertaking expansion into foreign markets. We cannot assure you that we will expand into new, or continue our existing operations in, international markets or that we will be successful in international markets.

In addition to the uncertainty regarding our ability to generate revenues from foreign operations and expand or maintain our international presence, there are risks inherent in doing business internationally, including, among others:

- different legal and regulatory requirements;
- difficulties in staffing and managing foreign operations;
- longer payment cycles;
- different accounting practices;
- fluctuating currency exchange rates;
- problems in collecting accounts receivable;
- legal uncertainty regarding liability, ownership and protection of intellectual property;
- tariffs and other trade barriers;
- seasonal reductions in business activity;
- potentially adverse tax consequences; and
- political instability.

Any of the above factors could adversely affect the success of our international operations. To the extent we expand our international operations, we will become more exposed to the above risks. To the extent we have increasing portions of our revenues denominated in foreign currencies, we will become subject to increased risks relating to foreign currency exchange rate fluctuations. We cannot assure you that one or more of the factors discussed above will not have a material adverse effect on our international operations and, consequently, on our results of operations and financial condition.

Buyers and sellers might not adopt online auction or other dynamic pricing solutions as a means for buying and selling goods and services.

Online auction and other dynamic pricing solutions are relatively new methods of buying and selling that market participants may not adopt at levels sufficient to sustain our business. Traditional purchasing is often based on long-standing relationships or familiarity with sellers. For online dynamic pricing solutions to succeed, buyers and sellers must adopt new purchasing practices. Buyers must be willing to rely less upon traditional relationships in making purchasing decisions, and businesses must be willing to offer products for sale through online dynamic

pricing solutions. We cannot assure you that online dynamic pricing solutions will be adopted at levels sufficient to sustain our business.

We may enter into strategic alliances or license technologies to expand our business or service offerings but may not be successful in doing so.

In addition to internal development of new technologies, our future success may depend to a certain degree on our ability to enter into and implement strategic alliances to expand our product and service offerings and our distribution channels and/or to jointly market or gain market awareness for our service offerings. For example, during the second quarter of 2001 we expanded our auction service in the U.S. to provide customers with the opportunity to list, manage and transact sales through eBay. In the second quarter of 2002, we entered into an exclusive 18-month agreement with eBay to provide our loyalty marketing program technology platform to third parties. We may also expand our service offerings by licensing or purchasing complementary technologies from third parties. For example, during the first quarter of 2001 we announced that we licensed certain real-time e-business infrastructure software from TIBCO Software Inc. to enable us to provide real-time messaging infrastructure. We cannot assure you that we will be successful in identifying, developing or maintaining such alliances and relationships or that such alliances and relationships will achieve their intended purposes.

We may acquire other businesses or technologies, which could result in dilution to our stockholders, or operational or integration difficulties which could impair our financial performance.

If appropriate opportunities present themselves, we may acquire businesses, technologies, services or products that we believe will be useful in the growth of our business. We do not currently have any commitments or agreements with respect to any acquisition. We may not be able to identify, negotiate or finance any future acquisition successfully. Even if we do succeed in acquiring a business, technology, service or product, the process of integration may produce unforeseen operating difficulties and expenditures and may require significant attention from our management that would otherwise be available for the ongoing development of our business. Moreover, we have not made any acquisitions, have no experience in integrating an acquisition into our business and may never achieve any of the benefits that we might anticipate from a future acquisition. If we make future acquisitions, we may issue shares of stock that dilute other stockholders, incur debt or assume contingent liabilities, any of which might harm our financial results and cause our stock price to decline. Any financing that we might need for future acquisitions may only be available to us on terms that restrict our business or that impose on us costs that reduce our revenue.

Others may assert that our technology infringes their intellectual property rights.

The e-commerce industry is characterized by the existence of a large number of patents and frequent claims and litigation based on allegations of patent infringement and violation of other intellectual property rights. As the e-commerce market and the functionality of products in the industry continues to grow and overlap, we believe that the possibility of intellectual property claims against us will increase. For example, we may inadvertently infringe a patent of which we are unaware, or there may be patent applications now pending of which we are unaware which we may be infringing when they are issued in the future, or our service or systems may incorporate third party technologies that infringe the intellectual property rights of others. We have been and expect to continue to be subject to alleged infringement claims. The defense of any claims of infringement made against us by third parties, whether or not meritorious, could involve significant legal costs and require our management to divert time from our business operations. Either of these consequences of an infringement claim could have a material adverse effect on our operating results. If we are unsuccessful in defending any claims of infringement, we may be forced to obtain licenses or to pay royalties to continue to use our technology. We may not be able to obtain any necessary licenses on commercially reasonable terms or at all. If we fail to obtain necessary licenses or other rights, or if these licenses are costly, our operating results may suffer either from reductions in revenues through our inability to serve customers or from increases in costs to license third-party technologies.

Our business may suffer if we are not able to protect important intellectual property.

Our ability to compete effectively against other companies in our industry will depend, in part, on our ability to protect our proprietary technology and systems designs. While we have attempted to safeguard and maintain our proprietary rights, we cannot assure you that we have been or will be completely successful in doing so. Further, our competitors may independently develop or patent technologies that are substantially equivalent or superior to ours.

We have applied for patents on aspects of our technology and processes and those applications are pending with the U.S. Patent and Trademark Office. We cannot assure you that any patents will be issued. Even if some or all of these patents are issued, we cannot assure you that they will not be successfully challenged by others or invalidated, that they will adequately protect our technology and processes or that they will result in commercial advantages for us. "FairMarket" is a registered service mark in the U.S. We have applied for trademark registrations for some of our other brand names, and our marketing materials are copyrighted, but these protections may not be adequate. Effective patent, trademark, service mark, copyright and trade secret protection may not be available in every country where we provide services. We may, at

times, have to incur significant legal costs and spend time defending our copyrights and, if issued, our service marks and patents. Any defense efforts, whether successful or not, would divert both time and resources from the operation and growth of our business.

We may not be able to maintain the confidentiality of our proprietary knowledge.

We rely, in part, on contractual provisions to protect our trade secrets and proprietary knowledge. These agreements may be breached, and we may not have adequate remedies for any breach. Our trade secrets may also be known without breach of such agreements or may be independently developed by competitors. Our inability to maintain the proprietary nature of our technology could harm our business, results of operations and financial condition by adversely affecting our ability to compete.

Our business may be adversely affected if we are unable to continue to license software that is necessary for our service offering.

Through distributors, we license a variety of commercially-available Microsoft technologies, including our database software and Internet server software, which is used in our services and systems to perform key functions. We also license other third party technology to perform certain functions of our service, such as our search functionality, which utilizes technology from Verity, Inc., and technology that we license from TIBCO Software Inc., which we use in certain of our integration solutions. As a result, we are to a certain extent dependent upon those third parties continuing to maintain their technologies. We cannot assure you that we would be able to replace the functionality provided by these third party technologies on commercially reasonable terms or at all. The absence of or any significant delay in the replacement of certain functionalities could have a material adverse effect on our business, financial condition and results of operations.

Our systems infrastructure may not keep pace with the demands of our customers.

Interruptions of service as a result of a high volume of traffic and/or transactions could diminish the attractiveness of our services and our ability to attract and retain customers. We cannot assure you that we will be able to accurately project the rate or timing of increases, if any, in the use of our service, or that we will be able to expand and upgrade our systems and infrastructure to accommodate such increases in a timely manner. We currently maintain separate systems in the U.S. for our U.S., U.K. and Australia services. Any failure to expand or upgrade our systems could have a material adverse effect on our results of operations and financial condition by reducing or interrupting revenue flow and by limiting our ability to attract new customers. Any such failure could also have a material adverse effect on the business of our customers, which could damage our reputation and expose us to a risk of loss or litigation and potential liability. The majority of the server capacity of our systems for each of the countries named above is currently not utilized.

A system failure could cause delays or interruptions of service to our customers.

Service offerings involving complex technology often contain errors or performance problems. Many serious defects are frequently found during the period immediately following introduction and initial implementation of new services or enhancements to existing services. Although we attempt to resolve all errors that we believe would be considered serious by our customers before implementation, our systems are not error-free. Errors or performance problems could result in lost revenues or cancellation of customer agreements and may expose us to litigation and potential liability. We have from time to time discovered errors in our software or software of others used in our operating systems after its incorporation into our systems. We cannot assure you that undetected errors or performance problems in our existing or future services will not be discovered or that known errors considered minor by us will not be considered serious by our customers. We have experienced periodic minor system interruptions, which may continue to occur from time to time. Most of our contracts provide for the payment or credit to the customer of specified money damages (based on the monthly service fee paid by the customer) if we are unable to maintain specified levels of service based on downtime of either their FairMarket-hosted sites or our centralized service over a specified period, typically one month. The total dollar amount of our potential payment or credit obligations under these provisions if the service levels specified in all of those agreements were not met over the typical one month measurement period could be material. In addition, certain of our contracts also provide the customer with the right to terminate the contract if we are unable to maintain a minimum specified level of service. Performance problems in our technology could also damage our reputation which could reduce market acceptance of our services and lead to a loss of revenues.

The functioning of our systems or the hosting facilities of third parties on which we rely could be disrupted by factors outside our control.

Our success depends on the efficient and uninterrupted operation of our computer and communications hardware systems. Substantially all of our computer hardware for operating our U.S., U.K. and Australia services is currently located at the facilities of Navisite, Inc. in Andover, Massachusetts. The computer hardware for our end-user customer service system is also hosted by a third party. These systems are vulnerable to damage or interruption from natural disasters, fires, power loss, telecommunication failures, break-ins, sabotage, computer viruses, intentional acts of vandalism, acts of terrorism and similar events. All of our systems are located in the same facility and we do not currently have a backup system in place for any of these systems. Despite any precautions we take or plan to take, the occurrence of a natural disaster or other unanticipated problems at any third party hosting facility could result in interruptions in our services. In addition, if any third party hosting service fails to provide the data communications capacity we require, as a result of human error, natural disaster or other operational disruption, interruptions in our service could result. Any damage to or failure of our systems could result in reductions in, or terminations of, our service, which could have a material adverse effect on our business, results of operations and financial condition.

Our business may suffer if buyers and sellers do not make payments or deliver goods.

Our success may depend to some extent upon sellers on customer sites reliably delivering and accurately representing their listed goods and buyers paying the agreed purchase price. Our customers have received in the past, and we anticipate that they will receive in the future, communications from sellers and buyers who did not receive the purchase price or the goods that were to have been exchanged. Neither we nor our customers have the ability to require end-users to make payments or deliver goods or otherwise make end-users whole. Our customers also periodically receive complaints from buyers as to the quality of the goods purchased. We are unaware of any complaints that have materially impacted our customers' businesses in a detrimental manner. Neither we nor our customers have the ability to determine the level of such complaints that are made directly between buyers and sellers. We expect that both we and our customers will continue to receive requests from end-users requesting reimbursement or threatening legal action against either our customers or us if no reimbursement is made.

We may have to monitor or control activities on customer sites.

The law relating to the liability of providers of online services for the activities of users of their services is currently unsettled in the U.S. and in other countries. Our service automatically screens by key word all listings submitted by end-users for pornographic material. We also have notice and take-down procedures related to infringing and illegal goods. These procedures are not foolproof and goods that may be subject to regulation by U.S. local, state or federal authorities or local foreign authorities could be sold through our service. These goods include, for example, firearms, alcohol and tobacco. We cannot assure you that we will be able to prevent the unlawful exchange of goods on our service or that we will successfully avoid civil or criminal liability for unlawful activities carried out by users through our service. The potential imposition of liability for unlawful activities of end-users of our customers could require us to implement measures to reduce our exposure to such liability, which may require us, among other things, to spend substantial resources and/or to discontinue one or more of our service offerings. Any costs incurred as a result of such liability or asserted liability would harm our results of operations.

Future government regulation of auctions and auctioneers may add to our operating costs.

Numerous U.S. jurisdictions have laws and regulations regarding the conduct of auctions and the liability of auctioneers, which were enacted for consumer protection many years ago. We believe that

the U.S. laws and regulations do not apply to our online auction services. However, little precedent exists in this area, and one or more jurisdictions in the U.S. or in other countries in which we do business are attempting or may attempt to impose these laws and regulations to online auction providers and may attempt to impose these laws and regulations on our operations or the operations of our customers in the future. Certain states are currently considering whether to apply their auctioneer regulations to online auctions and at least one state has passed legislation that applies to the conduct of all auctions, including auctions conducted over the Internet. If any such statute or regulation is interpreted to apply to us or to our customers, we and/or those of our customers to whom the statute applies could be required to obtain a license. This could adversely affect our ability to attract and retain customers, could adversely affect our results of operations by decreasing activity on our customers' auction sites and could subject us or our customers to fines if we or our customers are unable to obtain the required licenses. In addition, as the nature of the products listed by our customers or their end-users changes, we may become subject to new regulatory restrictions. If we do become subject to these laws and regulations in the future, it could adversely affect our ability to attract and retain customers and could adversely affect our results of operations by decreasing activity on our customers' FairMarket-hosted sites.

Future sales of our common stock could adversely affect our stock price.

A substantial portion of our common stock is held by a small number of investors and can be resold or is subject to registration rights. Sales of substantial amounts of our common stock in the public market, or the perception that a large number of shares are available for sale, could cause the market price of our common stock to decline. In addition to the adverse effect a price decline could have on holders of our common

stock, such a decline would likely impede our ability to raise capital through the issuance of additional shares of our common stock or other equity securities. Such a decline could also cause our common stock to trade at a per share price of less than $1.00 which could lead to a delisting of our common stock from Nasdaq.

The holders of a substantial portion of our common stock (including at least approximately 8.8 million shares held by former holders of our Series C and D convertible preferred stock or their transferees) and the holder of our Series B Preferred Stock (including at least 952,380 shares of common stock issuable upon conversion of such shares of Series B Preferred Stock), with all 9.76 million of these shares of common stock having been registered pursuant to a Registration Statement on Form S-3, File No. 333-97461, that we filed with the SEC in July 2002, have rights, subject to some conditions, to require us to file registration statements covering their shares, or to include their shares in registration statements that we may file for FairMarket or other stockholders. By exercising their registration rights and selling a large number of shares, these holders could cause the price of our common stock to decline. Furthermore, if we were to include in a FairMarket-initiated registration statement shares held by those holders pursuant to the exercise of their registration rights, those sales could impair our ability to raise needed capital by depressing the price at which we could sell our common stock.

Risks Related to Our Industry

Our success depends on the continued growth of the Internet and online commerce.

Our future revenues and profits depend upon the widespread acceptance and use of the Internet and other online services as a medium for commerce by businesses and consumers. The use of the Internet and e-commerce may not continue to develop at past rates and a sufficiently broad base of business and individual customers may not adopt or continue to use the Internet as a medium of commerce. The market for the sale of goods and services over the Internet is an emerging market. Demand and market acceptance for online services and for the sale of goods and services over the Internet are subject to a high level of uncertainty. Growth in our customer base depends on obtaining businesses and consumers who have historically used traditional means of commerce to purchase goods and services. For us to be successful, these market participants must accept and use novel ways of conducting business and exchanging information.

E-commerce may not prove to be a viable medium for purchasing for the following reasons, any of which could seriously harm our business:

- the necessary infrastructure for Internet communications may not develop adequately;
- our potential customers, buyers and suppliers may have security and confidentiality/privacy concerns;
- complementary products, such as high-speed modems and high-speed communication lines, may not be developed;
- alternative purchasing solutions may be implemented;
- buyers may dislike the reduction in the human contact inherent in traditional purchasing methods;
- use of the Internet and other online services may not continue to increase or may increase more slowly than expected;
- the development or adoption of new technology standards and protocols may be delayed or may not occur; and
- new and burdensome governmental regulations may be imposed.

Our success depends on the continued reliability of the Internet.

The Internet continues to experience significant growth in the number of users, frequency of use and bandwidth requirements. We cannot assure you that the infrastructure of the Internet and other online services will be able to support the demands placed upon them. Furthermore, the Internet has experienced a variety of outages and other delays as a result of damage to portions of its infrastructure, and could face such outages and delays in the future. These outages and delays could adversely affect the level of Internet usage and also the level of traffic and the processing of transactions. In addition, the Internet or other online services could lose their viability due to delays in the development or adoption of new standards and protocols required to handle increased levels of Internet or other online service activity, or due to increased governmental regulation. Changes in or insufficient availability of telecommunications services or other Internet service providers to support the Internet or other online services also could result in slower response times and adversely affect usage of the Internet and other online services generally and our service in particular. If use of the Internet and other online services does not continue to grow or grows more slowly than expected, if the infrastructure of the Internet and other online services does not effectively support growth that may occur, or if the Internet and other online services do not become a viable commercial marketplace, we will have to adapt our business

model to the new environment, which would materially adversely affect our results of operations and financial condition.

Government regulation of the Internet may impede our growth or add to our operating costs.

Like many Internet-based businesses, we operate in an environment of tremendous uncertainty as to potential government regulation. The Internet has rapidly emerged as a commerce medium, and governmental agencies have not yet been able to adapt all existing regulations to the Internet environment. Laws and regulations have been introduced or are under consideration and court decisions have been or may be reached in the U.S. and other countries in which we do business that affect the Internet or other online services, covering issues such as pricing, user privacy, freedom of expression, access charges, content and quality of products and services, advertising, intellectual property rights and information security. In addition, it is uncertain how existing laws governing issues such as taxation, property ownership, copyrights and other intellectual property issues, libel, obscenity and personal privacy will be applied to the Internet. The majority of these laws were adopted prior to the introduction of the Internet and, as a result, do not address the unique issues of the Internet. Recent laws that contemplate the Internet, such as the Digital Millennium Copyright Act in the U.S., the European Union Electronic Commerce Directive (the "Electronic Commerce Directive") and the European Union Directive on Copyright in the Information Society ("Copyright Directive"), have not yet been fully interpreted by the courts and their applicability is therefore uncertain. The Digital Millennium Copyright Act provides certain "safe harbors" that limit the risk of copyright infringement liability for service providers such as FairMarket with respect to infringing activities engaged in by users of the service, such as end-users of our customers' dynamic pricing sites. We have adopted policies and practices to qualify for one or more of these safe harbors, but we cannot assure you that our efforts will be successful since the Digital Millennium Copyright Act has not been fully interpreted by the courts and its interpretation is therefore uncertain. In August 2002, the Electronic Commerce Directive was implemented in the United Kingdom. This Directive contains informational requirements for online sellers, requirements for electronic communications and concluding contracts online and provisions limiting the liability of service providers for unlawful content in certain instances. This Directive may affect our operations in the U.K. if our customers or we, as applicable, do not adequately update our respective practices to comply with the new U.K. regulations implementing this Directive. In Australia, recent amendments have been made to the Copyright Act 1968 to regulate copyright issues arising in the context of the Internet. In addition, the Broadcasting Services Act 1992 has been recently amended to establish a notice and take-down procedure with respect to offensive or obscene content. These amendments provide specific immunities and/or defenses for Internet service providers. However, the full application of these immunities and defenses has not yet been tested. The European Union Copyright Directive attempts to harmonize copyright in areas of digital transmission but has yet to be implemented in the Member States across Europe (including the U.K.). Member States must implement the Copyright Directive by December 22, 2002 and this may impact on our and our customer's business.

In the area of user privacy, several states have proposed legislation that would limit the uses of personal user information gathered online or require online services to establish privacy policies. The Federal Trade Commission also has become increasingly involved in this area, and recently settled an action with one online service regarding the manner in which personal information is collected from users and provided to third parties. The recently adopted European Union Directive on the Protection of Personal Data, as implemented in the relevant member states, may affect our operations in the U.K. if we or our customers do not afford adequate privacy to end-users of our customers' sites. The Australian Privacy Amendment (Privacy Sector) Act 2000, which has an exemption for certain types of small businesses, became effective in December 2001 and may have a similar effect. We do not sell personal user information from our customers' sites. Generally, as between FairMarket and our customers, the personal user information belongs to the customer, not FairMarket, and each site is

governed by the respective customer's own privacy policy. We do use aggregated data for analyses regarding our services, and do use personal user information in the performance of our services for our customers. Since we do not control what our customers do with the personal user information they collect, we cannot assure you that our customers' sites will be considered compliant.

As online commerce evolves, we expect that federal, state or foreign agencies will adopt regulations covering issues such as pricing, content, user privacy, hosting liability and quality of products and services. Any future regulation may have a negative impact on our business by restricting our methods of operation or imposing additional costs. Although many of these regulations may not apply to our business directly, we anticipate that laws regulating the solicitation, collection or processing of personal information could indirectly affect our business.

Title V of the Telecommunications Act of 1996, known as the Communications Decency Act of 1996, prohibited the knowing transmission of any comment, request, suggestion, proposal, image or other communication that is obscene or pornographic to any recipient under the age of 18. Substantial portions of the Communications Decency Act of 1996 regarding such communications have been held to be unconstitutional. Subsequent similar legislation, know as the Child Online Protection Act, designed to comport with the constitutional concerns articulated by the Supreme Court, has been enacted; however, the constitutionality of that legislation is currently being litigated as well. As such, the prohibition's scope and the liability associated with a violation are currently unsettled. In addition, we cannot be certain that similar legislation will not be enacted and upheld in the future. It is possible that such legislation could expose companies involved in online commerce to liability, which could limit the growth of online commerce generally. Legislation like the Communications Decency Act could reduce the growth in Internet usage and decrease its acceptance as a communications and commerce medium.

The worldwide availability of Internet web sites often results in sales of goods to buyers outside the jurisdiction in which we or our customers are located, and foreign jurisdictions may claim that we or our customers are required to comply with their laws. As an Internet company, it is unclear which jurisdictions may find that we are conducting business therein. Our failure to qualify to do business in a jurisdiction that requires us to do so could subject us to fines or penalties and could result in our inability to enforce contracts in that jurisdiction.

New taxes may be imposed on Internet commerce.

In the U.S., we do not collect sales or other similar taxes on goods sold by customers and users through customers' FairMarket-powered sites or service taxes on fees paid by end-users of those sites. The Internet Tax Freedom Act of 1998, which was extended through November 28, 2003 by the Internet Tax Non-Discrimination Act, prohibits the imposition of taxes on internet access services and new taxes on electronic commerce by U.S. federal and state taxing authorities. If the moratorium is not extended past the November 28, 2003 deadline, states may seek to impose sales tax collection obligations on out-of-state companies which engage in or facilitate online commerce, and a number of proposals previously have been made at the state and local level that would impose additional taxes on the sale of goods and services through the Internet. Such proposals, if adopted, could substantially impair the growth of electronic commerce, and could adversely affect our opportunity to derive financial benefit from such activities. Many non-U.S. countries impose service tax (such as value-added tax) collection obligations on companies that engage in or facilitate Internet commerce. We do not collect sales or other similar taxes on goods sold by customers and/or users of our customers' sites in Australia or the U.K., it being the responsibility of our customers to do so if required. Our systems in each of those countries do enable value-added or goods and services taxes to be charged and collected with respect to site usage fees, the determination of which is also the responsibility of our customers. A successful assertion by one or more states or any foreign country that we (rather than our customers) should collect sales or other taxes on the exchange of merchandise or site usage fees or other Internet-

based taxes (or any failure of our customers to collect any such taxes if required to do so) could impair our revenue and our ability to acquire and retain customers.

There may be significant security risks and privacy concerns relating to online commerce.

A significant barrier to online commerce and communications is the secure transmission of confidential information over public networks. A compromise or breach of the technology used to protect our customers' and their end-users' transaction data could result from, among other things, advances in computer capabilities, new discoveries in the field of cryptography, or other events or developments. Any such compromise could have a material adverse effect on our reputation and, therefore, on our business, results of operations and financial condition. Furthermore, a party who is able to circumvent our security measures could misappropriate proprietary information or cause interruptions in our operations. We may be required to expend significant capital and other resources to protect against such security breaches or to alleviate problems caused by such breaches. Concerns over the security of transactions conducted on the Internet and other online services and the privacy of users may also inhibit the growth of the Internet and other online services generally, especially as a means of conducting commercial transactions. We currently have practices and procedures in place to protect the confidentiality of our customers' and their end-users' information. However, our security procedures to protect against the risk of inadvertent disclosure or intentional breaches of security might fail to adequately protect information that we are obligated to keep confidential. We may not be successful in adopting more effective systems for maintaining confidential information, and our exposure to the risk of disclosure of the confidential information of others may grow with increases in the amount of

information we possess. To the extent that our activities involve the storage and transmission of proprietary information, such as credit card numbers, security breaches could damage our reputation and expose us to a risk of loss or litigation and possible liability. Our insurance policies may not be adequate to reimburse us for losses caused by security breaches.

We could be subject to potential product liability claims and third party liability claims related to products and services purchased through our customers' sites.

Any errors, defects or other performance problems in our services and systems could result in financial or other damages to our customers. Although our agreements with our customers typically contain provisions designed to limit our exposure to claims, existing or future laws or unfavorable judicial decisions could negate these limitation of liability provisions.

In addition, we may not be able to successfully avoid civil or criminal liability for problems related to the products and services sold on customer sites. Even if we are successful, any such claims or litigation could still require expenditure of management time and other resources to defend ourselves. Liability of this sort could require us to implement measures to reduce our exposure to this liability, which may require us, among other things, to expend substantial resources or to discontinue service offerings or to take precautions to ensure that certain products and services are not available on customer sites.

Moreover, deliveries of products purchased on customer sites that are nonconforming, late or are not accompanied by information required by applicable law or regulations, could expose us to liability or result in decreased adoption and use of those sites and therefore our services, which would lead to decreased revenue.

Our stock price is likely to be highly volatile.

The stock market, and in particular the market for Internet-related stocks, has, from time to time, experienced extreme price and volume fluctuations. Many factors may cause the market price for our common stock to decline, perhaps substantially, including:

- failure to meet our development plans;
- the demand for our common stock;
- changes in general market conditions;
- technological innovations by competitors or in competing technologies; and
- investor perception of our industry or our prospects.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Investment Portfolio

We do not use derivative financial instruments for investment purposes and only invest in financial instruments that meet high credit quality standards, as specified in our investment policy guidelines. This policy also limits the amount of credit exposure of any one issue, issuer, and type of investment. Due to the conservative nature of our investments, we do not believe that we have a material exposure to interest rate risk.

Foreign Currency Risk

International sales are made mostly from our foreign sales subsidiaries in the respective countries and are denominated in the local currency of each country. These subsidiaries also incur most of their expenses in the local currency. Accordingly, all foreign subsidiaries use the local

currency as their functional currency. Our international business is subject to risks typical of an international business, including, but not limited to differing economic conditions, changes in political climate, differing tax structures, other regulations and restrictions, and foreign exchange rate volatility. Accordingly, our future results could be materially adversely impacted by changes in these or other factors. Our intercompany accounts are typically denominated in the functional currency of the foreign subsidiary in order to centralize foreign exchange risk with the parent company in the United States. We are also exposed to foreign exchange rate fluctuations as the financial results of foreign subsidiaries are translated into U.S. dollars in consolidation. As exchange rates vary, these results, when translated, may vary from expectations and adversely impact overall financial results. The effect of foreign exchange rate fluctuations on FairMarket in the quarter ended June 30, 2002 was not significant.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Reference is made to "Item 3. Legal Proceedings" on page 9 of our Report on Form 10-K for the year ended December 31, 2001 for a discussion of certain purported class action lawsuits filed by individual shareholders relating to FairMarket's initial public offering.

Item 2. Changes in Securities and Use of Proceeds

(d) Use of Proceeds

On March 17, 2000, we completed the initial public offering of our common stock. The shares of the common stock sold in the offering were registered under the Securities Act of 1933 on a Registration Statement on Form S-1 (No. 333-92677). The Securities and Exchange Commission declared the Registration Statement effective on March 13, 2000. We estimate that as of June 30, 2002, of the approximately $89 million in net proceeds from the initial public offering, approximately $36.5 million has been used for working capital purposes, including approximately $5.1 million used for the purchase of equipment. At June 30, 2002, substantially all of the remaining net proceeds (approximately $60 million) was held in investments in commercial paper, government bonds and other interest-bearing accounts. None of the costs and expenses related to the offering have been paid directly or indirectly to any director, officer or general partner of FairMarket or their associates or persons owning 10% or more of any class of equity securities of FairMarket or an affiliate of FairMarket.

Item 3. Defaults upon Senior Securities.

Not applicable.

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

On June 27, 2002, we held our 2002 annual meeting of stockholders for the purpose of electing each of Rory J. Cowan and Joseph R. Wright, Jr. as a Class II Director, to serve until our 2005 annual meeting of stockholders or until the qualification and election of his successor. The results of the vote with respect to the election of Mr. Cowan were as follows: For: 20,977,440; Withheld: 3,137,325. The result of the vote with respect to the election of Mr. Wright were as follows: For: 23,959,000; Withheld: 155,765.

On May 7, 2002, we entered into a Settlement and Standstill Agreement (the "Settlement Agreement") with JHC Investment Partners, LLC, MM Companies, Inc. (f/k/a musicmaker.com, Inc.), Jewelcor Management, Inc., Barington Capital Group, L.P. and Barington Companies Equity Partners, L.P. (collectively, the "JHC Entities") under which we expanded the size of our Board from four to five members, appointed Joseph R. Wright, Jr. as a Class II director to serve until our 2002 annual meeting of stockholders (the "2002 Annual Meeting") and nominated Mr. Wright, together with our then-existing Class II director, Rory J. Cowan, for re-election as Class II directors at the 2002 Annual Meeting, to serve until our 2005 annual meeting of stockholders. In return, the JHC Entities agreed not to engage in a proxy contest at the 2002 Annual Meeting and voted in favor of Mr. Cowan at the 2002 Annual Meeting. In addition, the JHC Entities agreed to vote in favor of our Board's nominees for election as directors at our 2003 and 2004 annual meetings of stockholders. The JHC Entities also agreed not to take certain specified actions with respect to its ownership of our common stock until January 22, 2005. We entered into the Settlement Agreement in order to avoid the expense and diversion of management attention that would have been required to defend against a proxy contest.

Item 5. Other Information.

Not applicable.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

10.1
Letter agreement dated April 9, 2002 between FairMarket, Inc. and N. Louis Shipley

10.2
Promotions Agreement dated as of April 10, 2002 between FairMarket, Inc. and eBay Inc.

(b) Reports on Form 8-K

On May 20, 2002, FairMarket filed a Current Report on Form 8-K dated May 17, 2002 with the Securities and Exchange Commission with respect to the issuance of our Series B Preferred Stock to eBay Inc.

SIGNATURE

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.

FairMarket, Inc.

Date: August 14, 2002

By: /s/ JANET SMITH

Janet Smith,
Chief Financial Officer
(Principal Financial and Accounting Officer)

EXHIBIT INDEX

Exhibit No.	Title
10.1	Letter agreement dated April 9, 2002 between FairMarket, Inc. and N. Louis Shipley
10.2	Promotions Agreement dated as of April 10, 2002 between FairMarket, Inc. and eBay Inc. [PORTIONS OF THIS EXHIBIT HAVE BEEN OMITTED PURSUANT TO A REQUEST FOR CONFIDENTIAL TREATMENT]

QuickLinks

FAIRMARKET, INC. FORM 10-Q For the Quarter Ended June 30, 2002 INDEX
PART I. FINANCIAL INFORMATION
FAIRMARKET, INC. Condensed Consolidated Balance Sheets (Unaudited)
FAIRMARKET, INC. Condensed Consolidated Statements of Operations (Unaudited)
FAIRMARKET, INC. Condensed Consolidated Statements of Cash Flows (Unaudited)
FAIRMARKET, INC. Notes to Condensed Consolidated Financial Statements (Unaudited)

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk
PART II. OTHER INFORMATION

Item 1. Legal Proceedings
Item 2. Changes in Securities and Use of Proceeds
Item 3. Defaults upon Senior Securities.
Item 4. Submission of Matters to a Vote of Security Holders
Item 5. Other Information.
Item 6. Exhibits and Reports on Form 8-K
SIGNATURE
EXHIBIT INDEX