INTERSHOP™

Annual Report
2003

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Letter to the Stockholders

Dear Stockholders, Customers, Partners, and Employees:

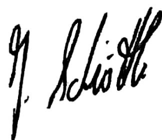
2003 was another difficult year for Intershop. Companies remained reluctant to invest in information technology in 2003 due to the weak overall economy. As a result, Intershop's business from e-commerce software solutions declined in the fiscal year 2003, forcing the Company to make further adjustments to its operational business.

In sales, Intershop focused on large key accounts and made greater use of indirect channels via partners and distributors, particularly abroad. Our activities mainly involved upgrading existing customer systems to include the improved e-commerce functionality offered by Intershop's Enfinity MultiSite software, and extending our substantial competitive edge at Europe's leading online shops.

In view of the difficult market situation, Intershop consolidated its international sales structure and reduced its global headcount. This enabled the Company to cut its total operational costs year-on-year, and therefore to reduce its net loss for 2003 by 32% year-on-year.

On behalf of the management team at Intershop, I would like to thank all of our stockholders, customers, partners, and employees for their continuing trust and their active support.

Sincerely,



Dr. Jürgen Schöttler
Chief Executive Officer

This annual report contains forward-looking statements regarding future events or the future financial and operational performance of Intershop. Actual events or performance may differ materially from those contained or implied in such forward-looking statements. Risks and uncertainties that could lead to such differences could include, among other things: Intershop's limited operating history, the unpredictability of future revenues and expenses and potential fluctuations in revenues and operating results, significant dependence on large single customer deals, consumer trends, the level of competition, seasonality, risks related to electronic security, possible governmental regulation, and general economic conditions. Additional information regarding factors that could potentially affect Intershop's business, financial condition, and operating results is included in Intershop's filings with the Securities and Exchange Commission, including the Company's Form 20-F dated June 6, 2003.

Group Management Report and Management Report for Intershop Communications AG

Market Environment

In the fiscal year 2003, the business of the Intershop Communications AG Group ("Intershop," "the Company," or "the Intershop Group") and Intershop Communications AG (the "AG"), which acts as the holding entity for the Intershop Group, was impacted by sustained weak demand for enterprise software and a general reluctance to invest in corporate information technology (IT).

Although Internet usage increased again in the fiscal year 2003, IT expenditure on enterprise application software continued to decline. According to a survey conducted by Forrester Research, IT expenditure by companies in Germany – the key market for Intershop's products – fell by 4% year-on-year in 2003. The European Information Technology Observatory (EITO) also calculates expenditure on software products by companies in Germany as having decreased as against the previous year by 0.3% to €15 billion.

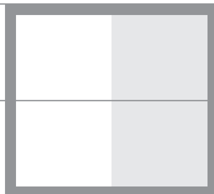
The reluctance of companies to invest in IT was a reflection of the generally weak macroeconomic environment. After a year of economic stagnation in 2002, GDP (gross domestic product) in Germany contracted by 0.2% year-on-year in 2003.

As a result of the economic downturn in the fiscal year 2003, companies tended to postpone or even scale back their IT spending. As was the case in 2002, IT spending decisions were dominated by return-on-investment (ROI) considerations. Enterprise customers focused on products with high ROI and low-risk turnkey solutions requiring minimal levels of customization to achieve a low total cost of ownership (TCO). Customer demand patterns in 2003 shifted to the replacement and enhancement of existing systems and prolonging their lifecycles.

In the light of these developments, fiscal 2003 was a year of operational consolidation for Intershop. To improve the Company's financial performance, it further adjusted its operations to reflect the year-on-year fall in revenue.

Operational Consolidation

To streamline the Group structure, Intershop Communications AG as the holding entity for the Group acquired the assets of Intershop Software Entwicklungs GmbH, a formerly wholly-owned subsidiary of Intershop Communications AG, by way of a merger entered in the commercial register of the Local Court of Gera, Germany, on October 1, 2003 with retroactive effect from January 1, 2003. As a result, all operating functions as well as the intellectual property rights of Intershop Software Entwicklungs GmbH were merged into Intershop Communications AG, which previously acted exclusively as the holding entity for the Intershop Group of companies. The AG thus acquired all significant assets and the majority of the employees of the Intershop Group.



Prior to the completion of this merger, the merger of Intershop Communications GmbH, a formerly wholly-owned subsidiary of Intershop Communications, Inc., with Intershop Software Entwicklungs GmbH was effected on September 25, 2003 by way of entry in the commercial register of the Local Court of Gera, Germany.

As part of the implementation of the Company's restructuring plans announced on January 21, 2003 and July 2, 2003, operations in France were discontinued and European sales activities outside Germany were transferred to local distributors in Sweden, Norway, Denmark, and the United Kingdom (as of January 1, 2004).

To support operational realignment efforts within the Company, Intershop adjusted its business activities in line with the lower level of revenue recorded in the fiscal year 2003.

Total revenue fell from €45.1 million in fiscal 2002 to €23.2 million in fiscal 2003. As a result, the number of employees declined across all areas of the Group. As of December 31, 2003, the Group had 278 full-time equivalent employees, representing a decrease of 42% or 201 full-time equivalent employees as against the previous year. As of December 31, 2003, Intershop employed 71% of its global workforce in technical departments such as research and development as well as services; 14% were employed in sales and marketing; and 15% were employed in general and administrative functions.

The AG had an average of 371 employees in the fiscal year 2003. By comparison, it employed an average of 13 employees in the fiscal year 2002.

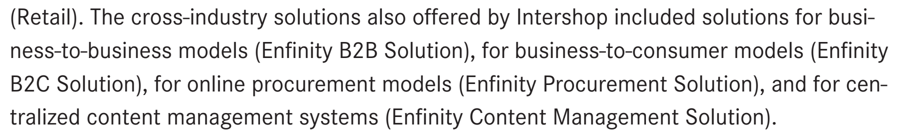
As part of the reorganization, the Supervisory Board appointed Dr. Jürgen Schöttler as Chairman of the Management Board on July 14, 2003. Stephan Schambach, co-founder and major shareholder of Intershop, was the Chairman of the Management Board until this date. From this date until he left the Company on February 4, 2004, he was the Management Board member responsible for Strategy and Product Development. In addition, former Management Board member Werner Fuhrmann left the Company on July 16, 2003.

▫ Product and Sales Strategy

In 2003, Intershop positioned itself as a provider of high-quality e-commerce software for enterprise customers with complex requirements for their online sales channels.

As in the previous year, the Company continued to target global enterprise clients with its high-end product offering.

Intershop supported a large number of online commerce models with its core Enfinity technology, including industry-specific solutions for the automobile industry (Automotive), for the high-tech sector and manufacturing industry (High-Tech/Manufacturing), and for trade



(Retail). The cross-industry solutions also offered by Intershop included solutions for business-to-business models (Enfinity B2B Solution), for business-to-consumer models (Enfinity B2C Solution), for online procurement models (Enfinity Procurement Solution), and for centralized content management systems (Enfinity Content Management Solution).

Alongside specific e-commerce solutions, Intershop also marketed Enfinity MultiSite, its latest platform based on Enfinity technology. Enfinity MultiSite enables enterprises to deploy and centrally manage multiple e-commerce initiatives across different business units from a single platform, thus minimizing the implementation and operating costs of e-commerce solutions.

Enfinity MultiSite allows enterprises to pursue an IT-strategy, enabling them to centrally manage multiple online channels and web content simultaneously. These systems focus on integrating all e-commerce processes across disparate countries, markets, business units, applications, and systems.

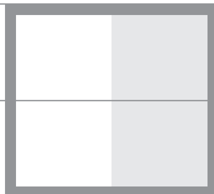
In fiscal 2003, Intershop's Enfinity-based software solutions formed the cornerstone of the e-commerce strategies of a large number of enterprises. According to an industry analysis conducted by Nielsen/NetRatings in September 2003, four out of five German online shops run Intershop Enfinity; these include extremely popular sites such as Otto.de, Tchibo.de, T-Com.de, and Quelle.de.

In the light of the difficult market environment and the restructuring measures implemented in 2003, Intershop's activities in Germany focused primarily on existing business with large customers such as Deutsche Telekom, Otto, KarstadtQuelle, and HP.

Revenue

Due to the continued weakness in corporate IT spending, Intershop's total revenue in 2003 fell to €23.2 million from €45.1 million in the previous year. License revenue totaled €6.5 million in 2003, compared with €22.5 million in the comparable prior-year period. Service revenue (including consulting, customer support, maintenance, and other revenue) totaled €16.7 million in 2003 as against €22.6 million in 2002.

Europe remained Intershop's primary market, accounting for €19.2 million or 83% of total global revenue in 2003 as against €35.0 million or 78% in the previous year. As part of its restructuring measures, Intershop reduced its European workforce by 43% year-on-year to 248 full-time equivalent employees (as of December 31, 2003). This reduction was achieved mainly through headcount reductions in Germany, the discontinuation of operations in France, and the transfer of sales activities to local distributors in Sweden, Norway, Denmark and – as of January 1, 2004 – in the United Kingdom. This means that Germany is the only country in Europe where Intershop is still operating using a direct sales model via its offices in Jena, Hamburg, and Stuttgart.



The AG, which is responsible for the Group's business in Germany, generated revenue of €17.5 million in the year under review as against €0 million in the previous year; this was due to the transfer of operating activities following the merger. Following the merger of Intershop Software Entwicklungs GmbH into the AG, the latter employed average 371 employees as of December 31, 2003, as against an average of 13 employees at December 31, 2002 prior to the merger.

In the fiscal year 2003, Intershop generated €3.3 million in total revenue or 14% of total global revenue in the Americas region, compared with €9.0 million or 20% in 2002. Intershop's U.S. headquarters in San Francisco ensured that it was represented in the strategically important U.S. software market in 2003. Further organizational streamlining throughout 2003 reduced headcount in the Americas by 51% year-on-year to 19 full-time equivalent employees as of December 31, 2003.

In the Asia Pacific region, Intershop generated €0.7 million in revenue in the fiscal year 2003, representing 3% of total global revenue, compared with €1.1 million or 2% of total global revenue in the comparable prior-year period. Intershop has moved to a full distributor model in the Asia Pacific region, supported by its global partners to provide the most efficient client support. The Company increased headcount across its remaining Asia Pacific office locations in Tokyo, Japan, and Hong Kong, China, by 5 full-time equivalent employees year-on-year to 11 as of December 31, 2003.

In 2003, Intershop sold 44 Enfinity configurations (i.e., Enfinity platforms and solutions as well as Enfinity MultiSite), bringing the total number of Enfinity configurations sold worldwide since the fourth quarter of 1999 to 456. In comparison, Intershop sold 94 Enfinity configurations in the fiscal year 2002.

In 2003, the Company continued to utilize indirect sales channels via partners. Business with Intershop's partners generated approximately 12% of license revenue in 2003, as against 52% in 2002. The decline in revenue generated through partners largely reflects the overall weak demand for e-commerce software as a result of reduced corporate IT spending.

In further developing its indirect sales channels, Intershop established new sales and development partnerships in 2003, including with CaContent GmbH, the Bertelsmann subsidiary Arvato Systems, the software provider Avail Intelligence, as well as Bsteel in China and Brel Software in Singapore.

Gross Profit

Gross profit generated in the fiscal year 2003 was €11.1 million, as against €26.0 million in the fiscal year 2002. Gross margin on sales for 2003 was 48%, down from 58% in the previous year. This decrease was primarily due to both the absolute and relative declines in high-margin license revenues.

The license gross margin in 2003 amounted to 92%, compared with 94% in 2002.

The Company's service gross margin (including consulting, customer support, maintenance, and other revenue) amounted to 31% in the fiscal year 2003, as against 21% in the fiscal year 2002.

This year-on-year improvement in the service gross margin was driven primarily by a better utilization of service personnel in conjunction with a reduction in the service workforce.

Expense and Income

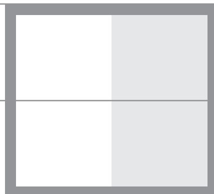
During the course of the implementation of the restructuring measures announced on January 21, 2003 and July 2, 2003, Intershop reduced its global workforce by 201 employees in the course of 2003, to 278 full-time equivalent employees as of December 31, 2003. Due to these measures and the resulting efficiency gains, Intershop reduced total operational costs (cost of revenue and operating expense) by 39%, from €73.8 million in 2002 to €45.0 million in 2003.

Headcount reductions affected all areas of the Company but were aimed at largely preserving Intershop's core technological expertise in research and development. As of December 31, 2003, Intershop employed 197 full-time equivalents in technical departments such as research and development and services, 40 full-time equivalents in sales and marketing, and 41 full-time equivalents in general and administrative functions.

As a result of implementing its cost savings measures, the Company recorded restructuring charges of €3.6 million in the fiscal year 2003, driven primarily by severance payments to former employees and facility-related consolidation charges. By comparison, the Company recorded restructuring costs of €5.3 million in the fiscal year 2002.

In line with further workforce reductions in the research and development (R&D) department, Intershop's R&D costs decreased from €7.2 million in the previous year to €6.3 million in 2003.

Due to lower revenue-dependent commission payments to sales employees, as well as an improved cost structure in the sales and marketing department, sales and marketing



expenses were further reduced in the fiscal year 2003. They decreased from €29.4 million in 2002 to €14.2 million in 2003.

Included in the Company's sales and marketing expenses for 2003 were costs for the 2003 CeBIT trade fair in Hanover, Germany, as well as for a marketing campaign to roll out Enfinity MultiSite.

Due to the Company's centralization efforts and the resulting significantly reduced infrastructure supporting its business model, general and administrative (G&A) expenses decreased from €12.8 million in the fiscal year 2002 to €9.0 million in the fiscal year 2003.

Depreciation and amortization charges amounted to €3.2 million in 2003, as against €9.1 million in the previous year. This is due primarily to lower depreciation charges for purchased customer relationship management software in the fiscal year 2003. Investments in 2003 focused on capital replacements to adequately support the Company's ongoing operations in line with reduced business activities and current restructuring measures.

Due to the significant year-on-year decline in total operational costs, Intershop reduced its operating loss from €28.7 million in 2002 to €21.8 million in 2003 despite generating lower revenues year-on-year.

The operating loss generated by the AG fell from €59.7 million in the fiscal year 2002 to €15.5 million in the fiscal year 2003. This was primarily due to lower valuation allowances at the AG.

Reflecting significant cost reductions, Intershop reduced its net loss from €27.6 million or a net loss of €1.47 per share in 2002 to €18.6 million or a net loss of €0.90 per share in 2003; this represents a fall of 32%.

Liquidity and Balance Sheet

Net cash usage related to operating activities decreased from €22.7 million in the fiscal year 2002 to €13.1 million in the fiscal year 2003, primarily driven by lower net losses from operating activities and by reduced net working capital requirements in 2003 as compared with 2002.

Investing activities generated a total of €4.9 million in 2003, largely driven by proceeds from the sale of marketable securities. In comparison, investing activities generated net cash of €15.7 million in 2002; this was also primarily due to proceeds from the sale of marketable securities. The cash generated in both periods reflects reclassifications between

the balance sheet items "cash and cash equivalents" and "marketable securities," which, together with the balance sheet item "restricted cash," represent the Company's total liquidity.

No net cash was generated by financing activities in the fiscal year 2003, compared with €10.0 million the fiscal year 2002. All of the cash generated from financing activities in 2002 related to the cash investment through a private equity placement of Intershop common bearer shares by Stephan Schambach, the co-founder of the Company, who was a Management Board member at the balance sheet date.

Cash, cash equivalents, marketable securities, and restricted cash totaled €8.8 million as of December 31, 2003, compared with €22.5 million as of December 31, 2002. Intershop is in active negotiations with a number of international financial and strategic investors in order to improve its cash position and capital resources.

Days sales outstanding (DSO) fell from 78 as of December 31, 2002 to 63 as of December 31, 2003, reflecting the improvements in receivables management achieved in the fiscal year 2003.

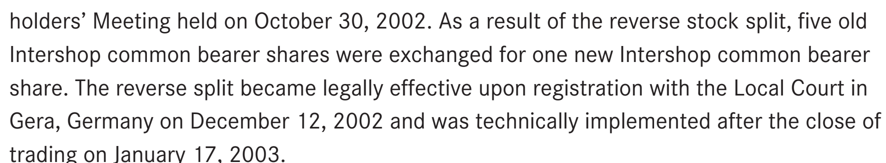
Trade receivables amounted to €3.3 million as of December 31, 2003, compared with €11.1 million as of December 31, 2002. This decrease was driven primarily by a year-on-year reduction in sales in the fiscal year 2003, as well as a lower DSO as of December 31, 2003 compared with December 31, 2002.

As of December 31, 2003, Intershop had short-term deferred revenues of €5.1 million, compared with €6.3 million as of December 31, 2002. This decrease is primarily due to lower service revenue.

Capital Structure

Effective January 1, 2003, Intershop's common bearer shares were admitted to the Prime Standard trading segment of the Frankfurt Stock Exchange. The Prime Standard trading segment, newly created at the beginning of 2003, essentially replaced the former Neuer Markt trading segment, on which Intershop's common bearer shares had previously been traded. With admission to the Prime Standard, Intershop complies with the comprehensive transparency requirements of this segment, including quarterly financial reporting, use of internationally accepted accounting standards (e.g., U.S. GAAP), publication of a financial calendar, at least one analyst conference per year, ad-hoc disclosures, and ongoing financial communication in both German and English.

On January 14, 2003, the Company announced an effective date of January 17, 2003 for the technical execution of the reverse stock split approved at the Company's Special Stock-



holders' Meeting held on October 30, 2002. As a result of the reverse stock split, five old Intershop common bearer shares were exchanged for one new Intershop common bearer share. The reverse split became legally effective upon registration with the Local Court in Gera, Germany on December 12, 2002 and was technically implemented after the close of trading on January 17, 2003.

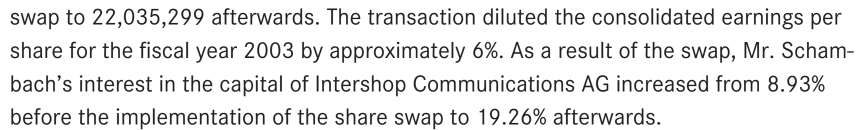
The converted Intershop common bearer shares were traded for the first time on January 20, 2003. Following the stock split, the International Securities Identification Number (ISIN) of Intershop Communications AG's common bearer shares changed from ISIN DE 0006227002 (equivalent to German Securities Identification Number – WKN – 622700) to ISIN DE 0007472920 (equivalent to German Securities Identification Number – WKN – 747292), and the ticker symbol of Intershop's common bearer shares listed in the Prime Standard segment changed from ISH to ISH1.

Subsequent to the 5:1 reverse stock split of Intershop's ordinary common bearer shares traded in Germany, a change in the ratio of Intershop's American Depositary Receipt (ADR) listed on the Nasdaq National Market to the underlying common bearer shares traded in Germany was effected on February 6, 2003. After the ratio change, 1 Intershop ADR evidenced 1 Intershop common bearer share, instead of 5 Intershop common bearer shares as previously. The ratio change did not affect the value of Intershop investors' ADR holdings.

On June 18, 2003, Intershop confirmed that the share swap announced on January 23, 2002, under which co-founder and then Management Board member Stephan Schambach exchanged his shares in subsidiary Intershop Communications, Inc. for common bearer shares in the parent Company, Intershop Communications AG, had been completed. Under the transaction, Mr. Schambach exchanged his 4,166,665 shares of Intershop Communications, Inc., the U.S. subsidiary majority-owned by Intershop Communications AG, for 2,499,999 common bearer shares of Intershop Communications AG. To this end, Intershop Communications AG issued 2,499,999 new common bearer shares from Conditional Capital III. As of December 31, 2003, no application for admission of these shares to trading at a German stock exchange had been filed.

Similarly, on June 17, 2003, Burgess Jamieson, a member of the Supervisory Board of Intershop Communications AG, exchanged his 381,500 shares of Intershop Communications, Inc. for 228,900 new common bearer shares of Intershop Communications AG on the basis of an existing exchange option. To this end, Intershop Communications AG issued 228,900 new common bearer shares from Conditional Capital III. As of December 31, 2003, no application for admission of these shares to trading at a German stock exchange had been filed.

The transaction by Mr. Schambach increased the number of issued shares of Intershop Communications AG by 12.8%, from 19,535,300 before the implementation of the share



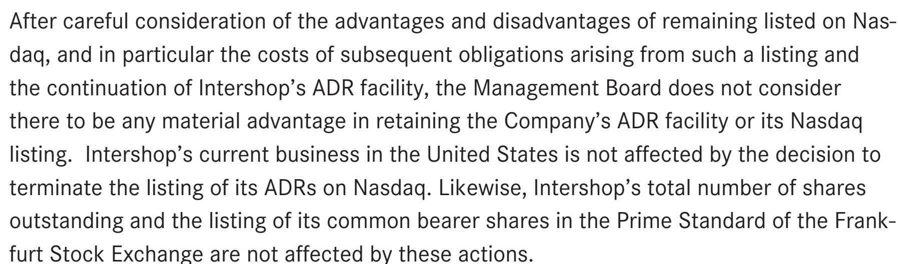
swap to 22,035,299 afterwards. The transaction diluted the consolidated earnings per share for the fiscal year 2003 by approximately 6%. As a result of the swap, Mr. Schambach's interest in the capital of Intershop Communications AG increased from 8.93% before the implementation of the share swap to 19.26% afterwards.

The share swaps by Mr. Schambach and Mr. Jamieson represent a consolidation of the shareholder structure within the Intershop Group between one of the subsidiaries and the parent Company, Intershop Communications AG. The transaction facilitates the consolidation of the ownership structure that arose following the Company's IPO in 1998. In the course of the preparations for the IPO of the newly founded Intershop Communications AG in 1998, both Mr. Schambach and Mr. Jamieson were granted the right to exchange their interests in Intershop Communications, Inc. for common bearer shares of Intershop Communications AG within a period of five years. As a result of the exchanges, Mr. Schambach's and Mr. Jamieson's entire stakes in Intershop Communications, Inc. were transferred to Intershop Communications AG, which now holds 100% of the common stock of Intershop Communications, Inc. following the completion of the transaction.

On July 24, 2003, Intershop announced that the Company was planning to merge all assets of its previously wholly-owned subsidiary Intershop Software Entwicklungs GmbH with those of Intershop Communications AG. As a result, all operating functions as well as the intellectual property rights of Intershop Software Entwicklungs GmbH were merged into Intershop Communications AG, which previously acted exclusively as the holding entity for the Intershop Group of companies. Intershop's stockholders were notified of the planned merger in the German Federal Gazette (Bundesanzeiger) on July 25, 2003 pursuant to section 62 (3) of the Umwandlungsgesetz (German Reorganization and Transformation Act). The merger of Intershop Software Entwicklungs GmbH into Intershop Communications AG was effected on October 1, 2003 by entry in the commercial register at the Local Court of Gera, Germany. Prior to this, the merger of Intershop Communications GmbH, a previously wholly-owned subsidiary of Intershop Communications, Inc., with Intershop Software Entwicklungs GmbH was effected on September 25, 2003, by entry in the commercial register at the Local Court of Gera, Germany.

In 2003, no employee stock options were exercised and exchanged for Intershop Communications AG common bearer shares.

On October 30, 2003, Intershop announced that, due to the low trading volume of Intershop American Depositary Receipts (ADRs) and the fact that the ADR facility accounted for a low proportion of the total number of outstanding shares issued by Intershop, the Management Board intended to terminate its ADR facility and the listing of its ADRs on the Nasdaq National Market in the United States and to deregister both the Intershop ADRs and the Intershop common bearer shares underlying the ADRs in accordance with the Securities Exchange Act of 1934 (the "Exchange Act").



After careful consideration of the advantages and disadvantages of remaining listed on Nasdaq, and in particular the costs of subsequent obligations arising from such a listing and the continuation of Intershop's ADR facility, the Management Board does not consider there to be any material advantage in retaining the Company's ADR facility or its Nasdaq listing. Intershop's current business in the United States is not affected by the decision to terminate the listing of its ADRs on Nasdaq. Likewise, Intershop's total number of shares outstanding and the listing of its common bearer shares in the Prime Standard of the Frankfurt Stock Exchange are not affected by these actions.

Foreign Exchange Exposure

Business transactions carried out by Intershop's various operations are denominated in their respective local currencies and are translated into the reporting currency, the euro, at the end of the period. The largest portion of Intershop's 2003 business was conducted in currencies that are part of the European Monetary Union exchange rate mechanism and are thus pegged to the euro. The Company's foreign exchange exposure was therefore limited to business transactions conducted in currencies that were not part of the European Monetary Union exchange rate mechanism, notably the U.S. dollar and the pound sterling.

Organizational Changes

On March 31, 2003, Dr. Harald Rieger was appointed to the Supervisory Board by the Local Court in Gera, Germany; Dr. Rieger stepped down from his position as a member of the Supervisory Board for personal reasons effective October 31, 2003.

On July 14, 2003, Intershop announced that, after approval by the Supervisory Board, the Company's founder Stephan Schambach had handed over the positions of Chairman of the Management Board and Chief Executive Officer (CEO) to Intershop's Chief Financial Officer (CFO), Dr. Jürgen Schöttler, with immediate effect, and that Stephan Schambach would remain a member of the Management Board with responsibility for Strategy and Product Development. The Company further announced that Dr. Schöttler would jointly perform the tasks of CEO and CFO until further notice.

On July 16, 2003, Intershop announced that, for personal reasons, Werner Fuhrmann had asked the Supervisory Board to be immediately released from his duties as a member of the Management Board. The Supervisory Board accepted Mr. Fuhrmann's decision. Since joining Intershop in July 2002, Mr. Fuhrmann had served as a Management Board member and President EMEA, in which role he was responsible for sales in the region of Europe, the Middle East, and Africa. The Company announced that, for the time being, Mr. Fuhrmann's position would not be filled and that Intershop's sales management would report directly to Dr. Jürgen Schöttler, Chairman of the Management Board.

□ Group Risks and Risks Intershop Communications AG

Various risks could prove to be a threat to the financial situation, assets, earnings, and continued existence of Intershop, including (but not limited to) the following:

Plans to continue to invest in operational activities in order to strengthen the Company's market position may have a negative effect upon profitability in the future and reduce the Company's liquidity. As of December 31, 2003, cash and cash equivalents, marketable securities, and restricted cash totaled €8.8 million. This was comprised of unrestricted cash in the amount of €2.6 million and restricted cash for lease obligations relating to the office building in Jena (Intershop Tower) in which Intershop is the main tenant, which amounted to €6.2 million. The increasingly strained financial situation in 2003 also had a negative effect on confidence among customers, partners, and employees as regards the long-term future of the Company and may also result in Intershop's customers being reluctant to place orders in the future, which would significantly impact the Company's operating activities. Although the Management Board has been actively looking for financial and strategic investors since the fiscal year 2002, no external source of finance for the Company's ongoing business and future growth has been found to date. If it is not possible to raise sufficient capital in the future, Intershop could be forced to delay, reduce, or completely discontinue operations.

The Company has developed a business plan to address its operational needs in the future. According to this plan, the Company's operating result is expected to break even in 2004 as a result of cost reductions to a level of €6.5 million per quarter and an increase in revenue to €26 million. The expected increase in revenue is based on the one hand on the assessment made by market analysts, who are predicting an increase in investments in the areas of information technology and software, and on the other on the transactions expected with existing and new customers of the Company. In addition, the forecasts for the years after 2005 assume annual revenue increases of approximately 10%, while costs are assumed to remain at current levels through 2006 and then increase in line with revenue from 2007. This expected development will lead to an increase in operating result, from expected break-even in 2004, to €2.7 million in 2005, and €4.6 million in 2006, with further growth of approximately 10% p.a. expected for subsequent years. The forecast also includes a significant contribution toward growth from the U.S. market, due on the one hand to the Company's sales expectations, and on the other to a general increase in demand. On the basis of these assumptions, the Company expects U.S. revenue growth of 48% in 2004, 30 % in 2005 and 2006, and 20% to 25% in subsequent years.

Should revenues not materialize and expenses decrease to planned levels, or additional equity financing be unavailable to the Company, management will restrict certain of the Company's planned activities and operations, as necessary, to sustain operations and conserve cash resources.

In the past three fiscal years, Intershop's business has been heavily impacted by the economic downturn, both globally and in particular in Germany, and the subsequent weakness in corporate IT spending, especially in Europe. This may adversely affect Intershop's ability to generate revenue from business with corporate customers, significantly impact operating results in the future, and substantially increase the need for additional funding.

The market for e-commerce applications is maturing and is subject to ongoing change. Even for the short term, future developments are therefore hard to predict. Accordingly, any forecasts carry a high level of uncertainty. For planning purposes, Intershop uses analyses available from market research companies as well as the information it obtains through its many contacts with other market participants. However, there is a fundamental risk that market trends may not be recognized in a timely fashion and that management may fail to gauge the demand for e-commerce solutions with regard to customer requirements correctly.

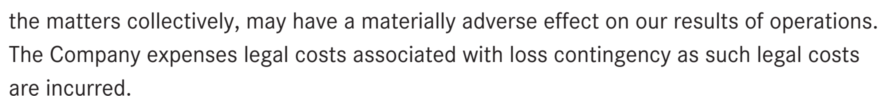
Intershop's quarterly revenue in the past has frequently included a certain number of large single deals that represented relatively large portions of overall quarterly revenue. Furthermore, the Company generated more than 16.6% and 15% of total revenue in 2003 from two individual customers. The Company's significant dependence on large single deals and single customers may in the future continue to hamper revenue forecasts and may adversely affect the Company's financial performance if certain large deals cannot be signed during a quarter.

Operating results for future periods are never entirely predictable, even in the most stable of economic times. Intershop expects to continue to experience fluctuations in its quarterly results and in its guidance, when provided, for financial performance in future periods. These fluctuations, which in the future may be significant, could cause substantial volatility in the price of Intershop's stock and could harm the Company's ability to obtain future funding.

Intershop competes directly with other providers of e-commerce technologies. In the dynamic e-commerce market, it must be assumed that new and existing providers will significantly improve their product portfolio and their sales operations. Intershop's market position could be threatened if it does not succeed in maintaining or improving its competitiveness with regard to the profile and quality of its products and services, and the manner in which they are marketed.

Intershop's success in the market is heavily dependent on the technical performance of its products. Software faults that lead to the restricted functionality or performance of existing and future products could considerably reduce the acceptance of Intershop's products.

The Company is a defendant in various legal matters arising in the normal course of business. It is possible that an adverse ruling in any such matter individually, or some or all of

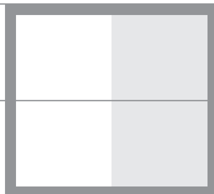


the matters collectively, may have a materially adverse effect on our results of operations. The Company expenses legal costs associated with loss contingency as such legal costs are incurred.

The Company is a defendant in a consolidated class-action lawsuit in the United States and an investigation by the German Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht, BAFin; formerly German Federal Supervisory Office for Securities Trading (Bundesaufsichtsamt für den Wertpapierhandel, BAWe)). At the beginning of 2001, several securities class-action lawsuits were filed in the U.S. against Intershop Communications AG, Management Board members, certain other officers, and the underwriters of the Company's September 2000 public offering. The plaintiffs allege that the defendants made material misrepresentations and omissions of material facts concerning the Company's business performance. The plaintiffs seek an unspecified amount of damages. The Management Board believes there is no merit to these allegations and intends to defend itself vigorously. However, there can be no assurance that the Company will prevail in the lawsuit, or that the outcome of the lawsuit will not adversely affect the Company's operations. In Germany, BAFin announced in January 2001 that it had initiated an investigation regarding a possible violation of the duty to disclose material information in connection with the release on January 2, 2001, of Intershop Communications AG's preliminary results for 2000. BAFin handed this case over to the public prosecutor in Hamburg, Germany, who initiated an investigation into complaints about stock price manipulations in May 2001. The Company is cooperating fully with these investigations and, to the best of the management's knowledge, has never previously been the subject of such investigations. The Company believes there is no merit to these allegations.

Intershop has taken extensive measures to protect the brand names it uses worldwide. Nonetheless, there is always a possibility that conflicts with third parties may arise concerning the use of individual brand names. In accordance with the prevailing standards in Europe, the programs and technologies developed by Intershop do not enjoy total patent protection. Although Intershop takes great care in protecting its intellectual property, it is impossible to rule out violation of property rights by third parties. It is also possible that third parties may take legal actions against Intershop for violation of patents or other rights. Patent disputes are widespread in the software industry, particularly in the U.S., and are often associated with significant costs for court action or out-of-court settlements. Although Intershop is convinced that it has not violated any patents, it is impossible to rule out a negative impact on Intershop's operating results due to such claims from third parties.

When choosing enterprise software, customers' decisions are partly based on a provider's reputation and profile, not just on the performance of its products. Should Intershop fail to achieve the necessary profile and desired image with its target groups, this could have a negative effect on the demand for Intershop products.



Intershop's products are also sold and implemented by IT service companies. If Intershop does not succeed in training a sufficient number of these companies in the use of its products and attracting them as partners, this could negatively impact sales of the products.

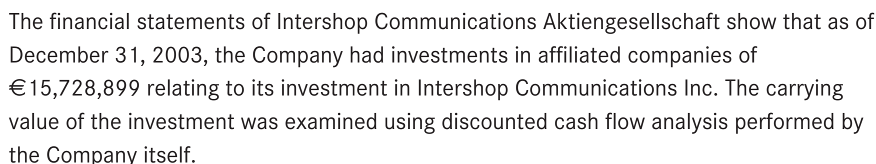
The success of Intershop's business depends substantially upon the performance of executive officers and key employees, especially in the areas of product development and sales. Failure to retain present employees and executive officers and to attract sufficient numbers of new personnel could have a negative effect upon the Company's operating results.

License revenue accounts for a significant share of Intershop's overall revenue. Under U.S. GAAP, software license revenue is recognized as such when sales agreements have been signed, the licenses have been delivered, the license fee is fixed and determinable, and payment is probable. If a sale includes services that are essential to the features and functionality of the software, revenue is recognized as such in proportion to the extent of completion of the overall project. In view of the uncertainty with respect to the length of sales and implementation cycles, which primarily depends upon Intershop customers, revenue is subject to strong variation from one quarter to the next. Given that a small number of large contracts often account for a large portion of revenue, this effect can be very substantial. Since operating costs are heavily dependent on the number of personnel employed at any one time and, therefore, cannot be varied significantly in the short term, this means that fluctuations in revenue may lead to corresponding fluctuations in operating results.

In the software industry, a large portion of license revenue is often not recorded evenly over a quarter, but rather toward the end of a quarter. This is due to the fact that, in many cases, contracts are not awarded until the last third of a quarter. Because of this, a high level of uncertainty as to whether the planned revenue target will be achieved usually remains well into the quarter.

To a certain extent, Intershop's operating and financial results are reported in local currencies that are not pegged to the euro, and are therefore translated into euros for inclusion in the Company's consolidated financial statements. Since no hedging or other arrangements have been made to guard against the risk of currency fluctuations, currency fluctuations could affect the results of operations and Intershop's earnings.

As part of the substantial restructuring measures that are being implemented within the Intershop Group, headcount was reduced further in the fiscal year 2003. As of December 31, 2003, Intershop employed 278 full-time equivalents, representing a decline of 201 full-time equivalents or 42% as against December 31, 2002. The headcount reduction in 2003, particularly in the finance department, meant a fall in the number of full-time employees responsible for both external financial reporting and internal financial planning and control. For a company that is listed simultaneously on two stock exchanges, one in Germany (Prime Standard of the Frankfurt Stock Exchange) and one in the U.S. (Nasdaq National Market), with correspondingly high transparency standards, the headcount reduction increases the risk of incomplete, inaccurate, or delayed financial reporting, both externally and internally.



The financial statements of Intershop Communications Aktiengesellschaft show that as of December 31, 2003, the Company had investments in affiliated companies of €15,728,899 relating to its investment in Intershop Communications Inc. The carrying value of the investment was examined using discounted cash flow analysis performed by the Company itself.

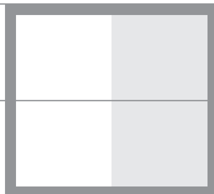
The measurement of the carrying value is based on a detailed forecast for 2004 through 2008, followed by a transition to a perpetual annuity. Based on the sales forecast of Intershop Communications Inc., revenue is expected to grow by 48% in 2004, from the very low level achieved the previous year. Revenue is expected to grow annually by 30% in 2005 and 2007, by 25% in 2007, and by 23% in 2008. Based on these assumptions the operating result of Intershop Communications Inc. will be €0.7 million in 2004, and is expected to grow further over the period covered by the forecast. The continuous growth assumption is based on general analyst expectations with regard to investment activity in the area of information technology in the US market, as well as projects expected with existing and new customers. The present value is calculated by discounting free cash flows by 15 %.

If the described expectations are not met, or if Intershop Communications Inc. cannot achieve the expected results for other reasons, the carrying value of the investment in affiliated companies would have to be written down for impairment in the financial statements of Intershop Communications Aktiengesellschaft.

Risk Management

Intershop's objective has been to exploit business opportunities worldwide in order to maximize shareholder value. Yet, along with these opportunities, Intershop has faced a number of risks that are intrinsically linked with such opportunities. Generally, risks to the Company's future development cannot be excluded completely, due to ever-changing market trends and limited planning certainty with regard to the license business. Intershop is anxious to minimize operating risks by continuously expanding its comprehensive risk management system.

At Intershop, a variety of systems and procedures are in place to monitor, analyze, and document corporate risks. Intershop's strategy to mitigate and manage risk has included a forward-looking product strategy to anticipate developments in the marketplace and future needs of customers, emphasis upon product development, and the technological performance of the Company's products. Also included in this strategy were ongoing efforts to boost the Company's profile with the relevant target groups, the formation of new business partnerships and alliances, training for third parties that market, sell, and deploy Intershop products, as well as measures to retain and recruit executive officers and key personnel, and to provide the necessary organizational infrastructure.



In the fiscal year 2003, the Company has continued to monitor market trends and the activities of its competitors on an ongoing basis and has made use of market analyses and forecasts provided by leading market research companies. Intershop has maintained a comprehensive system of project management and quality controls in the area of product development, where risk awareness plays a major role.

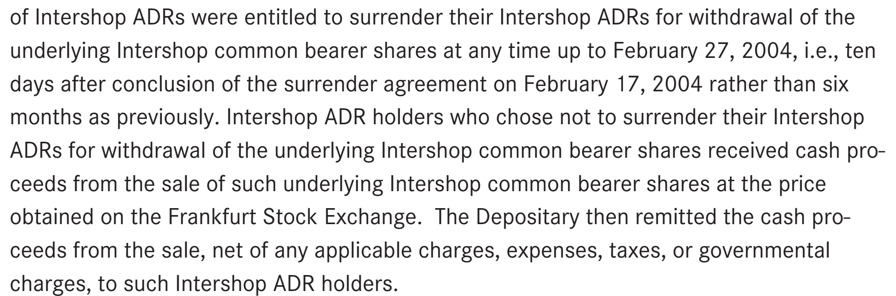
Intershop has used financial accounting, controlling, and forecasting software by SAP and Hyperion as well as customer relationship management (CRM) software by Siebel Systems to monitor and manage key corporate information worldwide. Quarterly financial statements have ensured that information on business trends has remained up-to-date. In addition to the annual budget planning process, the Company has used time-adjusted forecasts to update budgets on a continuous basis. Budgets were reviewed periodically and adjusted when necessary. Ongoing accounting and controlling activities have provided information on variances between actual and target figures.

In addition, management has regularly analyzed the Company's assets, financial position, and earnings. Frequent meetings at all hierarchy levels worldwide have ensured that there is an efficient exchange of information and a rapid decision-making process throughout the Company. The Management Board has informed the Supervisory Board at least once a quarter, but typically more often, about important corporate developments. The Supervisory Board's audit committee held meetings with the CFO and the head of accounting on a regular basis to discuss, analyze, and monitor corporate financial issues of day-to-day business operations. Intershop's internal policies on risk management and internal controls, on insider trading, and on the disclosure of material information have ensured that regulatory requirements are met, and that best management practices and the corporate governance recommendations contained in the German Corporate Governance Code were implemented.

Subsequent Events

On January 14, 2004, Intershop announced that it would voluntarily delist from the Nasdaq National Market ("Nasdaq"), and gave notice to Citibank, N.A., the depositary for Intershop's American Depositary Receipts (ADR) facility (the "Depositary"), to terminate the ADR facility effective as of the close of trading on February 17, 2004. From this date, ADRs issued by Intershop were no longer tradable on Nasdaq. Effective January 15, 2004, Intershop also terminated its F-6 registration statement with the U.S. Securities and Exchange Commission in respect of all 98,550,000 unissued ADRs in its ADR facility.

On January 27, 2004, Intershop announced that it had agreed with Citibank, N.A. to shorten the six-month period for holders of Intershop ADRs to surrender them in order to withdraw the underlying Intershop common bearer shares ("surrender period"). In accordance with the termination provision, which was amended as of January 27, 2004, holders



of Intershop ADRs were entitled to surrender their Intershop ADRs for withdrawal of the underlying Intershop common bearer shares at any time up to February 27, 2004, i.e., ten days after conclusion of the surrender agreement on February 17, 2004 rather than six months as previously. Intershop ADR holders who chose not to surrender their Intershop ADRs for withdrawal of the underlying Intershop common bearer shares received cash proceeds from the sale of such underlying Intershop common bearer shares at the price obtained on the Frankfurt Stock Exchange. The Depositary then remitted the cash proceeds from the sale, net of any applicable charges, expenses, taxes, or governmental charges, to such Intershop ADR holders.

Intershop's issued and outstanding ADRs were deregistered with the SEC by submission of Form 15.

On February 4, 2004, Intershop announced that Stephan Schambach had asked the Supervisory Board to be immediately released from his duties as a Member of the Management Board. The Supervisory Board accepted Mr. Schambach's decision. As a result, Mr. Schambach, a major shareholder of the Company with an interest in the capital stock of 19.26% at the balance sheet date, left the Company following the mutual termination of his contract of service.

On March 5, 2004 Intershop announced that the Company's Executive Board (*Vorstand*) and Supervisory Board (*Aufsichtsrat*) had decided to implement a public rights issue from authorized capital in order to raise cash and strengthen the Company's balance sheet.

As part of the subscription offer published on March 9, 2004 in the electronic *Bundesanzeiger* (Federal Gazette) and the *Frankfurter Allgemeine Zeitung (FAZ),* a German daily newspaper, the Company offered all current Intershop shareholders the opportunity to subscribe for one new Intershop common bearer share per 11.5 existing Intershop common bearer shares held at a price of €2.00 per share (indirect pre-emptive right) during the period from March 10, 2004 to March 24, 2004. To this end, Intershop issued 1,916,113 new common bearer shares from authorized capital. Any shares not subscribed by shareholders were placed with institutional investors by Munich, Germany-based VEM Aktienbank AG, the investment bank handling the transaction.

The new shares increased the total number of Intershop issued and outstanding shares by 1,916,113, from 22,035,299 before the transaction to 23,951,412 after the transaction. The capital increase took legal effect by entry in the commercial register at the Local Court of Gera, Germany on March 30, 2004. The new shares were admitted to trading on the Frankfurt Stock Exchange on April 6, 2004. The new shares were traded for the first time on April 8, 2004.

Business Outlook

In the light of the ongoing weak economic development – particularly in Germany, the primary sales market for Intershop's products – independent industry experts and Intershop itself forecast that the further increase in commercial Internet usage will be accompanied by continued reluctance on the part of companies to invest in IT.

For example, Forrester Research expects Internet usage for online commerce to continue to rise. According to a study it has published, retail sales in the United States for purchases concluded online will total around $230 billion in 2008; this represents 10% of all retail sales. The figure attributable to online sales will increase by an annual average of 19% between 2003 and 2008. In Germany, too, demand for e-business application solutions is expected to grow, particularly in the areas of purchasing, sales, and marketing, as well as customer services and maintenance.

Many industry experts believe that the forecast increase in commercial Internet usage will not be reflected in the form of increased corporate IT expenditure in the short term. Forrester Research expects IT expenditure by companies in Germany, the primary market for Intershop's products, to decrease further year-on-year in 2004 (-1%), only picking up again in 2005 (+4%). Growth in global IT expenditure is expected to be moderate. For example, the investment bank Goldman Sachs forecasts only a slight year-on-year increase in IT expenditure of 0.9%.

Apart from short- to medium-term IT spending constraints, Intershop believes that e-commerce software sales will be dominated by applications that centrally manage multiple online channels and web content. These systems focus on integrating all e-commerce processes across disparate countries, markets, business units, applications, and systems. Intershop expects that customers adopting this approach will demand IT systems that can manage and exchange data seamlessly across heterogeneous software platforms and integrate existing, often highly fragmented online commerce initiatives in order to save systems maintenance or reengineering costs. In the opinion of the Management Board, Intershop's Enfinity MultiSite software platform puts it in an excellent position to meet these market requirements, and it is focusing all of its efforts on further expanding its technology leadership in the area of e-commerce software.

On the basis of the significant reduction in total operational costs as of the end of 2003 and the slight increase in IT expenditure by companies in 2004, Intershop expects to break even in the fiscal year 2004.

Report of Independent Auditors, Group

We have issued the following audit opinion on the consolidated financial statements and the report on the situation of the Company and the Group:

“We have audited the consolidated financial statements comprising the balance sheet, statement of operations, statements of changes in shareholders’ equity and cash flows as well as the notes to the financial statements prepared by INTERSHOP Communications Aktiengesellschaft, Jena, for the fiscal year from January 1 to December 31, 2003. The preparation and content of the consolidated financial statements are the responsibility of the Company’s management board. Our responsibility is to express an opinion whether the consolidated financial statements are in accordance with United States generally accepted accounting principles (US GAAP) based on our audit.

We conducted our audit of the consolidated financial statements in accordance with German auditing regulations and generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftprüfer [in Deutschland] (IDW). Those standards require that we plan and perform the audit such that it can be assessed with reasonable assurance whether the consolidated financial statements are free of material misstatement. Knowledge of the business activities and the economic and legal environment of the Group and evaluations of possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the amounts of disclosures in the consolidated financial statements are examined on a test basis within the framework of the audit. The audit includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements give a true and fair view of the net assets, financial position, results of operations and cash flows of the Group for the fiscal year in accordance with US GAAP.

Our audit, which also extends to the report prepared by the management board on the situation of the Company and the Group for the fiscal year from January 1 to December 31, 2003, has not led to any reservations. In our opinion, the report on the situation of the Company and the Group together with the other disclosures in the consolidated financial statements accurately present the situation of the Group and the risks to future development. We confirm that the consolidated financial statements and the group management report for the fiscal year from January 1 to December 31, 2003 satisfy with the condition required for the Company’s exemption from its obligation to prepare consolidated financial statements and a group management report in accordance with German law.

Without, however, qualifying this opinion, we also refer to the explanations by the Company in the report on the situation of the Company and the Group. In section 11. 'Risks to the Group and INTERSHOP Communications AG', the Company explains the proposed measures to improve the results of operations and the cash flow and presents the assumptions which are the basis of its corporate planning. If INTERSHOP Communications Aktienge-

sellschaft is not able to implement its business plan for 2004, because, for example, these assumptions do not hold true, additional funds may become necessary to support business operations. If in such case such funds cannot be made available in time, INTERSHOP Communications Aktiengesellschaft's and the Group's ability to continue as a going concern could be jeopardized."

Eschborn/Frankfurt/M., April 19, 2004

Ernst & Young
Revisions- und Treuhandgesellschaft mbH
Wirtschaftsprüfungsgesellschaft
Steuerberatungsgesellschaft

Nendza
Wirtschaftsprüfer

Jöns
Wirtschaftsprüfer

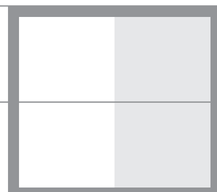
Consolidated Financial Statements

Consolidated Balance Sheets

(in thousands €, except share and per-share amounts)

As of December 31,	**2002**	**2003**
ASSETS		
Current assets		
Cash and cash equivalents	11,303	2,611
Marketable securities	4,172	-
Restricted cash	7,073	6,190
Trade receivables, net of allowances for doubtful accounts of €5,254 in 2003 and €7,511 in 2002	11,131	3,345
Prepaid expenses and other current assets	7,427	1,370
Total current assets	41,106	13,516
Property and equipment, net	4,301	1,106
Goodwill	4,473	4,473
Other assets	2,268	557
Total assets	**52,148**	**19,652**
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Current debt and current maturities of long-term debt	98	-
Accounts payable	840	249
Accrued restructuring costs	4,881	2,657
Other accrued liabilities	13,472	3,827
Deferred revenue	6,295	5,058
Total current liabilities	25,586	11,791
Long-term liabilities, net of current portion	152	-
Deferred revenue	38	23
Total liabilities	**25,776**	**11,814**
Shareholders' equity		
Common share, stated value €1–authorized: 78,567,219 shares; outstanding: 22,035,299 shares at December 31, 2003, and 19,306,400 shares at December 31, 2002, respectively	19,306	22,035
Additional paid-in capital	-	-
Accumulated deficit/ retained earnings	4,124	-17,245
Accumulated other comprehensive income	2,942	3,048
Total shareholders' equity	**26,372**	**7,838**
Total liabilities and shareholders' equity	**52,148**	**19,652**

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



Consolidated Statements of Operations

(In thousands €, except per-share amounts)

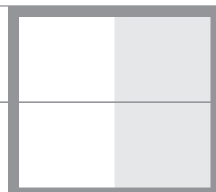
For the year ended December 31,	2001	2002	2003
Revenues			
Licenses	20,480	22,462	6,505
Services, maintenance, and other	48,174	22,635	16,654
Total revenues	**68,654**	**45,097**	**23,159**
Cost of revenues			
Licenses	2,338	1,288	523
Services, maintenance, and other	41,433	17,814	11,522
Total costs of revenues	**43,771**	**19,102**	**12,045**
Gross profit	**24,883**	**25,995**	**11,114**
Operating expenses			
Research and development	15,179	7,225	6,260
Sales and marketing	60,766	29,363	14,181
General and administrative	38,108	12,760	8,942
Goodwill and acquired intangible asset amortization	21,091	-	-
Restructuring costs and asset impairment	23,276	5,326	3,576
Total operating expenses	**158,420**	**54,674**	**32,959**
Operating loss	**(133,537)**	**(28,679)**	**(21,845)**
Other income (expense)			
Interest income	3,759	651	609
Interest expense	(76)	(31)	(374)
Write-down of investments	(2,482)	-	-
Other income	538	504	2,970
Total other income	**1,739**	**1,124**	**3,205**
Net loss	**(131,798)**	**(27,555)**	**(18,640)**
Basic and diluted loss per share	**(7.48)**	**(1.47)**	**(0.90)**
Shares used in computing			
For basic and diluted loss per share	17,627	18,731	20,749

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

Consolidated Statements of Cash Flows

For the year ended December 31 (in thousands €)	2001	2002	2003
CASH FLOWS FROM OPERATING ACTIVITIES			
Net loss	(131,798)	(27,555)	(18,640)
Adjustments to reconcile net loss to cash used in operating activities			
Depreciation and amortization	14,146	9,115	3,181
Amortization of goodwill	21,091	-	-
Write-down of investments	2,482	-	-
Non-cash income from deconsolidation	-	-	(2,521)
Provision for doubtful accounts	13,712	(4,686)	(1,614)
(Gain) loss on disposal of marketable securities	(1,552)	152	(40)
(Gain) loss on disposal of property and equipment	137	689	(114)
Changes in operating assets and liabilities			
Accounts receivable	12,446	4,809	8,751
Prepaid expenses and other current assets	(4,050)	2,497	5,772
Other assets	(738)	1,104	1,599
Accounts payable	(6,946)	(2,643)	(483)
Deferred revenue	(1,383)	818	(504)
Accrued restructuring costs	10,653	(5,773)	(1,455)
Accrued expenses and other liabilities	824	(1,270)	(7,033)
Net cash used in operating activities	**(70,976)**	**(22,743)**	**(13,101)**
CASH FLOWS FROM INVESTING ACTIVITIES			
Restricted cash	(7,705)	800	882
Proceeds on disposal of equipment	456	536	286
Purchases of property and equipment, net of capital leases	(5,731)	(670)	(368)
Proceeds from sales of marketable securities	92,605	47,541	8,294
Purchases of marketable securities	(83,875)	(32,498)	(4,162)
Net cash (used in) provided by investing activities	**(4,250)**	**15,709**	**4,932**
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from sale of common shares	519	10,005	-
Repayment of indebtedness	-	-	-250
Net cash provided by investing activities	**519**	**10,005**	**-250**
Effect of change in exchange rates on cash	(248)	(775)	(273)
Net change in cash and cash equivalents	(74,955)	2,196	(8,692)
Cash and cash equivalents, beginning of period	**84,062**	**9,107**	**11,303**
Cash and cash equivalents, end of period	**9,107**	**11,303**	**2,611**
Supplemental cash flow information			
Interest paid	**17**	**31**	**374**
Taxes paid	**30**	**93**	**136**

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

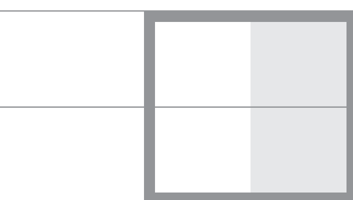


Consolidated Statement of Shareholders' Equity

(in thousands €, except share data)

	Common Shares	Common Shares Stated Value
Balance, January 1, 2001	**88,003,016**	**88,003**
Other comprehensive loss:		
Net loss		
Foreign currency translation adjustments		
Unrealized gain (loss) on available-for-sale security, net		
Comprehensive loss		
Exercise of stock options	188,306	188
Appropriation of additional paid-in capital		
Balance, December 31, 2001	**88,191,322**	**88,191**
Other comprehensive loss:		
Net loss		
Foreign currency translation adjustments		
Unrealized gain (loss) on available–sale security, net		
Comprehensive loss		
Exercise of stock options	6,678	7
Private placement of common stock, net	8,334,000	8,334
Allocation of par value resulting from reverse stock split	(77,225,600)	(77,226)
Appropriation of additional paid-in capital		
Balance, December 31, 2002	**19,306,400**	**19,306**
Other comprehensive loss:		
Net loss		
Foreign currency translation adjustments		
Unrealized gain (loss) on available-for-sale security, net		
Comprehensive loss		
Conversion of common stock of subsidiary to common stock of parent, net of share amounts not converted	2,499,999	2,500
Conversion of preferred stock of subsidiary to common stock of parent, net of share amounts not converted	228,900	229
Balance, December 31, 2003	**22,035,299**	**22,035**

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



	Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Compre-hensive Income	Total Shareholders' Equity
	168,585	**(84,329)**	**1,709**	**173,969**
		(131,798)		(131,798)
			837	837
			348	348
				(130,613)
	330			518
	(155,495)	155,495		
	13,420	**(60,632)**	**2,894**	**43,874**
		(27,555)		(27,555)
			157	157
			(109)	(109)
				(27,507)
	(3)			4
	1,667			10,001
	77,226			
	(92,310)	92,310		
	0	**4,124**	**2,942**	**26,372**
		(18,640)		(18,640)
			(83)	(83)
			189	189
				(18,534)
	-	(2,500)		
	-	(229)		
	0	**(17,245)**	**3,048**	**7,838**

Notes to the Consolidated Financial Statements

Organization and Operations of the Company

The Company

Intershop (Intershop Communications AG together with its subsidiaries and predecessors; hereinafter referred to as the “Company,” “Intershop,” or the “Group”) is a provider of standardized, end-to-end e-commerce software for enterprise clients. The Company’s products offer basic e-commerce functionality and state-of-the-art features such as intelligent merchandising, electronic workflow management, and channel integration systems. Intershop’s core Enfinity technology is designed to support a large number of online commerce models: industry-specific business models for the automobile industry (Automotive), for the high-tech sector and manufacturing industry (High-Tech and Manufacturing), and for trade (Retail), as well as cross-industry solutions for business-to-business models (B2B), business-to-consumer models (B2C), online procurement solutions (Online Procurement), and centralized content management systems (Content Management). Intershop's software easily integrates into a company's existing infrastructures, enabling seamless transactions between suppliers, distributors, and customers along the value chain.

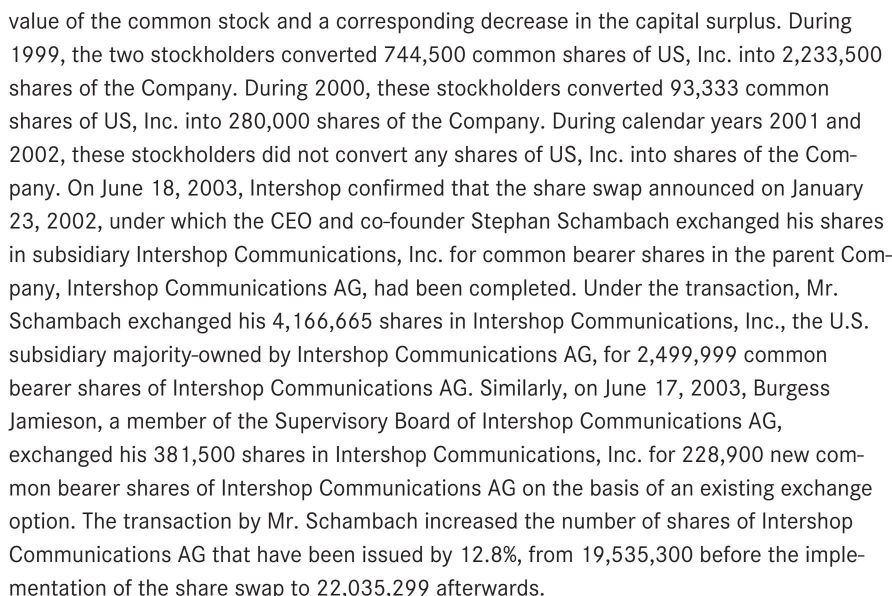
Alongside these specific e-commerce solutions, Intershop also offers Enfinity MultiSite, its latest platform based on Enfinity technology. Enfinity MultiSite enables enterprises to deploy and centrally manage multiple online commerce initiatives across different business units from a single platform, thus minimizing the implementation and operating costs of e-commerce solutions. Enfinity MultiSite allows enterprises to pursue a Unified Commerce Management (UCM) strategy, with which they can centrally manage multiple online channels and web content simultaneously. These systems focus on integrating all e-commerce processes across disparate countries, markets, business units, applications, and systems.

The Company also offers its customers support, professional consulting services, and education services in relation to its software products.

Share swap agreement

In December 1996, Intershop Communications, Inc. (“US, Inc.”) entered into a share swap agreement with Intershop Communications GmbH (“GmbH”) to acquire 100% of GmbH's outstanding shares. The shareholders of GmbH's common shares received common shares in US, Inc. Holders of existing debt (approximately €1.1 million) and capital (approximately €200,000) in GmbH – approximately €1.4 million in total – received 6,720,000 shares of preferred stock in US, Inc. The fair value of the preferred stock issued was equal to the carrying amount of the debt and capital for which it was exchanged. The share swap did not alter the relative ownership interest of the parent company. Upon completion of the transaction, US, Inc. became the parent company of GmbH and its subsidiaries.

On June 23, 1998, the holders of 79.26% of the shareholders’ equity of US, Inc. exchanged their shares of preferred and common stock of US, Inc. (20,591,348 in total) for 61,729,050 shares of the Company. As a result of this transaction, US, Inc. became a majority-owned subsidiary of the Company. Conversions of US, Inc. shares into AG shares subsequent to the initial conversion in June 1998 are treated as an increase in the stated



value of the common stock and a corresponding decrease in the capital surplus. During 1999, the two stockholders converted 744,500 common shares of US, Inc. into 2,233,500 shares of the Company. During 2000, these stockholders converted 93,333 common shares of US, Inc. into 280,000 shares of the Company. During calendar years 2001 and 2002, these stockholders did not convert any shares of US, Inc. into shares of the Company. On June 18, 2003, Intershop confirmed that the share swap announced on January 23, 2002, under which the CEO and co-founder Stephan Schambach exchanged his shares in subsidiary Intershop Communications, Inc. for common bearer shares in the parent Company, Intershop Communications AG, had been completed. Under the transaction, Mr. Schambach exchanged his 4,166,665 shares in Intershop Communications, Inc., the U.S. subsidiary majority-owned by Intershop Communications AG, for 2,499,999 common bearer shares of Intershop Communications AG. Similarly, on June 17, 2003, Burgess Jamieson, a member of the Supervisory Board of Intershop Communications AG, exchanged his 381,500 shares in Intershop Communications, Inc. for 228,900 new common bearer shares of Intershop Communications AG on the basis of an existing exchange option. The transaction by Mr. Schambach increased the number of shares of Intershop Communications AG that have been issued by 12.8%, from 19,535,300 before the implementation of the share swap to 22,035,299 afterwards.

Going Concern

As of December 31, 2003, the Company had cash and cash equivalents (including restricted cash) of EUR 8.8 million, compared with EUR 22.5 million as of December 31, 2002. The Company has incurred significant operating losses since inception, and had an accumulated deficit of EUR 266.4 million (prior to the appropriation of the additional paid-in capital of EUR 247.8 million) as of December 31, 2002. The Company does not expect to achieve sufficient revenues to support future operations without additional financing. These conditions raise substantial doubt about the Company's ability to continue as a going concern. The financial statements have been prepared assuming that the Company will continue as a going concern and, accordingly, do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of this uncertainty.

The Company has developed a business plan to address its operational needs in the future. This plan includes further headcount and other cost reductions, and obtaining additional future financing. Management believes that its business plan is appropriate for the Company to secure adequate financing until the Company is operating profitably. Management also believes additional financing and current operations will be sufficient to allow the Company to continue as a going concern at least through 2004. Should revenues not materialize and expenses decrease to planned levels, or additional equity financing be unavailable to the Company, management will restrict certain of the Company's planned activities and operations, as necessary, to sustain operations and conserve cash resources.

Summary of Significant Accounting Policies

The accompanying financial statements reflect the application of certain significant accounting policies as described in this note and elsewhere in the accompanying notes.

Principles of Consolidation
The consolidated financial statements reflect the consolidated results of the Company and its wholly- and majority-owned subsidiaries, and have been prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP"). All significant intercompany transactions and balances between the consolidated companies have been eliminated.

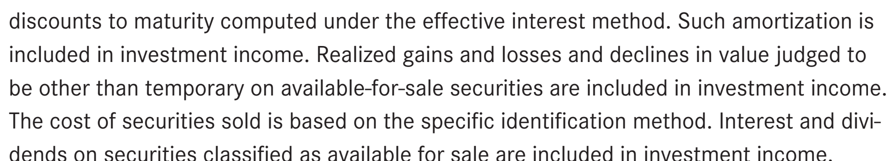
Use of Estimates
The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results may differ from these estimates.

Foreign Currency Translation
The functional currency for the Company and its subsidiaries is the local currency of the country in which the subsidiary is located. In accordance with Statement of Financial Accounting Standards ("SFAS") No. 52, "Foreign Currency Translation," assets and liabilities of operations outside euro-denominated countries are translated into euros using exchange rates at the end of each reporting period. Revenues and expenses are translated at the average exchange rates prevailing during the period. Cumulative translation gains and losses are reported in accumulated other comprehensive income as a separate component of shareholders' equity.

Transactions in foreign currencies are translated at the exchange rate in effect at the date of each transaction. Differences in exchange rates during the period between the date a transaction denominated in a foreign currency is consummated and the date at which it is either settled or translated are recognized in the statement of operations and are shown in "other income (expense), net." Currency gains and losses were €(241,460) in 2001, €59,073 in 2002 and € 51,025 in 2003.

Cash Equivalents
The Company considers all investments with original maturities of 90 days or less to be cash equivalents.

Marketable Securities
In accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," the Company classifies its investments in readily marketable debt and equity securities as available-for-sale securities. Available-for-sale securities are carried at fair value, with the unrealized gains and losses, net of tax, reported in accumulated other comprehensive income as a separate component of shareholders' equity. The amortized cost of debt securities in this category is adjusted for amortization of premiums and accretion of



discounts to maturity computed under the effective interest method. Such amortization is included in investment income. Realized gains and losses and declines in value judged to be other than temporary on available-for-sale securities are included in investment income. The cost of securities sold is based on the specific identification method. Interest and dividends on securities classified as available for sale are included in investment income.

Investments

Investments without readily available market value, which contain less than a twenty percent ownership and where the Company cannot exercise significant influence, are accounted for under the cost method. Declines in value judged to be other than temporary on investments are included in investment income.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of accounts receivable. The Company performs ongoing credit checks on its customers and the risk with respect to trade receivables is further mitigated by the fact that the Company's customer base is diversified. Beyond this, the Company does not require collaterals from its customers.

In 2003, customer A accounted for 16.6% of total revenue and was responsible for 13.6% of trade receivables. Customer B accounted for 15% of total revenue and was responsible for 13.8% of trade receivables as of December 31, 2003. In 2002, customer A accounted for 23.4% of total revenue and was responsible for 14.3% of trade receivables as of December 31, 2002. In 2001, no single customer accounted for 10% or more of total revenue.

Fair Value of Financial Instruments

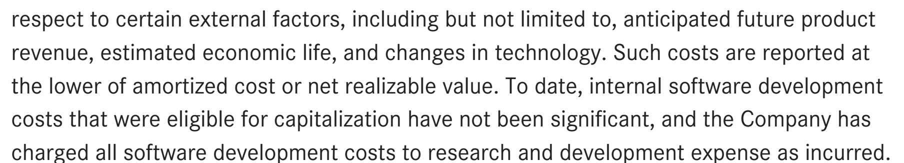
The carrying amounts of the Company's financial instruments, including cash, and cash equivalents, restricted cash, accounts receivable, and accounts payable, approximate their fair values. Marketable securities designated as available for sale are recorded at market value.

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 ranging from three to five years. Leasehold improvements are amortized on a straight-line basis over the shorter of the lease terms or their estimated useful lives.

Software Development Costs

The Company accounts for internally generated software development costs in accordance with SFAS No. 86, “Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed.” Capitalization of software development costs begins upon the establishment of technological feasibility of the product, which the Company defines as the development of a working model and further defines as the completion of beta testing of the software. The establishment of technological feasibility and the ongoing assessment of the recoverability of these costs requires considerable judgment by management with



respect to certain external factors, including but not limited to, anticipated future product revenue, estimated economic life, and changes in technology. Such costs are reported at the lower of amortized cost or net realizable value. To date, internal software development costs that were eligible for capitalization have not been significant, and the Company has charged all software development costs to research and development expense as incurred.

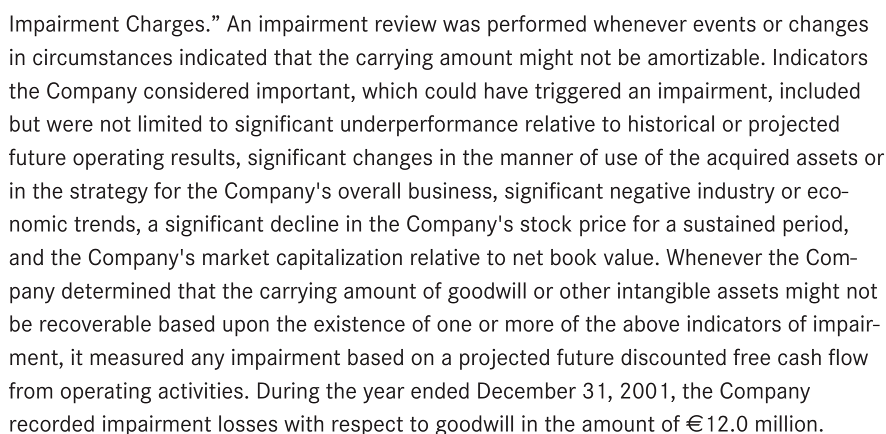
The Company expenses all research and development costs as incurred.

Long-Lived Assets
Prior to 2002, the Company periodically evaluated the recoverability of the carrying amounts of its long-lived assets and any attributable goodwill in accordance with SFAS No. 121, “Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of.” Whenever events or changes in circumstances indicated that the carrying amounts of such assets may have not be recoverable, the Company compared estimated future undiscounted free cash flows from operating activities for these assets to their carrying amounts. When these undiscounted cash flows were less than the carrying amounts of the assets, the Company would record impairment losses to write the asset down to fair value, as measured by the discounted estimated net future cash flows expected to be generated from the assets.

In August 2001, the FASB issued SFAS No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets.” SFAS No. 144 establishes a single accounting model for long-lived assets to be disposed of by sale consistent with the fundamental provisions of SFAS No. 121. While it supersedes portions of APB Opinion 30, “Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions,” it retains the discontinued operations presentation, yet it broadens that presentation to include a component of an entity (rather than a segment of a business). However, discontinued operations are no longer recorded at net realizable value and future operating losses are no longer recognized before they occur. Under SFAS No. 144, it is no longer necessary to allocate goodwill to long-lived assets and then perform impairment testing. Furthermore, it has been stipulated that in situations where it is expected that certain flows of capital will be accumulated in areas subject to impairment testing, these can be calculated on the basis of a probability-weighted cash flow estimate. SFAS No. 144 also establishes criteria for determining when an asset should be treated as held for sale.

SFAS No. 144 was effective for the fiscal years beginning after December 15, 2001. Accordingly, the Company adopted SFAS No. 144 as of January 1, 2002. The adoption of SFAS No. 144 did not have a material impact on the Company’s financial position, results of operations, or cash flows.

Goodwill
Until December 31, 2001, the Company periodically assessed the impairment of enterprise level goodwill in accordance with the provisions of Accounting Principles Board Opinion No. 17, “Intangible Assets,” and Staff Accounting Bulletin No. 100, “Restructuring and



Impairment Charges." An impairment review was performed whenever events or changes in circumstances indicated that the carrying amount might not be amortizable. Indicators the Company considered important, which could have triggered an impairment, included but were not limited to significant underperformance relative to historical or projected future operating results, significant changes in the manner of use of the acquired assets or in the strategy for the Company's overall business, significant negative industry or economic trends, a significant decline in the Company's stock price for a sustained period, and the Company's market capitalization relative to net book value. Whenever the Company determined that the carrying amount of goodwill or other intangible assets might not be recoverable based upon the existence of one or more of the above indicators of impairment, it measured any impairment based on a projected future discounted free cash flow from operating activities. During the year ended December 31, 2001, the Company recorded impairment losses with respect to goodwill in the amount of €12.0 million.

Since the beginning of 2002, the Company has adopted the accounting standard SFAS No. 142, "Goodwill and Other Intangible Assets," which was published in June 2001. Under SFAS No. 142, goodwill will no longer be amortized but will be tested for impairment on an annual basis and whenever indicators of impairment arise. The Company identified indicators of impairment under SFAS No. 142 to be the same as under SAB No. 100, as listed previously. The goodwill impairment test, which is based on fair value, is to be performed on a reporting unit level. A reporting unit is defined by SFAS No. 131 as an operating segment or one level lower. The Company markets its products and services in one segment and thus allocates goodwill to one reporting unit. Therefore, impairment is tested at the enterprise level using the Company's market capitalization as fair value. Goodwill will no longer be allocated to other long-lived assets for impairment testing in accordance with SFAS No. 121.

Derivatives
Since January 1, 2001, the Company has applied SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," which establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts or used in hedging activities. All derivatives, whether designated in hedging relationships or not, are required to be recorded on the balance sheet at fair value. If the derivative is designated as a fair value hedge, the changes in fair value of the derivative and of the hedged item attributable to the hedged risk are recognized in earnings. If the derivative is designated as a cash flow hedge, the effective portions of changes in the fair value of the derivative are recorded in accumulated other comprehensive income and are recognized in the income statement when the hedged item affects earnings.

Advertising Costs
Advertising costs are expensed as incurred. Advertising expenses of €3.2 million, €0.5 million, and €0.3 million were included in sales and marketing expenses for 2001, 2002, and 2003, respectively.

Stock-Based Compensation

The Financial Accounting Standards Board ("FASB") issued SFAS No. 123, "Accounting for Stock-Based Compensation," in October 1995. This accounting standard permits the use of either a fair value based method of accounting or the method defined in Accounting Principles Board Opinion 25, "Accounting for Stock Issued to Employees" ("APB 25"), to account for stock-based compensation arrangements. The Company has elected to continue to account for its stock-based compensation arrangements under the provisions of APB 25, and, accordingly, has included in Note 12 the pro forma disclosures required under SFAS No. 123. If compensation cost for the Plan had been determined based on the fair value at the grant dates for the awards calculated in accordance with the method prescribed by SFAS No. 123, the impact on the Company's net loss and net loss per share would have been as follows (in thousands of €, except per-share amounts):

Year ended December 31,	2001	2002	2003
Net loss attributable to common shareholders			
As reported	(131,798)	(27,555)	(18,640)
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(55,751)	(11,271)	(259)
Pro forma	(187,549)	(38,826)	(18,899)
Basic and diluted loss per share			
As reported	(7.48)	(1.47)	(0.90)
Pro forma	(10.64)	(2.07)	(0.91)

The following assumptions have been made to estimate the fair value of the options:

	2001	2002	2003
Risk-free interest on the date of grant	4.5%	4.0%	3.0%
Assumed dividend	0%	0%	0%
Volatility	115%	92%	107%
Expected option lives (in years)	4.1	4.1	3.7

Revenue Recognition

Intershop derives revenues from two primary sources: (1) software license revenues and (2) services revenues, which include maintenance, consulting, and education. While the basis for software license revenue recognition is substantially governed by the provisions of Statement of Position No. 97-2, "Software Revenue Recognition," as amended by SOP 98-4 and SOP 98-9 and related Interpretations (collectively, "SOP 97-2") issued by the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants, the Company exercises judgment and uses estimates in connection with the determination of the amount of software license and services revenues to be recognized in each accounting period.

For software license arrangements that do not require significant modification or customization of the underlying software, the Company recognizes revenue when: (1) it enters into a legally binding arrangement with a customer for the license of software; (2) it deliv-

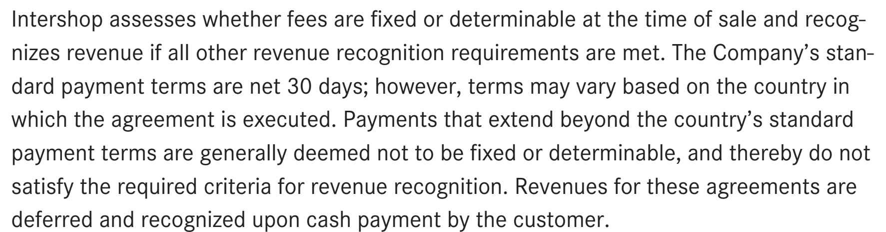
ers the products or performs the services; (3) customer payment is deemed fixed or determinable and free of contingencies or significant uncertainties; and, (4) collection is probable. Substantially, all of the Company's license revenues are recognized in this manner.

Some of the Company's software arrangements include implementation services sold separately under consulting engagement contracts. Revenues from these arrangements are generally accounted for separately from the license revenue because the arrangements qualify as "service transactions," as defined in SOP 97-2. The more significant factors considered in determining whether the revenue should be accounted for separately include the nature of services (i.e., consideration of whether the services are essential to the functionality of the licensed product), degree of risk, availability of services from other vendors, timing of payments, and impact of milestones or acceptance criteria on the realizability of the software license fee.

If an arrangement does not qualify for separate accounting of the license and service transactions, then license revenue is generally recognized together with the consulting services based on contract accounting using either the percentage-of-completion or completed-contract method as described below. Contract accounting is also applied to any arrangements: (1) that include milestones or customer-specific acceptance criteria, which may affect collection of the license fees; (2) where services include significant modification or customization of the software; (3) where significant consulting services are provided for in the contract without additional charges; or, (4) where the license payment is tied to the performance of consulting services.

For arrangements with multiple elements, the Company allocates revenue to each element of a transaction based upon its fair value as determined in reliance on "vendor-specific objective evidence" (VSOE). Vendor-specific objective evidence of fair value for all elements of an arrangement is based upon the normal pricing and discounting practices for those products and services when sold separately and, for support services, is additionally measured by the renewal rate. If the Company cannot objectively determine the fair value of any undelivered element included in bundled software and service arrangements, it defers revenue until all elements are delivered, services have been performed, or until fair value can objectively be determined. When VSOE of a license or other delivered element has not been established, the Company uses the residual method to record license revenue if VSOE of all undelivered elements is determinable. Under the residual method, VSOE of the undelivered elements is deferred and the remaining portion of the arrangement fee is allocated to the delivered elements and is recognized as revenue.

Intershop's license arrangements generally do not include acceptance provisions. However, if acceptance provisions exist within previously executed terms and conditions that are referenced in the current agreement, the Company then applies judgment in assessing the significance of the provision. If the Company determines that the likelihood of non-acceptance of these arrangements is remote, it then recognizes revenue once all of the criteria described above have been met. If such a determination cannot be made, revenue is recognized upon the earlier of receipt of written customer acceptance or expiration of the acceptance period.



Intershop assesses whether fees are fixed or determinable at the time of sale and recognizes revenue if all other revenue recognition requirements are met. The Company's standard payment terms are net 30 days; however, terms may vary based on the country in which the agreement is executed. Payments that extend beyond the country's standard payment terms are generally deemed not to be fixed or determinable, and thereby do not satisfy the required criteria for revenue recognition. Revenues for these agreements are deferred and recognized upon cash payment by the customer.

Revenue for consulting services is generally recognized as the services are performed. If there is a significant uncertainty about the project completion or receipt of payment for the consulting services, revenue is deferred until the uncertainty is sufficiently resolved.

The Company estimates the percentage of completion on contracts with fixed or "not to exceed" fees on a monthly basis, utilizing hours incurred to date as a percentage of total estimated hours to complete the project. If Intershop does not have a sufficient basis to measure progress towards completion, revenue is recognized when the Company receives final acceptance from the customer. When total cost estimates exceed revenues, Intershop accrues for the estimated losses immediately based upon an average fully burdened daily rate applicable to the consulting organization delivering the services.

The complexity of the estimation process and issues related to the assumptions, risks, and uncertainties inherent in the application of the percentage-of-completion method of accounting affect the amounts of revenues and related expenses reported in the Company's consolidated financial statements. A number of internal and external factors can affect Intershop's estimates, including labor rates, utilization and efficiency variances, and specification and testing requirement changes.

Allowances for Doubtful Accounts

The Company makes judgments as to its ability to collect outstanding receivables and provide allowances for the portion of receivables when collection becomes doubtful. Provisions are made based upon a specific review of all significant outstanding invoices. For those invoices not specifically reviewed, provisions are provided at differing rates, based upon the age of the receivable. In determining these percentages, Intershop analyzes its historical collection experience and current economic trends. If the historical data the Company uses to calculate the allowance provided for doubtful accounts does not reflect the future ability to collect outstanding receivables, additional provisions for doubtful accounts may be needed and the future results of operations could be materially affected.

Segment Reporting

The Company's primary line of business is the production and marketing of e-commerce software that enables customers to automate and simplify their purchasing and sales processes, and to consolidate and manage all their sales and procurement channels from a central platform. Accordingly, the Company does not disclose significant additional segment information as defined by SFAS No. 131.

Comprehensive Income

The Company accounts for comprehensive income in accordance with SFAS No. 130, "Reporting Comprehensive Income." Comprehensive income is the total of net income and all other changes in shareholders' equity that are not connected with changes at shareholder level.

Accumulated other comprehensive income consists of the following (in thousands of €):

At December 31,	2002	2003
Foreign currency translation gains	3,132	3,048
Unrealized gain (loss) on available-for-sale securities	(190)	-
Accumulated other comprehensive income	**2,942**	**3,048**

Income Taxes

The Company uses the asset and liability method in accounting for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes." Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws which will be in effect when the differences are expected to reverse.

Earnings Per Share

The basic net loss per common share is presented in conformity with SFAS No. 128, "Earnings Per Shares" for all periods presented. Basic net loss per share is computed using the weighted-average number of vested outstanding shares of common stock.

The diluted net loss per share is computed using the weighted-average number of vested shares of common stock outstanding and, in the case of dilution, the unvested common stock outstanding and the potential number of common shares from options and warrants to purchase common stock using the treasury stock method. In the case of convertible securities the "if-converted method" is used. The options exercised that result in shares subject to repurchase have been excluded in computing the number of weighted-average shares outstanding for basic earnings per share purposes. All potential common shares have been excluded from the computation of the diluted net loss per share for 2001, 2002, and 2003 because the effect would be antidilutive.

The following table provides a reconciliation of the numerators and denominators used in calculating basic and diluted earnings per share for the three years ended December 31 respectively (in thousands of €, except per-share data):

Year ended December 31,	2001	2002	2003
Net loss	(131,798)	(27,555)	(18,640)
Basic and diluted net loss per share:			
Weighted-average common shares outstanding	17,627	18,731	20,749
Basic and diluted net loss per share	**(7.48)**	**(1.47)**	**(0.90)**

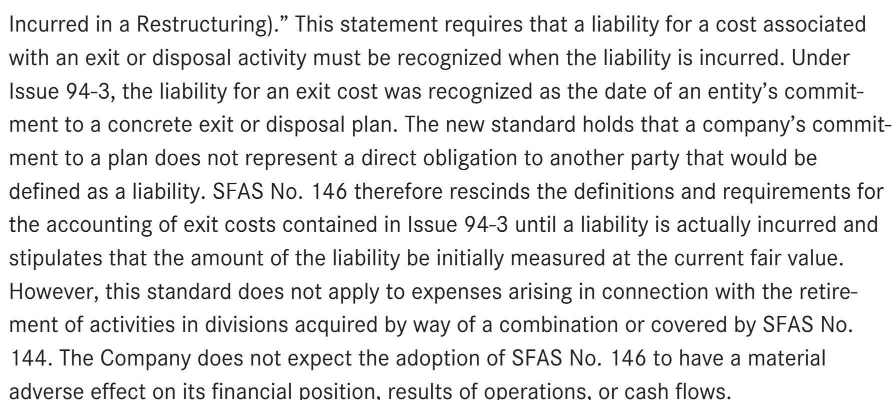
Due to the share swap involving shares of US, Inc. and the AG detailed in Note 1, the weighted-average number of common shares increased by 1,442,325 in the year under review.

The net loss per share for the year ended December 31, 2001 has been adjusted to reflect the Company's 5:1 reverse stock split during 2002. Share amounts in the consolidated statement of changes of shareholders' equity for the year ended December 31, 2001 have not been adjusted to reflect this reverse stock split.

Recent Accounting Pronouncements
In June 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 requires companies to record an appropriate charge in connection with the retirement or disposal of property and equipment in the period in which this took place, provided that the fair value can be reasonably determined. The costs incurred in the retirement or disposal of assets are netted against the carrying amount of the long-lived assets. Companies will calculate the changes over time in the amount of the anticipated expenses to be incurred for the retirement or disposal of an asset by discounting the amount calculated at the beginning of the period. The interest rate used in the calculation of this change corresponds to the risk-adjusted rate to be fixed in accordance with the company's credit rating the first time the expenses are recognized. The carrying amount of the related property and equipment increases by the amount calculated, which is then written down over the objects' remaining useful lives and recorded as operating expenses in the income statement. SFAS No. 143 is effective for the fiscal years beginning after June 15, 2002. The adoption of SFAS No. 143 did not have a material effect on it´s the Company´s financial position, results of operations, or cash flows.

In April 2002, the FASB issued SFAS No. 145 "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections." Effective for fiscal year 2003, under SFAS No. 145, gains and losses on extinguishments of debt will be required to be classified as income or loss from continuing operations rather than as extraordinary items as previously required under Statement 4. Extraordinary treatment will be required for certain extinguishments as provided in APB Opinion No. 30. All other provisions for SFSA No. 145 became effective for transactions occurring after May 15, 2002. Statement 145 also amends Statement 13 to require certain modifications to capital leases be treated as a sale-leaseback and modifies the accounting for sub-leases when the original lessee remains a secondary obligor (or guarantor). In addition, the FASB rescinded Statement 44, which addressed the accounting for intangible assets of motor carriers and made numerous technical corrections. The adoption of SFAS No. 145 did not have a material impact on the Company's Group's financial position, results of operations or cash flows.

In June 2002, the FASB published SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." This statement addresses financial accounting and reporting for costs associated with exit or disposal activities and supersedes the preliminary provisions of the Emerging Issues Task Force (EITF) Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs

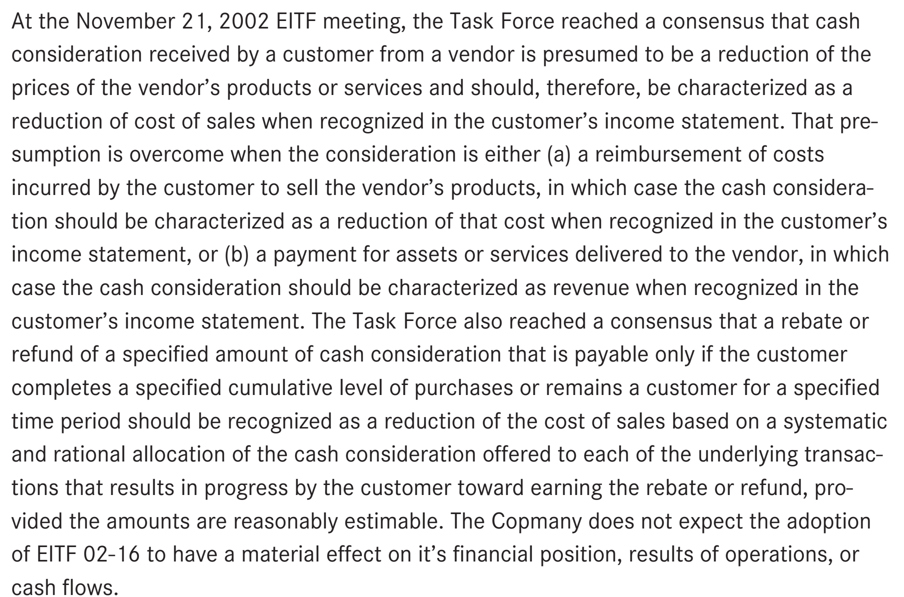


Incurred in a Restructuring).” This statement requires that a liability for a cost associated with an exit or disposal activity must be recognized when the liability is incurred. Under Issue 94-3, the liability for an exit cost was recognized as the date of an entity’s commitment to a concrete exit or disposal plan. The new standard holds that a company’s commitment to a plan does not represent a direct obligation to another party that would be defined as a liability. SFAS No. 146 therefore rescinds the definitions and requirements for the accounting of exit costs contained in Issue 94-3 until a liability is actually incurred and stipulates that the amount of the liability be initially measured at the current fair value. However, this standard does not apply to expenses arising in connection with the retirement of activities in divisions acquired by way of a combination or covered by SFAS No. 144. The Company does not expect the adoption of SFAS No. 146 to have a material adverse effect on its financial position, results of operations, or cash flows.

In May 2003, the FASB published SFAS No. 150 “Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity”. The Standard describes how the issuer classifies and measures such financial instruments. The financial instruments that are within the scope of this Standard must therefore be classified as liabilities (or assets in some circumstances) because these financial instruments embody an obligation of the issuer. SFAS No. 150 is effective for financial instruments issued or modified after March 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of SFAS No. 150 did not have any material effect on the Company’s financial position, results of operations, or cash flows.

In November 2002, the FASB issued FASB Interpretation No. 45 (“FIN 45”), “Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others.” FIN 45 requires a guarantor to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken by it in issuing the guarantee. It also expands the disclosure requirements in the financial statements of the guarantor with respect to its obligations under certain guarantees that it has issued. The Company is required to adopt the initial recognition and initial measurement accounting provisions of this interpretation on a prospective basis to guarantees issued or modified after December 31, 2002. The Company does not anticipate the adoption to have a material effect on the Company’s financial position, results of operations, or cash flows.

In January 2003, the FASB issued FASB Interpretations No. 46 (“FIN 46”), “Consolidation of Variable Interest Entities.” This interpretation clarifies the application of Accounting Research Bulletin No. 51, “Consolidated Financial Statements,” to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective February 1, 2003 for variable interest entities created after January 31, 2003, and July 31, 2003 for variable interest entities created prior to February 1, 2003. The Company does not anticipate the adoption of FIN 46 to have a material impact on its financial position, results of operations, or cash flows.



At the November 21, 2002 EITF meeting, the Task Force reached a consensus that cash consideration received by a customer from a vendor is presumed to be a reduction of the prices of the vendor's products or services and should, therefore, be characterized as a reduction of cost of sales when recognized in the customer's income statement. That presumption is overcome when the consideration is either (a) a reimbursement of costs incurred by the customer to sell the vendor's products, in which case the cash consideration should be characterized as a reduction of that cost when recognized in the customer's income statement, or (b) a payment for assets or services delivered to the vendor, in which case the cash consideration should be characterized as revenue when recognized in the customer's income statement. The Task Force also reached a consensus that a rebate or refund of a specified amount of cash consideration that is payable only if the customer completes a specified cumulative level of purchases or remains a customer for a specified time period should be recognized as a reduction of the cost of sales based on a systematic and rational allocation of the cash consideration offered to each of the underlying transactions that results in progress by the customer toward earning the rebate or refund, provided the amounts are reasonably estimable. The Copmany does not expect the adoption of EITF 02-16 to have a material effect on it's financial position, results of operations, or cash flows.

At the July 31, 2003 meeting, the ETIF discussed whether non-software deliverables (e.g., non-software related equipment or services) included in an arrangement that contains software that is more than incidental to the products or services as a whole are included within the scope of AICPA Statement of Position 97-2, "Software Revenue Recognition". The Task Force reached the following consensus: In an arrangement that includes software that is more than incidental to the products or services as a whole, software and software-related elements are included within the scope of SOP 97-2. Software-related elements include software-products and services such as those listed in paragraph 9 of SOP 97-2 (examples of software deliverables include software products, upgrades/enhancements, postcontract customer support, and services) as well as any non-software deliverable(s) for which a software deliverable is essential to its functionality. For example, in an arrangement that includes software, computer hardware that will contain the software, and additional unrelated equipment, if the software is essential to the functionality of the hardware, the hardware would be considered software-related and, therefore, included within the scope of SOP 97-2. However, because the software is not essential to the functionality of the unrelated equipment, the equipment would not be considered software-related and would, therefore, be excluded from the scope of SOP 97-2. The Task Force agreed that the consensus in Issue 03-5 should be applied to arrangements entered into in the first reporting period (annual or interim) beginning after the date of Board ratification of the consensus, which was August 13, 2003. The Company does not anticipate the adoption to have a material effect on the Company's financial position, or results of operations, or cash flows.

In December 2003, the Securities & Exchange Commission ("SEC") published Staff Accounting Bulletin ("SAB") No. 104, "Revenue Recognition." This SAB updates portions of the SEC staff's interpretive guidance provided in SAB 101 and included in Topic 13 of the Codification of Staff Accounting Bulletins. SAB 104 deletes interpretative material no

longer necessary, and conforms the interpretive material retained, because of pronouncements issued by the FASB's EITF on various revenue recognition topics, including EITF 00-21, "Revenue Arrangements with Multiple Deliverables." SAB 104 also incorporates into the SAB Codification certain sections of the SEC staff's "Revenue Recognition in Financial Statements – Frequently Asked Questions and Answers." To the extent not incorporated into the SAB codification, the SEC staff's FAQ on SAB 101 (Topic 13) has been rescinded. The adoption of SAB 104 will not have a material effect on the Group's financial position, results of operations or cash flows.

Prepaid Expenses and Other Current Assets

At December 31, 2002 and 2003, prepaid expenses and other current assets consisted of the following (in thousands of €):

As of December 31,	**2002**	**2003**
VAT and other tax receivables	5,224	453
Pre-payments	1,410	479
Unbilled receivables	261	37
Receivables from employees	72	49
Other	460	352
Total	**7,427**	**1,370**

The Company recorded a doubtful debt allowance of €1.2 million and €0.9 million against receivables due from employees in the fiscal years ended December 31, 2002 and 2003 respectively.

Property and Equipment

At December 2002 and 2003, property and equipment consisted of the following (in thousands of €):

	2002	Currency	Additions	Disposals	Impairment	**2003**
Computer equipment	19,547	(1,121)	247	(1,398)	(64)	17,211
Furniture and fixtures	3,592	(150)	67	(427)	(24)	3,058
Leasehold improvements	1,271	(121)	54	(59)	-	1,145
Subtotal	**24,410**	**(1,392)**	**368**	**(1,884)**	**(88)**	**21,414**
Accumulated depreciation	(20,109)	1,189	(3,093)	1,706		(20,308)
Property and equipment, net	**4,301**					**1,106**

The impairment relates to assets held in the UK and Scandinavia, where the operations have been transferred to independent distributors.

Investments

During 1998 and 1999, the Company made investments in a non-public company in Israel totaling €0.5 million and €1.2 million, respectively. The total investment of €1.7 million in this entity represented an ownership interest of approximately 6% at that time. Due to the difficult economic climate and the financial condition and performance of this non-public company, the Company wrote down the whole value of this investment in the fiscal year 2001. This resulted in a non-operational charge of €1.7 million to the statement of operations for the year ended December 31, 2001.

Marketable Securities

Investments in debt and marketable equity securities are categorized as available for sale and are stated at fair value, with unrealized gains and losses, net of deferred income taxes, and reported as a component of accumulated other comprehensive income.

In 1999, the Company acquired approximately €1.5 million of common stock in a public company in the United Kingdom. This investment was classified as an available-for-sale security and recorded at fair value. In June 2001, the Company determined that the decline in fair value of this investment was other-than-temporary in nature and recorded a write-down of €0.7 million on this investment. In October 2001, the Company sold this investment for €0.9 million. The related gain of €0.1 million is included in other income.

As of December 31, 2002, available-for-sale securities consisted of the following (in thousands of €):

	Cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
December 31, 2002				
Money market funds	4,171	1	-	4,172

The Company did not hold any available-for-sale securities at December 31, 2003.

For the years ended December 31, 2001, 2002, and 2003, the gross realized gains on sales of available-for-sale securities totaled €2,043,838, €46,953, and €39,802, respectively, and the gross realized losses totaled €491,838, €198,745, and €0, respectively. The net adjustment to unrealized holding gains (losses) on available-for-sale securities included in other comprehensive income totaled €429,417, €80,981, and €189,539 in 2001, 2002, and 2003 respectively.

Changes to the Bases of Consolidation

Intershop Communications S.a.r.l.

In September 2003, the Company discontinued the funding of operations of its French subsidiary, Intershop Communications S.a.r.l. The subsidiary sought relief through filing petitions under bankruptcy in France. Due to a court order as of that date requiring its liquidation and a preliminary receiver being appointed, Intershop Communications S.a.r.l. was removed from the consolidation effective October 21, 2003. Prior to that liquidation order, Intershop Communications S.a.r.l. had assets of EUR 0.5 million and liabilities of EUR 3.0 million. As a result of the liquidation order, the Company received complete relief from its liabilities while surrendering all of its assets. The Company's consolidated financial statements contain a gain from the deconsolidation of Intershop Communications S.a.r.l. of EUR 2.5 million. This gain has been recorded in other income in the statement of operations for the year ended December 31, 2003.

The following information has been prepared for better comparability of the statement of operations for the years ended December 31, 2003 and 2002. These are the effects from the results of operations and deconsolidation of the subsidiary (in thousands of €):

	2002 including Subsidiary	2002 Subsidiary	2002 excluding Subsidiary
Sales	45,097	1,434	43,663
Operating loss	(28,679)	(1,491)	(27,188)
Net loss	(27,555)	(1,571)	(25,984)

Goodwill

Goodwill consisted of the following (in thousands of €):

	2002	**2003**
Goodwill	4,473	4,473

In June 2001, the FASB issued SFAS No. 141, "Business Combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets." The Company implemented these new accounting standards on a transitional basis for 2002. Under the new rules, an assembled workforce is no longer considered an intangible asset. Accordingly, the carrying value of the Company's assembled workforce, €0.2 million, was reclassified as goodwill on January 1, 2002.

In accordance with the rules for transition to SFAS No. 142, the Company recorded no further scheduled goodwill amortization after January 1, 2002. The Company performs an impairment test once a year, or whenever events or changes in circumstances occur that indicate the carrying amount might be impaired. The annual impairment test will be carried at the end of each fiscal year (December 31).

The initial impairment test must be carried out on the date the new accounting rules are adopted. Exceptional amortization resulting from the transitional impairment test must be recorded separately from the operating results, as a "cumulative effect arising from the adoption of new accounting principles." The goodwill impairment test is performed in two steps. The first step involves determining the fair value for each reporting unit. If the fair value of a reporting unit exceeds the carrying value of its net assets, no exceptional goodwill amortization is necessary. If the fair value is lower than the carrying value, the fair value of all the unit's balance sheet assets and liabilities, as well as the identifiable intangible assets, excluding goodwill, must be determined for the valuation date. The excess fair value over the amount allocated to the assets and liabilities of a reporting unit is the implied fair value of goodwill. If the implied fair value of goodwill is lower than the carrying value of the goodwill, an amortization charge must be recorded to reflect the reduced fair value.

In applying SFAS No. 142, the Company has defined the Intershop Group as a single reporting unit, since the Group companies outside Germany merely provide sales support for the Group companies located in Germany. The directors of the Group companies outside Germany report directly to the Management Board of Intershop Communications AG.

The Company's transitional impairment test, required in the year in which SFAS No. 142 is adopted, was performed as of January 1, 2002. The fair value of the reporting unit was determined based on the Company's market capitalization. According to these calculations, the fair value of the reporting unit exceeded the carrying value of its net assets. Accordingly, the additional analysis was not required, and there was no impairment of goodwill upon adoption of SFAS No. 142. The Company's annual impairment test was performed on December 31, 2002 and 2003, based upon the Company's market capitalization. Because the fair value of the reporting unit exceeded its carrying value, the additional analysis was not required, and there was no impairment of goodwill at December 31, 2002 or 2003.

As required by SFAS No. 142, the following table discloses the pro forma net loss for the year and the net loss per share for the year in all periods shown in the statement of operations, adjusted to exclude amortization of goodwill and intangible assets that are no longer amortized.

	2001
Reported net loss	(131,798)
Goodwill amortizations	20,621
Amortization of intangible assets that are no longer being amortized (assembled workforce reclassified as goodwill)	470
Adjusted net loss	**(110,707)**

Corresponding per-share amounts, basic and diluted (in €):

	2001
Reported consolidated profit/loss before the cumulative effect of a change in accounting principles (basic and diluted)	(7.48)
Add-back: Goodwill amortization	1.17
Add-back: Amortization of intangible assets that are no longer being amortized (assembled workforce reclassified as goodwill)	0.03
Adjusted net profit/net loss for the year per share before the cumulative effect of a change in accounting principles (basic and diluted)	**(6.28)**

Other Accrued Liabilities

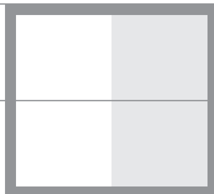
Other accrued liabilities consist of the following (in thousands of €):

Year ended December 31,	2002	2003
VAT payable	5,149	188
Employee compensation	2,886	1,251
Unvouchered invoices	1,530	970
Accrued legal costs	746	135
Other	3,161	1,283
Total	**13,472**	**3,827**

Restructuring Charges and Asset Impairments

In the quarter ended March 31, 2002, the Company adopted measures to reduce its workforce and to consolidate existing facilities, among other things. Other measures included the appointment of new management, the creation of a simplified organizational structure, and a sales campaign for new products. These steps were aimed at aligning the Company's cost structure with changing market conditions and accelerating its path to profitability. The Company completed the majority of these restructuring measures by December 2002.

In the third quarter of 2003, the restructuring measures implemented in the previous year meant that the Company further reduced its headcount in line with reduced revenue expectations, and transferred the majority of its European sales activities outside Germany to local distributors.



The following table summarizes restructuring charges for the fiscal year 2003 and accrued restructuring costs as at December 31, 2003 (in thousands of €):

	Employee-related charges	Facility-related charges	Other costs	Total
Accrued restructuring costs as of January 1, 2002	183	10,313	157	**10,653**
Restructuring charges for the year	2,447	2,713	166	**5,326**
Cash payments	(1,944)	(5,300)	(237)	**(7,481)**
Currency adjustments	(68)	(845)	(4)	**(917)**
Impairment of property and equipment	-	(2,700)	-	**(2,700)**
Accrued restructuring costs as of December 31, 2002	618	4,181	82	**4,881**
Restructuring charges for the year	2,236	1,219	33	**3,488**
Cash payments	(2,593)	(2,849)	(114)	**(5,556)**
Currency adjustments	(37)	(30)	(1)	**(68)**
Impairment of property and equipment	-	(88)	-	**(88)**
Accrued restructuring costs as of December 31, 2003	224	2,433	0	**2,657**

The above costs are broken down as follows:

Employee-Related Charges

As of December 31, 2002, Intershop employed 479 full-time equivalents worldwide. Following the completion of the previous year's restructuring measures in the first quarter of 2003 and further cost reductions beginning in the third quarter of 2003, the number of employees fell by a further 201 full-time equivalents. In 2003, this related to 187 full-time employees in Europe and 20 in the Americas. Employee reductions affected all functional departments, with 52 full-time employees affected in services, 30 full-time employees in general and administrative functions, 90 full-time employees in sales, 26 full-time employees in marketing, and 4 full-time employees in research and development. Headcount reductions occurred in all employee groups within each function.

As of December 31, 2003, the Group employed 278 full-time equivalents.

The accruals for employee-related charges mainly comprise expected future payments relating to the termination of contracts, including severance payments, payroll taxes, and legal costs.

Facility-Related Charges

In the fiscal year 2003, the Intershop Group recorded restructuring costs of approximately €1.2 million in connection with the consolidation of existing facilities, which principally relate to probable future payments for existing lease commitments for property no longer in use, net of sublease income. The determination of the related accrual is based on assumptions with regards to the period during which vacant spaces cannot be sublet. This period varies between six and twelve months.

The sublease income has been estimated on the basis of the contractual agreements in place as of the date the financial statements were prepared.

Other Costs

The accruals for other restructuring costs principally relate to various non-cancelable contracts for which there is no future benefit to the Company.

Restructuring accruals are calculated on the basis of financial estimates and data available as of December 31, 2003. Adjustments to this restructuring reserve will be made in future periods, if necessary, based upon actual events and available information at that moment in time.

Commitments and Contingencies

Operating Leases

Facilities and certain furniture and equipment are leased under operating leases. As of December 31, 2003, future minimum annual lease payments were as follows (in thousands of €):

Year ending December 31	
2004	4,203
2005	3,885
2006	3,733
2007	3,733
2008	3,733
Subsequent years	16,042
Total	**35,329**

Rent expense in 2001, 2002, and 2003 amounted to €10.3 million, €4.0 million, and €3.0 million, respectively. Rent expense for 2003, 2002, and 2001 excludes any facility-related restructuring costs discussed in Note 9. Rental income of €0.2 million and €1.4 million was received in 2002 and 2003, respectively and offsets rent expense. There was no rental income in 2001. The future rental income secured by contract as of December 31, 2003 totaled €2.4 million.

A bank issued a guarantee to cover the lease payments on leased property in Jena, Germany, should the Company fail to fulfill its obligations under the lease agreement. This cash account has been placed in a restricted account. The level of restricted cash will decrease over the term of the lease. The lease has been contracted for until November 2013. The restricted cash will be released by 10% of the original amount every year, beginning October 10, 2003.

Legal Matters

The Company is a defendant in various legal matters arising in the normal course of business. It is possible that an adverse ruling in any such matter individually, or some or all of the matters collectively, may have a materially adverse effect on our results of operations. The Company expenses legal costs associated with loss contingency as such legal costs are incurred.

The Company is a defendant in a consolidated class-action lawsuit in the United States and an investigation by the German Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht, BAFin; formerly German Federal Supervisory Office for Securities Trading (Bundesaufsichtsamt für den Wertpapierhandel, BAWe)). At the beginning of 2001, several securities class-action lawsuits were filed in the U.S. against Intershop Communications AG, Management Board members, certain other officers, and the underwriters of the Company's September 2000 public offering. The plaintiffs allege that the defendants made material misrepresentations and omissions of material facts concerning the Company's business performance. The plaintiffs seek an unspecified amount of damages. The Management Board believes there is no merit to these allegations and intends to defend itself vigorously. However, there can be no assurance that the Company will prevail in the lawsuit, or that the outcome of the lawsuit will not adversely affect the Company's operations. In Germany, BAFin announced in January 2001 that it had initiated an investigation regarding a possible violation of the duty to disclose material information in connection with the release on January 2, 2001 of Intershop Communications AG's preliminary results for 2000. BAFin handed this case over to the public prosecutor in Hamburg, Germany, who initiated an investigation into complaints about stock price manipulations in May 2001. The Company is cooperating in full with these investigations and, to the best of the management's knowledge, has never previously been the subject of such investigations. The Company believes there is no merit to these allegations.

In January 2001, a U.S. company filed a suit in the federal district court in Delaware against Intershop Communications, Inc., claiming violation of certain patent rights. The plaintiff seeks an unspecified amount of compensation for damages based on the alleged patent infringements. This case was settled for US$0.5 million on September 24, 2001. As part of the settlement, the parties exchanged certain licenses and rights for a limited term under their respective United States patents and patent applications, in addition to other terms and conditions of the settlement agreement that were not disclosed.

In the reporting period, a claim of €5 million regarding the violation of a license agreement was legally asserted by another software company. An out-of-court settlement with this software company was reached, subject to the approval of the software Company's stockholders. This approval was not granted during the period under review; for this reason, the Company has restarted legal proceedings with the aim of having the claim fully dismissed. As of December 31, 2003 the court had not issued its ruling.

□ Shareholders' Equity

Stock Splits and Change in Stated Value

On September 11, 2002, the Management Board of Intershop Communications AG announced that the Company's capital stock had been reduced by 50% and convened a Special Stockholders' Meeting. This meeting on October 30, 2002 approved a simplified reduction of capital by way of a 5:1 reverse stock split to offset losses and other impairments. This took effect on its entry in the commercial register on December 12, 2002 and was technically implemented at the close of trading on January 17, 2003. The Company's common stock amounted to €19,306,400 on December 31, 2002.

The 5:1 reserve stock split of the Company's common bearer shares admitted to trading was implemented on January 17, 2003 at the close of trading; the first trading date for the converted common bearer stock was January 20, 2003.

The net loss per share for the year ended December 31, 2001 has been adjusted to reflect the Company's 5:1 reverse stock split during 2002. Share amounts in the consolidated statement of changes of shareholders' equity for the year ended December 31, 2001 have not been adjusted to reflect this reverse stock split.

Capital Increase in Fiscal Year 2002

On March 12, 2002, the Company's Chief Executive Officer, Stephan Schambach, completed the purchase of 8,334,000 shares of common stock from the Company at a price of €1.20 per share, in a private placement transaction. The capital increase was made from authorized capital, and shareholders' subscription rights were excluded. The transaction resulted in total proceeds of approximately €10.0 million to the Company. The purchase price per share was based on the XETRA daily closing price at the Frankfurt Stock Exchange on March 1, 2002, the last trading day prior to the day on which the Company's Supervisory Board granted Mr. Schambach the right to purchase the shares.

Capital Increase in Fiscal Year 2003

On June 18, 2003, the share swap under which then CEO and co-founder Stephan Schambach exchanged his shares in subsidiary Intershop Communications, Inc. for common bearer shares in the parent Company, Intershop Communications AG, was completed. Under the transaction, Mr. Schambach exchanged his 4,166,665 shares in Intershop Communications, Inc., the U.S. subsidiary majority-owned by Intershop Communications AG, for 2,499,999 common bearer shares of Intershop Communications AG. To this end, Intershop Communications AG issued 2,499,999 new common bearer shares from Conditional Capital III.

In addition, on June 17, 2003, Burgess Jamieson, a member of the Supervisory Board of Intershop Communications AG, exchanged his 381,500 shares in Intershop Communications, Inc. for 228,900 new common bearer shares of Intershop Communications AG on the basis of an existing exchange option. To this end, Intershop Communications AG issued 228,900 new common bearer shares from Conditional Capital III.

As a result of these two transactions, the common stock of Intershop Communications AG was increased from Conditional Capital III by a total of €2,728,899 to €22,035,299 in 2003.

American Depositary Receipts (ADRs)
In February 2002, the Company changed the ratio of its American Depositary Receipts (ADRs). The ratio of ADRs to underlying Intershop Communications AG common bearer shares was changed from two ADRs equaling one common bearer share to one ADR equaling five common bearer shares. With this ratio change, each of Intershop's Nasdaq-listed ADRs evidenced ownership of five underlying common bearer shares listed on its primary stock exchange, the Prime Standard in Frankfurt, Germany. The ratio change did not affect the value of an investor's ADR holdings. Stockholders of Intershop common bearer shares did not see any change in the number of shares held. The ratio change was non-dilutive and had no impact on Intershop's balance sheet.

In connection with the Company's reverse stock split, a change in the exchange ratio of ADRs to the underlying common bearer shares from 1:5 to 1:1 took legal effect on February 6, 2003. This means that since February 6, 2003 each of Intershop Communications AG's Nasdaq-listed ADRs evidences ownership of one underlying common bearer share listed on the Company's primary stock exchange, the Prime Standard in Frankfurt. Intershop's issued and outstanding ADRs were deregistered with the SEC, refer to Note 17, Subsequent events.

1997 Equity Incentive Plan (all data subsequent to 5:1 reverse stock split)
The Company had originally reserved 2,000,000 shares of common stock for issuance to employees, directors, and consultants under its 1997 Equity Incentive Plan (the 1997 Plan). The Supervisory Board may grant incentive or non-statutory stock options at prices not less than 100% or 85%, respectively, of the fair value as determined by the Supervisory Board at the date of grant. Options vest ratably over periods determined by the Board, generally three years. The Board also has the authority to set exercise dates (no longer than ten years from the date of grant), payment terms, and other provisions for each grant. The Company had the right of first refusal for all common stock issued under the 1997 Plan should the holder desire to sell or otherwise transfer any of the shares. The Company's right of first refusal terminated upon the effective date July 16, 1998, of the Company's initial public offering.

1999 Equity Incentive Plan (all data subsequent to 5:1 reverse stock split)
Effective as of June 21, 1999, the Company adopted a new stock option plan (the 1999 Plan) for the issuance of shares to Management Board members, executive officers, and certain employees. The options under the 1999 Plan vest ratably over a four-year period, beginning six months from the date of grant; however, pursuant to the German Stock Corporation Act, no options will be exercisable, even though a portion is vested, prior to the second anniversary of the date of grant. The exercise price of the options is equal to 120% of the market price of the shares at the date of grant, where the market price is determined to be the average closing price as quoted on the Prime Standard for the 10 trading days prior to the date of grant.

There are two pools of shares authorized under the 1999 Plan. There are 133,000 shares for grants of stock options to members of the Management Board and general managers of subsidiaries and 1,500,000 shares for grants of stock options to all other employees.

2001 Equity Incentive Plan (all data subsequent to 5:1 reverse stock split)
As of January 1, 2001, the Company adopted a new stock option plan (the 2001 Plan) for the issuance of shares to all employees. No options under this plan have been allocated to the Management Board. The options under the 2001 Plan vest ratably over a fifty-month period beginning from the date of grant; however, pursuant to the German Stock Corporation Act, no options will be exercisable, even though a portion is vested, prior to the six months after the date of grant. The exercise price of the options is the fair value at the date of grant, defined as equivalent to the XETRA closing price on the Frankfurt Stock Exchange for voting shares of stock of the Company.

The Company has reserved 1,930,500 shares of common stock for issuance to employees under its 2001 Equity Incentive Plan.

Appropriation of Additional Paid-In-Capital
In accordance with the German Stock Corporation Act (Aktiengesetz), the Company reclassified €155.5 million in 2001 and €92.3 million in 2002 of its additional paid-in capital to accumulated deficit, thus fully offsetting the losses carried forward. In 2003, the exchange of shares in Intershop Communications Inc. (see capital increase in fiscal 2003) was reported as a reclassification from accumulated deficit because reclassification from capital reserves was not possible after the withdrawals in previous years. Without this reclassification, the accumulated deficit would be as follows (in thousands of €):

As of December 31,	**2001**	**2002**	**2003**
(Accumulated deficit) retained earnings, as reported	(60,632)	4,124	(17,245)
Add: appropriation of additional paid-in capital	(155,495)	(247,805)	(249,200)
Accumulated deficit, pro forma	**(216,127)**	**(243,681)**	**(266,445)**

Stock-Based Compensation
The Company applies APB Opinion No. 25 and related interpretations in accounting for the 1997 Plan, 1999 Plan, and 2001 Plan.

Option activity under the plans was as follows (in thousands of €, except per-share data). To facilitate comparison, the figures for 2001 were adjusted using a 5:1 ratio in line with the reduction in capital in 2002.

Year Ended December 31,	2001 Number of shares outstanding	2001 Weighted-average exercise price (€)	2002 Number of shares outstanding	2002 Weighted-average exercise price (€)	2003 Number of shares outstanding	2003 Weighted-average exercise price (€)
Outstanding at beginning of period	986	332.40	1,158	174.25	1.979	77.60
Granted	791	23.25	1,325	6.90	882	1.82
Exercised	(38)	10.75	1	3.19	0	0
Forfeited	(581)	250.30	(505)	103.75	(806)	85.94
Outstanding at end of period	**1,158**	**174.25**	**1,979**	**77.60**	**2,055**	**36.50**
Exercisable options at end of period	387	216.72	681	141.98	767	82.66
Weighted average fair market value of options granted during the year (€)	791	13.75	1,325	4.63	882	1.31

The following table summarizes information with respect to the stock options outstanding on December 31, 2003:

Range of Exercise Price	Number of options outstanding (000s)	Weighted average remaining contractual life (in years)	Weighted average exercise price (€)	Number exercisable on December 31, 2003 (000s)	Weighted average exercise price (€)
0,07 – 5,99	980	9.0	2.46	94	4.38
6,00 – 6,99	220	7.2	6.03	106	6.04
7,00 – 16,99	424	6.2	7.98	221	7.98
17,00 – 49,99	280	2.2	21.12	208	21.42
50,00 – 758,04	150	1.3	412.40	138	407.96
	2,055	**6.7**	**36.50**	**767**	**82.66**

The 1997 Plan allows for the issuance of options that are immediately exercisable through execution of a restricted stock purchase agreement. Shares purchased subject to a restricted stock purchase agreement generally vest over three years. As of December 31, 2003, no shares of common stock issued and outstanding were unvested and subject to repurchase by the Company. All shares that were exercised early are held by a trustee on behalf of the employee. In the event that an employee leaves the Company with unvested shares, the Company repurchases the unvested shares from the employee at a price equal to the original issuance price and sells the shares in the open market, with the proceeds of the sale being contributed to the Company.

Shares Reserved for Future Issuance
As of December 31, 2003, the Company had authorized and conditional capital of € 48,262,500 and € 41,220,320, respectively. Authorized capital is equivalent to additional authorized shares for acquisitions or sales of common stock with the approval of the Company's Supervisory Board. Conditional capital is reserved for employee stock options.

☐ Income Taxes

The Company accounts for income taxes using an asset and liability approach, under which deferred income taxes are calculated based upon enacted tax laws and rates applicable to the periods in which taxes become payable.

The income tax benefit differs from the amounts that would result by applying the applicable German statutory rates 40.4%, to the loss before taxes, as follows (in thousands of €):

Year ended December 31,	2001	2002	2003
Provision (benefit) at German statutory rate	(53,246)	(11,132)	(7,531)
Foreign income/losses taxed/benefited at a different tax rate	3,611	880	889
Change in valuation allowance	68,715	31,623	(7,476)
Permanent differences	270	49	15
Consolidation differences	(13,096)	(19,088)	8,745
Benefit of changes to the bases of consolidation	-	-	1,008
Other	(6,254)	(2,332)	4,340
Provision (benefit) for income taxes	**-**	-	-

The components of the deferred tax asset were as follows (in thousands of €):

Year ended December 31,	2002	2003
Net operating loss carryforwards	175,154	160,687
Other	3,757	2,568
	178,911	**163,246**
Valuation allowance	(178,911)	(163,246)
Net deferred tax assets	-	-

A valuation allowance has been recorded for the entire deferred tax assets for all periods through December 31, 2002 as a result of uncertainties regarding the realization of the assets due to the limited operating history of the Company and its lack of profitability through December 31, 2003.

For the year ended December 31, 2003, the Company had net loss carryforwards for tax reporting purposes in various tax jurisdictions as follows (in thousands of €):

US Federal	104,209
US State	32,211
German	272,384
Other	58,309
Total	**467,113**

US federal and state net operating loss carryforwards expire in various periods through 2019. The German net operating loss carryforwards relate to corporate income tax and municipal trade tax and carry forward indefinitely. The US Tax Reform Act of 1986 and German tax laws contain provisions that may limit the net operating loss and tax credit carryforwards to be used in any given year upon the occurrence of certain events, including a significant change in ownership interest.

Related Parties

In 2001, the Company generated revenue from certain related parties. In this year, members of our Supervisory Board were executives or board members of these customers. Revenues from sales to these related parties as a percentage of total revenues were as follows:

	2001	2002	2003
Related Party A	2%	0%	0%
Related Party B	1%	0%	0%

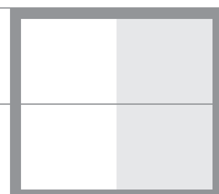
Industry Segment and Geographic Information

The Company’s primary line of business is the production and marketing of e-commerce software that enables customers to automate and simplify their purchasing and sales processes and to consolidate and manage all their sales and procurement channels from a central platform. Accordingly, the Company does not disclose significant additional segment information as defined by SFAS No. 131. However, the Company’s business has five international sales geographies: Germany, United States, United Kingdom, Asia Pacific, and other (which includes France, Denmark, Norway, and Sweden). These geographies are supported by the central General Administration as well as by the Research & Development and Technical Support departments. The Company’s products are developed at its headquarters in Jena, Germany, and are sold in Europe, North America, Australia, and Asia via the Company’s own direct distribution, sales partners, and independent distributors.

For the years ended December 31, 2003, 2002, and 2001, information concerning the Company's geographic locations is summarized as follows (in thousands of €):

2003	Germany	United States	United Kingdom	Asia Pacific	Other	Total
Revenues						
Licenses	3,473	1,149	1,123	491	269	6,505
Services, maintenance, and other	12,042	2,191	582	163	1,676	16,654
Total revenues	15,515	3,340	1,705	654	1,945	23,159
Gross profit						
Licenses	2,949	1,151	1,123	491	271	5,985
Services, maintenance, and other	519	1,166	372	163	1,453	3,673
Total gross profit (loss)	3,468	2,317	1,495	654	1,724	9,658
Total operating expenses	31,706	4,226	2,567	2,173	4,332	45,004
Operating income (loss)	**(16,191)**	**(886)**	**(862)**	**(1,519)**	**(2,387)**	**(21,845)**
Other income (expense), net						**3,205**
Net loss						**(18,640)**
Long-lived assets	**713**	**37**	**333**	**16**	**7**	**1,106**

2002	Germany	United States	United Kingdom	Asia Pacific	Other	Total
Revenues						
Licenses	14,669	4,580	685	751	1,777	22,462
Services, maintenance, and other	14,151	4,368	861	326	2,929	22,635
Total revenues	28,820	8,948	1,546	1,077	4,706	45,097
Gross profit						
Licenses	13,400	4,514	684	751	1,825	21,174
Services, maintenance, and other	263	2,497	(195)	192	2,064	4,821
Total gross profit (loss)	13,663	7,011	489	943	3,889	25,995
Total operating expenses	47,235	9,570	6,351	2,814	7,806	73,776
Operating income (loss)	**(18,415)**	**(622)**	**(4,805)**	**(1,737)**	**(3,100)**	**(28,679)**
Other income (expense), net						**1,124**
Net loss						**(27,555)**
Long-lived assets	**3,473**	**189**	**451**	**2**	**186**	**4,301**



2001	Germany	United States	United Kingdom	Asia Pacific	Other	Total
Revenues						
Licenses	13,331	1,832	793	1,538	2,986	20,480
Services, maintenance, and other	30,496	6,353	7,672	789	2,864	48,174
Total revenues	43,827	8,185	8,465	2,327	5,850	68,654
Gross profit						
Licenses	12,906	1,530	566	1,049	2,091	18,142
Services, maintenance, and other	7,407	(2,096)	2,116	(1,717)	1,031	6,741
Total gross profit (loss)	20,313	(566)	2,682	(668)	3,122	24,883
Total operating expenses	82,682	41,952	10,362	12,531	10,893	158,420
Operating income (loss)	**(62,369)**	**(42,518)**	**(7,680)**	**(13,199)**	**(7,771)**	**(133,537)**
Other income (expense), net						**1,739**
Net loss						**(131,798)**
Long-lived assets	**8,501**	**1,635**	**2,380**	**645**	**361**	**13,522**

The accounting policies followed by the Company's business segments are the same as those described in Note 2 to the consolidated financial statements.

The Company generated the following license revenues from its Enfinity and Intershop 4 product lines (in thousands of €):

Year ended December 31,	2001	2002	2003
Enfinity	17,391	20,259	6,505
Intershop 4	3,089	2,203	-
Total	**20,480**	**22,462**	**6,505**

The service revenue generated by Intershop can be broken down into consulting, customer support, and training revenue as follows (in thousands of €):

Year ended December 31	2001	2002	2003
Consulting	36,649	15,335	9,203
Customer support	9,320	6,171	6,862
Training	2,101	581	392
Other revenue	104	548	197
Total	**48,174**	**22,635**	**16,654**

Local Disclosure Requirements

Management Board

Dr. Jürgen Schöttler, Management Board Chairman, Chief Executive Officer (since July 14, 2003) and Chief Financial Officer
Stephan Schambach, Management Board member responsible for Strategy and Product Development (retired as Management Board Chairman on June 14, 2003; retired from Management Board on February 4, 2004)

Werner Fuhrmann, Management Board member responsible for Sales and President EMEA (retired on July 16, 2003)

Supervisory Board

Eckhard Pfeiffer, Chairman (re-elected May 28)
Theodore J. Smith, Deputy Chairman (re-elected May 28)
Hans W. Gutsch (re-elected May 28)
Peter Mark Droste (re-elected May 28)
Burgess Jamieson (re-elected May 28)
Dr. Harald Rieger (elected March 31, re-elected May 28, resigned October 31)

Board Compensation

The compensation of the Management Board for the fiscal year 2003 amounted to €922,297, of which €210,000 in unpaid performance-related remuneration was set aside. The members of the Management Board were granted a total of 320,000 stock options from the 1999 Equity Incentive Plan.

In the fiscal year 2003, the annual compensation, accrued but not paid, for the Supervisory Board was €106,250. According to the Articles of Association, this consists solely of fixed, not performance-related remuneration.

By way of a unanimous vote by the Supervisory Board in which he did not take part, Mr. Hans W. Gutsch, a Supervisory Board member since 2001, was engaged to advise the management during the Company's difficult restructuring phase in 2002 and 2003. Mr. Gutsch was chosen for this task because of his in-depth knowledge of the industry. His remuneration amounts to €200,000 per annum plus a lump-sum compensation of €10,000 per month.

Investments

The following table lists directly and indirectly held investments of the Company that are included in the consolidated financial statements as of December 31, 2003:

	Ownership %
Intershop Communications, Inc., San Francisco, USA	100
Intershop Communications Ventures GmbH, Jena, Germany	100
Intershop (UK) Ltd., London, United Kingdom	100
IS Nordic, AB, Stockholm, Sweden	100
Intershop Communications Hong Kong Co. Ltd., Hong Kong, China	99.99
Intershop Communications Singapore Pte Ltd., Singapore	100
Intershop Communications Australia Pty Ltd., Sydney, Australia	100
Intershop Communications Taiwan Co. Ltd., Taipei, Taiwan	100
Intershop Communications Korea Co. Ltd., Seoul, Korea	99.98
Intershop Communications K.K., Tokyo, Japan	100

Employees

The Intershop Group had an average of 385 employees in the fiscal year 2003.

Declaration of Conformity
The Company has published and made available permanently its declaration of conformity as required by sec. 161 AktG (German Stock Corporation Law) in 2003.

Subsequent Events

On January 14, 2004, Intershop announced that it would voluntarily delist from the Nasdaq National Market (“Nasdaq”), and gave notice to Citibank, N.A., the depositary for Intershop’s American Depositary Receipts (ADR) facility (the “Depositary”), to terminate the ADR facility effective as of the close of trading on February 17, 2004. From this date, ADRs issued by Intershop were no longer tradable on Nasdaq. With effect from January 15, 2004, Intershop also terminated its F-6 registration statement with the U.S. Securities and Exchange Commission in respect of all 98,550,000 unissued ADRs in its ADR facility.

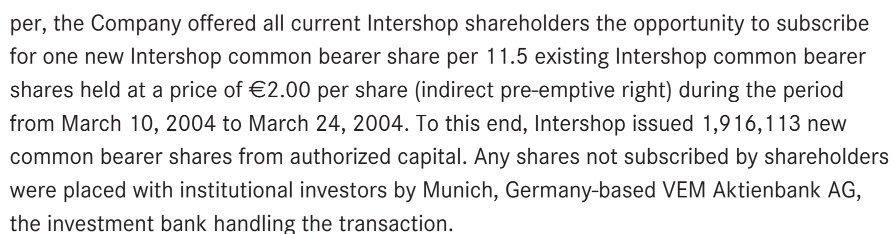
On January 27, 2004, Intershop announced that it had agreed with Citibank, N.A. to shorten the six-month period for holders of Intershop ADRs to surrender them in order to withdraw the underlying Intershop common bearer shares (“surrender period”). In accordance with the termination provision, which was amended as of January 27, 2004, holders of Intershop ADRs were entitled to surrender their Intershop ADRs for withdrawal of the underlying Intershop common bearer shares at any time up to February 27, 2004, i.e., ten days after conclusion of the surrender agreement on February 17, 2004 rather than six months as previously. Intershop ADR holders who chose not to surrender their Intershop ADRs for withdrawal of the underlying Intershop common bearer shares received cash proceeds from the sale of such underlying Intershop common bearer shares at the price obtained on the Frankfurt Stock Exchange. The Depositary then remitted the cash proceeds from the sale, net of any applicable charges, expenses, taxes, or governmental charges, to such Intershop ADR holders.

Intershop’s issued and outstanding ADRs were deregistered with the SEC by submission of Form 15.

On February 4, 2004, Intershop announced that Stephan Schambach had asked the Supervisory Board to be immediately released from his duties as a member of the Management Board. The Supervisory Board accepted Mr. Schambach’s decision. As a result, Mr. Schambach, a major shareholder of the Company with an interest in the capital stock of 19.26% at the balance sheet date, left the Company following the mutual termination of his contract of service.

On March 5, 2004 Intershop announced that the Company's Executive Board (*Vorstand*) and Supervisory Board (*Aufsichtsrat*) had decided to implement a public rights issue from authorized capital in order to raise cash and strengthen the Company’s balance sheet.

As part of the subscription offer published on March 9, 2004 in the electronic *Bundesanzeiger* (Federal Gazette) and the *Frankfurter Allgemeine Zeitung (FAZ),* a German daily newspa-



per, the Company offered all current Intershop shareholders the opportunity to subscribe for one new Intershop common bearer share per 11.5 existing Intershop common bearer shares held at a price of €2.00 per share (indirect pre-emptive right) during the period from March 10, 2004 to March 24, 2004. To this end, Intershop issued 1,916,113 new common bearer shares from authorized capital. Any shares not subscribed by shareholders were placed with institutional investors by Munich, Germany-based VEM Aktienbank AG, the investment bank handling the transaction.

The new shares increased the total number of Intershop issued and outstanding shares by 1,916,113, from 22,035,299 before the transaction to 23,951,412 after the transaction. The capital increase took legal effect by entry in the commercial register at the Local Court of Gera, Germany on March 30, 2004. The new shares were admitted to trading on the Frankfurt Stock Exchange on April 6, 2004. The new shares were traded for the first time on April 8, 2004.

Differences between US GAAP and HGB

▫ General

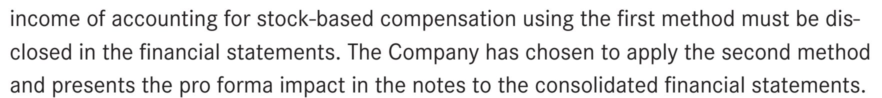
The consolidated financial statements of Intershop Communications Aktiengesellschaft (hereinafter referred to as the “Company” or “Intershop Communications AG”) as of December 31, 2002 were prepared as exempting consolidated financial statements in accordance with section 292a of the German Commercial Code - HGB (Handelsgesetzbuch) in conformity with US generally accepted accounting principles (“US GAAP”) and on the basis of the German Accounting Standard No 1 (GAS 1) issued by the German Standardization Committee (Deutscher Standisierungsrat DRSC e.V.). The provisions of the HGB and the German Stock Corporation Act (Aktiengesetz - AktG) differ from US GAAP in certain significant respects. The main differences that may be relevant to an evaluation of the net assets, financial position, and results of operations of the Company are described below. Pursuant to the HGB, all items in the balance sheet and income statement must be set out in the form and order laid down in sections 266 and 275 of the HGB. US GAAP requires a different presentation, in which balance sheet items are presented with more liquid items first. Under US GAAP, the short-term portions of long-term receivables and liabilities are shown in a separate balance sheet item. The portion that is due in less than one year is treated as short term. Software purchased for internal use is not shown as an intangible asset, as it is in financial statements prepared in accordance with the HGB, but as property and equipment (furniture, fixtures, and office equipment). According to US GAAP, the development cost of internally generated software can be capitalized and amortized over its estimated useful life. The HGB does not allow internally generated software forming part of fixed assets to be capitalized. From 1998 until the present time, the Company has charged all software development costs to research and development as incurred in accordance with US GAAP.

▫ Deferred Taxes on Loss Carryforwards

According to the HGB, deferred tax refund claims arising from tax loss carryforwards may not be shown on the balance sheet, as expected future tax savings are deemed to be not yet realized. US GAAP requires these types of future tax reduction claims to be capitalized. Their recognition depends upon the probability of the loss carryforwards being utilized within the required period. The Company has written off its capitalized tax loss carryforwards as of December 31, 2002 due to uncertainties regarding their realization.

▫ Employee Stock Options

According to US GAAP, stock-based compensation issued to employees may be accounted for in two ways. Under the first method, the fair value of stock-based compensation is determined and recorded as an expense over the vesting period of the option or other equity instrument. Alternatively, only the difference between the exercise price of the option and the market price of the underlying security at the date of grant are recognized as an expense over the vesting period. Under this method, the pro forma impact on net



income of accounting for stock-based compensation using the first method must be disclosed in the financial statements. The Company has chosen to apply the second method and presents the pro forma impact in the notes to the consolidated financial statements.

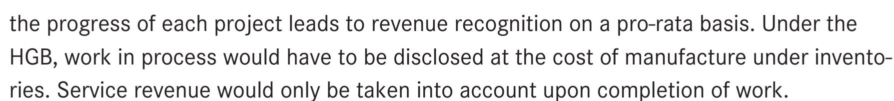
As noted above, the difference between the exercise price of the option and the market price of the underlying security at the date of grant are to be treated, according to US GAAP, as personnel expenses recorded ratably over the vesting period of the option and deferred in shareholders' equity. In line with currently accepted accounting rules, no expense would be recognized in the income statement pursuant to HGB.

▫ Shareholders' Equity

According to the HGB, the Company would have had to prepare consolidated financial statements for the first time following the acquisition of the majority of shares in Intershop Communications, Inc. on June 22, 1998 and to perform the capital consolidation as of this date. The difference between the book value of the participation and the equity capital of the subsidiary Intershop Communications, Inc. would have to be distributed according to the actual value of the assets and liabilities included in consolidation. The remainder would have to be disclosed as goodwill and either amortized over its expected useful life or offset against the capital reserves on the face of the balance sheet. The valuation base from the Company's single-entity financial statements would have to be shown as capital stock. The amount allotted to the minority shareholders in Intershop Communications, Inc. would have to be disclosed under shareholders' equity as "minority interests in capital" and in the income statement as "minority interests in profit/loss." Under US GAAP, the capital consolidation of the Company in line with APB 16 "Business Combinations" is effected as a "transaction under common control," which eliminates the transfer of the shares in Intershop Communications GmbH, Jena, to Intershop Communications, Inc., as well as the transfer of the shares in Intershop Communications, Inc. to Intershop Communications AG and means that only the amount actually raised is reported as capital stock. In line with this, no differences resulted from these transactions under US GAAP. Due to the fact that the minority shareholders of Intershop Communications, Inc. have a right of conversion for the conditional capital of the shareholders, no minority shares in the capital or the profit/loss are shown. Therefore, under US GAAP, the time of first consolidation does not apply, so that the disclosures made before the formation of Intershop Communications AG reflect the individual group structures.

▫ Revenue Recognition

In accordance with US GAAP, sales revenue is recognized in compliance with the American Institute of Public Accountants´ Statement of Position (SOP) 97-2, "Software Revenue Recognition," and related interpretations. There is no general difference to HGB with regard to licensing revenue. US GAAP requires accounting for work in process on service transactions to be performed according to the percentage of completion method, whereby



the progress of each project leads to revenue recognition on a pro-rata basis. Under the HGB, work in process would have to be disclosed at the cost of manufacture under inventories. Service revenue would only be taken into account upon completion of work.

Costs Associated with Certain Equity Transactions

According to US GAAP, costs associated with certain equity transactions (for example, public offerings of stock), net of any related income tax effects, are treated as a reduction of the proceeds from the transaction. Under the HGB, these costs represent expenses for the period.

Foreign Currency Transactions

Under US GAAP, foreign currency transactions (for example, foreign currency denominated trade receivables or payables) are measured at the rate prevailing on the date on which they are initially recognized. These balance sheet items must be measured at the year-end rates at each subsequent balance sheet date. Foreign currency adjustments resulting from exchange rate fluctuations are recognized in income, with any unrealized gains being recorded in the income statement. Under HGB, revaluation losses are recognized in the income statement at each balance sheet date only, while gains are only recognized when realized (for example, upon payment of a foreign currency liability).

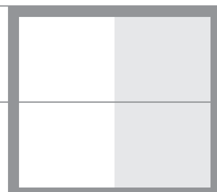
Acquisitions

Under US GAAP, all acquisitions after June 30, 2001 are accounted for using the purchase method in accordance with Statement of Financial Accounting Standard ("SFAS") No. 141, "Business Combinations." This method requires the assets and liabilities of the acquired company to be re-measured at the time of combination. Any difference between the re-measured assets and liabilities (net assets) acquired and the consideration given is disclosed as goodwill. Gains or losses by the acquired company are recognized only from the acquisition date forward. Effective January 1, 2002, Intershop no longer amortizes the goodwill that arose from acquisitions before June 30, 2001 on a straight-line basis over its estimated useful life but reviews goodwill for impairment on an annual basis in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets." Under HGB, the purchase method is used to measure combinations, and, in certain circumstances, the profits and losses of the acquired company may be recognized retroactively.

Financial Statements Intershop Communications AG

Balance Sheets Intershop Communications AG

As of December 31, (in €)	2002	2003
ASSETS		
Fixed Assets		
Intangible assets		
Software licenses	644,518	51,639
Property and equipment		
Other facilities, furniture, and equipment	39,869	752,707
Financial Assets		
Investments in affiliated companies	21,619,288	15,728,899
Loans to affiliated companies	7,000,000	0
	28,619,288	15,728,899
	29,303,675	**16,533,245**
Current Assets		
Inventories		
Finished goods and merchandise	0	37,485
Payments on account	0	233,131
	0	270,616
Receivables and other assets		
Accounts receivable	0	1,666,258
Receivables from affiliated companies	2,140,538	1,521,582
Other assets	1,672,090	860,425
	3,812,628	4,048,265
Short-term security investments		
Other securities	4,170,636	0
Cash-in-hand, bank balances	7,725,805	7,404,082
	15,709,069	**11,722,963**
Prepaid expenses	**106,181**	**71,379**
Total Assets	**45,118,925**	**28,327,587**
SHAREHOLDERS' EQUITY AND LIABILITIES		
Shareholders' Equity		
Common stock		
Conditional capital: €41,220,320 (previous year: €43,949,219)	19,306,400	22,035,299
Capital surplus	3,973,876	3,973,876
Accumulated Deficit	-	(7,799,016)
	23,280,276	**18,210,159**
Accrued Liabilities		
Other accrued liabilities	**18,652,451**	**4,522,526**
Liabilities		
Accounts payable	220,184	1,106,416
Liabilities due to affiliated companies	2,866,691	1,021,582
Other liabilities		
thereof from taxes: €190,107 (previous year: €61,519)		
thereof from social security benefits: €300,326 (previous year: €11,421)	99,323	576,975
	3,186,198	**2,704,973**
Deferred Charges		**2,889,929**
Total Shareholders' Equity and Liabilities	**45,118,925**	**28,327,587**



Statements of Operations Intershop Communications AG

(in €)

For the year ended December 31	2002	2003
Revenues	0	17,525,740
Decrease in inventories of finished goods and work in progress	0	(288,112)
Other operating income	10,822,688	8,923,981
Cost of Materials		
Cost of raw materials, consumables and supplies, and purchased merchandise	0	(39,251)
Cost of purchased services	0	(1,566,873)
Personnel Costs		
Salaries	(1,897,761)	(15,283,536)
Social security contribution and other pension costs	(171,063)	(2,612,672)
Depreciation and amortization		
of intangible fixed assets and property and equipment, and capitalized start-up and business expansion costs	(1,325,379)	(2,766,729)
of current assets to the extent it exceeds depreciation and amortization that is normal for the Company	(32,970,786)	(8,696,400)
Other operating expenses	(14,239,080)	(15,225,892)
Other interest and similar income		
thereof from affiliated companies €7,487,827 (previous year: €10,182,612)	10,633,258	8,076,072
Amortization of financial assets and short-term security investments	(30,509,353)	(3,232,909)
Interest and similar expenses		
thereof from affiliated companies €43,410 (previous year: €43,485)	(51,080)	(339,845)
Loss from ordinary operations	**(59,708,556)**	**(15,526,426)**
Extraordinary income	0	7,717,750
Extraordinary result	0	7,717,750
Taxes on income	46,885	9,660
Net Income/Loss	**(59,661,671)**	**(7,799,016)**
Accumulated deficit carried forward	(38,898,941)	0
Transfer from capital surplus	98,560,612	0
Accumulated Deficit	**0**	**(7,799,016)**

Accounting Policies

Property and equipment is stated at cost, less depreciation.

Financial assets are stated at cost, less necessary valuation allowances.
Inventories are measured at manufacturing costs. Receivables and other assets are stated at face value, less any necessary valuation allowances.

Prepaid expenses and deferred charges are measured using the portion of expenses or income that relates to a period after the balance sheet date.

Other accrued liabilities cover all recognizable risks and are measured in the amount dictated by prudent business practice.

Liabilities are stated at their redemption amount.

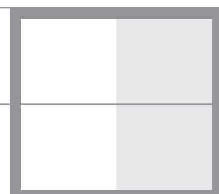
Foreign currency receivables and liabilities are measured using the principle of lower of cost or market and the imparity principle, respectively.

Explanations on the Annual Financial Statements

Fixed assets changed as follows (in €):

	Jan. 1, 2003	Additions*	Disposals	Dec. 31, 2003
Intangible Assets				
Software licenses	2,578,074	199,634	-	2,777,708
Tangible Assets				
Other equipment, operating and office equipment	110,285	2,802,355	191,769	2,720,871
Financial Assets				
Shares in affiliated companies	52,081,761	2,728,899	5,386,379	49,424,281
Loans to affiliated companies	30,000,000	-	30,000,000	-
	82,081,761	2,728,899	35,386,379	49,424,281
	84,770,120	**5,730,888**	**35,578,148**	**54,922,860**

* Included with these asset additions are the following additions resulting from the merger of former Intershop Communications subsidiaries:
software licenses: € 143,819
Other equipment, operating and office equipment : € 2,512,724



	Cumulative depreciation and amortiza-tion Jan. 1, 2003	Additions	Disposals	Cumulative depreciation and amortiza-tion Dec. 31, 2003	Net book value Dec. 31, 2003	Net book value Dec. 31, 2002
Intangible Assets						
Software licenses	1,933,556	792,513	-	2,726,069	51,639	644,518
Tangible Assets						
Other equipment, operating and office equipment	70,416	1,974,216	76,468	1,968,164	752,707	39,869
Financial Assets						
Shares in affiliated companies	30,462,473	3,232,909	-	33,695,382	15,728,899	21,619,288
Loans to affiliated companies	23,000,000	-	23,000,000	-	-	7,000,000
	53,462,473	3,232,909	23,000,000	33,695,382	15,728,899	28,619,288
	55,466,445	**5,999,638**	**23,076,468**	**38,389,615**	**16,533,245**	**29,303,675**

Receivables from affiliated companies and other assets have a maturity of up to one year.

Cash and cash equivalents totaling €6,190,424 (previous year: €7,072,858) reported under cash-in-hand and bank balances have been assigned as security (restricted cash).

The share capital in the amount of €22,035,299 consists of 22,035,299 no-par value bearer shares.

The authorized capital totaling €48,262,500 entitles the Management Board to issue an additional 48,262,500 no-par value bearer shares.

The resolution of the Annual Stockholders’ Meeting on June 6, 2002 authorized the Management Board, with the approval of the Supervisory Board, to increase the Company's share capital by a total of up to €38,610,000 on one or several occasions up to November 11, 2007, by issuing a maximum of 38,610,000 new no-par value bearer shares (Authorized Capital I). The Management Board is also authorized to exclude the shareholders' subscription rights with the approval of the Supervisory Board.

Furthermore, the resolution of the Annual Stockholders’ Meeting on June 6, 2002 authorized the Management Board, with the approval of the Supervisory Board, to increase the Company's share capital by a total of up to €9,652,500 for the purposes approved by the Annual Stockholders’ Meeting on June 6, 2002. This increase may be carried out by issuing a maximum of 9,652,500 new no-par value bearer shares on one or several occasions up to November 11, 2007 (Authorized Capital II); shareholders' subscription rights have been excluded.

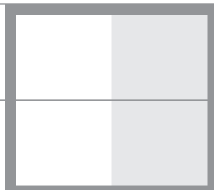
An amount totaling €41,220,320 is available as conditional capital for the issuance of 41,220,320 no-par value bearer shares. Due to the reverse stock split and the lapsing of options, however, a maximum of 23,220,706 shares can be issued from conditional capital.

Of the conditional capital created for granting employee stock options, € 8,165,000 (Conditional Capital I) are reserved for options in compliance with section 192 (2) clause 3 of the German Stock Corporation Act (Aktiengesetz). Conditional Capital I is reserved for exercising the options based on the 1999 option model. These options must be exercised no earlier than two years and no later than five years from the time they were granted. The conversion price for the new shares is based upon the average price of the shares during the last ten trading days prior to the day the options were granted, plus 20%. Due to the one-for-five reverse stock split resolved on October 30, 2002, which became legally effective on December 12, 2002, subscription rights from Conditional Capital I decreased in the same ratio, i.e., to 1,633,000 shares, in accordance with section 218 of the AktG.

Moreover, € 690,016 from Conditional Capital II created in compliance with section 192 (2) clause 3 of the German Stock Corporation Act are reserved to implement the rights granted to known holders of options to exchange shares in Intershop Communications, Inc., which was acquired by the Company in 1998, for shares in the Company at a ratio of 5:15. Due to the one-for-five reverse stock split resolved on October 30, 2002, which became legally effective on December 12, 2002, subscription rights from Conditional Capital I decreased in the same ratio, i.e., to 138,003 shares, in accordance with section 218 of the AktG.
As of the balance sheet date, Conditional Capital III amounted to €10,915,601. On June 17 and 18, 2003, respectively, Stephan Schambach and Burgess Jamieson exercised in full their option to exchange their shares in Intershop Communications, Inc. for common bearer shares of the Company and contributed all of their shares in Intershop Communications Inc. to Intershop Communications AG. To this end, the Company issued 2,728,899 new shares from Conditional Capital III. As the beneficiaries no longer hold any options, no further shares will be issued from Conditional Capital III.
The resolution of the Annual Stockholders' Meeting on June 13, 2001 authorized the Management Board to grant, on one or several occasions up to May 31, 2006, bearer convertible bonds as well as bonds with warrants for a total of up to 21,449,703 no-par value bearer shares of the Company, in which case shareholders' subscription rights can be excluded. In order to cover these convertible bonds, the Company's share capital was conditionally increased by up to €21,449,703 (Conditional Capital IV).

The capital surplus is unchanged from the previous year at €3,973,876.

Other accrued liabilities consist primarily of pending losses from ongoing obligations and litigation risks, year-end closing costs and the costs of the Annual Stockholders' Meeting, outstanding invoices, warranties, holiday entitlements, license fees, and commission.



Liabilities can be broken down as follows (in thousands €):

	Due within 1 year	Due in 1 – 5 years	Due after more than 5 years	Total	Mortgage-backed
Trade payables	1,106	-	-	1,106	-
Liabilities to affiliated companies	1,022	-	-	1,022	-
Other liabilities	577	-	-	577	-
	2,705	**-**	**-**	**2,705**	**-**

Contingent Liabilities

As of December 31, 2003, the Company has financial obligations of €29.6 million relating to a lease agreement for its office premises that are due ratably until the term of the lease ends on September 14, 2013.

Statement of Operations

The following table shows a breakdown of revenues by region:

Germany	15,371,249
Rest of Europe	1,400,724
Rest of the world excluding Europe	753,767
	17,525,740

€4,825,815 of revenues relates to license income and €12,699,925 to income from consulting services.

Other operating income in the fiscal year 2003 includes prior-period income of €5,795,785.

The write-downs charged in accordance with section 253 (2) of the HGB amount to €3,232,909 (previous year: €30,509,353); those charged in accordance with section 253 (3) of the HGB amount to €8,696,400 (previous year: €32,970,786).
€7,487,827 of other interest and similar income relates to affiliated companies (previous year: €10,182,612), and these also account for €43,410 of interest and similar expenses (previous year: €43,485).
The extraordinary income is due to the merger of the former subsidiaries with Intershop Communications AG.

Other Disclosures

The Company had an average of 371 employees during the fiscal year 2003 (prior year: 13).

The Supervisory Board comprised the following members in 2003:

Eckhard Pfeiffer
Chairman of the Supervisory Board
Investor
Former President and Chief Executive Officer, Compaq Computer Corporation
Other board memberships:
General Motors Corporation
Hughes Electronics Corporation
L.M. Ericsson AB
Biogen, Inc.
IFCO Systems NV
Synetc Capital AG

Theodore J. Smith
Deputy Chairman of the Supervisory Board
Investor
Founder and former President, FileNET Corporation
Other board memberships:
FileNET Corporation

Peter Mark Droste
Graduate engineer
Former Manager Central and Northern Europe, Siebel Systems
Former Manager of Compaq Germany
Other board memberships:
Infor Business Solution AG
Member of the Advisory Council of Aventeon

Hans W. Gutsch
Graduate in business administration
Former Senior VP Human Resources and Organization, Compaq Computer Corporation
Other board memberships:
EyeTicket Corporation (Deputy Chairman of the Supervisory Board)
El-Nets, Ltd., Singapore
RYNEX Corporation New York, USA

Burgess Jamieson
Engineer
Investor and shareholder
Project Manager and Technology Manager at aerospace companies

Division Vice President, Electronic Memories, Inc.
Chief Operating Officer, Sycor, Inc.
Co-founder, Institutional Venture Associates

Dr. Harald Rieger
(from March 31 to October 31, 2003)
Lawyer

The Management Board included the following persons in 2003:

Dr. Jürgen Schöttler
Management Board member responsible for finance and Chief Financial Officer (until July 13, 2003)
Chairman of the Management Board and Chief Executive Officer and Chief Financial Officer (since July 14, 2003)

Stephan Schambach
Chairman of the Management Board and Chief Executive Officer (until July 13, 2003)
Management Board member responsible for Strategy and Product Development (since July 14, 2003)

Werner Fuhrmann
Management Board member and President EMEA (until July 16, 2003)

The Management Board received remuneration from the Company totaling €922,297. The members of the Management Board were granted a total of 320,000 stock options from the 1999 Equity Incentive Plan. The remuneration for the members of the Supervisory Board for the fiscal year amounted to €106,250.

Information on the shareholdings of the members of the executive bodies (Supervisory and Management Boards) as of December 31, 2003 can be found in Note 16 of the notes to the consolidated financial statements, “Local Disclosure Requirements.” As a listed company, Intershop Communications AG prepares consolidated financial statements in accordance with US GAAP which, according to the provisions of section 292a of the German Commercial Code (HGB), exempt it from the need to file HGB consolidated financial statements. The consolidated financial statements are filed with the commercial register of the Local Court in Gera, Germany. These consolidated financial statements include the financial statements of the parent company and the following companies:

Intershop Communications, Inc., San Francisco, USA
Intershop (UK) Ltd., London, United Kingdom
Intershop Communications Ventures GmbH, Jena, Germany
IS Nordic AB, Stockholm, Sweden
Intershop Communications Hong Kong Co. Ltd., Hong Kong, China
Intershop Communications Korea Co. Ltd., Seoul, Korea

Intershop Communications Taiwan, Taipei, Taiwan
Intershop Communications Dubai LLC, Dubai, United Arab Emirates
Intershop Communications Singapore Pte Ltd., Singapore
Intershop Communications K.K, Tokyo, Japan
Intershop Communications Australia Pty Ltd., North Sydney, Australia

The following list shows the subsidiaries of Intershop Communications AG and the Company's respective interest as of December 31, 2003:

	Interest in %	Currency	Nominal capital	Equity*	Net loss*
Intershop Communications, Inc., San Francisco, USA	100	€	7,332,682	(103,789,364)	(6,080,451)
Intershop Communications Ventures GmbH, Jena	100	€	1,000,000	(1,877,477)	(94,153)
Intershop (UK) Ltd., London, United Kingdom	100	€	1,586	(21,215,980)	(1,959,888)
IS Nordic AB, Stockholm, Sweden	100	€	11,437	101,506	(1,177,685)
Intershop Communications Hongkong Co. Ltd., Hong Kong, China	99.99	€	1,378	(12,856,545)	(2,004,739)
Intershop Communications Korea Co. Ltd., Seoul, Korea	99.98	€	50,940	(2,765,979)	(27,267)
Intershop Communications Taiwan, Taipei, Taiwan	100	€	32,393	(663,780)	15,125
Intershop Communications Singapore Pte Ltd., Singapore	100	€	65,168	(963,227)	(22,977)
Intershop Communications K.K., Tokyo, Japan	100	€	109,064	(4,760,209)	(515,691)
Intershop Communications Australia Pty Ltd., Sydney, Australia	100	€	238,278	(2,046,730)	(82,478)

* The above figures for equity and the net loss for the year are provisional.

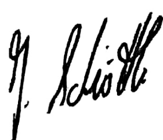
Declaration of Conformity in Accordance with Section 161 of the German Stock Corporation Act

The corporate governance declaration of conformity required under section 161 of the German Stock Corporation Act *(Aktiengesetz)* was submitted and has been permanently available to stockholders on the Company's web site at http://www.intershop.com/investors since February 13, 2004.

Appropriation of Net Income/Loss

The Management Board of Intershop Communications AG proposes to carry forward the accumulated deficit of €7,799,016 to new account.

Jena, April 2004
The Management Board



Dr. Jürgen Schöttler

Report of Independent Auditors, Intershop Communications AG

We have issued the following opinion on the financial statements and report on the situation of the Company and the Group:

"We have audited the annual financial statements, together with the bookkeeping system, and the report on the situation of the Company and the Group of INTERSHOP Communications Aktiengesellschaft, Jena, for the fiscal year from January 1 to December 31, 2003. The maintenance of the books and records and the preparation of the annual financial statements and report on the situation of the Company and the Group in accordance with German commercial law are the responsibility of the Company's management. Our responsibility is to express an opinion on the annual financial statements, together with the bookkeeping system, and the report on the situation of the Company and the Group based on our audit.

We conducted our audit of the annual financial statements in accordance with Sec. 317 HGB ["Handelsgesetzbuch": German Commercial Code] and the generally accepted German standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer in Germany (IDW). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the annual financial statements in accordance with German principles of proper accounting and in the report on the situation of the Company and the Group are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Company and evaluations of possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the books and records, the annual financial statements and the report on the situation of the Company and the Group are examined primarily on a test basis within the framework of the audit. The audit includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the annual financial statements and report on the situation of the Company and the Group. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

In our opinion, the annual financial statements give a true and fair view of the net assets, financial position and results of operations of the Company in accordance with German principles of proper accounting. On the whole, the report on the situation of the Company and the Group provides a suitable understanding of the Company's position and suitably presents the risks to future development. Without, however, qualifying this opinion, we also refer to the explanations by the Company in the report on the situation of the Company and the Group. In section 11. 'Risks to the Group and INTERSHOP Communications AG', the Company explains the proposed measures to improve the results of operations and the cash flow and presents the assumptions which are the basis of its corporate planning. If INTERSHOP Communications Aktiengesellschaft is not able to implement its business plan for 2004, because, for example, these assumptions do not hold true, additional funds may become necessary to support business operations. If in such case such funds cannot be

made available in time, INTERSHOP Communications Aktiengesellschaft's and the Group's ability to continue as a going concern could be jeopardized. The Company further emphasises that unplanned write-downs on the carrying amounts of its investment in INTERSHOP Communications Inc., San Francisco, U. S. A. cannot be excluded, if the future economic development of this subsidiary deviates significantly from the expected development."

Eschborn/Frankfurt/M., April 19, 2004

Ernst & Young
Revisions- und Treuhandgesellschaft mbH
Wirtschaftsprüfungsgesellschaft
Steuerberatungsgesellschaft

Nendza	Jöns
Wirtschaftsprüfer	Wirtschaftsprüfer

Corporate Governance Report

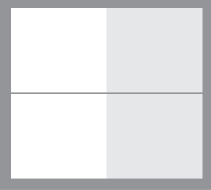
The recommendations of the German Corporate Governance Code were largely complied with in the fiscal year 2003. The Supervisory Board and the Management Board made the following joint declaration of conformity in accordance with section 161 of the German Stock Corporation Act (Aktiengesetz) on February 13, 2004:

1. Intershop Communications AG has complied with the recommendations of the Government Commission on the German Corporate Governance Code since the last declaration of conformity dated December 31, 2002, which was based on the then current version of the Code, with the following exceptions:

    a) The convention documents for the stockholders' meeting are not sent via electronic channels (section 2.3.2).
    b) An individual breakdown of the compensation components of Executive Board salaries is not given in the notes to the consolidated financial statements (section 4.2.4).
    c) The Supervisory Board has no separate Terms of Reference (section 5.1.3).
    d) The Chairman of the Supervisory Board does not chair the committee that handles Executive Board contracts; this committee is chaired by Hans Gutsch, a member of the Supervisory Board (section 5.2).
    e) No age limit has been specified for members of the Supervisory Board (section 5.4.1).
    f) The Supervisory Board does not receive performance-related compensation. Compensation is published as an aggregate amount (section 5.4.5).
    g) The consolidated financial statements are published no later than 30 days after the deadline stated in the Code, in accordance with the deadline laid down in section 62 (3) of the Exchange Rules of the Frankfurt Stock Exchange (section 7.1.2).

2. Intershop Communications AG will comply with the recommendations of the Government Commission on the German Corporate Governance Code, as amended in the version dated May 21, 2003, with the following exceptions:

    a) The convention documents for the stockholders' meeting will not be sent via electronic channels (section 2.3.2).
    b) Following the resignation of Mr. Stephan Schambach the Executive Board consists for the time being of only one person, Dr. Jürgen Schöttler. (section 4.2.1).
    c) The Supervisory Board will not receive performance-related compensation. Compensation will be published as an aggregate amount. (section 5.4.5).
    d) The consolidated financial statements will be published no later than 30 days after the deadline stated in the Code, in accordance with the deadline laid down in section 62 (3) of the Exchange Rules of the Frankfurt Stock Exchange (section 7.1.2).



This declaration has been permanently available to stockholders on the Company's web site at http://www.intershop.com/investors since February 13, 2004.

Jena, March 19, 2004
Intershop Communications AG

Eckhard Pfeiffer
Chairman of the Supervisory Board

Dr. Jürgen Schöttler
Chief Executive Officer

Report of the Supervisory Board

The Supervisory Board oversaw and monitored the activities of the Management Board in accordance with the tasks imposed upon it by law and the Articles of Association and assured itself that corporate governance standards were implemented and observed throughout the Company. The Supervisory Board convened for meetings on January 30, 2003, April 11, 2003, May 27, 2003, September 11, 2003, and October 27, 2003.

During 2003, the Supervisory Board continued to support the activities of the Management Board. The Supervisory Board was consulted by the Management Board on a series of strategic decisions in several telephone and video conferences. The Management Board regularly reported to the Supervisory Board both on the Company's progress towards achieving annual targets and on the prospects for future periods. The Supervisory Board's Audit Committee held meetings with the Management Board member responsible for finance and the head of accounting on a monthly basis to discuss, analyze, and monitor financial issues relating to day-to-day business operations.

In 2003, no member of the Supervisory Board attended fewer than half of the Supervisory Board's meetings. No conflicts of interest arose for any of the Supervisory Board members during the year.

One change was made to the composition of the Supervisory Board in 2003. The Gera Local Court appointed Dr. Harald Rieger as a new member of the Supervisory Board with effect from March 31, 2003. Dr. Rieger resigned from the Supervisory Board with effect from October 31, 2003 for personal reasons. He also resigned as a member of the Audit Committee at the same time. The Supervisory Board would like to thank Dr. Rieger for his work.

There were a number of changes to the Management Board in the fiscal year 2003. On July 14, 2003, Mr. Stephan Schambach handed over his position as Chairman of the Management Board and Chief Executive Officer (CEO) with immediate effect to Dr. Jürgen Schöttler, the Management Board member responsible for finance and Chief Financial Officer (CFO). Dr. Schöttler now holds the positions of both CEO and CFO. Mr. Stephan Schambach's duties on the Management Board focused on strategy and product development until he left the company and at the same time resigned as a Management Board member on February 4, 2004. Mr. Werner Fuhrmann resigned as a Management Board member with immediate effect on July 16, 2003. Mr. Fuhrmann was responsible for sales in the Europe, Middle East, and Africa regions. We would like to thank Mr. Schambach and Mr. Fuhrmann for their contributions to Intershop Communications AG.

Ernst & Young Revisions- und Treuhandgesellschaft mbH Wirtschaftsprüfungsgesellschaft Steuerberatungsgesellschaft (auditors and tax consultants; formerly Arthur Andersen Wirtschaftsprüfungsgesellschaft Steuerberatungsgesellschaft mbH), which was elected by the Annual Stockholders' Meeting on May 28, 2003 as auditor for fiscal year 2003, audited the accounts, the annual and consolidated financial statements, and the combined management report and group management report of Intershop Communications AG and issued unqualified audit opinions. After detailed reviews by the Audit Committee, the Supervisory

Board also reviewed the annual financial statements and the consolidated financial statements for the year ended December 31, 2003, and the combined management report and group management report. On April 28, 2004, the Supervisory Board concurred with the audit results and approved the annual and consolidated financial statements prepared by the Management Board. The annual financial statements of Intershop Communications AG have thus been adopted.

On behalf of the Supervisory Board, I would like to thank the Management Board and all our employees for their hard work and commitment in the past fiscal year.
Jena, April 28, 2004

Eckhard Pfeiffer
Chairman of the Supervisory Board
Intershop Communications AG

Corporate Structure

Intershop Communications AG:

	Ownership %
Intershop Communications, Inc., San Francisco, USA	100
Intershop Communications Ventures GmbH, Jena, Germany	100
Intershop (U.K.) Ltd., London, United Kingdom	100
IS Nordic, AB, Stockholm, Sweden	100
Intershop Communications Hong Kong Co. Ltd., Hong Kong, China	99.99
Intershop Communications Singapore Pte. Ltd., Singapore	100
Intershop Communications Australia Pty Ltd., Sydney, Australia	100
Intershop Communications Taiwan Co. Ltd., Taipei, Taiwan	100
Intershop Communications Korea Co. Ltd., Seoul, Korea	99.98
Intershop Communications K.K., Tokyo, Japan	100

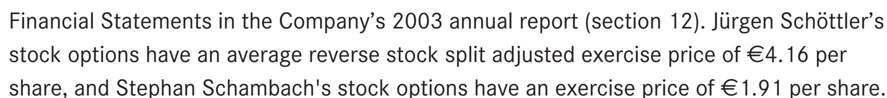
Directors' Holdings

As of December 31, 2003, post one-for-five reverse stock split

Name	Title, Function	Shares held*	Stock options held*, **
Eckhard Pfeiffer	Chairman of the Supervisory Board	80,000	0
Theodore J. Smith	Vice-Chairman of the Supervisory Board	21,458	0
Peter Mark Droste	Member of the Supervisory Board	0	0
Hans W. Gutsch	Member of the Supervisory Board	70,000	0
Burgess Jamieson	Member of the Supervisory Board	228,900***	0
Dr. Jürgen Schöttler	Chief Executive Officer, Chairman of the Management Board, Chief Financial Officer ****	14,000	160,000
Stephan Schambach	Member of Management Board ****	4,244,299***	100,000

* All information post one-for-five reverse stock split. As part of the Company's initiative to strengthen its balance sheet and increase its financial flexibility, on October 30, 2002 Intershop's stockholders approved the reduction of the company's capital by €77,225,600, or a ratio of five to one, from €96,532,000 to €19,306,400. This reduction in share capital took legal effect on December 12, 2002, when a resolution on a simplified reduction of capital was entered in the commercial register of Gera, Germany, local court, in accordance with sections 229 ff. of the Aktiengesetz (German Stock Corporation Act). The new shares began trading on a consolidated basis on January 20, 2003. Following the stock split, the International Securities Identification Number (ISIN) of Intershop Communications AG's common bearer shares changed from ISIN DE 000 622 700 2 to ISIN DE 000 747 292 0.

** The stock options were granted under the conditions of the 1999 Equity Incentive Plan. Details on the 1999 Equity Incentive Plan can be found in the Notes to the Consolidated



Financial Statements in the Company's 2003 annual report (section 12). Jürgen Schöttler's stock options have an average reverse stock split adjusted exercise price of €4.16 per share, and Stephan Schambach's stock options have an exercise price of €1.91 per share.

*** On June 18, 2003, Intershop disclosed that the share swap announced on January 23, 2002, under which the Chairman of the Management Board and co-founder Stephan Schambach would exchange his shares in the subsidiary Intershop Communications, Inc. for common bearer shares of the parent Company, Intershop Communications AG, had been completed. Under the transaction, Mr. Schambach exchanged his 4,166,665 shares of Intershop Communications, Inc., the U.S. subsidiary majority-owned by Intershop Communications AG, for 2,499,999 common bearer shares of Intershop Communications AG. To this end, Intershop Communications AG issued 2,499,999 new common bearer shares from Conditional Capital III. Similarly, on June 17, 2003, Burgess Jamieson, a Member of the Supervisory Board of Intershop Communications AG, exchanged his 381,500 shares of Intershop Communications, Inc. for 228,900 common bearer shares of Intershop Communications AG on the basis of an existing exchange option. To this end, Intershop issued 228,900 new common bearer shares from Conditional Capital III. Neither Mr. Schambach's nor Mr. Jamieson's new shares have yet been admitted for trading on the Frankfurt Stock Exchange. The transaction by Mr. Schambach increased the number of issued shares of Intershop Communications AG by 12.8%, from 19,535,300 before the implementation of the share swap to 22,035,299 afterwards. As a result of the swap, Mr. Schambach's interest in the share capital of Intershop Communications AG increased from 8.93% before the implementation of the share swap to 19.26% afterwards.

**** On July 14, 2003 the Company's Supervisory Board appointed Dr. Jürgen Schöttler to the position of Chairman of the Management Board and Chief Executive Officer. Dr. Schöttler remained the Management Board member responsible for finance and Chief Financial Officer. Mr. Stephan Schambach was the Management Board member responsible for Strategy and Product Development at the balance sheet date. On February 4, 2004, Mr. Schambach resigned as a member of the Management Board and at the same time left the Company.

Securities Transactions Subject to Reporting Requirements

The members of the Company's executive bodies made the following purchases of Intershop common bearer shares during the fiscal year 2003 (expressed in line with the 5:1 reverse stock split):

Name	Date	Type of transaction	Amount	Total value (€)
Supervisory Board:				
Burgess Jamieson	June 17, 2003	Purchase*	228,900	228,900
Management Board:				
Dr. Jürgen Schöttler	February 28, 2003	Purchase	2,100	5,250
Dr. Jürgen Schöttler	March 3, 2003	Purchase	5,900	14,750
Stephan Schambach	March 5, 2003	Purchase	77,000	254,100
Stephan Schambach	June 18, 2003	Purchase*	2,499,999	2,499,999

* please refer to the information on the shares acquired by Burgess Jamieson and Stephan Schambach on June 17, 2003 and June 18, 2003 respectively, under section 2 "Directors' Holdings", footnote ***.

Offices

Jena / Hamburg / Stuttgart / San Francisco

Financial Calendar 2004

Date	Event
February 13, 2004	Release of Q4/03 and FY 2003 financials
April 30, 2004	Release of Q1/04 financials
July 7, 2004	Annual stockholders' meeting
July 30, 2004	Release of Q2/04 and 6-month financials
October 29, 2004	Release of Q3/04 and 9-month financials

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