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

Form 10-K

(Mark One)

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

For the fiscal year ended June 30, 2000

OR

☐ 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 000-24671

EMusic.com Inc.
(Exact name of Registrant as specified in its charter)

Delaware 94-329054
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

1991 Broadway, 2nd Floor 94063
Redwood City, California (Zip Code)
(Address of principal executive offices)

Registrant's telephone number, including area code: (650) 216-0200

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:
Common stock, \$.001 par value

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 ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405
of Regulation S-K is not contained herein, and will not be contained, to the
best of the Registrant's knowledge, in definitive proxy or information
statements incorporated by reference to Part III of this Form 10-K or any
amendment to this Form 10-K. ☒

The aggregate market value of voting stock held by non-affiliates of the
Registrant was approximately \$61,087,000 as of August 31, 2000, based upon the
closing price on the Nasdaq National Market reported for such date. This
calculation does not reflect a determination that certain persons are affiliates
of the Registrant for any other purpose.

43,101,913 shares of the Registrant's Common stock, \$.001 par value, were
outstanding at August 31, 2000.

DOCUMENTS INCORPORATED BY REFERENCE

None

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EMUSIC.COM INC.
FORM 10-K
INDEX

Page

PART I

Item 1. Business	1
Item 2. Facilities	8
Item 3. Legal Proceedings.....	8
Item 4. Submission of Matters to a Vote of Security holders.....	8

PART II

Item 5. Market For Registrant's Common Equity and Related Stockholder Matters.....	9
Item 6. Selected Consolidated Financial Data.....	10
Item 7. Management's Discussion and Analysis of Financial Condition	

and Results of Operations.....	11
Item 7A. Quantitative and Qualitative Disclosures About Market Risk.....	25
Item 8. Financial Statements and Supplementary Data.....	25
Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure.....	25
PART III	
Item 10. Directors and Executive Officers of the Registrant.....	26
Item 11. Executive Compensation.....	30
Item 12. Security Ownership of Certain Beneficial Owners and Management.....	32
Item 13. Certain Relationships and Related Transactions.....	34
PART IV	
Item 14. Exhibits, Financial Statement Schedules and Reports on Form 8-K.....	35
SIGNATURES	

PART I

ITEM 1. BUSINESS.

When used in this Form 10-K, the words "expects," "anticipates," "estimates" and similar expressions are intended to identify forward-looking statements. Such statements, which include statements concerning the timing of the development of the market for downloadable music, our ability to obtain content for sale as downloadable music, and announcements and actions by our existing and future competitors, are subject to risks and uncertainties, including those set forth below under "Factors That May Affect Our Results," that could cause actual results to differ materially from those projected. These forward-looking statements speak only as of the date hereof. The Company expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in the Company's expectations with regard thereto or any change in events, conditions or circumstances on which any statement is based. You should read this discussion together with the financial statements and other financial information included in this Form 10-K.

Overview

We are the owner and operator of one of the leading online music networks, providing music fans with extensive music content, news and information and community features. Our network of websites ranked among the top five music content websites as measured by unique visitors in June 2000. EMusic.com is a website for sampling and purchasing music in the mp3 format. Through direct relationships with leading artists and exclusive licensing agreements with over 600 independent record labels, EMusic.com offers an expanding collection of over 125,000 tracks for purchase, the largest collection of digital music content from recognized artists currently available for legal distribution in mp3 format over the Internet. RollingStone.com is the Internet's premier authority on music and popular culture. The site leverages Rolling Stone magazine's unrivaled deep archives, including more than 7,000 artist profiles, an extensive collection of exclusive photos and interviews, more than 30 years of magazine covers and over 1,000 on-demand videos. We also operate additional websites including IUMA.com, Tunes.com and Downbeatjazz.com.

Industry Background

The Internet has emerged as a global platform that allows millions of people to share information, communicate and conduct business. The Internet presents a significant opportunity for the rapid and cost-effective distribution, promotion and sale of recorded music. Downloading music files is also facilitated by the increased use of high-speed connections to the Internet, such as digital cable modems, ISDN and digital subscriber lines.

Jupiter Communications, a leading provider of research on Internet commerce, estimates that total online music revenues in the United States are expected to grow from \$387 million in 1999 to approximately \$5.4 billion in 2005. In 2005, Jupiter estimates that online music sales will account for approximately 25 percent of the total U.S. music market. Of this amount, Jupiter further estimates that 28 percent (or approximately \$1.5 billion) of online music dollars will be generated through digitally distributed products in 2005. In addition, Jupiter predicts that music subscription services will account for approximately \$980 million in 2005.

According to Jupiter, online advertising revenues are expected to reach approximately \$16.5 billion by 2005. Jupiter projects those online ad revenues to grow at a compound annual growth rate of 30 percent between 1999 and 2005. Several trends will drive the growth of the online advertising market, including the increasing size of the online population, a rise in time spent online, and increasing Internet commerce revenues.

Business Strategy

Our objective is to become the leading online music commerce company by providing music consumers with extensive music content, information and community features. The following are key elements of our strategy:

- Build on First Mover Advantage in Downloadable Music. We intend to continue to increase the number of musical selections available on our websites in order to build our global consumer base and increase the number of online music purchases.
- Continue to Enhance EMusic.com. We intend to devote substantial resources to improving the quality of consumers' experience on our websites by incorporating additional ease-of-use, information and community features.
- Continue to Develop and Enhance RollingStone.com. We intend to continue to add to the breadth and depth of music news and information and community features of RollingStone.com. We also intend to expand the scope of the site by adding other entertainment related information, such as information regarding movies.

- Create Strong Brand Awareness. Building brand awareness of EMusic and RollingStone.com is fundamental to expanding our global Internet user base. We intend to promote our brands through traditional media, event sponsorships, online media and other marketing activities as well as leveraging strategic relationships within the industry.
- Generate Advertising and Sponsorship Revenue. As we grow our user base and traffic, we will develop an increasingly attractive channel for advertisers to reach consumers. We seek to leverage our unique position with respect to the sale of downloadable music and the power of the RollingStone.com brand. We emphasize the attractive demographics of our user base, the emotional appeal and power of music to our users, and the ability to target specific segments of our audience based on their music preferences.

Downloadable Music

We currently offer our music for sale in the mp3 format, the most universally accepted music format used by consumers. Consumers can purchase our music either by enrolling in our EMusic Unlimited subscription program or by purchasing individual albums or songs. Our EMusic Unlimited service, which was introduced in July 2000, offers consumers the opportunity to download substantially all of the music available for sale at our site for a fixed monthly fee (currently ranging from \$19.99 for a one-month subscription to \$9.99 per month for a twelve-month subscription). EMusic Unlimited is the first music subscription service of its kind. Non-subscribers can purchase individual albums generally for \$8.99 and individual songs for \$0.99.

We have acquired, and intend to continue to seek, download rights to master recordings owned by independent record labels and other owners and distributors of significant recording catalogs. These agreements, which generally have been exclusive, multi-year licenses, typically include all existing and future recordings created during the term of the agreement. To date, we have focused on partnering with independent record labels and established recording artists. We are actively identifying and targeting independent record labels spanning every well known music genre, including, urban/hip hop, jazz, classical, country, blues, world, alternative and rock/pop.

We recently began to offer music from the Universal Music Group, including tracks and albums from artists such as The Allman Brothers, Blink 182, Al Jarreau, Steely Dan and Marvin Gaye. These are offered through our RollingStone.com website. We expect to be offering additional material from other major labels as the programs from such labels go into effect in the next several months.

All of the music that we offer for sale is from established artists with recording contracts with major or independent labels. In many genres of music, we have successfully acquired the exclusive multi-year, digital download rights to market sales leaders, and are continuing those efforts in each new genre of music we add to our expanding online catalog. The following is a sampling of labels with which we have signed content deals with genre market leaders:

- Epitaph Records
- Lookout Records
- Trauma Records
- Relix Records
- Shanachie Records
- Concord Jazz
- Justice Records
- Blackberry Music
- Metal Blade Records

We have also entered into contracts giving us the exclusive right to allow our customers to download music from a variety of recognizable, brand name artists, including, Elvis Costello, Phish, They Might Be Giants, The Violent Femmes, Willie Nelson, The Goo Goo Dolls, Green Day, Kid Rock, Tom Waits, Groove Armada, DJ Spooky and many others.

In certain cases, we acquire all rights (both physical and digital) to music rather than a limited license. For example, we have purchased the Jewel-Paula-Ronn catalog of master recordings with such Blues and R&B artists as B.B. King, John Lee Hooker,

Aretha Franklin and Lightnin' Hopkins, the Xanadu Records catalog of master recordings, including such Jazz artists as Dexter Gordon and Jimmy Raney and the Black Top Records catalog of master recordings, including Blues artists Freddie King and Snooks Eaglin. When we acquire masters, we seek to work with label partners to exploit the physical distribution rights while also selling the music in downloadable form on our website.

Music Information and Services

RollingStone.com offers one of the Web's most comprehensive collections of music content, including approximately 47,000 song clips, 1,500 music videos, 1,000 album reviews and 5,000 artist profiles covering major genres. On RollingStone.com, a consumer may:

- watch a live concert in our Virtual Venue, a high bandwidth music video in our Big Video section;
- read a daily news story, artist biography or album review;
- listen to an audio preview from an album;
- download near CD-quality digital music through a number of technologies including mp3, Windows Media and Liquid Audio;
- browse our extensive collection of artist photos;
- post concert or album reviews;
- access concert tour information;
- access user generated reviews or music; or
- play music based trivia games.

We believe the quality, quantity and nature of our content provides a valuable online music experience for our users. Rolling Stone magazine provides us with a continuing source of new and fresh content such as news, photos, interviews, feature stories and album and concert reviews. We also have access to over 30 years of Rolling Stone covers and reviews. Our editorial and artist relations staff focuses on developing and acquiring content with and from artists and many of the major and independent record labels.

Through relationships with record labels and other music industry participants, we are able to offer a variety of music content on our websites, including interviews, broadcasts over the Web, also known as webcasts, music videos and in-studio performances. We have featured video interviews and performances from a variety of new and established artists and exciting events.

We believe that music consumers' tastes are an important part of their personal identity and a powerful magnet for forming online communities. We are developing personalization and customization tools to facilitate community development by enabling members to actively express and share their music interests with each other. Many of our RollingStone.com community activities and features encourage user interaction and the creation of user-generated content. Through our community-building activities and features, members may:

- . post on message boards;
- . write and post album reviews; and
- . upload original music for other members to download and enjoy.

These activities provide an additional source of music discovery and encourage regular, active participation in our music communities. We believe that the more time a user invests to develop content and interact with others on our websites, the more likely it is that such a user will continue to return to our websites for music content. We believe that this is particularly compelling when combined with our EMusic Unlimited Subscription service.

Advertising Sales and Promotion

We generate a substantial portion of our revenue by selling advertising and promotions prominently displayed on our websites. Because music preferences are frequently considered by advertisers to be indicative of an individual's interests and lifestyle, we intend to gather extensive data on site traffic, user demographics, personal interests and psychographic data, using industry-standard measurement tools. Subject to appropriate privacy policies and limitations, we plan to use this data with the goal of providing our advertisers with a large, demographically desirable audience, which can be targeted by segment, genre and individual tastes.

We offer several different advertising options that may be purchased as stand alone products or as part of a more integrated marketing campaign. Additionally, unlike traditional websites that offer only text based banner advertisements, our extensive use of audio, video and multimedia content on our websites enables us to offer advertisers compelling rich-media advertisements. Advertising options on our websites include:

- . Banners. We offer banner advertisements on a general rotation or "run of site" or "run of network" basis primarily to advertisers seeking to establish general brand recognition across one or more of our sites. Targeted banner campaigns generally appeal to advertisers seeking to communicate a particular message regarding their product or service and are displayed when a user browses through specific content sections on our sites.
- . Sponsorship. We also offer sponsorship opportunities that enable advertisers to associate their messages with our websites, live concerts and coverage of events, such as Farm Aid and the Voodoo Music Festival and special features of our websites, such as Big Video. Sponsorships are generally in the form of special promotions or contests and are offered through fixed positions within our websites.
- . Rich media. We offer advertisers the ability to place their messages in rich-media formats, which incorporate audio, video or other multimedia elements. These advertisements typically are incorporated into the presentation of music videos, audio clips, concert webcasts, audio and video interviews and multimedia features. These advertisements are presented to our users prior to, during, or at the conclusion of the performance of our streaming or multimedia content. We currently sell these advertisements at a higher rate than traditional banner ads.
- . Private Label Internet Radio Players. We develop streaming radio players for our advertiser sites, allowing them to effectively add music and "stickiness" to their site.
- . Custom Microsites. We build and design custom microsites for our advertisers that reside on RollingStone.com. These are done primarily for advertiser clients that do not have a music-related consumer site, but would like to gain the music affiliation which results from being part of our site.

We target traditional music advertisers for advertising on our websites, including consumer product and service companies, record labels, entertainment companies, technology companies, consumer electronics manufacturers, motion picture studios, home video distributors, book publishers and automobile companies. Some of our largest advertising customers include American Express, Anheuser-Busch, Ford, General Motors, Microsoft, Sony, Polaroid and Tommy Hilfiger.

Sales and Marketing

We are aggressively pursuing a variety of partnerships aimed at building a channel of distribution for our downloadable music, music information and music-related products and services across the Internet.

We have entered into a variety of agreements and arrangements pursuant to which our downloadable music is highlighted or made available for sale at high traffic internet sites, including sites such as America Online's ICQ, Spinner and WinAmp interactive properties, Yahoo, RealNetworks, AltaVista, Listen.com, Bolt.com and Launch.com.

Similarly, we have entered into agreements or arrangements pursuant to which our RollingStone.com information is highlighted, including AOL and Microsoft's MSN.com, where we are the premiere music information provider as well as with Lycos, Netscape, Alta Vista and other high traffic sites.

We have an active affiliate program, with over 11,000 participating sites, which is designed to make it easy for any website to become an affiliate and sell the EMusic catalog from their websites.

We have built relationships with various manufacturers of computers and consumer electronics devices to create additional visibility as a source for downloadable music. For example, in June 2000, we announced that Hewlett-Packard agreed to

purchase a minimum of approximately \$3 million of EMusic Unlimited subscriptions to be bundled with CD-Writer products between July 1, 2000 and March 31, 2001.

Industry Relationships

Pursuant to an agreement with the publisher of Rolling Stone magazine, we are the exclusive licensee on the Internet of selected content of all domestic editions of Rolling Stone, including covers, photos, feature stories, reviews, editorials and access to the archives of Rolling Stone. Our agreement remains in effect until February 2011, and, at that time, will be renewed automatically until February 2016 if our market capitalization is at least \$2 billion at the time of renewal.

The reporting of information relating to the sales and performance of music is a legally required and complex aspect of the worldwide music industry. We have a licensing agreement with the Harry Fox Agency, or HFA, a wholly-owned licensing subsidiary of the National Music Publishers' Association pursuant to which we submit regular reports to HFA, account for each song purchased and pay the appropriate statutory payments to HFA for distribution to copyright owners. This agreement helps ensure that songwriters and music publishers will receive royalty payments for music distributed electronically. We have also entered into agreements with ASCAP, BMI and SESAC, the major rights reporting organizations in the United States. Under each of these agreements, we pay music performance royalties to the copyright holders or performers.

IUMA--Internet Underground Music Archive

IUMA.com was founded in 1993 and pioneered the delivery of music on the Internet. The IUMA site features approximately 20,000 artists on individual websites with unique URLs (bandname.iuma.com). IUMA artist websites enable audio sampling in mp3 and RealAudio formats, and offer options for the sales of physical products and downloadable music. IUMA artist websites also feature other content, including artist biographies, cover art, lyrics, photos and tour dates.

Operations

Our services and tools provide functionality in the following areas:

Digital Asset Management. The continued development of a database management system that indexes, retrieves and manipulates our growing multimedia content is central to our digital asset management system. This scalable system allows us to, among other things, track user preferences to enable effective marketing programs and maintain an efficient royalty accounting program.

Ordering and Fulfillment. EMusic.com includes an ordering system that is designed to be easy-to-use and that facilitates convenient purchasing of downloadable music. In order to maintain high customer satisfaction, we place an emphasis on website and download reliability. At any time during a visit to our website, a customer is able to click a "buy now" button to immediately place a song or album in their personal "shopping cart." The customer can then continue to shop on our website and add additional items if desired. New customers are prompted to register with us at the time of purchase and to enter their email addresses and passwords. Customers then securely submit their credit card information online to purchase the music. The customers' email addresses and passwords are used to identify them in the future, eliminating the need to resubmit credit card and billing information for subsequent orders.

Audio Encoding and Delivery. We use a variety of audio compression technologies for our audio samples and downloads, tailoring them to specific applications. We currently use the mp3 format for digital distribution of the downloadable music available for sale of music at EMusic.com and intend to incorporate additional formats required by major labels in connection with the sale of their content. We continue to explore other download formats and plan to adjust the format of its content to stay current with industry trends and customer preferences. We may need to obtain a third party license to use a newly adopted format.

Infrastructure. Our hardware and software are built upon a distributed transaction processing model which allows software to be distributed among multiple parallel servers. Web servers are deployed in large numbers on inexpensive Intel platforms, managed by Cisco load-balancing technology, and served by Solaris database servers. Our EMusic.com servers are currently based in a co-location facility in Sunnyvale, California. Our architecture can scale by either adding new servers or increasing the capacity of existing servers while maintaining both user performance and cost per transaction. The system's template technology and modular database design allows the addition or replacement of server-based applications such as multimedia

formats and delivery systems, and search and retrieval engines. This architecture also enables low-cost, rapid deployment of additional websites that integrate with our existing sites. Our RollingStone.com servers are based in co-location facilities in Jersey City, New Jersey and El Segundo, California.

Competition

The market for the online promotion and distribution of music and music-related products and services is new, highly competitive and rapidly changing. The number of websites on the Internet competing for the attention and spending of consumers and advertisers has increased, and we expect it to continue to increase, because there are few barriers to entry to Internet commerce. In addition, the competition for advertising revenues, both on Internet websites and in more traditional media, is intense. We currently face only limited competition with respect to the sale of downloadable music as few sites have substantial rights to sell downloadable music. However, as the major labels increasingly make their content available for sale in a downloadable format, we expect to face increasing competition with respect to the sale of that content. In addition, we face substantial competition with respect to advertising and promotion revenues. Our current and most likely potential competitors include the following categories of companies:

- . publishers and distributors of traditional media, such as television, radio and print, including MTV, VH1, CMT, SPIN and their Internet affiliates;
- . online services or websites targeted at music consumers, such as SonicNet, ARTISTdirect/Ultimate Band List and Launch;
- . general purpose consumer online services such as America Online and Microsoft Network, each of which provides access to music and entertainment-related content and services;
- . Web search and retrieval services and other online services such as Excite, Infoseek, Lycos and Yahoo!;
- . online music retailers such as CDnow and Amazon.com;

- . Internet radio services such as Spinner Networks and NetRadio;
- . traditional music companies, including BMG Entertainment, EMI Group, Sony Music Entertainment, Time Warner and Universal Music Group;
- . companies focused on digitally distributed music, including MP3.com and various private companies; and
- . online services or websites targeted to enthusiasts of particular artists or bands, including websites maintained by their labels.

In many cases, companies with which we have certain joint marketing or other arrangements may be or may become direct competitors as well. We anticipate that the number of direct and indirect competitors will increase in the future.

We believe that we compete primarily on the bases of:

- . the price and breadth of the downloadable music content;
- . the quality and variety of our music information and services;
- . the ease of use and consumer acceptance of our websites;
- . the ability to effectively promote brand equity; and
- . the ease of use and speed of our website.

Competition is likely to increase significantly as new companies enter the market and current competitors expand their services. Many of our current and potential competitors in the Internet and music entertainment businesses may have substantial competitive advantages to us, including:

- . longer operating histories;
- . significantly greater financial, technical and marketing resources;
- . greater brand name recognition;
- . larger existing customer bases; and
- . more popular content or artists.

These competitors may be able to respond more quickly to new or emerging technologies and changes in customer requirements and to devote greater resources to the development, promotion, and sale of their products or services than we can. Websites maintained by our existing and potential competitors may be perceived by consumers, artists, talent management companies and other music-related vendors or advertisers as being superior to ours. In addition, we may not be able to maintain or increase our website traffic levels, purchase inquiries and number of click-throughs on our online advertisements. Further, our competitors may experience greater growth in these areas than we do. Increased competition could result in advertising price reduction, reduced margins or loss of market share, any of which could harm our business.

Intellectual Property

Our success and ability to compete are substantially dependent on our internally developed technology. We pursue the registration of trademarks in the United States and internationally. While we rely on trademark, service mark, copyright and trade secrets laws and restrictions in the United States and other jurisdictions, together with contractual restrictions, to protect our proprietary rights, such trademark, service mark, copyright and trade secret protection may not be available in every jurisdiction in which we distribute or make available our musical and information content and technology through the Internet. Although we believe that the use of material on our websites is protected under current provisions of copyright law, legal rights to certain aspects of Internet content and commerce are not clearly settled. We may not be able to maintain rights to information, including webcasting of popular sound recordings, downloadable music samples, and artist, entertainment and other information. The failure to be able to offer such information would harm our business.

While we have generally entered into confidentiality or license agreements with our employees, consultants, and corporate partners in order to limit access to and distribution and disclosure of our proprietary information, we cannot assure you that the steps we have taken will adequately protect or prevent misappropriation of our proprietary rights, particularly in foreign countries where laws or law enforcement practices may not protect our proprietary rights as fully as in the United States. Despite our efforts, unauthorized parties may attempt to copy or otherwise obtain and use our products and technology. Policing unauthorized use is difficult.

There are no pending material lawsuits against us regarding infringement of any existing patents or other intellectual property rights or any material notices that our websites are infringing the intellectual property rights of others. However, there can be no assurance that such infringement claims will not be asserted by third parties in the future. Any such claims could result in litigation subjecting us to significant liability for damages, or invalidation of our proprietary rights. Any such claims, with or without merit, could be time consuming to defend, result in costly litigation, divert management attention and resources, or require us to enter into royalty or licensing agreements.

The music, music videos and live and archived webcasts featured on our sites include copyrighted works of third parties, including record labels, artists and songwriters. Each piece of music or music video content may have multiple copyright owners, some with rights in the sound recording covering the particular performance, others with rights in the musical composition covering the lyrics and music, and in the case of music videos, others with rights to the visual content. We have different licensing arrangements with these parties depending on our use of the song or music video and the length of portion of the song included. For the music that we sell, we generally have long-term licenses directly with the label owner or the artist which created or owns the work. In some cases, we use informational content without a license because we do not believe a license is required; however, this area of the law is uncertain. Our arrangements range from binding written contracts to informal arrangements based on the promotional nature of the content. In some cases we pay a fee to the licensor for use of the music or music video and in other cases our use is free. We also use other content, including images that are copyrighted works of others. We rely on our working relationships with copyright owners to obtain licenses on favorable terms. Any changes in the nature or terms of these arrangements, including any requirement for us to pay significant fees for the use of the content, could have a negative impact on the availability of content for our business.

Government Regulation

There are an increasing number of laws and regulations pertaining to the Internet, including laws or regulations relating to user privacy, liability for information retrieved from or transmitted over the Internet, online content regulation, user privacy, taxation and domain name registration. Moreover, the applicability to the Internet of existing laws governing issues such as intellectual property ownership and infringement, copyright, patent, trademark, trade secret, obscenity, libel employment and personal privacy is uncertain and developing.

Privacy Concerns. Legislatures and government agencies have adopted and are considering adopting laws and regulations restricting the collection and use of personal information obtained from individuals when accessing websites, which could limit our ability to use our databases to generate revenue.

Internet Taxation. A number of legislative proposals would impose additional taxes on the sale of goods and services over the Internet, which may substantially impair the growth of commerce on the Internet and, as a result, adversely affect our opportunity to derive financial benefit from these activities.

Domain Names. The current system for registering, allocating and managing domain names has been the subject of litigation and proposed regulatory reform. Although we and our magazine content providers assert trademark rights in our domain names, third parties may bring claims for infringement against us for the use of these trademarks. There can be no assurance that these domain names will not lose their value, or that we will not have to obtain entirely new domain names in addition to or in lieu of our current domain names if reform efforts result in a restructuring in the current system.

Jurisdiction. Due to the global nature of the Internet, it is possible that, although transmissions by us over the Internet originate primarily in New Jersey and California and we principally operate our business in California and Illinois, the governments of other states and foreign countries might attempt to regulate our business activities. In addition, as our service is available over the Internet in multiple states and foreign countries, these jurisdictions may require us to qualify to do business as a foreign corporation in each of these states or foreign countries, which could subject us to taxes and other regulations.

Employees

As of August 31, 2000, we had 184 full-time employees, including 73 in selling and marketing, 89 in product development and 22 in finance and operations. Our future success depends, in significant part, upon the continued service of our key technical, editorial, product development, and senior management personnel and on our ability to attract and retain highly qualified technical and management personnel, for whom competition is intense. None of our employees are represented by a collective bargaining unit, and we have never experienced a work stoppage. We believe that our relationships with our employees are good.

ITEM 2. FACILITIES

Our corporate headquarters are located in approximately 20,000 square feet in Redwood City, California occupied under a lease expiring in April 2004. We also maintain offices in Chicago, New York, San Francisco, Los Angeles and Nashville. We believe that our existing facilities will be adequate for the foreseeable future, and that suitable additional facilities will be available in the future as needed on commercially reasonable terms.

ITEM 3. LEGAL PROCEEDINGS

From time to time, we may be involved in litigation relating to claims arising out of our operations. However, we are not currently engaged in any legal proceedings that, individually or in the aggregate, are expected to have a material adverse effect on our business.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

Our common stock is traded on the Nasdaq National Market under the symbol "EMUS." Prices reported represent prices between dealers, do not include markups, markdowns or commissions and do not necessarily represent actual transactions.

The following table sets forth the high and low bid quotations for the common stock for the fiscal years ending June 30, 1999 and 2000 and the portion of the fiscal year ended June 30, 1998 for which our common stock was traded.

	High	Low
	-----	-----
Fiscal Year Ended June 30, 1998		
Fourth Quarter (after May 12, 1998).....	\$ 6.50	\$ 5.00
Fiscal Year Ended June 30, 1999		
First Quarter.....	\$ 8.00	\$ 5.88
Second Quarter.....	7.50	5.00
Third Quarter.....	23.88	7.00
Fourth Quarter.....	29.13	13.63
Fiscal Year Ending June 30, 2000		
First Quarter.....	\$26.19	\$11.56
Second Quarter.....	17.88	9.40
Third Quarter.....	10.88	5.19
Fourth Quarter.....	6.50	1.94
Fiscal Year Ending June 30, 2001		
First Quarter (through August 31, 2000) ..	\$ 2.56	\$ 1.47

At June 30, 2000, there were approximately 592 stockholders of record of our common stock. We have never declared or paid cash dividends on our common stock and do not anticipate paying any cash dividends in the foreseeable future. We currently intend to retain future earnings for the development of our business.

ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

This section presents our selected historical financial data. You should read carefully the financial statements included in this Form 10-K, including the notes to the financial statements. The selected data in this section is not intended to replace the financial statements.

The statement of operations data for the years ended June 30, 2000 and 1999 and period from January 8, 1998 (Inception) to June 30, 1998, and the balance sheet data at June 30, 2000 and 1999, are derived from our audited financial statements, which are included elsewhere in this Form 10-K. Historical results are not necessarily indicative of future results. We have paid no cash dividends on our common stock.

Statement of Operations Data (in thousands, except per share data)	Year ended June 30, 2000	Year ended June 30, 1999	January 8, 1998 (Inception) to June 30, 1998
Revenues:			
Music.....	\$ 1,321	\$ 9	\$ --
Advertising.....	5,153	83	--
	-----	-----	-----
Total revenues.....	6,474	92	--
Costs of revenues:			
Music.....	\$ 650	\$ 5	\$ --
Advertising.....	1,195	22	--
	-----	-----	-----
Total costs of revenues.....	1,845	27	--
	-----	-----	-----
Gross profit.....	4,629	65	--
	-----	-----	-----
Operating expenses:			
Product development, excluding stock compensation.....	15,638	3,629	209
Stock compensation.....	11,948	8,061	752
	-----	-----	-----
Total product development.....	27,586	11,690	961
Selling and marketing.....	27,917	556	--
General and administrative.....	6,581	1,599	219
Amortization of intangible assets.....	21,519	1,682	--
	-----	-----	-----
Total operating expenses.....	83,603	15,527	1,180
	-----	-----	-----
Operating loss.....	(78,974)	(15,462)	(1,180)
Interest and other income, net.....	2,984	322	--
	-----	-----	-----
Net loss.....	\$(75,990)	\$(15,140)	\$(1,180)
	=====	=====	=====
Net loss applicable to common stockholders.....	\$(76,707)	\$(47,677)	\$(1,180)
	=====	=====	=====
Net loss per share-basic and diluted.....	\$ (2.56)	\$ (3.52)	\$ (0.12)
	=====	=====	=====
Balance Sheet Data:	June 30, 2000	June 30, 1999	June 30, 1998
	-----	-----	-----
Cash and short-term investments.....	\$ 34,260	\$ 19,002	\$ 510
Working capital.....	\$ 35,290	\$ 16,593	\$ 396
Total assets.....	\$253,260	\$ 54,221	\$ 582
Redeemable convertible preferred stock.....	\$ --	\$ 32,550	\$ --
Capital lease obligations.....	\$ 424	\$ --	\$ --
Total stockholders' equity.....	\$241,842	\$ 18,987	\$ 447

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

We are the owner and operator of one of the leading online music networks, providing music fans with extensive music content, news and information and community features. Our network of websites ranked among the top five music content websites as measured by unique visitors in June 2000. EMusic.com is a website for sampling and purchasing music in the mp3 format. Through direct relationships with leading artists and exclusive licensing agreements with over 600 independent record labels, EMusic.com offers an expanding collection of over 125,000 tracks for purchase, the largest collection of digital music content from recognized artists currently available for legal distribution in mp3 format over the Internet. RollingStone.com is the Internet's premier authority on music and popular culture. The website leverages Rolling Stone magazine's unrivaled deep archives, including more than 7,000 artist profiles, an extensive collection of exclusive photos and interviews, more than 30 years of magazine covers and over 1,000 on-demand videos. We also operate additional websites including IUMA.com, Tunes.com and Downbeatjazz.com.

In addition to historical statements, this Annual Report on Form 10-K contains certain forward-looking statements that are subject to certain risks and uncertainties, which could cause actual results to differ materially from those stated or implied. Forward-looking statements are those that use the words "expects," "estimates," "will," "may," "anticipates," "believes" or similar expressions. These forward-looking statements reflect management's opinions only as of the date hereof, and we assume no obligation to update this information. Risks and uncertainties include, but are not limited to those discussed below and in the section entitled "Factors That May Affect Our Results." Other risks and uncertainties are disclosed in our prior SEC filings.

The following discussion should be read in conjunction with our Consolidated Financial Statements and Notes thereto, included elsewhere in this report.

RESULTS OF OPERATIONS

Since incorporation, we have incurred significant costs to acquire our catalog of downloadable music and to develop the Internet websites through which we conduct our business. We began selling musical recordings over the Internet in

July 1998, and have since sold more than 2.7 million songs via download over the Internet. We may experience significant fluctuations in operating results in future periods due to a variety of factors, including, but not limited to, market acceptance of the Internet as a medium for consumers to obtain downloadable sound recordings, our ability to create, license, and deliver compelling music-related content, our ability to obtain additional financing in a timely manner and on terms favorable to us, our ability to successfully integrate prospective asset or company acquisitions into our existing business operations, the level of traffic on our websites, intense competition from other providers of music-related content over the Internet, the entrance of established music and/or software companies into the on-line music industry, delays or errors in our ability to effect electronic commerce transactions, our ability to upgrade and develop our systems and infrastructure in a timely and effective manner, technical difficulties, system downtime or Internet brownouts, our ability to attract customers at a steady rate and maintain customer satisfaction, seasonality of the recorded music industry, seasonality of advertising sales, the amount and timing of operating costs and capital expenditures relating to expansion of our business, operations and infrastructure and the implementation of marketing programs, key agreements and strategic alliances, the number of recorded music releases introduced during the period, the level of returns experienced by us and general economic conditions and economic conditions specific to the Internet, on-line commerce and the recorded music industry.

On February 15, 2000, we acquired all of the outstanding stock of Tunes.com Inc., the operator of RollingStone.com in a stock-for-stock transaction. On December 13, 1999, we acquired all of the outstanding stock of Group K, Inc. (dba "Cductive"), an online custom CD compilation company. We accounted for these acquisitions using the purchase method of accounting and included the results of Tunes.com and Cductive in the consolidated financial statements from the respective dates of acquisition.

Revenues

Revenues are derived from the sale and licensing of downloadable music to consumers and other companies and from advertising services provided to other companies. Substantially all of our revenues are related directly to the Internet. Net revenues increased to \$6,474,000 for the year ended June 30, 2000 from \$92,000 for the year ended June 30, 1999. The revenue increase was primarily attributable to the increasing sales of downloadable music and to increasing advertising sales following the completion of our acquisition of Tunes.com. We earned no revenue for the period from January 8, 1998 (Inception) through June 30, 1998, when we were in the development stage.

We have acquired and control the exclusive legal rights to the largest catalog of music available for purchase as downloadable mp3 files. At June 30, 2000, we offered approximately 125,000 songs from over 7,300 professional artists and over 600 record labels for sale and download over the Internet. Via the Internet, customers browse, purchase and download these files from EMusic.com, and can link to our website from approximately 11,000 other affiliate websites. Music revenues for the year ended in June 30, 2000 include \$1,121,000 from the sale of approximately 1.7 million downloadable songs directly to customers. Music revenues for the year also include \$200,000 from the licensing of portions of our catalog for use by other music companies. Music revenues totaled \$9,000 for the year ended June 30, 1999.

We expect that downloadable music revenues will increase significantly in future periods. In July 2000, we launched EMusic Unlimited, a subscription program that allows customers to download an unlimited amount of music from the EMusic catalog in exchange for a flat, monthly fee. We also offer customers the opportunity to purchase individual tracks and albums, generally priced at 99 cents to download a single song and \$8.99 to download an entire album. In June 2000, we announced that Hewlett-Packard agreed to purchase a minimum of approximately \$3 million of EMusic Unlimited subscriptions to be bundled with CD-Writer products between July 1, 2000 and March 31, 2001. In August 2000, we also announced that we sold approximately \$1 million of downloadable music to SuperTracks, Inc., which revenue we expect to recognize during fiscal year 2001.

We generate advertising revenues from the sale of integrated marketing campaigns, banner advertisements and sponsorships on our network of websites, especially RollingStone.com. Advertising revenues are derived principally from short-term agreements and are generally recognized ratably over the term of the agreements, provided that we have no significant remaining obligations and our collection of the resulting receivable is probable. Our obligations typically include guarantees of a minimum number of advertising impressions delivered or times that the advertisement is viewed on our websites. Some of our top advertising customers include American Express, Anheuser-Busch, Ford, General Motors, Microsoft, Sony, Polaroid and Tommy Hilfiger.

Advertising revenues include barter revenue, which represents an exchange of advertising space on our websites for reciprocal advertising space on the websites or other media of third parties. Advertising revenue from barter transactions is recognized based on the fair value of the advertising surrendered in the transaction. Such fair value is determined based on our historical practice of receiving cash, or other consideration that is readily convertible to cash, for similar advertising from buyers unrelated to the counter-party in the barter transaction. The cost of the advertising space we receive from the third party is recorded as advertising expense. For the year ended June 30, 2000, approximately 12 percent of EMusic's revenues were derived from barter agreements. No barter revenue was recorded in the year ended in June 1999.

Advertising revenues for the year ended in June 2000 were \$5,153,000, compared to \$83,000 for the year ended June 30, 1999. Advertising revenues for the year ended June 30, 2000 included the results of RollingStone.com since the acquisition of Tunes.com in February 2000. In part because RollingStone.com will be included for the full twelve months, we expect that advertising revenues will be higher in future years.

Cost of Revenues

Cost of revenues comprise principally license fees paid to the owners of Rolling Stone magazine and of royalties paid to the owners of copyrighted songs sold to customers as downloadable files. Other costs of revenues include the cost of acquiring or creating editorial content, the cost to deliver advertising on the company's websites, and credit card processing fees. Cost of revenues for the years ended in June 2000 and 1999 were \$1,845,000 and \$27,000, respectively. Gross margins as a percentage of sales for the years ended in June 2000 and 1999 were 72% and 71%, respectively.

Because gross margins from advertising and sponsorship are higher than downloadable music, future gross margins may fluctuate depending on the relative

proportion of advertising and downloadable music revenues. Although we expect that sales and gross profits related to downloadable music will increase in future periods, gross margins related to the EMusic Unlimited program may be lower than those we have historically experienced with our individual album and track sales. Because the EMusic Unlimited program has only recently been introduced and the gross margin on subscription sales is significantly impacted by the number of songs downloaded by our subscribers, we do not yet have enough data to predict the extent to which these margins may be lower.

Product Development Expenses

Product development activities are those related to acquiring the rights to musical works and information and to building the systems necessary to deliver music and information to customers. Product development activities include website design and maintenance, audio production, graphic design, content acquisition and artist development. Product development expenses include salaries, rent, depreciation, telecommunications charges, stock compensation and certain non-recoverable advances to artists.

Stock compensation expenses represent the cost of common stock options and warrants granted to consultants in exchange for their help in acquiring the rights to musical works. For accounting purposes, the cost of the options granted to non-employees and warrants is calculated using the Black-Scholes Model. These stock options and warrants give the recipient the right to purchase shares of EMusic common stock from EMusic in the future at a specified price. The price specified is generally equal to the market price of our common stock on the date the instrument was issued to the consultant. Stock compensation expenses were \$11,948,000 and \$8,061,000 in the years ended in June 2000 and 1999, respectively, and \$752,000 for the period from January 8, 1998 (Inception) through June 30, 1998.

Exclusive of stock compensation expenses, product development expenses for the years ended in June 2000 and 1999 were \$15,638,000 and \$3,629,000 respectively, a 331% increase in year-over-year expenses, and \$209,000 for the period from January 8, 1998 (Inception) through June 30, 1998. This reflects our increased development efforts, particularly in graphic design and development of the infrastructure and "e-commerce" required to deliver downloadable music from our Internet website. The increase also reflected costs related to the addition of Tunes.com operations subsequent to February 15, 2000.

As a result of the cost reduction actions taken in June 2000, we expect to experience a substantial reduction in product development expenses for the year ending in June 2001.

Selling and Marketing Expenses

Selling and marketing consists principally of activities designed to promote our EMusic.com and RollingStone.com websites, to attract new customers and traffic to our websites and to sell advertisements and downloadable music to corporate customers. Selling and marketing expenses were \$27,917,000 and \$556,000 in the years ended in June 2000 and 1999, respectively. The increase in selling and marketing expenses during fiscal year 2000 reflects the launch of an extensive marketing campaign to establish the brand name "EMusic" as well as the cost of programs designed to promote our network of websites through strategic alliances, targeted advertising, direct promotion, trade shows and other such activities designed specifically to attract new customers and traffic. In addition, the headcount in our sales and marketing departments increased with the acquisition of Tunes.com in February 2000. We incurred no significant selling and marketing costs for the period from January 8, 1998 (Inception) through June 30, 1998. Because we were in the early stages of developing our catalog of downloadable music and our business and computer systems in 1999, selling and marketing expenses were limited primarily to developing our marketing processes and systems in the year ended in June 1999.

As a result of the cost reduction actions taken in June 2000, we expect to experience a substantial reduction in sales and marketing expenses for the year ending in June 2001.

General and Administrative Expenses

General and administrative expenses consist primarily of executive management, finance, legal, administrative and related overhead costs, such as rent, and insurance. General and administrative expenses for the years ended in June 2000 and 1999 were \$6,581,000 and \$1,599,000, respectively, and \$219,000 for the period from January 8, 1998 (Inception) through June 30,

1998. General and administrative expenses increased principally as a result of additional insurance and professional fees and headcount required to manage our growing operations as a public company and as a result of the acquisition of Tunes.com. We expect that general and administrative expenses will decrease in future periods as a result of efficiencies resulting from the integration of the two companies.

Amortization of Intangible Assets

Amortization of intangible assets for the years ended in June 2000 and 1999 were \$21,519,000 and \$1,682,000, respectively. During 1999, we acquired the "EMusic," "IUMA" and certain other trade names for a combined total of \$26,362,000 in cash and stock. We began amortizing these costs over a three-year period, resulting in an amortization expense of \$2,283,000 per quarter.

On December 13, 1999, we acquired Cductive.com and began amortizing the goodwill and intangible assets associated with this purchase of \$35,869,000, over a three-year period, resulting in an amortization expense of \$2,989,000 per quarter.

On February 15, 2000, we acquired Tunes.com and began amortizing the goodwill and trade name totaling \$134,652,000 over a ten-year period and the other intangible assets of \$1,418,000 associated with this purchase over a one-year period, resulting in an amortization expense of \$3,721,000 per quarter.

Liquidity and Capital Resources

At June 30, 2000, we had cash, cash equivalents and short-term investments totaling \$34,260,000. Net cash of \$42,976,000 was used for operating activities during the year ended in June 2000, principally as a result of net losses of \$75,990,000 generated during the year and the increase of prepaid expenses and other assets of \$3,315,000, offset by non-cash expenses associated with stock options and warrants granted to advisors of \$11,948,000, amortization of

intangible assets of \$21,519,000 and depreciation of \$1,908,000. For the period from January 8, 1998 (Inception) through June 30, 1999, net cash of \$5,297,000 was used for operating activities consisting of net losses of \$16,320,000, substantially offset by non-cash expenses associated with stock options and warrants granted to advisors of \$8,813,000 and the amortization of intangible assets of \$1,682,000. We expect to incur negative cash flow from operations during fiscal 2001, as the market continues to develop and we expand our operations. However, in June 2000, we announced that we had taken cost-reduction actions that we believe will result in aggregate cost savings of more than \$15 million over the 12 months ending in June 2001. Although we plan to continue to build our catalog of downloadable music and develop the software necessary to manage customer downloads, we expect that quarterly product development and marketing expenses will decrease in the future as a result of these actions.

Net cash used for investing activities totaled \$44,123,000 for the year ended in June 2000 as we spent \$11,967,000 for royalty advances, \$3,830,000 on capital equipment and software, invested a net of \$19,669,000 in short-term marketable securities and purchased \$4,481,000 in music catalogs and investments. For the period from January 8, 1998 (Inception) through June 30, 1999, net cash for investing activities totaled \$8,913,000, as we spent \$5,117,000 for royalty advances, \$1,128,000 on capital equipment and software and \$2,200,000 on music catalogs and investments.

Net cash provided by financing activities totaled \$82,688,000 for the year ended in June 2000. This was a result of proceeds from a September 1999 public offering, net of issuance costs, which totaled \$83,077,000. For the period from January 8, 1998 (Inception) through June 30, 1999, net cash provided by financing activities totaled \$33,212,000, as proceeds from the issuance of preferred stock and warrants totaled \$30,300,000, net of issuance costs.

Under an agreement with Rolling Stone LLC we are required to purchase \$1,100,000 of advertising and other services annually in Rolling Stone magazine until February 2011 and to pay Rolling Stone an annual license fee of \$1,000,000, which increases to \$1,250,000 in 2001 and \$1,500,000 in 2006.

In April 1999, we entered into a five-year lease agreement for new office space. Under the terms of the agreement, we will make minimum monthly lease payments of approximately \$67,000 for a period of 60 months, which began in April 1999. This monthly amount includes certain maintenance costs associated with the leased space, and is subject to annual increases based on the Consumer Price Index.

We have incurred significant losses from operations during each fiscal year since inception and have been dependent upon raising money from issuances of our preferred stock and common stock in order to fund these losses and our investment in content and other assets needed to establish our business.

We currently plan to increase our revenues to a level that will finance expected expenditures and result in at least neutral cash flows from operations. However until we reach this stage we will continue to use our current cash and cash equivalent and short-term investment balances to meet the shortfall. We also plan to raise additional financing where necessary. There can be no assurance that, in the event we require additional financing that such financing will be available on terms, which are acceptable to us or at all.

In the event that we are unable to increase revenue levels or financing is unavailable to us management has developed alternative plans which will entail the reduction of expenses to levels that could be financed by revenues generated. Such reductions in expenditures may include actions similar or greater in scope to the cost-reduction exercises undertaken in June 2000. There can be no assurance that the exercise undertaken in June or any further cost cutting exercises will be successful in completely eliminating the difference between expenditures and revenues or that such actions would not have a harmful effect on our business and results of operations.

Based on our current plans we believe that the current balances of our cash and cash equivalents and short-term investments will be sufficient to meet our cash requirements for at least the next twelve months.

FACTORS THAT MAY AFFECT OUR RESULTS

Investing in our Common Stock involves a high degree of risk. You should carefully consider the following factors and other information contained in this Form 10-K and other filings which we make with the SEC from time to time before deciding to invest in our stock.

Any of the following risks, if they actually occur, could materially and adversely affect our business, financial condition or results of operations. In such event, the trading price of our common stock could decline, and stockholders could lose all or part of their investments.

We have a new and unproven business model and it may not generate sufficient revenue for our business to survive or be successful.

Our model for conducting business and generating revenues is new and unproven and if it fails to develop as we plan, our business may not succeed. Our business model depends upon our ability to generate revenue streams from multiple sources primarily through our websites, including:

- . online sales of downloadable music;
- . website advertising and sponsorship fees from third parties; and
- . licensing of musical recordings for use by others.

It is uncertain whether a music-based website such as EMusic.com, that relies on attracting people to purchase and download music, mostly from lesser-known artists, can generate sufficient revenues to survive. This business model may not succeed or it may not be sustainable as our business grows.

We are substantially dependent upon our recently introduced EMusic Unlimited subscription service which allows users to download substantially all of the music for sale at EMusic.com for a fixed monthly fee. If our subscription service is not accepted by users, our ability to increase our revenues will be adversely affected. Likewise, if users download greater numbers of albums or tracks than we currently expect, our operating results would be adversely affected.

In order for our business to be successful, we must not only develop services that directly generate revenue, but also provide content and services that attract consumers to our websites on a regular basis. We will need to develop new offerings as consumer preferences change and new competitors emerge. We may not be able to provide consumers with an acceptable blend of products, services,

and informational and community offerings that will attract consumers to our websites on a regular basis. We provide many of our products and services without charge, and we may not be able to generate sufficient revenue to pay for these products and services. Accordingly, we cannot be certain that our business model will be successful or that we will sustain revenue growth or be profitable.

We are competing in a new market that may not develop sufficiently to support our business.

The market for online music promotion and distribution is new and rapidly evolving. As a result, demand and market acceptance for our products and services are subject to a high degree of uncertainty and risk. In the early stages of this market, we are attempting to capitalize on a talent pool of artists underserved by the traditional recording industry. Consumers may not continue to be interested in listening to, or purchasing music from, these artists. If this new market fails to develop, develops

more slowly than expected or becomes saturated with competitors, or our products and services do not achieve or sustain market acceptance, we may not generate sufficient revenues to become profitable.

The future popularity of downloadable music will depend on consumer acceptance of downloading music generally. We believe that consumer acceptance is, in part, dependent on the availability of music from major record labels and portable devices to store and play this music. Although the major labels have announced plans to make music available for download, to date they have only announced the availability of limited portions of their catalogs at prices which are substantially higher than the prices which we have been charging for downloadable music. These actions may slow the overall consumer acceptance of downloadable music and adversely impact our ability to increase our revenues. Likewise, to the extent that new devices are not available at affordable prices, or consumer acceptance or distribution of these portable devices is delayed, our potential market, and thus our ability to increase our revenues, may be reduced.

We have a limited operating history that makes an evaluation of our business difficult.

We were incorporated in January 1998. During 1998 and 1999, our operating activities consisted largely of developing the infrastructure necessary to download music on the Internet and obtaining exclusive digital rights to sell music. We acquired Tunes.com Inc., the original operator of RollingStone.com, in early 2000. Our limited operating history makes it difficult to evaluate our current business and prospects. As a result of our limited operating history, we do not have meaningful historical financial data upon which to forecast quarterly revenues and results of operations. Before investing in us, you should evaluate the risks, expenses and problems frequently encountered by companies such as ours that are in the early stages of development.

We have incurred substantial losses to date and we expect net losses in the future.

From inception through June 30, 2000, we had accumulated net losses of \$92.3 million. We expect substantial net losses for the foreseeable future and although we believe that we have a plan which can lead to positive cash flow from operations, there can be no assurance that our plan can be achieved. We believe it is critical to our long-term success that we continue to develop "EMusic" and "RollingStone.com" brand awareness and loyalty through marketing and promotion, expand our artist and consumer networks, develop our online content and expand our other services. We have recently reduced our operating expenses. If we determine that we need to increase operating expenses in order to achieve our goals, we will need to generate significant additional revenues to achieve profitability. As a result, we may never achieve profitability and, if we do achieve profitability in any period, we may not be able to sustain or increase profitability.

Our quarterly revenues and operating results are subject to fluctuation, which may result in volatility or a decline in the price of our stock.

We believe that period-to-period comparisons of our operating results are not meaningful and should not be relied upon as indicators of future performance. Our quarterly operating results are likely to fluctuate significantly in the future as a result of a variety of factors, many of which are outside of our control, including:

- . the demand for downloadable music content and Internet advertising;
- . the application of revenue recognition policies to large contracts under generally accepted accounting principles;
- . the addition or loss of advertisers;
- . the level of traffic on our Internet sites;
- . amount and timing of capital expenditures and other costs relating to the expansion of our operations;
- . the introduction of new sites and services by us or our competitors;
- . seasonal trends in Internet use, purchases of downloadable music, and advertising placements;
- . price competition or pricing changes in the industry;
- . technical difficulties or system downtime; and
- . general economic conditions, and economic conditions specific to the Internet and Internet media.

In addition, while our revenues may vary significantly, a portion of our expenses are fixed. As a result, any decrease in revenues will not be accompanied by a decrease in our fixed operating expenses and our operating results will suffer. Our quarterly results may also be significantly impacted by the accounting treatment of acquisitions, financing transactions or other matters. Because of these and other factors it is likely that our operating results will fall below expectations in some future quarter and the trading price of our stock may drop.

We depend on our exclusive relationship with the publisher of RollingStone magazine for content and brand recognition and may not be able to attract visitors to our RollingStone.com web site if this relationship is terminated or becomes nonexclusive.

We depend significantly upon our relationship with the publisher and owner of Rolling Stone magazine, for editorial content, access to the archives of Rolling Stone and our use of the brand name "Rolling Stone," as well as for press coverage, business and marketing opportunities, strategic relationships and potential acquisitions. If we are unable to continue this relationship and to utilize the Rolling Stone brand name and content on our websites, or if the Rolling Stone content or brand name is made accessible to our competitors, we may generate less traffic, which would reduce our revenue. In addition, if Rolling Stone is not able to continue to obtain license rights for online distribution of its magazine content from third-party contributors, we would not be able to make this content available on our Web sites which could reduce the number of visitors to our websites. Our agreement with Rolling Stone will terminate in 2011 unless we have a market capitalization of at least \$2 billion at that time, in which case it will terminate in 2016. The agreement may be terminated earlier if we fail to comply with our obligations under the agreement.

Under our agreement with Rolling Stone, we obtained the right to use the "Rolling Stone," "RollingStone Online" and "RollingStone.com" trademarks and their derivatives in connection with the Internet and the right to use the RollingStone.com domain name. If our agreement terminates, we will not be entitled to use these trademarks or the RollingStone.com domain. The loss of our right to use the Rolling Stone trademarks, domain or content would damage our reputation and severely limit our ability to generate advertising, e-commerce and other revenue.

Shares eligible for future sale in the open market may depress our stock price.

As of June 30, 2000, there were approximately 43,000,000 shares of Common Stock outstanding, substantially all of which were tradable without registration under the Securities Act or pursuant to currently effective registration statements.

Our stock price has been and may continue to be volatile.

Our Common Stock is currently traded on the Nasdaq National Market under the ticker symbol "EMUS." There can be no assurance that an active trading market will be sustained in the future. In addition to fluctuations in our operating results, the following factors could cause the price of our securities to be volatile:

- . development of the downloadable music market;
- . technological innovations;
- . legal development with respect to copyright law and downloadable music;
- . new products;
- . acquisitions or strategic alliances entered into by us or our competitors;
- . failure to meet securities analysts' expectations;
- . government regulatory action;
- . patent or proprietary rights developments; and
- . market conditions for Internet and technology stocks in general.

If our brand names are not accepted, our ability to attract content and customers to our website will be harmed.

We believe that establishing and maintaining the EMusic and RollingStone.com brands is a critical aspect of our efforts to attract and expand our Internet audience and acquire new content and that the importance of brand recognition will increase due to the growing number of Internet sites and the relatively low barriers to entry in providing Internet content. We intend to incur significant expenses in our brand building efforts. If these efforts do not generate increased revenues our operating results will suffer. If we are unable to provide high quality content or otherwise fail to promote and maintain our brand, our business will be harmed.

If we are unable to maintain or expand our contracts for music content, or if the content we license does not sell, our popularity and business may suffer.

We believe that a primary draw to our EMusic.com website is the ability to access music from known artists and independent record labels. Currently, we have exclusive multi-year contracts for much of our music library. However, if we are unable to sign contracts for new content, or if we are unable to extend the terms of existing contracts as they expire, our website may fail to attract new, or retain existing, customers which would harm our business.

For much of the content we license, we pay advances against future royalties, which will be owed on the sale of the content. If the content we license does not sell in sufficient quantities, we may not be able to recover all or part of the advances we have paid and our business could be harmed.

We rely on third parties for the hosting of our websites and if these hosting services become unavailable, our customers will not be able to access our websites.

We currently rely on third parties, which host our EMusic.com and RollingStone.com websites. We currently do not maintain redundant websites. If for any reason our current website hosting services become unavailable or if our hosting service experiences technical problems, customers will not be able to access our websites until these services are restored or until we are able to make arrangements with an alternate provider.

If we fail to adequately manage our growth, we may not be successful as we may miss market opportunities.

If our revenues grow rapidly, we will also need to expand the scope of our operations and the number of our employees rapidly. In particular, we will need to hire additional engineering, sales, marketing, content acquisition and administrative personnel. Additionally, we may complete additional acquisitions which could increase our employee headcount and business activity substantially. Any such rapid growth would place significant stress on our technology, operations, management and employee base. Any failure to successfully address such issues would harm our business.

Our technology systems must be expanded and enhanced for our business to grow.

In order to support a growing business, we will need to continue to enhance and expand the technology infrastructure, which supports our business. We have recently converted our central database for EMusic.com to a new database based upon technology licensed from Oracle Corporation and implemented a new accounting system. As our business continues to grow, we will need to add additional servers and other hardware and software systems as well as additional sites for website hosting. If we fail to successfully implement these new and enhanced systems, our operations could be disrupted, we may become less competitive, our revenues could be reduced and we may need to incur additional costs to address these issues.

We may have difficulty executing acquisitions and integrating the acquired companies into our business.

Our business strategy includes entering into strategic alliances and acquiring complementary businesses, technologies, content or products. During the last two fiscal years, we completed the acquisitions of Creative Fulfillment, Inc., IUMA, Cductive and Tunes.com. These and any other future acquisitions involve risks commonly encountered in acquisitions of companies, including:

- . exposure to unknown liabilities of acquired companies;
- . incurring acquisition costs and expenses in excess of what we anticipated;
- . the occurrence of fluctuations in our quarterly and annual operating results due to the costs and expenses of acquiring and integrating new businesses or technologies;
- . experiencing difficulties and expenses in assimilating the operations and personnel of the acquired businesses;
- . disruption of our ongoing business and diversion of our management's time and attention;
- . a possible inability to integrate successfully or to complete the development and application of acquired technology and a possible failure to achieve the anticipated financial, operating, and strategic benefits from these acquisitions;
- . experiencing difficulties in establishing and maintaining uniform standards, controls, procedures, and policies;
- . impairment of our relationships with key employees and customers of acquired businesses or the loss of these key employees and customers as a result of changes in management and ownership of the acquired businesses.

In addition, our stockholders may be diluted if the consideration for future acquisitions consists of equity securities. We may not overcome these risks or any other problems encountered in connection with acquisitions. If we are unsuccessful in doing so, our business could be harmed.

We expect competition to increase significantly in the future and we may not be able to compete successfully.

The market for the online promotion and distribution of music and music-related products and services is new, highly competitive and rapidly changing. The number of websites on the Internet competing for the attention and spending of consumers, users and advertisers has increased, and we expect it to continue to increase, because there are few barriers to entry to Internet commerce. In addition, the competition for advertising revenues, both on Internet websites and in more traditional media, is intense. Currently, there are more than one hundred music retailing websites on the Internet. We face competitive pressures from numerous actual and potential competitors.

All of the major record label companies have announced initiatives with respect to the sale of downloadable music. To date we have announced an agreement pursuant to which we are selling music from the Universal Music Group. If we are unable to obtain licenses to sell or otherwise distribute content from all or most of the major record label companies, our ability to increase our sales will be limited to our ability to obtain licenses from the independent record label segment of the music market, which has historically represented approximately 20% of the total music market. To the extent that other companies are able to obtain rights to content from major record labels, such companies may have a significant competitive advantage over us.

Competition is likely to increase significantly as new companies enter the market and current competitors expand their services. Many of our current and potential competitors in the Internet and music entertainment businesses may have substantial competitive advantages relative to us, including:

- . longer operating histories;
- . significantly greater financial, technical and marketing resources;
- . greater brand name recognition;
- . larger existing customer bases; and
- . more popular content or artists.

These competitors may be able to respond more quickly to new or emerging technologies and changes in customer requirements and devote greater resources to the development, promotion, and sale of their products or services than we can. Websites maintained by our existing and potential competitors may be perceived by consumers, artists, talent management companies and other music-related vendors or advertisers as being superior to ours. In addition, we may not be able to maintain or increase our website traffic levels, purchase inquiries and number of click-throughs on our online advertisement. Further, our competitors may experience greater growth in these areas than we do. Increased competition could result in advertising price reduction, reduced margins or loss of market share, any of which could harm our business.

We may need to obtain additional funds to execute our business plan and if we are unable to obtain such funds, we will not be able to expand our business as planned.

We believe that our existing capital will be sufficient to fund our planned level of operating activities, capital expenditures and other obligations through the next 12 months. However, unless we raise additional capital, we may need to reduce the scope of certain activities. In addition, we may need to raise additional funds in order to:

- . finance unanticipated working capital requirements;
- . develop or enhance existing services or products;
- . fund distribution relationships;
- . advertise to build global brand recognition;
- . respond to competitive pressures; or
- . acquire complementary businesses, technologies, content or products.

Additional financing may not be available on terms favorable to us, or at all. If adequate funds are not available or are not available on acceptable terms, our ability to fund our expansion, take advantage of unanticipated opportunities, develop or enhance services or products or otherwise respond to competitive pressures would be significantly limited. If we raise additional funds by issuing equity or convertible debt securities, the percentage ownership of our then existing stockholders will be reduced, and these securities may have rights, preferences or privileges senior to those of our stockholders.

Our business is dependent on the continued development and maintenance of the Internet and the availability of increased bandwidth to consumers.

The success of our business will depend largely on the development and maintenance of the Internet infrastructure. This includes maintenance of a reliable network with the necessary speed, data capacity and security, as well as timely development of complementary products such as high-speed modems, for providing reliable Internet access and services. Because global commerce on the Internet and the online exchange of information is new and evolving, we cannot predict whether the Internet will prove to be a viable commercial marketplace in the long term.

The success of our business will rely on the continued improvement of the Internet as a convenient means of consumer interaction and commerce, as well as an efficient medium for the delivery and distribution of music. Our business will depend on the ability of our artists and consumers to continue to upload and download mp3 and other music file formats, as well as to conduct commercial transactions with us, without significant delays or aggravation that may be associated with decreased availability of Internet bandwidth and slower access to our websites. Our penetration of a broader consumer market will depend, in part, on continued proliferation of high speed Internet access. Even compressed in mp3 format, a typical three-minute song file can occupy more than three megabytes of storage space. This file could take approximately seven minutes to download over a conventional 56 kbps modem compared to less than one minute over an xDSL or cable modem.

The Internet has experienced, and is likely to continue to experience, significant growth in the numbers of users and amount of traffic. As the Internet continues to experience increased numbers of users, increased frequency of use and increased bandwidth requirements, the Internet infrastructure may be unable to support the demands placed on it. In addition, increases in users or bandwidth requirements may harm the performance of the Internet. The Internet has experienced a variety of outages and other delays as a result of damage to portions of its infrastructure, and it could face outages and delays in the future. This might include outages and delays resulting from denial of service problems such as those experienced by major Internet sites, such as Yahoo!. These outages and delays could reduce the level of Internet usage as well as the level of traffic, and could result in the Internet becoming an inconvenient or uneconomical source of music and music-related products and services. The infrastructure and complementary products or services necessary to make the Internet a viable commercial marketplace for the long term may not be developed successfully or in a timely manner. Even if these products or services are developed, the Internet may not become a viable commercial marketplace for the products or services that we offer.

We must maintain and establish strategic alliances to increase our customer base and enhance our business.

In an attempt to increase our customer base and traffic on our websites, build brand recognition, attract paid advertising and enhance content, distribution and commerce opportunities, we have entered into agreements with various media, hardware device and Internet-related companies such as America Online, RealNetworks, and Microsoft. Our failure to maintain or renew our existing strategic alliances or to establish and capitalize on new strategic alliances could harm our business. Our future success depends to a significant extent upon the success of such alliances. Moreover, we are substantially dependent on our ability to advertise on other Internet sites and the willingness of the owners of other sites to direct users to our Internet sites through hypertext links. We may not achieve the strategic objectives of these alliances, and parties to strategic alliance agreements with us may not perform their obligations as agreed upon. Such agreements also may not be specifically enforceable by us. In addition, some of our strategic alliances are short term in nature and may be terminated by either party on short notice. The termination or impairment of these strategic alliances could reduce our ability to attract new customers.

Our success depends on our retention of key personnel.

Our performance is substantially dependent on the services of Gene Hoffman, Jr., our chief executive officer, as well as on our ability to recruit, retain and motivate other officers and key employees. Competition for qualified personnel is intense and there are a limited number of persons with knowledge of and experience in the Internet and music entertainment industries. The loss of the services of any of our officers or senior managers could harm our business.

We may not be able to hire and retain a sufficient number of qualified employees to grow our business as planned.

Our future success will depend on our ability to attract, train, retain and motivate other highly skilled technical, managerial, marketing and customer support personnel. Competition for these personnel is intense, especially for engineers, web designers and advertising sales personnel, and we may be unable to successfully attract sufficiently qualified personnel. A large percentage of our employees have joined us within the last 12 months and if revenues grow rapidly, our rate of hiring will need to continue. To manage the expected growth of our operations, we will need to integrate these employees into our business. Our inability to hire, integrate and retain qualified personnel in sufficient numbers may reduce the quality of our programs, products and services, and could harm our business. In addition, companies in the Internet and music industries whose employees accept positions with competitive companies frequently claim that their competitors have engaged in unfair hiring practices. We may be subject to claims in the future as we seek to hire qualified personnel and those

claims may result in material litigation. Even if unsuccessful, these claims could harm our business by damaging our reputation, requiring us to incur legal costs and diverting management's attention away from our business.

Security concerns regarding credit card or other confidential information transmitted over the web could limit our growth and subject us to liability.

A significant barrier to e-commerce and communications over the Internet has been the need for secure transmission of confidential information over public networks. Internet usage may not increase at the rate we expect unless some of these concerns are adequately addressed and found acceptable by the market. Internet usage could also decline if any well-publicized compromise of security occurred. We may incur significant costs to protect against the threat of security breaches or to alleviate problems caused by such breaches. Protections against security breaches may not be available at a reasonable price or at all. If a third party were able to circumvent our security measures and misappropriate our users' personal information, it may cause interruptions to our retail website operation, damage our reputation or subject us to claims by users. Any compromise of confidential data during transmission over the Internet may harm our business.

Any failure of our internal security measures could cause us to lose customers and subject us to liability.

Our business is dependent on maintaining a database of confidential user information, including credit card numbers. If the security measures that we use to protect personal information are ineffective, we may lose customers and our business would be harmed. We rely on security and authentication technology licensed from third parties. With this technology, we perform real-time credit card authorization and verification. We cannot predict whether new technological developments could allow these security measures to be circumvented.

In addition, our software, databases and servers may be vulnerable to computer viruses, physical or electronic break-ins and similar disruptions. We may need to spend significant resources to protect against security breaches or to alleviate problems caused by any breaches and we may not be able to prevent all security breaches.

Our intellectual property protection may be inadequate, and any loss or reduction in intellectual property protection may harm our business.

Our intellectual property includes our trademarks and copyrights, proprietary software, and other proprietary rights. We believe that our intellectual property is important to our success and our competitive position, and we try to protect it. However, our efforts to protect our intellectual property could be inadequate. Use of the "EMusic" name by others could dilute our brand identity and confuse the market. In addition, our ability to conduct our business may be harmed if others claim we violate their intellectual property rights. For example, Sightsound.com, Inc. has asserted that many online music providers, including us, violate patent rights that it allegedly owns covering the sale of music over the Internet through digital downloads. If successful, these claims, or similar claims by others, could seriously harm our business by forcing us to cease using intellectual property that we depend on to operate our business. Even if unsuccessful, these claims could harm our business by damaging our reputation, requiring us to incur legal costs and diverting management's attention away from our business.

Government regulation may require us to change the way we do business.

Laws and regulations directly applicable to Internet communications, commerce and advertising are becoming more prevalent. The United States Congress has enacted Internet laws regarding children's privacy, copyrights and taxation. Such legislation could dampen the growth in use of the Internet generally and decrease the acceptance of the Internet as a communications, commercial and advertising medium. Although our transmissions originate in California and New Jersey, the governments of other states or foreign countries might attempt to regulate our transmissions or levy sales or other taxes relating to our activities. The European Union has enacted its own privacy regulations that may result in limits on the collection and use of certain user information. The laws governing the Internet, however, remain largely unsettled, even in areas where there has been some legislative action. It may take years to determine whether and how existing laws such as those governing intellectual property, privacy, libel and taxation apply to the Internet and Internet advertising. In addition, the growth and development of the market for Internet commerce may prompt calls for more stringent consumer protection laws, both in the United States and abroad, that may impose additional burdens on companies conducting business over the Internet. Furthermore, the Federal Trade Commission has recently investigated the disclosure of personal identifying information obtained from individuals by Internet companies. Evolving areas of law that are relevant to our business include privacy law, proposed encryption laws, content regulation and sales and use tax. For example, changes in copyright law could require us to change the manner in which we conduct business or increase our costs of doing business. In addition, currently pending litigation involving copyright infringement claims brought against MP3.com and Napster may result in decisions which have a significant impact on our business. If the unlicensed distribution of music is held to be lawful, our ability to sell music could be materially harmed. Because of this rapidly evolving and uncertain regulatory environment, we cannot predict how these laws and regulations might affect our business. In addition, these uncertainties make it difficult to ensure compliance with the laws and regulations governing the Internet. These laws and regulations could harm us by subjecting us to liability or forcing us to change how we do business. In the event the Federal Trade Commission or other governmental authorities adopt or modify laws or regulations applicable to our business, including those relating to the Internet and copyright matters, our business could be harmed.

We may have liability for content on our website and liability for other materials, which we distribute.

We may be liable to third parties for content on our website and any other materials we distribute if:

- . the music, text, graphics or other content on our website violates their copyright, trademark, or other intellectual property rights;
- . our artists or labels violate their contractual obligations to others by providing content on our website; or
- . content we distribute is deemed obscene, defamatory or excessively violent.

We may also be subject to these types of liability for content that is accessible from our websites through links to other websites.

Although we believe that we have valid licenses for the music that we sell, other artists or labels may challenge whether the party granting us the license had the right to do so. Even if we are entitled to indemnification, defending any such claim could be costly and damage our reputation and adversely affect revenues if we must remove content from our site completely or temporarily.

Liability or alleged liability for content or other materials could harm our business by damaging our reputation, requiring us to incur legal costs in defense, exposing us to significant awards of damages, fines and costs and could divert management's

attention away from our business. In particular, in addition to civil damages, liability for violations of copyright law currently can result in penalties of up to \$10,000 per occurrence.

Imposition of sales and other taxes on e-commerce transactions may impair our ability to derive financial benefits from e-commerce.

Except for sales of tangible merchandise into certain states, we do not collect sales or other taxes on sales of our products through our websites. Although the Internet Tax Freedom Act precludes, for a period of three years ending October 2001, the imposition of state and local taxes that discriminate against or single out the Internet, it does not currently impact existing taxes. However, one or more states may seek to impose sales tax collection obligations on out-of-state companies such as us, which engage in or facilitate online commerce. A number of proposals have been made at the state and local level that would impose additional taxes on the sale of goods and services through the Internet. Such proposals, if adopted, could substantially impair the growth of electronic commerce and could adversely affect our opportunity to derive financial benefit from electronic commerce. Moreover, if any state or foreign country were to successfully assert that we should collect sales or other taxes on the exchange of merchandise on its system, it could affect our cost of doing business.

Legislation limiting the ability of states to impose taxes on Internet based transactions has been proposed in the U.S. Congress. We cannot assure you that this legislation will ultimately become law or that the tax moratorium in the final version of this legislation will be ongoing. Failure to enact or renew this legislation, if enacted, could allow various states to impose taxes on Internet-based commerce, which could harm our business.

We may have difficulty expanding into international markets, which could limit the growth of our business.

Our future growth and success will depend in part on our ability to generate international sales. There can be no assurance, however, that we will be successful in generating international sales of our products. Sales to customers in certain international countries may be subject to a number of risks, including: currency exchange rate risk; the risks that agreements may be difficult or impossible to enforce and receivables difficult to collect through an international country's legal system; foreign customers may have longer payment cycles; or foreign countries could impose withholding taxes or otherwise tax our foreign income, impose tariffs, embargoes, or exchange controls, or adopt other restrictions on foreign trade. In addition, the laws of certain countries do not protect our offerings and intellectual property rights to the same extent as the laws of the United States. If we fail to compete successfully or to expand the distribution of our offerings in international markets the growth of our business could be limited.

Development of new standards for the electronic delivery of music may threaten our business.

We currently rely on mp3 technology as a delivery method for the digital distribution of music. Mp3 is an open standard adopted by the Moving Picture Experts Group for the compression of audio files. We do not own or control mp3 technology and are dependent upon a license to obtain rights to certain patents relating to the technology. The onset of competing industry standards for the electronic delivery of music could significantly affect the way we operate our business as well as the public's perception of EMusic as a company. For example, in December 1998, the major recording studios announced a plan to develop a universal standard for the electronic delivery of music, called the Secured Digital Music Initiative. If new standards are developed and adopted by consumers, we may not be able to obtain a license to such technology on favorable terms or at all and our business could be harmed. Even if new standards are not developed, delays with respect to proposed standards, such as those which have occurred with respect to SDMI, can cause confusion in the marketplace, slow the development of the market for downloadable music and otherwise harm our business.

Mp3 technology is controversial within certain segments of the traditional music industry and we may face continued opposition to our use of mp3, which may slow market development and harm our business.

Certain segments of the traditional music industry have not embraced the development of the mp3 format to deliver music, in part because users of mp3 technology can download and distribute unauthorized or "pirated" copies of copyrighted recorded music over the Internet. We believe that our success is largely dependent upon the ease with which customers can download and

play music. We may face opposition from a number of different music industry sources including record companies and studios, the Recording Industry Association of America and certain artists. The adoption of competing standards may slow the development of the market for downloadable music or result in increased costs of doing business, which could harm our business.

Our executive officers and directors control approximately 16% of our Common Stock and have power to influence significant corporate matters, which may delay, deter or prevent transactions that could benefit our stockholders.

Executive officers and directors, in the aggregate, beneficially own approximately 19% of our outstanding Common Stock. These stockholders are able to significantly influence all matters requiring approval by our stockholders, including the election of directors and the approval of significant corporate transactions. This concentration of ownership may also have the effect of delaying, deterring or preventing a change in control of EMusic and may make some transactions more difficult or impossible without the support of these stockholders.

Anti-takeover provisions in our charter documents could negatively impact our

stockholders.

Our Board of Directors has the authority to issue up to 20,000,000 shares of Preferred Stock without need for stockholder approval. The board may also determine the economic and voting rights, of this Preferred Stock. The holders of our Common Stock could be adversely affected by the issuance of Preferred Stock. Issuance of Preferred Stock could impede or prevent transactions that would cause a change in control of our company. This might discourage bids for our Common Stock as a premium over the market price of our Common Stock and adversely affect the trading price of our Common Stock. We have no current plans to issue shares of Preferred Stock. In addition, other provisions in our charter documents could make it more difficult for a third party to acquire us, even if doing so would be beneficial to our stockholders.

Our data warehousing and web server systems are vulnerable to natural disasters, failure of third-party services and other unexpected problems.

Since our data warehousing, web server and network facilities for EMusic.com are all located in California, an earthquake or other natural disaster could affect all of our facilities simultaneously. An unexpected event such as a power or telecommunications failure, fire, flood or earthquake at our on-site data warehousing facility or at our Internet service providers' facilities could cause the loss of critical data and prevent us from offering our services to artists and consumers. Our business interruption insurance may not adequately compensate us for losses that may occur. In addition, we rely on third parties to securely store our archived data, house our web server and network systems, and connect us to the Internet. A failure by any of these third parties to provide these services satisfactorily could harm our business.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Quantitative and Qualitative Disclosures About Market Risk

We have considered the provisions of Financial Reporting Release No. 48 "Disclosure of Accounting Policies for Derivative Financial Instruments and Derivative Commodity Instruments, and Disclosure of Quantitative and Qualitative Information about Market Risk Inherent in Derivative Financial Instruments, Other Financial Instruments and Derivative Commodity Instruments." We had no holdings of derivative financial or commodity instruments at June 30, 2000.

However, we are exposed to financial market risks, including changes in interest rates. All of our revenue and capital spending is transacted in U.S. dollars. Our investments portfolio comprises amounts invested in short term cash deposits and therefore we believe that the fair value of our investment portfolio or related income would not be significantly impacted by increases or decreases in interest rates due mainly to the short-term nature of our investment portfolio. However, a sharp increase in interest rates could have a material adverse effect on the fair value of our investment portfolio. Conversely, sharp declines in interest rates could seriously harm interest earnings of our investment portfolio.

The table below presents principal amounts by expected maturity (in U.S. dollars) and related weighted average interest rates by year of maturity for our investment portfolio.

	2000	Thereafter	Total
	-----	-----	-----
Cash and cash equivalents..	\$14,591,000	\$ --	\$14,591,000
Weighted Average Interest Rate	5.25%		
Short-term Investments....	\$19,669,000	\$ --	\$19,669,000
Weighted Average Interest Rate	6.19%		
Total Portfolio.....	\$34,260,000	\$ --	\$34,260,000

All of the above securities are held for non trading purposes.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

Annual Financial Statements: See Part IV, Item 14 of this Form 10-K.

Selected Quarterly Data: See Part II, Item 7 of this Form 10-K.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

Not applicable

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT.

Executive Officers, Directors and Key Employees

Our current executive officers and directors as well as certain members of our senior management, and their ages and positions as of August 31, 2000 are as follows:

Name	Age	Position(s)
Robert H. Kohn *	43	Chairman
Gene Hoffman, Jr. *	25	President & Chief Executive Officer
Joseph Howell *	48	Executive Vice President, Chief Financial Officer
Peter Astiz *	42	Acting Chief Operating Officer, Executive Vice President, Secretary & General Counsel
James R. Chapman *	33	Executive Vice President, Corporate Strategy
Brett Thomas	30	Senior Vice President, Technology
Todd Anderman	32	Senior Vice President, Sales
Brian Brinkerhoff	37	Vice President, Content Acquisition
Steve Grady	34	Vice President, Marketing
Marv Su	37	Vice President, Interactive Marketing
Emily Rupp	31	Vice President, Corporate Controller
Debbie Shotwell	38	Vice President, HR
Chris Henger	33	Vice President and GM, Rollingstone.com

Tor Braham	42	Director
Ralph Peer II	55	Director
Ed Rosenblatt	65	Director
Howard Tullman	55	Director

 * Executive Officer

Robert H. Kohn, a co-founder of EMusic, has been Chairman of the Board since January 1998. From October 1996 to December 1997, Mr. Kohn was Vice President, Business Development and General Counsel of Pretty Good Privacy, Inc., a developer and marketer of Internet encryption and security software. From March 1987 to September 1996, he was Senior Vice President of Corporate Affairs, Secretary, and General Counsel of Borland International, Inc., a software company. Mr. Kohn also served as chief legal counsel for Ashton-Tate Corporation. Prior to Ashton-Tate, he was an attorney at the Beverly Hills law offices of Rudin & Richman, an entertainment law firm whose clients included Frank Sinatra, Liza Minelli, Cher and Warner Brothers Music. He was also Associate Editor of the Entertainment Law Reporter, for which he continues to serve as a member of the Advisory Board. A member of the California Bar Association, Mr. Kohn co-authored Kohn On Music Licensing, a treatise on music industry law for lawyers, music publishers, and songwriters. He graduated from Loyola Law School, Los Angeles and received a Bachelor of Arts degree in Business Administration from California State University at Northridge. Mr. Kohn is also a member of the Board of Directors of GlobalNet International, Inc., a telecommunications company and Borland International and serves as Chairman and CEO of Laugh.com Inc. Mr. Kohn is also an adjunct professor of law at Monterey College of Law, where he teaches Corporate Law.

Gene Hoffman, Jr., a co-founder of EMusic, has been President, Chief Executive Officer, and a Director since January 1998. From November 1996 to December 1997, Mr. Hoffman was Director of Business Development and Director of Interactive Marketing of Pretty Good Privacy. From October 1995 to November 1996, he was founder, director and Executive Vice President of PrivNet, Inc., an Internet privacy software company. From August 1993 to October 1995, Mr. Hoffman was a student at the University of North Carolina, Chapel Hill.

Joseph H. Howell joined EMusic in April 1998 as Executive Vice President and Chief Financial Officer. From January 1995 to April 1998, Mr. Howell was Senior Vice President and Chief Financial Officer of Merix Corporation, a manufacturer of multi-layer printed circuit boards. From May 1988 to January 1995, Mr. Howell served as Vice President and Controller of Borland. He also served as Borland's acting Chief Financial Officer in 1994. Mr. Howell received a Bachelor of Arts degree in Political Science from the University of Michigan and a Masters of Science in Accounting from Eastern Michigan University.

Peter M. Astiz joined EMusic in July 1999 as Executive Vice President and General Counsel. From October 1996 to July 1999, Mr. Astiz was a partner of Gray Cary Ware & Freidenrich LLP, a law firm. From July 1989 until October 1996, Mr. Astiz was a partner of the law firm of Baker & McKenzie. Mr. Astiz received a Bachelor of Science degree in Business Administration from the University of California in 1979 and a J.D. from the University of San Francisco.

James R. Chapman joined EMusic in April 1999 as Executive Vice President, Corporate Strategy. From April 1997 to April 1999, Mr. Chapman was Director of the Global Private Capital Group at Warburg Dillon Read LLC (formerly UBS Securities LLC), a major investment bank. From July 1995 to April 1997 Mr. Chapman was President and Founder of Ashley Capital Management, a private equity and advisory firm focused on principal investments in emerging growth companies located in the Pacific Northwest and Rocky Mountain States. From September 1994 to July 1995, Mr. Chapman was a partner of Jacobson Partners, a boutique merchant bank focused on middle market buyouts and direct equity investments. From May 1990 to September 1994, Mr. Chapman also worked as an associate in the technology and healthcare investment banking groups of Oppenheimer & Co. and PaineWebber Incorporated. Mr. Chapman received a Bachelor of Arts degree in Economics from Middlebury College.

Brett A. Thomas joined EMusic in April 1998 as Vice President, Technology and appointed Senior Vice President, Technology in May 2000. From November 1996 to January 1998, Mr. Thomas was Principal Engineer for Pretty Good Privacy, where he was responsible for the design and implementation of PGP 4.5 and 5.0 for Win32, PGP for Unix and its key server software. Previously, Mr. Thomas was a senior engineer for NCR Prior to NCR, he wrote automated document processing programs for MCI, internal management software for an insurance company, and inventory control systems under contract to IBM. Since 1994, Mr. Thomas has been involved in the Linux software community, maintaining websites operating on Linux platform and making several modifications to the source code of the core of the Linux operating system.

Todd S. Anderman joined EMusic in February 2000 as Senior Vice President, Sales. From May 1999 until February 2000 he served as Vice President, Sales of iTunes.com Inc. From 1990 to April 1999, Mr. Anderman was employed by Ziff Davis, a large publisher, in various capacities. In his most recent position with Ziff Davis, as National Associate Publisher,

Mr. Anderman headed the sales and marketing efforts of Family PC magazine. Mr. Anderman received a B.S. from Brandeis University.

Brian Brinkerhoff joined EMusic in November 1998 as Vice President, Content Acquisition. From January 1995 to November 1998, Mr. Brinkerhoff was Head of Creative Music Publishing at the Walt Disney Company, a multinational entertainment company. From January 1992 to December 1994, he was a principal of Vis-a-Vis Entertainment Company, a music publishing company. From May 1989 to December 1991, Mr. Brinkerhoff was Product Manager, Kodak Interactive Systems, a developer and marketer of personal computer software. Mr. Brinkerhoff received a Bachelors of Arts degree in Economics from the University of California at Davis.

Steve Grady joined EMusic in June 1998 as Vice President, Corporate Communications and was promoted to Vice President, Marketing in January 1999. From July 1997 to May 1998, Mr. Grady was Director, Corporate Communications for Borland, where he was responsible for public relations and investor relations. From July 1996 to July 1997, he was Director, Marketing Communications for Infoseek Corporation. From 1992 to June 1995, he served as Director, Corporate Communications for Borland. Prior to Borland, Mr. Grady served in a variety of corporate communications and marketing positions with Ashton-Tate, TeraData, and Lotus Development. Mr. Grady received a Masters degree in Communications Studies from Emerson College and a Bachelor of Arts degree in Public Communications from Ashland University.

Marv Su joined EMusic as Vice President, Interactive Marketing in February 1999. From January 1998 through January 1999, Mr. Su served as director of Small Business Internet Marketing and Community at Intuit, Inc., a software company. From February 1996 through December 1997, Mr. Su served as Senior Director of

Advertising Operations at Infoseek. From August 1991 through February 1996, Mr. Su held various management and marketing positions at Apple Computer. He received a Bachelor of Science in Electrical Engineering from Stanford University and a Master of Science in Management from the M.I.T. Sloan School of Management.

Emily Rupp has been Vice President, Corporate Controller since March 2000. From June 1999 to February 2000 Ms. Rupp was Vice President, Finance and Controller of Tunes.com Inc. and was Controller from September 1998 through June 1999. Prior to joining Tunes.com, Ms. Rupp was an audit manager with PricewaterhouseCoopers LLP, where she spent seven years in the Assurance and Business Advisory Services group. She holds a B.S. in Business from Miami University and is a C.P.A.

Debbie Shotwell joined EMusic as Vice President, Human Resources since May 2000. From September 1999, to April 2000 she was the Vice President, Human Resources for American Protective Services, Inc. From July 1995 to August 1999, Ms. Shotwell was the Sr. Vice President, Human Resources/Administration for AvalonBay Communities, Inc. Ms. Shotwell graduated from California State University, Sacramento, with a B.S. degree in Business Administration.

Chris Henger joined EMusic as Vice President and General Manager of Rollingstone.com in February 2000. He served as the Director of Business Development for Tunes.com from April of 1997 until February 2000. From August 1990 to April 1997, Mr. Henger served primarily as a consultant and systems analyst for CCC Information Services, a publicly traded company providing software and services to the insurance claims industry. Mr. Henger holds a B.A. from Indiana University and an M.B.A. from DePaul University.

Board of Directors

The terms of the board of directors are divided into three classes: Class I, whose term will expire at the annual meeting of stockholders to be held in 2002; Class II, whose term will expire at the annual meeting of stockholders to be held in 2000; and Class III, whose term will expire at the annual meeting of stockholders to be held in 2001. The Class I directors are Robert Kohn and Tor Braham, the Class II directors are Gene Hoffman, Jr. and Howard Tullman, and the Class III directors are Ralph Peer and Ed Rosenblatt. At each annual meeting of stockholders, the successors to directors whose term expires will be elected to serve a term of three years. This classification of directors may have the effect of delaying or preventing changes in our control. Our board of directors consists of five members. Our bylaws provide that the authorized number of directors may be changed by resolution of the board of directors.

Class II Directors whose terms expire at the 2000 Annual Meeting of Shareholders:

Gene Hoffman, Jr.

Howard A. Tullman became a Director in February, 2000. Mr. Tullman served as Chairman of Tunes.com Inc. since February 1999 and as Chief Executive Officer and a director since June 1997. Mr. Tullman also serves as a director of UBID, Inc. and serves as the Chairman of the board of directors of The Cobalt Group, Inc. From June 1993 to January 1998, Mr. Tullman served as Chief Executive Officer of Imagination Pilots, Inc., a developer and producer of interactive CD games and educational software. From 1990 to May 1993, Mr. Tullman served as Chief Executive Officer of Eager Enterprises, Inc., a venture capital firm concentrating in investments in the information and computer industries. Mr. Tullman holds a B.A. and J.D. from Northwestern University.

Class III directors whose terms expire at the 2001 Annual Meeting of Stockholders:

Ralph Peer, II became a Director in June 1998, is Chairman and Chief Executive Officer of peermusic, a global network of music publishing and production companies. In addition, Mr. Peer is Vice President and Director of the National Music Publishers' Association (U.S.A.) and the Harry Fox Agency. He is a lifetime director and past president of the Country Music Association and a publisher/director of ASCAP. Mr. Peer is also a director of Fox Agency International (Singapore) and a consultant to the board of the Mechanical Copyright Protection Society, U.K. He is a past president and a current director of the International Confederation of Music Publishers and in 1997 was elected "President d'Honneur" of the Confederation.

Ed Rosenblatt became a Director in 1999. From 1994 until his retirement in 1999, Mr. Rosenblatt served as Chairman of Geffen Records. Mr. Rosenblatt helped found Geffen Records in 1980, and served as its President and Chief Operating Officer until 1994. Prior to Geffen Records, Mr. Rosenblatt served as Senior Vice President of sales and promotion for Warner Brothers Records. Mr. Rosenblatt received a degree in Applied Arts from Brooklyn College.

Class I directors whose terms expire at the 2002 Annual Meeting of Stockholders:

Robert Kohn, Chairman.

Tor Braham, a Director since May 1999, has been a Managing Director at Credit Suisse First Boston since March 2000. Mr. Braham was Managing Director and Head of the Technology Mergers & Acquisitions Department for Warburg Dillon Read from December 1997 until March 2000. From February 1984 until November 1997, Mr. Braham was a partner of the law firm of Wilson Sonsini Goodrich & Rosati. Mr. Braham received a Bachelor of Science degree in English from Columbia University and a J.D. from the New York University Law School.

Executive officers are elected by the board of directors annually. There are no family relationships among any of our directors, officers or key executives.

Board Committees

We have established an Audit Committee and a Compensation Committee. The Audit Committee, which currently consists of Messrs. Braham, Peer and Rosenblatt, reviews our internal accounting procedures and consults with and reviews the services provided by our independent auditors. The Compensation Committee, which currently consists of Messrs. Braham, Peer and Rosenblatt, reviews and recommends to the Board of Directors the compensation and benefits of our executive officers, establishes and reviews general policies relating to our compensation and benefits and administers our stock plans.

Director Compensation

Directors do not receive cash compensation for their services as directors or

members of committees of the board of directors, but are reimbursed for reasonable expenses incurred in attending meetings of the board. In April 2000, we granted each of Messrs. Braham, Rosenblatt and Peer fully-vested, nonqualified stock options to purchase 30,000 shares of our common stock at an exercise price of \$2.31 per share.

Compensation Committee Interlocks and Insider Participation

None of our executive officers has served as a member of a compensation committee or board of directors of any other entity which has an executive officer serving as a member of the board of directors.

Change of Control Arrangements and Employment Agreements

Pursuant to agreements with Messrs. Kohn and Hoffman, upon any acquisition of EMusic or if their employment is terminated other than for cause, the repurchase right in favor of EMusic which applies to certain unvested shares owned by them will terminate. Pursuant to agreements with Messrs. Howell, Astiz and Chapman, upon any acquisition of EMusic, all unvested stock options held by each will become vested in full. Further each executive officer is entitled to twelve months severance in the event their employment is terminated other than for cause.

Limitation of Liability and Indemnification

Section 145 of the Delaware General Corporation Law permits indemnification of officers, directors and other corporate agents under certain circumstances and subject to certain limitations. Our amended and restated certificate of incorporation and bylaws provide that we shall indemnify our directors, officers, employees and agents to the full extent permitted by Delaware General Corporation Law, including in circumstances in which indemnification is otherwise discretionary under Delaware law. In addition, we intend to enter into separate indemnification agreements with our directors and officers which would require us, among other things, to indemnify them against certain liabilities which may arise by reason of their status or service (other than liabilities arising from willful misconduct of a culpable nature). We also intend to continue to maintain director and officer liability insurance, if available on reasonable terms. These indemnification provisions and the indemnification agreements may be sufficiently broad to permit indemnification of our officers and directors for liabilities (including reimbursement of expenses incurred) arising under the Securities Act.

At present, there is no pending litigation or proceeding involving any of our directors, officers, employees or other agents in which indemnification is being sought nor are we aware of any threatened litigation that may result in a claim for indemnification by any of our directors, officers, employees or other agents.

ITEM 11. EXECUTIVE COMPENSATION.

Summary Compensation Information

The following table presents information for the fiscal years ended June 30, 2000 and 1999 and for the period from January 8, 1998 (Inception) to June 30, 1998 regarding the compensation paid to our chief executive officer and each of our four highest-paid executive officers whose total salary and bonus exceeded \$100,000 for the fiscal year ended June 30, 2000.

Summary Compensation Table

Name and Principal Position	Year	Annual Compensation			Long Term Compensation Awards	
		Salary	Bonus	Other Annual Compensation	Securities Underlying Options	
Gene Hoffman, Jr., President and Chief Executive Officer	2000	129,000	--	--	--	--
	1999	85,000	--	--	250,000	--
	1998	28,000	--	--	--	--
Robert H. Kohn, Chairman	2000	129,000	--	--	--	--
	1999	85,000	--	--	250,000	--
	1998	23,000	--	--	--	--
Joseph Howell, Executive Vice President and Chief Financial Officer	2000	124,000	--	--	--	90,000
	1999	98,000	--	--	--	50,000
	1998	--	--	--	--	590,000
Peter Astiz, Acting Chief Operating Officer, Executive Vice President, Secretary & General Counsel*	2000	123,000	--	--	--	230,000
	1999	--	--	--	--	100,000
James R. Chapman, Executive Vice President Corporate Strategy *	2000	123,000	--	--	--	275,000
	1999	18,000	--	--	--	400,000

* Messrs. Astiz and Chapman became executive officers in 1999.

Option Grants

The following table provides the specified information concerning grants of options to purchase the Company's common stock made during the fiscal year ended June 30, 2000, to the persons named in the Summary Compensation Table. Except as otherwise noted these options vest over a four year period from the date of grant, with 25% vesting after one year and the remaining vesting 1/48th per month over the remaining three years. Vesting of the option shares will fully accelerate upon a change in our control.

Option Grants in Fiscal Year 2000

	Number of Securities	% of Total Options Granted to
--	----------------------	-------------------------------

	Underlying Options Granted	Employees in Fiscal 2000 (1)	Exercise Price Per Share	Expiration	Appreciation for Option Term (2)	
					5%	10%
Joseph Howell, Executive Vice President and Chief Financial Officer	40,000	0.5%	\$2.31	4/20/10	\$ 58,000	\$ 147,000
	50,000	0.7%	\$9.88	1/12/10	\$311,000	\$ 787,000
Peter Astiz, Acting Chief Operating Officer, Executive Vice President, Secretary & General Counsel	180,000	2.4%	\$2.31	4/20/10	\$261,000	\$ 663,000
	50,000	0.7%	\$9.88	1/12/10	\$311,000	\$ 788,000
James R. Chapman, Executive Vice President Corporate Strategy	200,000	2.6%	\$2.31	4/20/10	\$291,000	\$ 736,000
	75,000	1.0%	\$9.88	1/12/10	\$466,000	\$1,181,000

(1) Based on an aggregate of 7,615,000 shares subject to options granted in fiscal 2000.

(2) Potential realizable values are net of exercise price, but before taxes associated with exercise. Amounts represent hypothetical gains that could be achieved for the options if exercised at the end of the option term. The assumed 5% and 10% rates of stock price appreciation are provided in accordance with rules of the SEC and do not represent our estimate or projection of the future common stock price.

Option Exercises and Year-End Holdings

The following table provides the specified information concerning exercises of options to purchase the Company's Common Stock in the fiscal year ended June 30, 2000, and unexercised options held as of June 30, 2000, by the persons named in the Summary Compensation Table above.

Aggregated Option Exercises in Last Fiscal Year and Fiscal Year-End Values

Name	Shares Acquired on Exercise	Value Realized	Number of Securities Underlying Unexercised Options at 6/30/2000		Value of Unexercised In-the-Money Options at 6/30/2000	
			Vested	Unvested	Vested	Unvested
Gene Hoffman, Jr.	--	--	62,500	187,500	--	--
Robert Kohn	--	--	62,500	187,500	--	--
Joseph Howell	383,000	\$2,487,000	47,283	299,717	\$78,000	\$474,000
Peter Astiz	--	--	36,668	293,332	--	\$ 11,000
James Chapman	--	--	163,898	511,102	--	\$ 12,000

We have not awarded stock appreciation rights to any of our employees and we do not have any multi-year incentive plans.

Stock Plans

1998 Stock Option Plan. Our 1998 stock option plan was approved by the board of directors in March 1998 and was subsequently approved by our stockholders. The 1998 option plan provides for the grant to employees of incentive stock options within the meaning of section 422 of the Internal Revenue Code of 1986, as amended, and for grants of non-statutory stock options to employees, non-employee directors and consultants. Because non-employee directors are eligible to receive grants under the 1998 option plan, we have not adopted a separate plan which provides for the formula grant of stock options to non-employee directors.

The 1998 option plan is administered by the board of directors or a committee thereof. Subject to the provisions of the 1998 option plan, the board or committee has the authority to select the persons to whom options are granted and determine the terms of each option, including:

- . the number of shares of common stock covered by the option;
- . when the option becomes exercisable;
- . the per share option exercise price, which in the case of incentive stock options must be at least equal to the fair market value of a share of common stock on the grant date (or 110% of such fair market value for incentive stock options granted to 10% shareholders), and, in the case of non-statutory stock options, must be at least 85% of the fair market value of a share of common stock on the grant date; and
- . the duration of the option (which may not exceed ten years, or, with respect to incentive stock options granted to 10% shareholders, five years).

Generally, options granted under the 1998 option plan become exercisable as the underlying shares vest. Options granted under the 1998 option plan generally vest over four years, although the board or committee may specify a different vesting schedule for a particular grant. Options granted under the 1998 option plan are non-transferable other than by will or the laws of descent and distribution.

In the event of a change in control of EMusic, the acquiring or successor corporation may assume or substitute for the outstanding options granted under the 1998 option plan. The outstanding options will terminate to the extent that such options are neither exercised nor assumed or substituted for by the acquiring or successor corporation.

As of August 31, 2000, six million shares are reserved for issuance under the 1998 option plan, 724,512 shares have been issued upon the exercise of options, options to purchase of a total of 4,315,019 shares at a weighted average exercise price of \$6.45 per share were outstanding and 960,469 shares were available for future option grants.

1998 Non-statutory Stock Option Plan. Our 1998 non-statutory stock option plan was approved by the board of directors in December 1998. The non-statutory plan

provides for the grant of non-statutory stock options to employees (who are not officers or directors) and consultants. The non-statutory plan is administered by the board of directors or a committee thereof. Subject to the provisions of the non-statutory plan, the board or committee has the authority to select the persons to whom options are granted and determine the terms of each option, including:

- . the number of shares of common stock covered by the option;
- . when the option becomes exercisable;
- . the per share option exercise price, which must be at least equal to 85% of the fair market value of a share of common stock on the grant date; and
- . the duration of the option (which may not exceed ten years).

Generally, options granted under the non-statutory plan become exercisable as the underlying shares vest. Options granted under the non-statutory plan generally vest over four years, although the board or committee may specify a different vesting schedule for a particular grant. Options granted under the non-statutory plan are non-transferable other than by will or the laws of descent and distribution.

In the event of a change in control of EMusic, the acquiring or successor corporation may assume or substitute for the outstanding options granted under the non-statutory plan. The outstanding options will terminate to the extent that such options are neither exercised nor assumed or substituted for by the acquiring or successor corporation.

As of August 31, 2000, ten million shares are reserved for issuance under the non-statutory plan, 93,812 shares have been issued upon the exercise of options, options to purchase of a total of 6,293,570 shares at a weighted average exercise price of \$7.44 per share were outstanding and 3,612,618 shares were available for future option grants.

1999 Employee Stock Purchase Plan. A total of 250,000 shares of common stock have been reserved for issuance under our 1999 employee stock purchase plan, none of which have been issued as of August 31, 2000. The purchase plan, which is intended to qualify under section 423 of the Internal Revenue Code, is administered by the board or by a committee thereof. Our employees (including our officers and employee directors) and those of any of our subsidiaries designated by the board for participation in the purchase plan are eligible to participate in the purchase plan if they are customarily employed for more than 20 hours per week and more than five months per year. The purchase plan will be implemented by sequential offerings of approximately six months duration. We have not yet determined when the first offering period will commence. Shares will be purchased on the last day of each offering period. The board may change the dates or duration of one or more offerings, but no offering may exceed 27 months. The purchase plan permits eligible employees to purchase common stock through payroll deductions at a price no less than 85% of the lower of the fair market value of the common stock on (a) the first day of the offering, or (b) the purchase date. Participants generally may not purchase more than 1,000 shares in a six-month offering period or stock having a value (measured at the beginning of the offering) greater than \$25,000 in any calendar year. In the event of certain changes in control of EMusic, the board may accelerate the purchase date of the then current offering period to a date prior to the change in control unless the acquiring or successor corporation assumes or replaces the purchase rights outstanding under the purchase plan.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT.

The following table sets forth the ownership of our voting stock, including optioned shares, by:

- . each person or entity who is known by us to beneficially own more than 5% of our outstanding common stock;
- . each of our directors and executive officers; and
- . all executive officers and directors as a group.

Unless otherwise indicated, the address for each of the named individuals is c/o EMusic.com Inc., 1991 Broadway, 2nd Floor, Redwood City, California 94063. Except as otherwise indicated, and subject to applicable community property laws, the persons named in the table have sole voting and investment power with respect to all shares of common stock held by them.

Applicable percentage ownership in the table is based on shares of common stock outstanding as of August 31, 2000. Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission. Shares of common stock subject to options that are presently exercisable or exercisable within sixty (60) days of August 31, 2000 are deemed outstanding for the purpose of computing the percentage ownership of the person or entity holding such options, but are not treated as outstanding for the purpose of computing the percentage ownership of any other person or entity. To the extent that any shares are issued upon exercise of options, warrants or other rights to acquire our capital stock that are presently outstanding or granted in the future or reserved for future issuance under our stock plans, there will be further dilution to new public investors.

Beneficial Owner(1)	Number of Shares of Common Stock Owned	Percent(2)
-----	-----	-----
5% Stockholders		

Citiventure 96 Partnership, L.P. c/o Invesco Private Capital 1166 Avenue of the Americas, Suite 2700 New York, NY 10036 (3).....	3,333,400	7.7%
Directors and Executive Officers		

Gene Hoffman, Jr.(4)	3,285,333	7.62%
Robert Kohn (5)	2,960,033	6.86%
Joseph Howell (6)	413,336	*

Peter Astiz (7)	277,668	*
James Chapman (8)	271,607	*
Tor Braham (9)	76,600	*
Ralph Peer (10)	338,900	*
Ed Rosenblatt (11)	130,000	*
Howard Tullman (12)	422,027	*

- * Less than 1%
- (1) A person is deemed to be the beneficial owner of securities that can be acquired by such person within 60 days upon the exercise of options. Calculations of percentages of beneficial ownership assume the exercise by only the respective named shareholders of all options for the purchase of common stock held by such shareholder, which are exercisable within 60 days of August 31, 2000.
 - (2) Percentage of beneficial ownership excludes shares issuable upon exercise of outstanding stock options and warrants.
 - (3) Represents shares owned by Invesco related partnerships as follows: 58,300 shares owned by Chancellor Private Capital Offshore Partners I, C.V.; 624,000 shares owned by Chancellor Private Capital Offshore Partners II, L.P.; 379,000 shares owned by Chancellor Private Capital III, L.P.; 1,627,100 shares owned by Citiventure 96 Partnership, L.P.; and 645,000 shares owned by Drake & Co. for the account of Citiventure Private Participations III.
 - (4) Includes 83,333 shares issuable upon exercise of outstanding options.
 - (5) Includes 83,333 shares issuable upon exercise of outstanding options.
 - (6) Includes 120,336 shares issuable upon exercise of outstanding options.
 - (7) Includes 61,668 shares issuable upon exercise of outstanding options.
 - (8) Includes 225,007 shares issuable upon exercise of outstanding options.
 - (9) Includes 65,000 shares issuable upon exercise of outstanding options.
 - (10) Includes 130,000 shares issuable upon exercise of outstanding options. Includes 208,900 shares of common stock held by peermusic III, Ltd. Mr. Peer disclaims beneficial ownership of the shares held by peermusic III, Ltd. except to the extent of his pecuniary interest therein.
 - (11) Represents shares issuable upon exercise of outstanding options.
 - (12) Includes 374,324 shares issuable upon exercise of outstanding options.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Federal securities law requires that the executive officers and directors of the Corporation must report to the SEC and the Corporation, within certain periods, how many shares of the Corporation's equity securities they own and if they conducted any transactions in that stock. Based upon information furnished by these stockholders, the Corporation believes that all required filings for fiscal 2000 have been timely made.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.

In July 2000, the Company provided a short-term loan of \$250,000 to Gene Hoffman, Jr. The loan bears interest at market rates and is secured by a deed of trust and pledge of shares. Approximately \$50,000 of such amount has been re-paid with the remainder to be repaid prior to December 31, 2000.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K.

(a) The following documents are filed as a part of this Form 10-K:

- (1) Financial Statements:

Index to Financial Statements

Index to Financial Statements- June 30, 2000

	Page

Report of Independent Accountants.....	36
Consolidated Balance Sheets.....	37
Consolidated Statements of Operations.....	38
Consolidated Statement of Stockholders' Equity.....	39
Consolidated Statements of Cash Flows.....	40
Notes To Consolidated Financial Statements.....	41

Report of Independent Accountants

To the Board of Directors and Stockholders
of EMusic.com Inc:

In our opinion, the consolidated financial statements listed in the index appearing under Item 14(a)(1) on page 35 present fairly, in all material respects, the financial position of EMusic.com and its subsidiaries at June 30, 2000 and 1999, and the results of their operations and their cash flows for each of the two years in the period ended June 30, 2000 and the period from January 8, 1998 (Inception) to June 30, 1998 in conformity with accounting principles generally accepted in the United States. In addition, in our opinion, the financial statement schedule listed in the index appearing under Item 14 (a) (2) on page 60 presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and the financial statement schedule are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements and the financial statement schedule based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

San Jose, California
September 21, 2000

EMUSIC.COM INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except per share data)

	June 30, 2000	June 30, 1999
	-----	-----
ASSETS		
Current Assets:		
Cash and cash equivalents.....	\$ 14,591	\$ 19,002
Short-term investments.....	19,669	--
Accounts receivable, net of allowance of \$55 in 2000.....	2,488	51
Notes receivable.....	5,676	--
Prepaid expenses and other current assets.....	4,039	224
	-----	-----
Total current assets.....	46,463	19,277
Property and equipment, net.....	4,706	1,076
Advanced royalties, net.....	19,644	6,415
Music catalogs and investments, net.....	6,590	2,343
Tradenames, net.....	84,339	24,680
Goodwill and other intangible assets, net.....	90,995	--
Other assets.....	523	430
	-----	-----
Total assets.....	\$ 253,260	\$ 54,221
	=====	=====
LIABILITIES, MANDATORILY REDEEMABLE CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable.....	\$ 4,130	\$ 637
Accrued liabilities.....	3,540	1,679
Accrued compensation and related benefits.....	2,352	368
Deferred revenue.....	1,151	--
	-----	-----
Total current liabilities.....	11,173	2,684
Commitments (Note 7)		
Capital lease, net of current portion.....	245	--
Mandatorily redeemable convertible preferred Series B stock....	--	32,550
	-----	-----
Total liabilities.....	\$ 11,418	\$ 35,234
	-----	-----
Stockholders' Equity:		
Preferred stock, \$0.001 par value; 20,000 shares		
Authorized; no shares issued and outstanding.....	--	--
Common stock, \$0.001 par value; 200,000 shares authorized; 43,025 and 16,804 shares issued and outstanding, respectively.....	43	17
Additional paid-in capital.....	367,363	67,827
Accumulated deficit.....	(125,564)	(48,857)
	-----	-----
Total stockholders' equity.....	241,842	18,987
	-----	-----
Total liabilities, mandatorily redeemable convertible preferred stock and stockholders' equity.....	\$ 253,260	\$ 54,221
	=====	=====

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

EMUSIC.COM INC.
CONSOLIDATED STATEMENT OF OPERATIONS
(In thousands, except per share data)

	Year ended June 30, 2000	Year ended June 30, 1999	January 8, 1998 (Inception) to June 30, 1998
	-----	-----	-----
Revenues:			
Music.....	\$ 1,321	\$ 9	\$ --
Advertising.....	5,153	83	--
	-----	-----	-----
Total revenues.....	6,474	92	--
Costs of revenues:			
Music.....	650	5	\$ --
Advertising.....	1,195	22	--
	-----	-----	-----
Total costs of revenues.....	1,845	27	--
	-----	-----	-----
Gross profit.....	4,629	65	--
	-----	-----	-----
Operating expenses:			
Product development, excluding stock compensation.....	15,638	3,629	209
Stock compensation.....	11,948	8,061	752
	-----	-----	-----
Total product development.....	27,586	11,690	961
Selling and marketing.....	27,917	556	--
General and administrative.....	6,581	1,599	219
Amortization of intangible assets.....	21,519	1,682	--
	-----	-----	-----
Total operating expenses.....	83,603	15,527	1,180
	-----	-----	-----
Operating loss.....	(78,974)	(15,462)	(1,180)

Interest income.....	2,992	359	--
Interest expense.....	(8)	(37)	--
	-----	-----	-----
Net loss.....	\$ (75,990)	\$ (15,140)	\$ (1,180)
	-----	-----	-----
Accretion of preferred stock to redemption value.....	(224)	(247)	--
Beneficial conversion charge, preferred stock.....	--	(31,721)	--
Dividend on preferred stock.....	(493)	(569)	--
	-----	-----	-----
Net loss applicable to common stockholders.....	\$ (76,707)	\$ (47,677)	\$ (1,180)
	=====	=====	=====
Net loss per common share--basic and diluted.....	\$ (2.56)	\$ (3.52)	\$ (0.12)
	=====	=====	=====
Weighted average common shares outstanding--basic and diluted.....	29,950	13,564	10,234
	=====	=====	=====

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

EMUSIC.COM INC.
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(in thousands)

	Number of Shares	Common Stock	Additional Paid Capital	Note Receivable From Employee	Accumulated Deficit	Total Stockholders' Equity
	-----	-----	-----	-----	-----	-----
Issuance of common stock at inception.....	8,378	\$ 8	\$ (8)	\$ --	\$ --	\$ --
Issuance of common stock.....	1,192	1	9	(10)	--	--
Issuance of common stock for services.....	944	1	12	--	--	13
Conversion of notes payable into common stock.....	501	1	169	--	--	170
Payment on note receivable.....	--	--	--	4	--	4
Issuance of shares in connection with merger.....	3,700	4	684	--	--	688
Issuance of options to advisors.....	--	--	752	--	--	752
Net loss for the period from January 8, 1998 (inception) through June 30, 1998.....	--	--	--	--	(1,180)	(1,180)
	-----	-----	-----	-----	-----	-----
BALANCE, June 30, 1998.....	14,715	15	1,618	(6)	(1,180)	447
	-----	-----	-----	-----	-----	-----
Issuance of common stock for acquisitions.....	1,078	1	13,328	--	--	13,329
Issuance of common stock to Nordic.....	665	1	11,083	--	--	11,084
Issuance of warrants with preferred stock.....	--	--	343	--	--	343
Accretion of preferred stock to redemption value....	--	--	--	--	(247)	(247)
Beneficial conversion charge on preferred stock.....	--	--	31,721	--	(31,721)	--
Dividends on preferred stock.....	--	--	--	--	(569)	(569)
Exercise of warrants to purchase common stock.....	300	--	300	--	--	300
Exercise of options to purchase common stock.....	46	--	1	--	--	1
Payment on note receivable from employee.....	--	--	--	6	--	6
Issuance of common stock for services.....	--	--	--	--	--	--
Issuance of options to advisors.....	--	--	2,379	--	--	2,379
Issuance of warrants to advisors.....	--	--	5,682	--	--	5,682
Issuance of warrants in conjunction with the licensing of music content.....	--	--	1,184	--	--	1,184
Issuance of warrants in conjunction with the purchase of music catalog.....	--	--	143	--	--	143
Issuance of common stock options in exchange for assets.....	--	--	45	--	--	45
Net loss for the year ended June 30, 1999.....	--	--	--	--	(15,140)	(15,140)
	-----	-----	-----	-----	-----	-----
BALANCE, June 30, 1999.....	16,804	\$17	\$ 67,827	\$ --	\$ (48,857)	\$ 18,987
	-----	-----	-----	-----	-----	-----
Issuance of common stock through offering.....	5,570	6	84,213	--	--	84,219
Issuance costs associated with offering.....	--	--	(1,142)	--	--	(1,142)
Dividend on preferred stock.....	--	--	--	--	(493)	(493)
Accretion of preferred stock to redemption value....	--	--	--	--	(224)	(224)
Conversion of preferred stock into common stock.....	11,757	12	32,193	--	--	32,205
Issuance of common stock for acquisitions.....	8,103	8	116,235	--	--	116,243
Issuance of options for acquisitions.....	--	--	19,801	--	--	19,801
Issuance of warrants for acquisitions.....	--	--	34,374	--	--	34,374
Exercise of options to purchase common stock.....	791	--	746	--	--	746
Issuance of options to advisors.....	--	--	5,415	--	--	5,415
Issuance of warrants to advisors.....	--	--	6,228	--	--	6,228
Issuance of warrants in conjunction with the licensing of music content.....	--	--	1,473	--	--	1,473
Net loss for the year ended June 30, 2000.....	--	--	--	--	(75,990)	(75,990)
	-----	-----	-----	-----	-----	-----
BALANCE, June 30, 2000.....	43,025	\$43	\$367,363	\$ --	\$ (125,564)	\$241,842
	=====	=====	=====	=====	=====	=====

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

EMUSIC.COM INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Year Ended June 30, 2000	Year Ended June 30, 1999	January 8, 1998 (Inception) to June 30, 1998
	-----	-----	-----
Cash flows from operating activities:			
Net loss.....	\$ (75,990)	\$ (15,140)	\$ (1,180)
Adjustments to reconcile net loss to net cash used in operating activities (net of the effects of acquisitions):			
Depreciation.....	1,908	93	3
Amortization.....	21,519	1,682	--
Advanced royalties earned.....	296	2	--
Loan interest converted into preferred stock.....	--	34	--
Issuance of common stock for services.....	--	--	13
Stock compensation.....	11,948	--	--
Changes in assets and liabilities, excluding effects of acquisitions:			

Accounts receivable.....	(210)	(51)	--
Prepaid expenses and other assets.....	(3,315)	(616)	(38)
Accounts payable.....	3,082	149	67
Accrued liabilities.....	(3,548)	652	51
Accrued compensation and related benefits.....	934	152	17
Deferred revenue.....	400	--	--
	-----	-----	-----
Net cash used in operating activities.....	(42,976)	(4,982)	(315)
Cash flows from investing activities:			
Net purchases of short-term investments.....	(19,669)	--	--
Notes receivable.....	(5,676)	--	--
Advanced royalties.....	(11,967)	(5,117)	--
Music catalogs and investments.....	(4,481)	(2,200)	--
Acquisitions, net of cash acquired.....	1,500	(468)	--
Purchase of property and equipment.....	(3,830)	(1,091)	(37)
	-----	-----	-----
Net cash used in investing activities.....	(44,123)	(8,876)	(37)
Cash flows from financing activities:			
Proceeds from issuance of common stock through offering.....	84,219	--	--
Issuance costs related to offering.....	(1,142)	--	--
Common stock issued in connection with merger.....	--	--	688
Proceeds from exercise of stock options and warrants.....	746	301	--
Proceeds from issuance of preferred stock and warrants.....	--	30,300	--
Payment of preferred stock dividend.....	(1,062)	--	--
Proceeds from issuance of convertible notes.....	--	1,743	170
Payment on capital lease.....	(73)	--	--
Proceeds from repayment of employee notes receivable.....	--	6	4
	-----	-----	-----
Net cash provided by financing activities.....	82,688	32,350	862
	-----	-----	-----
Net increase (decrease) in cash.....	(4,411)	18,492	510
Cash and cash equivalents at beginning of period.....	19,002	510	--
	-----	-----	-----
Cash and cash equivalents at end of period.....	\$ 14,591	\$ 19,002	\$ 510
	=====	=====	=====
Supplemental disclosure of non-cash financing activities:			
Conversion of notes payable into common stock.....	\$ --	\$ --	\$ 170
	=====	=====	=====
Issuance of common stock for notes receivable.....	\$ --	\$ --	\$ 10
	=====	=====	=====
Conversion of notes payable and interest to Series B preferred stock.....	\$ --	\$ 1,777	\$ --
	=====	=====	=====
Accretion of preferred stock to redemption value.....	\$ 224	\$ 247	\$ --
	=====	=====	=====
Beneficial conversion charge, preferred stock.....	\$ --	\$ 31,721	\$ --
	=====	=====	=====
Accrued dividend payable on preferred stock.....	\$ --	\$ 569	\$ --
	=====	=====	=====
Conversion of preferred stock into common stock.....	\$ 32,205	\$ --	\$ --
	=====	=====	=====
Issuance of common stock options for fixed assets.....	\$ --	\$ 45	\$ --
	=====	=====	=====
Issuance of warrants for licensed music content.....	\$ 1,473	\$ 1,184	\$ --
	=====	=====	=====
Issuance of warrants for acquired music catalog.....	\$ --	\$ 143	\$ --
	=====	=====	=====
Issuance of warrants with preferred stock.....	\$ --	\$ 343	\$ --
	=====	=====	=====
Issuance of common stock in conjunction with acquisitions.....	\$116,243	\$ 13,329	\$ --
	=====	=====	=====
Issuance of options in conjunction with acquisitions.....	\$ 19,801	\$ --	\$ --
	=====	=====	=====
Issuance of warrants in conjunction with acquisitions.....	\$ 34,374	\$ --	\$ --
	=====	=====	=====
Issuance of common stock to Nordic.....	\$ --	\$ 11,084	\$ --
	=====	=====	=====
Accrual for amount due on content license.....	\$ --	\$ 116	\$ --
	=====	=====	=====

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

EMUSIC.COM INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

The Company

EMusic.com Inc. ("EMusic" or the "Company") sells downloadable music over the Internet and operates a network of music-oriented Web sites, including RollingStone.com, EMusic.com, DownBeatJazz.com and IUMA.com that generates revenue from the sale of advertising. The Company also generates revenue from the licensing of its acquired music catalogs. A Delaware corporation formerly known as GoodNoise Corporation, EMusic was incorporated on January 8, 1998 and is based in Redwood City, California, with regional offices in New York, Los Angeles and Chicago.

Basis of Presentation

These consolidated financial statements contemplate the realization of assets and the satisfaction of liabilities in the normal course of business. The Company has incurred losses in each fiscal year since inception as a result of incurring costs to establish its business, which were significantly in excess of revenues. The Company has also used its cash resources to make substantial investments in music content for its websites.

Management's plans to reverse the recent trend of losses and negative cash flows are to increase revenues while controlling costs. If the Company is unable to generate adequate cash flows from operations, the Company may need to seek additional sources of capital. There can be no assurance that the Company will be able to obtain such funding, if necessary, on acceptable terms or at all.

Principles of Consolidation

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries from the dates of acquisition. All intercompany-balances and transactions have been eliminated.

Cash and Cash Equivalents

The Company considers all highly liquid investments with an original or remaining maturity of three months or less at the date of purchase to be cash equivalents. Cash and equivalents are stated at cost, which approximates market value.

Short-term Investments

Short-term investments are securities with maturities greater than 90 days but less than one year. They are classified as held-to-maturity securities, stated at cost and adjusted for amortization of premiums and accretion of discounts to maturity. There were no sales during the year ended June 30, 2000. Short-term investments at June 30, 2000 are comprised of the following:

Type of security -----	Amortized Cost -----	Market Value -----	Unrealized Gain/(Loss) -----
Corporate bonds	\$ 8,959,000	\$ 8,939,000	\$ (20,000)
Short-term notes	3,983,000	3,971,000	(12,000)
Euro dollar bonds	6,727,000	6,694,000	(33,000)
	-----	-----	-----
Total	\$19,669,000 =====	\$19,604,000 =====	\$ (65,000) =====

Note Receivable

During 2000, the Company loaned \$5,000,000 to an independent label from which the Company licenses music content. The note bears interest at 10% per annum and is due in quarterly installments ending June 30, 2001. At June 30, 2000 \$4,750,000 of principal and \$275,959 of accrued interest was outstanding on this note. The quarterly installment due on June 30, 2000 was not collected. Management, however, believes the note to be fully recoverable and therefore a valuation reserve has not been recorded.

Advanced Royalties

In accordance with Statement of Financial Accounting Standards No. 50, "Financial Reporting in the Record and Music Industry," royalty advances and minimum guarantees to license music content are recorded as an asset. Advances are then expensed as subsequent royalties are earned. Warrants issued in connection with these license agreements, which are not specifically recoupable against future royalty payments, are recorded at their fair value, estimated using the Black-Scholes Model, at the date of grant and amortized to product development expense over the life of the license agreement, generally three to five years. Any portion of advances that subsequently appear not to be fully recoverable from future royalties are charged to expense during the period in which the loss becomes evident.

Music Catalogs and Investments

Music catalogs and investments, net consist of acquired music catalogs net of amortization and investments in debt and equity securities of certain privately held record label and music distribution companies. Acquired music content is amortized over its useful life, generally ten years, using a straight-line approach.

Investments in the debt and equity securities of privately held companies where the Company does not exert significant influence are stated at cost less any provision for impairment. If the security is quoted on a recognized exchange it is classified as available for sale and is marked to market at the end of every reporting period. Any unrealized gain or loss is included in accumulated other comprehensive income until realized when it is included in operations. The Company did not hold any such securities during each of the periods presented. Any investments where the Company exerts a significant influence are accounted for using the equity method of accounting. The Company did not hold any such investments during each of the periods presented.

Property and Equipment

Property and equipment are stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally two to three years. Assets under capital leases are amortized using the straight-line method over the shorter of the estimated useful lives or the remaining lease terms, generally three years.

Revenue Recognition

Music revenues are derived principally from the sale of downloadable music and the licensing of the Company's music catalog to others. Revenue from the sale of downloadable music is recognized in the period in which the download occurs. License revenue is recognized ratably over the license term.

Advertising revenues are derived principally from short-term advertising agreements. These revenues are generally recognized ratably over the term of the agreements, provided the Company has no significant remaining obligations and collection of the resulting receivable is probable. Company obligations typically include guarantees of minimum number of advertising impressions delivered or times that the advertisement is viewed by users of the Company's websites. The Company also recognizes advertising revenue as a result of barter transactions with certain other internet and media-related companies. Advertising revenue from barter transactions is recognized based on the fair value of the advertising surrendered in the transaction. Such fair value is determined based on the Company's historical practice of receiving cash, or other consideration that is readily convertible to cash, for similar advertising from buyers unrelated to the counter-party in the barter transaction. Advertising revenue and expense from barter transactions during 2000 was \$749,000. No barter revenue was recorded during 1999.

Stock-Based Compensation

The Company accounts for stock-based employee compensation arrangements in accordance with provisions of APB No. 25 "Accounting for Stock Issued to Employees," and complies with disclosure provisions of SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"). The Company accounts for stock issued to non-employees in accordance with the provisions of SFAS 123 and Emerging Issues Task Force ("EITF") Issue No. 96-18.

Income Taxes

Income taxes are accounted for using an asset and liability method, which requires the recognition of deferred tax assets and liabilities for the future tax consequences of events that have been recognized in the Company's financial statements or tax returns. The measurement of current and deferred tax assets and liabilities are based on provisions of the enacted tax law; the effects of future changes in tax laws or rates are not anticipated. The measurement of deferred tax assets is reduced, if necessary, by the amount of any tax benefits that, based on available evidence, are not expected to be realized.

Use of Estimates

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

Risks and Uncertainties

The Company is subject to various risks, including those associated with Internet commerce, the ability to obtain additional financing, dependence on key personnel, the market acceptance of the Internet as a medium for consumers to obtain downloadable music, and competition from other providers of music-related content over the Internet. In addition the Company has made substantial investments in music content for its websites. To date the Company does not have sufficient operating history to determine whether it can fully recover the cost of such investments.

Fair Value of Financial Instruments

The amounts reported for cash equivalents, receivables, accounts payable, accrued liabilities and other financial instruments are considered to approximate their fair values based on comparable market information available at the respective balance sheet dates, and their short-term nature. The fair value of short-term investments at June 30, 2000, was \$19,604,000 compared to a carrying value of \$19,669,000.

Goodwill and Other Intangible Assets

Goodwill and other intangibles, recorded in connection with the Company's acquisitions, are being amortized on a straight-line basis over periods ranging from one to ten years from the date of acquisition (see Note 2). Whenever events or circumstances indicate the carrying value of a long-lived asset, including property and equipment, goodwill and other intangible assets might not be recoverable, the Company assesses the recoverability of such assets by determining whether the amortization of the asset balance over its remaining life can be recovered through undiscounted future operating cash flows of the acquired operations. The amount of impairment, if any, is recognized to the extent that the carrying value exceeds the projected discounted future operating cash flows and is recognized as a write down of the asset. To date, the Company has not recorded any impairment charges against the value of our intangible assets.

Website Development Costs

The Company recognizes website development costs in accordance with Statement of Position ("SOP") 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." As such, the Company expenses all costs incurred that relate to the planning and post implementation phases of development. Costs incurred in the development phase are capitalized and recognized over the product's estimated useful life if the product is expected to have a useful life beyond one year. Costs associated with repair or maintenance of the existing site or the development of website music content are included in product development expense in the accompanying consolidated statement of operations.

Advertising Costs

Advertising costs are expensed as incurred. Advertising expense, which is included in selling and marketing expense in the consolidated statement of operations, totaled \$17,424,000 and \$471,000 for the years ended June 30, 2000 and 1999, respectively. There were no similar costs for the period from January 8, 1998 (Inception) through June 30, 1998.

Advertising costs included in prepaid expenses totaled \$3,437,000 at June 30, 2000. There were no similar costs in prepaid expenses at June 30, 1999.

Segment Information

The Company adopted SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," which establishes annual and interim reporting standards for an enterprise's operating segments and related disclosures about its products, services, geographic areas and major customers. During all periods presented, the Company operated in a single business segment, an online music network of websites (including EMusic.com, RollingStone.com, IUMA.com and DownbeatJazz.com) that sells downloadable music and advertising. All long-lived assets and all revenues were located or generated in the United States of America.

Comprehensive Net Loss

There are no differences between the Company's net loss as reported for any of the periods reported herein and the Company's comprehensive loss, as defined by Statement of Financial Accounting Standards No. 130, for each of these respective periods.

Reclassifications

Certain previously reported amounts have been reclassified to conform to the current financial statement presentation format included herein.

Net Loss per Common Share

The weighted average shares used to compute basic net loss per common share include outstanding shares of common stock from the date of issuance, and exclude shares of common stock subject to repurchase by the Company. The calculation of diluted net loss per share for all periods presented excludes shares of common stock issuable upon exercise of employee stock options and common stock issuable upon the conversion of Series B preferred stock, as their effect would be antidilutive. Therefore, the weighted average number of shares

used in the calculation of basic and dilutive net loss per common share is the same. The following table summarizes the computation of basic and diluted net loss per share (in thousands, except per share data):

	Year Ended June 30, 2000 -----	Year Ended June 30, 1999 -----	January 8, 1998 (Inception) to June 30, 1998 -----
Net loss.....	\$ (75,990)	\$ (15,140)	\$ (1,180)
Accretion of preferred stock to redemption value.....	(224)	(247)	-
Beneficial conversion charge, preferred stock.....	--	(31,721)	-
Dividend on Series B preferred stock.....	(493)	(569)	-
	-----	-----	-----
Net loss applicable to common shares.....	\$ (76,707)	\$ (47,677)	\$ (1,180)
	-----	-----	-----
Net loss per common share - basic and diluted.....	\$ (2.56)	\$ (3.52)	\$ (0.12)
	-----	-----	-----
Weighted average common shares outstanding - basic and diluted..	29,950	13,564	10,234
	-----	-----	-----
Antidilutive securities:			
Options to purchase common stock.....	12,336	6,298	2,438
Common stock subject to repurchase.....	2,957	4,777	508
Series B preferred stock.....	--	11,757	-
Warrants.....	6,302	1,753	-
	-----	-----	-----
	21,595	24,585	2,946
	=====	=====	=====

Recent Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS 137 and SFAS 138. SFAS 133 establishes methods of accounting for derivative financial instruments and hedging activities related to those instruments as well as other hedging activities, and is effective for the first fiscal quarter ending after June 30, 2001. The Company believes the adoption of these pronouncements will not have a material impact on the Company's financial position and results of operations.

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 101 (SAB 101), "Revenue Recognition in Financial Statements," as amended by SAB 101 A and SAB 101 B. SAB 101 provides guidance for revenue recognition under certain circumstances. The Company is currently evaluating the impact of SAB 101 on its financial statements and related disclosures, but does not expect that such impact, if any, will be material. The accounting and disclosures prescribed by SAB 101 will be effective for the Company's fiscal year ending June 30, 2001.

In March 2000, the FASB issued FASB Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation, an interpretation of APB Opinion No. 25" ("Interpretation"). The Interpretation is intended to clarify certain problems that have arisen in practice since the issuance of APB 25. The Interpretation provides guidance, some of which is a significant departure from current practice. The Interpretation generally provides for prospective application for grants or modifications to existing stock options or awards made after June 30, 2000. However, certain provisions relate to certain transactions occurring after December 15, 1998 and January 12, 2000. The Company believes the adoption of this pronouncement will not have a material impact on the Company's financial position and results of operations.

In March 2000, the EITF reached a consensus on EITF No. 00-2, "Accounting for Website Development Costs". This EITF provides guidance on whether certain costs incurred to develop websites should be capitalized or expensed. The consensus is effective for website development costs incurred for fiscal quarters beginning after June 30, 2000. The Company does not expect the adoption of EITF No. 00-2 to have a material impact on our financial position or results of operations.

Note 2--Acquisitions

On December 13, 1999, the Company acquired all of the stock of Group K, Inc. (dba "Cductive"), an online custom CD compilation company. The total purchase price of \$36,612,000 consisted of 2,136,000 shares of common stock valued at \$30,975,000, assumption of outstanding warrants and options with an estimated fair value using the Black-Scholes Model of \$5,322,000, and professional fees of \$315,000. The acquisition was accounted for using the purchase method of accounting and, accordingly, the results of operations of Cductive have been included in the consolidated financial statements from the date of acquisition. The purchase price was allocated to the acquired tangible assets of \$1,211,000, liabilities of \$468,000, goodwill of \$34,096,000 and other intangible assets of \$1,773,000, pursuant to the review by an independent valuations consultant. The Company is amortizing the goodwill and intangible assets over the estimated life of three years using the straight-line method.

On February 15, 2000, the Company acquired all of the outstanding stock of Tunes.com Inc. ("Tunes") the operator of RollingStone.com and Downbeatjazz.com websites. The total purchase price of \$136,121,000 consisted of 5,967,000 shares of the Company's common stock valued at \$85,268,000, assumption of outstanding warrants and options with an estimated fair value using the Black-Scholes Model of \$48,853,000, and professional fees of \$2,000,000. The acquisition was accounted for using the purchase method of accounting and, accordingly, the results of operations of Tunes have been included in the consolidated financial statements from the date of acquisition. The purchase price was allocated to the acquired tangible assets of \$8,415,000, liabilities of \$8,364,000, which includes accrued severance pursuant to the acquisition, goodwill of \$63,182,000, the RollingStone.com agreement of \$71,470,000 and other intangible assets of \$1,418,000, pursuant to the review by an independent valuations consultant. The Company is amortizing the goodwill and RollingStone.com agreement over the estimated life of ten years and the other intangible assets over the estimated life of one year using the straight-line method.

On January 31, 1999, the Company completed the acquisition of Creative Fulfillment, Inc. ("Creative Fulfillment"), operator of EMusic.com for a combination of cash and stock, at which time Creative Fulfillment became a wholly owned subsidiary of the Company. The results of Creative Fulfillment have been included in the consolidated financial statements since the date of acquisition. The total purchase price of \$6,030,000 consisted of 630,179 shares of the Company's common stock valued at \$5,558,000, cash consideration of

\$313,000, liabilities assumed of \$11,000 and other acquisition related expenses of approximately \$150,000. Substantially all of the purchase price has been allocated, based on an independent appraisal to the domain name and trademark "Emusic," which the Company is amortizing over its estimated life of three years using the straight-line method.

On June 18, 1999, the Company completed the acquisition of Internet Underground Music Archive, Inc. ("IUMA"), operator of IUMA.com, a website designed and maintained for unsigned artists, for a combination of cash and stock, at which time IUMA became a wholly owned subsidiary of the Company. The results of IUMA have been included in the consolidated financial statements since the date of acquisition. The total purchase price of \$8,990,000 consisted of 448,000 shares of the Company's common stock valued at \$7,771,000, liabilities assumed of \$1,119,000 and professional fees of approximately \$100,000. The acquisition has been accounted for using the purchase method of accounting and the Company has allocated substantially the entire purchase price to the tradename "IUMA." The Company is amortizing this intangible asset over its estimated life of three years using the straight-line method.

Summarized below are the unaudited pro-forma results of the Company as though Tunes.com, Cductive, Creative Fulfillment and IUMA had been acquired at the beginning of the year ended June 30 1999.

	Year Ended June 30, 2000 -----	Year Ended June 30, 1999 -----
Revenue.....	\$ 11,274	\$ 3,900
Net loss.....	(109,770)	(71,549)
Net loss per common share, basic and diluted..	\$ (2.74)	\$ (4.65)

The above amounts are based upon certain assumptions and estimates, which the Company believes are reasonable. The pro forma financial information presented above is not necessarily indicative of either the results of operations that would have occurred had the acquisitions taken place as of the beginning of each of the fiscal years presented or of future results of operations of the combined companies.

Note 3--Property and Equipment

Property and equipment consist of the following as of June 30 (in thousands):

	2000 -----	1999 -----
Computer equipment.....	\$ 4,369	\$ 495
Software.....	1,178	81
Furniture and fixtures.....	1,151	584
	-----	-----
	6,698	1,160
Less: Accumulated depreciation..	(1,992)	(84)
	-----	-----
	\$ 4,706	\$1,076
	=====	=====

The original cost of equipment held under capital leases was \$439,000, and accumulated amortization was \$76,000 at June 30, 2000.

Note 4--Advanced Royalties and Music Catalogs and Investments

The following balances are as of June 30 (in thousands):

Advanced Royalties	2000 -----	1999 -----
Cash advances.....	\$17,590	\$5,233
Warrants issued.....	2,657	1,184
Less: Accumulated earned royalty.....	(298)	(2)
Less: Accumulated stock compensation expense..	(305)	--
	-----	-----
	\$19,644	\$6,415
	=====	=====

The Company has obtained the rights to distribute musical recordings over the Internet for periods generally ranging from three to five years. During the years ended June 30, 2000 and 1999, the Company paid cash advances on future royalties of \$11,967,000 and \$5,117,000, respectively. The Company also acquired \$390,000 of royalty advances with the acquisition of Cductive in December 1999 (see Note 2). In addition, as of June 30, 1999 an accrual of \$116,000 in respect of an amount due under one licensing contract entered into during the year ended June 30, 1999 was included above. This amount was paid during the year ended June 30, 2000. Also related to these license agreements, the Company issued warrants to purchase up to 409,113 shares of common stock with a fair value of \$1,473,000 in 2000 and issued warrants to purchase up to 229,500 shares of common stock with an estimated fair value of \$1,184,000 in 1999 (see Note 9).

Music Catalogs and Investments	2000 -----	1999 -----
Acquired music catalogs.....	\$4,341	\$2,343
Less: Accumulated amortization.....	(234)	--
	-----	-----
	4,107	2,343
Equity investments.....	2,233	--
Convertible note.....	250	--
	-----	-----
	\$6,590	\$2,343
	=====	=====

The Company has purchased certain music master sound recordings, copyrights and trademarks, including the full physical and electronic download distribution rights and other intangible assets related to certain record labels. The cash consideration for the purchase of these music catalogs totaled \$1,998,000 and \$2,200,000 during the years ended June 30, 2000 and 1999, respectively. In addition, warrants valued at \$143,000 were issued related to the purchase of music catalogs in 1999.

During the year ended June 30, 2000, the Company made cash investments in independent record labels and a distribution company totaling \$2,483,000. The convertible note can be converted at any time by the Company into a fifteen percent interest in the underlying private company's equity securities.

Note 5 - Trade Names, Goodwill & Other Intangible Assets

Trade Names, Goodwill & Other Intangible Assets consisted of the following as of June 30 (in thousands):

	2000	1999
	-----	-----
Trade names:		
EMusic tradename.....	\$ 17,372	\$17,372
IUMA tradename.....	8,990	8,990
Rollingstone.com Agreement(see note 2)...	71,470	--
Less: Accumulated amortization.....	(13,493)	(1,682)
	-----	-----
	\$ 84,339	\$24,680
	=====	=====
Goodwill & other intangible assets:		
Goodwill(see note 2).....	\$ 97,278	\$ --
Other intangibles(see note 2).....	3,191	--
Less: Accumulated amortization.....	(9,474)	--
	-----	-----
	\$ 90,995	\$ --
	=====	=====

Amortization is calculated on the straight-line basis over three to ten years for tradenames and goodwill and one to three years for other intangible assets.

On April 27, 1999, the Company completed a purchase of the rights related to the EMusic domain name and certain digital music distribution rights from Nordic Entertainment Worldwide, Inc. and affiliate entities ("Nordic"), Nordic continued as a stand-alone business following the transaction. The total purchase price of \$11,459,000 consisted of 665,188 shares of the Company's common stock valued at \$11,084,000 and cash consideration of \$375,000. The total purchase price was allocated to the EMusic domain name and music distribution rights in the amounts of \$11,354,000 and \$105,000, respectively.

Note 6--Mandatorily Redeemable Convertible Preferred Stock

Mandatorily redeemable convertible preferred stock at June 30, 1999, comprise the following:

	Shares		Liquidation
	Authorized	Outstanding	Amount
	-----	-----	-----
Series B.....	120,000	117,570	\$35,271,000
Undesignated.....	380,000	--	--
	-----	-----	-----
	500,000	117,570	\$35,271,000
	=====	=====	=====

Series A

On October 28, 1998, the Company raised proceeds of \$500,000 through the sale of 500 shares of Series A mandatorily redeemable preferred stock ("Series A") and warrants to purchase 100,000 shares of the Company's common stock to an accredited investor. The Series A shares were convertible into shares of the Company's common stock based on a conversion formula and contained certain redemption provisions. The Company recorded a charge to accumulated deficit in the amount of \$144,000 arising from the "in-the-money" conversion feature attached to the Series A shares. In conjunction with the Company's Series B financing discussed below, all 500 shares of Series A were converted into 2,048 shares of Series B mandatorily redeemable convertible preferred stock. The warrants, which remain outstanding at June 30, 2000, have a term of four years with an initial exercise price of \$7.10 per share and have been recorded at fair value, estimated using the Black Scholes Model, as additional paid in capital of \$343,000 (see Note 9).

Series B

On March 23, 1999 ("Issuance Date"), the Company completed a private placement of 117,570 shares of Series B Mandatorily Redeemable Convertible Preferred Stock ("Series B"), which includes the conversion of outstanding convertible notes and Series A shares into Series B Shares. Total proceeds, including proceeds from the convertible notes were \$31,577,000 net of issuance costs of approximately \$2,724,000.

During the year ended June 30, 1999, the Company recorded a charge to accumulated deficit for the "in-the-money" conversion feature attached to the Series B stock. The amount of this charge was limited to the aggregate amount of the net proceeds received of \$31,577,000. The remaining difference between the Series B carrying value and its redemption value, resulting from

issuance costs associated with the transaction, was accreted, using the effective interest rate method, as a charge to accumulated deficit through September 24, 1999, the date of the Company's public offering and the conversion of the Series B into common stock.

During the years ended June 30, 2000 and 1999, the Company recorded a charge of \$493,000 and \$569,000, respectively, to accumulated deficit for the 6% accrued

dividends on the Series B shares.

On September 24, 1999, the Company completed an underwritten public offering, and consequently, in accordance with terms of the Series B purchase agreement, the 117,570 shares of Series B were converted to 11,757,000 shares of Common Stock. In conjunction with this conversion, the Company recorded an addition to common stock of \$12,000 and an increase to additional paid in capital of \$32,193,000. During the year ended June 30, 2000, dividends on the Series B shares of \$1,062,000 were paid.

Note 7--Commitments:

License Agreement

In conjunction with the acquisition of Tunes.com (see Note 2) the Company assumed an agreement with Rolling Stone LLC (the "Agreement") pursuant to which the Company has certain rights with respect to brand name, trademarks, URL and other content-related services. Under the terms of the Agreement, the Company also assumed the outstanding warrants issued by Tunes (see Note 9), and is required to pay an annual license fee of \$1,000,000 (paid in quarterly installments), which increases to \$1,250,000 starting in January 2001 and \$1,500,000 in January 2006. Additionally, the Company is required pay a percentage of the revenues generated from the RollingStone.com Web site and to purchase \$1,100,000 of advertising and other services annually in Rolling Stone magazine. The initial term of the Agreement continues through February 2011, is automatically renewed for an additional five years if the Company has a market capitalization of at least \$2 billion, and may thereafter continue for additional renewal terms upon the mutual agreement of the parties. Rolling Stone LLC may terminate the Agreement earlier if the Company fails to maintain technical reliability reasonably required to keep the RollingStone.com website available, to pay amounts due under the Agreement, or is acquired by a competitor of Rolling Stone or another company unacceptable to Rolling Stone.

Lease Commitments

The Company leases office facilities under noncancelable operating leases, and equipment under capital leases.

During the year ended June 30, 1999, the Company entered into a five-year lease agreement for office space. The terms of the agreement require minimum monthly lease payments of approximately \$67,000 for a period of 60 months. This monthly amount includes certain maintenance costs associated with the leased space, and is subject to annual increases based on the Consumer Price Index.

Future minimum lease payments under these leases, net of sublease income, are as follows (in thousands):

	Capital Leases	Operating Leases
Year Ending June 30,		
2001.....	\$ 221	\$1,352
2002.....	189	1,303
2003.....	64	1,024
2004.....	--	820
2005.....	--	141
	-----	-----
Total minimum lease payments	\$ 474	\$4,640
Less: Amount representing interest	(50)	

Present value of net minimum lease payments	424	
Less: Current portion, included in accrued liabilities	(179)	

	245	
	=====	

Rent expense for operating leases was \$1,187,000, \$231,000 and \$13,000 for the years ended June 30, 2000 and 1999, and the period from January 8, 1998 (Inception) to June 30, 1998, respectively.

Note 8--Stockholders' Equity

Public Offering

On September 24, 1999, the Company completed a public offering of 5,270,000 shares of common stock for proceeds of \$79,682,000. Issuance costs associated with the public offering were \$1,142,000. On October 27, 1999, the Company issued an additional 300,000 shares of common stock for net proceeds of \$4,537,000 in connection with the exercise by the underwriters of their over-allotment option.

Restricted Common Stock

A total of 8,378,000 shares of common stock were issued to the Company's founders, of which 1,062,000 were issued subject to a restricted stock purchase agreement with one of the founders. The agreement provides the Company with the right to repurchase 590,000 of these shares at \$0.01 per share subject to ratable vesting over three years. In March 1999, pursuant to the stockholders' agreement entered into in conjunction with the Series B preferred stock issuance (Note 6), an additional 4,897,650 shares of the common stock originally issued to the Company's two other founders, were designated as newly restricted shares, subject to repurchase by the Company at \$0.01 per share. The shares vest ratably over three years from the date of the Series B preferred stock issuance. As of June 30, 2000, 2,957,000 shares were subject to the Company's right of repurchase.

Par Value

On July 16, 1999, the stockholders approved a proposal to amend the Company's Restated Articles of Incorporation in order to change its name from GoodNoise Corporation to EMusic.com Inc. and to recapitalize as a Delaware corporation. In connection with these changes, the par value of the Company's common shares changed from \$0.01 per share to \$0.001 per share. The accompanying financial statements reflect all share amounts after giving effect to this recapitalization.

Note 9--Warrants

Warrants to purchase 300,000 shares of the Company's common stock were exercised on August 10, 1998 for cash proceeds of \$300,000.

In conjunction with the Series A financing (see Note 6) during the year ended June 30, 1999, the Company issued warrants to purchase 100,000 shares of the Company's common stock at \$7.91 per share. The fair value of these warrants, estimated using the Black-Scholes Model, of \$343,000 has been recorded as additional paid in capital during the year ended June 30, 1999. These warrants, which expire on October 28, 2002, were outstanding as of June 30, 2000.

In conjunction with the acquisition of a music catalog on June 30, 1999 (see Note 4), the Company issued warrants to purchase 35,000 shares of the Company's common stock at a price of \$13.63 per share. The warrants, which expire on June 10, 2001, were valued at \$143,000 and were recorded as an addition to paid in capital. These warrants were outstanding at June 30, 2000.

During the years ended June 30, 2000 and 1999, the Company issued warrants for the purchase of 1,536,515 and 1,388,300 common shares, respectively, in exchange for product development activities by various parties operating in the music industry. The warrants were issued with exercise prices ranging from \$2.19 to \$21.63 and have two to three-year terms. The fair value of these warrants, estimated using the Black-Scholes Model, of \$6,228,000 and \$5,682,000 has been recorded as a charge to product development expense in the Consolidated Statement of Operations for the years ended June 30, 2000 and 1999, respectively. As of June 30, 2000, 2,284,715 of these warrants were outstanding.

In connection with agreements to license digitally downloadable rights from various record labels the Company issued warrants to purchase up to 409,113 and 229,500 shares of common stock during the years ended June 30, 2000 and 1999, respectively. These warrants were issued at exercise prices ranging between \$2.13 and \$24.50. The fair value of these warrants, estimated using the Black-Scholes Model, of \$1,473,000 and \$1,184,000 has been recorded as an addition to Advanced Royalties to be amortized over the term of the respective label agreements (see Note 4). During the year ended June 30, 2000, \$305,000 was amortized to product development expense in the Consolidated Statement of Operations. All these warrants were outstanding as of June 30, 2000.

In connection with the acquisition of Cductive, the Company assumed outstanding warrants to purchase up to 205,639 shares of common stock at exercise prices ranging between \$6.61 and \$9.92. The fair value of these warrants, estimated using the Black-Scholes Model, of \$2,337,000 was recorded as part of the purchase price. All these warrants were outstanding as of June 30, 2000.

In connection with the acquisition of Tunes.com, the Company assumed outstanding warrants to purchase up to 3,038,213 shares of common stock at an exercise price of \$3.62. The fair value of these warrants, estimated using the Black-Scholes Model, of \$32,037,000 was recorded as part of the purchase price. All these warrants were outstanding as of June 30, 2000.

The following table sets forth the warrants outstanding as of June 30, 2000:

	Number of Shares	Exercise Price	Weighted Average Exercise Price Per Share
	-----	-----	-----
Series A agreement.....	100,000	\$ 7.91	\$ 7.91
Acquisition of music catalog..	35,000	\$ 13.63	\$13.63
Product development services..	2,284,715	\$2.19--\$21.63	\$14.53
Advanced royalties.....	638,613	\$2.13--\$24.50	\$12.38
Acquisition of Cductive.....	205,639	\$6.61--\$ 9.92	\$ 7.31
Acquisition of Tunes.....	3,038,213	\$ 3.62	\$ 3.62
	-----		-----
Balance at June 30, 2000.....	6,302,180		\$ 9.81
	=====		=====

Note 10--Stock Plans

Stock Option Plans

On March 30, 1998, the Company adopted the 1998 Stock Option Plan and on December 31, 1998, the Company adopted the 1998 Non-Statutory Stock Option Plan (the "Plans") that provide for the granting of either incentive or nonqualified stock options to purchase shares of the Company's common stock, and for stock-based awards to officers, directors, key employees of the Company and non-employee consultants. Options granted to employees generally vest ratably over a period of three or four years, and expire ten years from the date of grant. As of June 30, 2000, there were 4,573,000 shares of common stock available for grant under the Plans.

In connection with the acquisition of Cductive, the Company assumed outstanding options to purchase up to 263,954 shares of the Company's common stock at exercise prices ranging between \$1.84 and \$8.27. The fair value of these options, estimated using the Black-Scholes Model, of \$2,985,000 was recorded as part of the purchase price. In connection with the acquisition of Tunes, the Company assumed outstanding options to purchase up to 1,594,656 shares of the Company's common stock at exercise prices ranging between \$1.21 and \$12.06. The fair value of these options, estimated using the Black-Scholes Model, of \$16,816,000 was recorded as part of the purchase price.

The following table summarizes activity under the Plans during the years ended June 30, 2000 and 1999 and the period from January 8, 1998 (Inception) to June 30, 1998.

	Number of Shares	Exercise Price	Weighted Average Exercise Price Per Share
	-----	-----	-----
Granted.....	2,437,550	\$0.01--\$ 5.00	\$ 0.85

Balance at June 30, 1998.....	2,437,550		\$ 0.85
Granted.....	4,216,000	\$5.75--\$13.63	\$ 10.76
Exercised.....	(45,400)	\$ 0.03	\$ 0.03
Canceled.....	(310,400)	\$ 11.00	\$ 11.00

Balance at June 30, 1999.....	6,297,750		\$ 7.12

Granted.....	6,943,575	\$2.16--\$15.13	\$	7.08
Assumed on acquisitions	1,858,610	\$1.21--\$12.06	\$	7.08
Exercised.....	(790,809)	\$0.03--\$ 7.49	\$	0.95
Canceled.....	(1,942,632)	\$0.03--\$15.00	\$	10.13

Balance at June 30, 2000.....	12,366,494		\$	7.04
	=====			

The following table summarizes information with respect to stock options outstanding at June 30, 2000:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding at June 30, 2000	Weighted-Average Remaining Contractual Life (Years)	Weighted-Average Exercise Price	Number Exercisable At June 30, 2000	Weighted-Average Exercise Price
\$ 0.01-\$0.03	1,120,644	7.79	\$ 0.03	732,240	\$ 0.03
1.21- 3.78	3,591,643	9.34	2.43	1,041,164	2.55
5.00- 6.75	1,551,852	7.37	5.68	1,122,905	5.59
7.19- 9.89	2,545,681	9.27	8.72	611,839	8.41
11.00-15.13	3,526,674	8.71	13.36	1,959,990	13.16
	-----			-----	
	12,336,494	8.76	7.04	5,468,138	7.29
	=====			=====	

Stock Compensation

During the year ended June 30, 2000 and 1999 and the period from January 8, 1998 (Inception) to June 30, 1998, the Company issued options for the purchase of 1,048,000, 666,000 and 280,000 common shares, respectively, in exchange for product development activities by various individuals. The options were issued with exercise prices ranging from \$0.01 to \$15.00 and have between ten and two-year terms. The fair value of these options, estimated using the Black-Scholes Model, of \$5,415,000, \$2,379,000 and \$752,000 for the years ended June 30, 2000 and 1999 and for the period January 8, 1998 (Inception) through June 30, 1998, respectively, were recorded as Product Development expense in the Consolidated Statement of Operations.

As discussed in note 9 to these consolidated financial statements, the Company also issued warrants to purchase 1,536,115 and 1,388,300 share of common stock with fair values of \$6,228,000 and \$5,682,000 during the years ended June 30, 2000 and 1999, respectively.

Options to purchase 103,500 shares of the Company's common stock at \$5.75 per share were issued for fixed assets during the year ended June 30, 1999. The fair value of these options, estimated using the Black-Scholes Model, of \$45,000 was recorded as an increase to fixed assets for the year ended June 30, 1999.

Pro forma stock compensation

The Company has adopted the disclosure-only provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123"). Had compensation cost been determined based on the fair value at the grant date for the awards in 2000, 1999 and 1998 consistent with the provisions of SFAS No. 123, the Company's net loss for 2000, 1999 and 1998, respectively, would have been as follows (in thousands except per share data):

	Year Ended June 30, 2000	Year Ended June 30, 1999	January 8, 1998 (Inception) through June 30, 1998
Net loss applicable to common stockholders - as reported...	\$(76,707)	\$(47,677)	\$(1,180)
Net loss applicable to common stockholders - pro forma....	\$(85,789)	\$(49,009)	\$(1,458)
Net loss per common share basic and diluted - as reported..	\$ (2.56)	\$ (3.52)	\$ (0.12)
Net loss per common share basic and diluted - pro forma....	\$ (2.86)	\$ (3.61)	\$ (0.14)

Such pro forma disclosures may not be representative of future compensation cost because options vest over several years and additional grants are made each year.

For the purposes of disclosure under SFAS No. 123, the fair value of the option grants to employees, in aggregate is estimated on the date of grant using the Black-Scholes Option Pricing Model with the following assumptions:

	Year Ended June 30, 2000	Year Ended June 30, 1999	January 8, 1998 (Inception) through June 30, 1998
Expected volatility.....	75%	46%	55%
Risk-free interest.....	6.00%	6.00%	5.73%
Expected life.....	5 years	5 years	5 years
Expected dividend yield..	0%	0%	0%

Employee Stock Purchase Plan

The 1999 Stock Purchase Plan permits eligible employees to purchase shares of the Company's common stock at a discount through payroll deductions. The Company's only expense relating to this plan is for its administration. A total of 250,000 shares of common stock were reserved for issuance under the plan. As

of June 30, 2000, no shares have been sold to employees under this plan.

Note 11 - Retirement Plans

The Company maintains qualified 401(k) savings plans covering substantially all employees. The plans permit eligible employees to make voluntary contributions on a pretax basis up to a certain limit. As of June 30, 2000, the Company has made no contributions to the plans.

Note 12--Income Taxes

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Realization of the future tax benefits related to the deferred tax assets is dependent on many factors, including the Company's ability to generate taxable income within the net operating loss carryforward period.

As of June 30, 2000 the Company has recorded a full valuation allowance against its net deferred tax assets as it believes that it is more likely than not that such assets will not be recovered prior to their expiration. As of June 30, 1999 the Company recognized deferred tax assets to the extent of its deferred tax liabilities.

Significant components of the Company's deferred income tax assets and liabilities were as follows (in thousands):

	June 30	
	2000	1999
Deferred tax assets:		
Net operating losses.....	\$ 35,511	\$ 4,120
Accruals and reserves.....	661	80
Depreciation and amortization.....	2,301	200
	38,473	4,400
Deferred tax liabilities:		
Non-deductible intangible assets.....	(32,067)	(4,400)
Net deferred tax asset.....	6,406	--
Valuation allowance.....	(6,406)	--
	\$ --	\$ --
	=====	=====

At June 30, 2000, the Company had federal and state net operating loss carryforwards available to offset future taxable income totaling approximately \$88 million, which expire in varying amounts beginning in 2006 through 2020. Included in the federal and state net operating loss carryforwards are approximately \$2,000,000 of deductions related to stock option exercises, the benefit of which will be credited to equity when realized. Based on the Internal Revenue Code the utilization of net operating

loss carryforwards may be limited in certain circumstances. Events that cause limitations in the amount of net operating losses that the Company may utilize in any one year include, but are not limited to, a cumulative change in ownership.

The acquisitions of IUMA and Creative Fulfillment in 1999 and Tunes.com and Cductive in 2000 were structured as tax-free exchanges of stock, therefore, the differences between the recognized fair values of acquired net assets and their historical tax bases are not deductible for tax purposes. A deferred tax liability has been recognized for the differences between assigned fair values of intangibles for book purposes and the tax bases of such assets.

Note 13--Subsequent Events

In July 2000, the Company broadened its revenue model with the launch of EMusic Unlimited, a subscription program that allows customers to download an unlimited amount of music from the EMusic catalog in exchange for a flat, monthly fee. This is an addition to the previous model where customers are offered the opportunity to purchase individual tracks and albums. Revenues from the subscription sales will be recognized over the respective subscriptions terms.

Note 14- Selected Quarterly Data (Unaudited)

	Fiscal year ended June 30, 2000				Fiscal year ended June 30, 1999			
(Amounts in \$000's)	Quarter ended June 30, 2000	Quarter ended March 31, 2000	Quarter ended December 31, 1999	Quarter ended September 30, 1999	Quarter ended June 30, 1999	Quarter ended March 31, 1999	Quarter ended December 31, 1998	Quarter ended September 30, 1998
Revenues:								
Music.....	\$ 509	\$ 529	\$ 229	\$ 54	\$ 6	\$ 2	\$ 1	\$ --
Advertising.....	3,262	1,571	194	126	45	19	7	12
Total revenues	3,771	2,100	423	180	51	21	8	12
Cost of revenues.....	1,094	579	147	25	14	9	4	--
Gross profit.....	2,677	1,521	276	155	37	12	4	12
Operating expenses:								
Product development, excluding stock compensation.....	5,730	4,922	2,935	2,051	1,879	789	391	570
Stock compensation.....	2,961	2,072	2,955	3,960	6,565	865	534	97
Total product development.....	8,691	6,994	5,890	6,011	8,444	1,654	925	667
Selling and marketing.....	8,699	8,810	5,637	4,771	556			
General and administrative.....	2,550	2,141	1,078	812	883	314	205	115

Amortization of intangible assets.....	9,227	7,132	2,877	2,283	1,348	334	--	--
Total operating expenses.....	29,167	25,077	15,482	13,877	11,231	2,302	1,130	864
Operating loss.....	(26,490)	(23,556)	(15,206)	(13,722)	(11,194)	(2,290)	(1,126)	(852)
Interest and other income, net..	806	1,027	948	203	317	1	1	3
Net loss.....	\$(25,684)	\$(22,529)	\$(14,258)	\$(13,519)	\$(10,877)	\$(2,289)	\$(1,125)	\$(849)
Net loss applicable to common stockholders.....	\$(25,684)	\$(22,529)	\$(14,258)	\$(14,236)	\$(11,620)	\$(33,914)	\$(1,294)	\$(849)
Net loss per share- basic and diluted.....	(0.64)	(0.62)	(0.47)	(1.09)	(1.02)	(2.31)	(0.09)	(0.06)
Weight average shares outstanding.....	39,956	36,201	30,586	13,058	11,438	14,674	14,581	14,591

(2) Financial Statement Schedules:

The following financial statement schedule of EMusic.com Inc. for the years ended June 30, 2000 and 1999 and the period from January 8, 1998 (Inception) to June 30, 1998 is filed as part of this Report and should be read in conjunction with the Consolidated Financial Statements of EMusic.com Inc.

	Reference Page
Schedule II -- Valuation and Qualifying Accounts.....	58

All other schedules are omitted because they are not applicable or the required information is shown in the financial statements or notes thereto.

Item 14. Exhibits, Financial Statements and Reports on Form 8-K (cont.)

(b) No reports on Form 8-K were filed during the three months ended June 30, 2000.

(c) Exhibits:

The exhibits listed below are required by Item 601 of Regulation S-K. Each management contract or compensatory plan or arrangement required to be filed as an exhibit to this Form 10-K has been identified.

Exhibit Number	Description of Document
2.1(a)	Agreement and Plan of Reorganization by and among GoodNoise Corporation, GNA Corporation, Internet Underground Music Archive, Inc. and certain shareholders of Internet Underground Music Archive, Inc. dated as of May 16, 1999
2.2(b)	Agreement and Plan of Reorganization by and among EMusic.com Inc., GNA Corporation, Group K Inc., d.b.a. CDuctive and the principal shareholders of CDuctive, dated as of November 15, 1999.
2.3(c)	Agreement and Plan of Reorganization dated as of November 29, 1999, among EMusic.com Inc., GNB Corporation and Tunes.com Inc.
3.1(c)	Amended and Restated Certificate of Incorporation
3.2(c)	Amended and Restated Bylaws
10.1(a)	Form of Indemnity Agreement
10.2(d)	1998 Stock Option Plan*
10.3(a)	1998 Nonstatutory Stock Option Plan*
10.5(a)	1999 Employee Stock Purchase Plan*
10.6(a)	Form of Amendment to Investor Rights Agreement dated July 19, 1999
10.7	Affiliation Agreement with Rolling Stone LLC (formerly Straight Arrow Publishers Company), as amended
21(c)	Subsidiaries
23.1	Consent of PricewaterhouseCoopers LLP
24.1	Power of Attorney (included in the signature page to this Form 10-K)
27.1	Financial Data Schedule

* Indicates management contract or compensatory plan or arrangement.

- (a) Previously filed as an exhibit to the Registrant's Form S-1 (Registration Statement No. 333-83685).
- (b) Previously filed as an exhibit to the Registrant's Form 8-K dated November 15, 1999.
- (c) Previously filed as an exhibit to the Registrant's Form 8-K dated November 29, 1999.
- (d) Previously filed as an exhibit to the Registrant's Form 10-SB/A dated December 24, 1998.

SCHEDULE II

EMusic.com Inc.
Valuation and Qualifying Accounts

Description	Balance at beginning of period	Additions charged to operations	Write-offs	Balance at end of period
Allowance for doubtful accounts:				
For the period from January 8, 1998 (Inception) to June 30, 1998.....	\$0	\$ 0	\$ 0	\$ 0
For the year ended June 30, 1999.....	\$0	\$ 0		
For the year ended June 30, 2000.....	\$0	\$61	\$ (6)	\$55

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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, on September 21, 2000.

EMUSIC.COM INC.
(Registrant)

By: /s/ GENE HOFFMAN, JR.
Gene Hoffman Jr.
President
Chief Executive Officer

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Gene Hoffman, Joseph Howell and Peter Astiz, and each of them, his or her true and lawful attorneys-in-fact, each with full power of substitution, for him or her in any and all capacities, to sign any amendments to this report on Form 10-K and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact or their substitute or substitutes may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the date indicated:

/s/ GENE HOFFMAN, JR. ----- Gene Hoffman, Jr. President, Chief Executive Officer Director September 21, 2000	/s/ ROBERT KOHN ----- Robert Kohn Chairman of the Board September 21, 2000
/s/ JOSEPH HOWELL ----- Joseph H. Howell Executive Vice President & Chief Financial Officer (Principal Financial and Accounting Officer) September 21, 2000	/s/ RALPH PEER, II ----- Ralph Peer, II Director September 21, 2000
/s/ TOR BRAHAM ----- Tor Braham Director September 21, 2000	/s/ ED ROSENBLATT ----- Ed Rosenblatt Director September 21, 2000

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