October 20, 1879
was a great day to be a candlemaker.

Digital River 2001 Annual Report

October 21, 1879

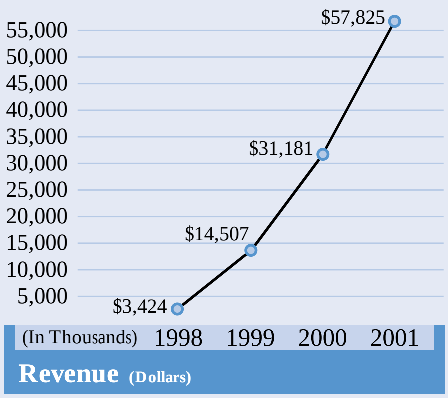
But on October 21, 1879, that all changed. On that remarkable day in history, Thomas Edison tested the first successful electric light bulb. With this single invention, he improved nearly every facet of daily life. No longer would the world's activities in education, recreation, commerce and many other areas be confined to the time between sunrise and sunset.

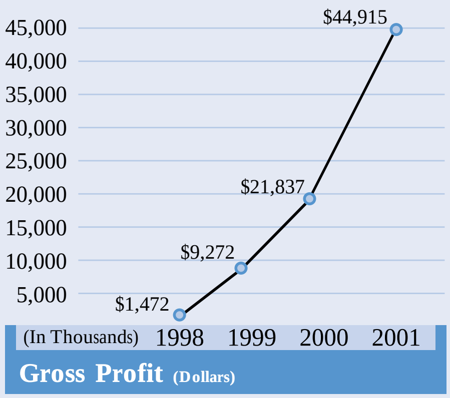
Only a handful of other inventions, such as the printing press, radio, airplane, computer and Internet, have had as great an impact on the world. Each invention made a significant initial impact on the way things were done, but also made an even greater impact after people created new, and often more valuable, ways of using them. Dr. Theodore H. Maiman understood this when he said, "When something radically new comes along, it takes a while to find proper use for it. People forget that it was about thirty years between the Wright brothers' first flight and the start of commercial aviation."

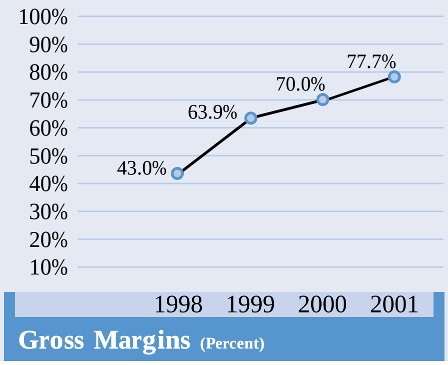
In addition to the inventions themselves, it was in how these inventions were used that helped them make a major impact on our lives. Did the Wright brothers know their flying machine would one day be the basis for space travel? Did the scientists who built ARPANET know that their invention would become the Internet and bring traditional commerce and business operations to an entirely new level? They may not have, but insightful, forward-thinking people made all these advances possible. We at Digital River share this insight. **The rest is history**!

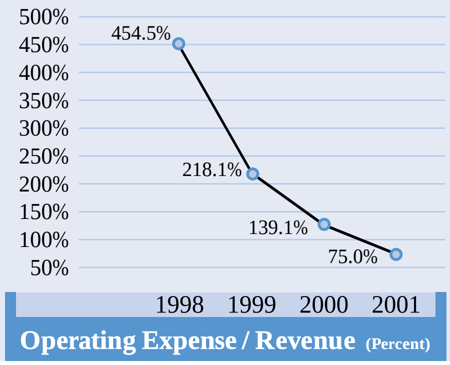
Staying Focused for the Future

Financial Highlights









About Our Company

Founded in 1994, Digital River is a leading global e-commerce provider, offering more than 32,000 companies complete e-commerce systems and services. The company's world-class infrastructure and professional services are proven to grow businesses quickly and profitably.

Digital River's services include e-commerce strategy, site development and hosting, order and transaction management, system integration, product fulfillment and returns, e-marketing and customer service. With over 450 employees, Digital River is headquartered near Minneapolis and has offices in Chicago, Raleigh, Seattle and the United Kingdom.

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To Our Stockholders

During an unprecedented year of challenges in our country, Digital River established its reputation for e-commerce and e-marketing expertise and also became known for its stability and focus.

Above all, we delivered on our goals as we achieved a key milestone in reporting our first full quarter of company-wide profitability, prior to the amortization of goodwill and acquisition related expenses, in the fourth quarter. We also exited the year as a company generating positive cash flows.

These significant milestones are a tribute to our executive and director teams as well as all of the talented associates at Digital River. Through our team's efforts, hard work and focus, our clients continue to see the true value that our e-commerce outsourcing model offers to their various businesses.

Digital River's mission is to be the leading global e-commerce provider. We not only build, host and manage e-commerce sites and operations for our clients, but we are also committed to and highly focused on growing their sales. We help companies quickly and profitably manage everything that goes into building their e-businesses.

We stayed this course despite a difficult economic environment. We continued to see opportunities and we demonstrated our ability to excel despite the catastrophic event that occurred on September 11 and the subsequent impact on businesses across multiple industries.

2001

Revenue	$57.8 Million	Up **85** percent
Gross Profit	$44.9 Million	Up **106** percent
Gross Margin	77.7%	Up **770** basis points
Revenue per Employee	$122,000	Up **49** percent

“We achieved a key financial milestone by meeting our profitability targets for 2001. We will continue to stay the course, focus on our business’ growth drivers and capitalize on future trends and opportunities.”

Joel A. Ronning
Chief Executive Officer

Joel A. Ronning - Chief Executive Officer

To Our Stockholders

Last year continued to be a period of rapid growth for Digital River. During the year, we saw revenue per employee grow to $122,000 from approximately $82,000 in 2000. We believe this growth will continue as companies worldwide look to us to design, build, manage and grow their e-commerce operations. We also believe our results point to an organization that continues to take advantage of operating efficiencies, leverages its technology investments and quickly reacts to changes in the economic environment.

Financial Results

As we mentioned, Digital River arrived at its company-wide profitability goal in the fourth quarter of 2001. In fact, during the year we exceeded overall revenue and profitability goals, held year-over-year operating expenses flat, on an absolute basis, and improved margins.

For the year ended December 31, 2001, Digital River's revenues totaled $57.8 million, an 85 percent increase from $31.2 million last year. For the full year, the net loss prior to the amortization of goodwill and acquisition related costs was $2.2 million, or $0.09 per share. The net loss, including the amortization of goodwill and acquisition related costs, totaled $19.2 million, or $0.79 per share, compared with a net loss of $38.1 million, or $1.78 per share for the full year in 2000.

Cash and investments at the end of the year totaled $31.7 million. We believe that our cash position is sufficient to continue investing in our business and will continue to grow from operations during 2002.

Operating Goals

During the year, we focused on four key performance metrics to gauge the success of our efforts. They continue to be:

1. Manage increases in our top line relative to growth in our employee base. Revenue growth outpaced the growth in employees at Digital River by four-fold last year.

2. Manage capital expense levels. We've substantially cut capital expenditures as we continue to leverage the investments that we have made over the past few years. Last year, we saw a nearly 40% decline in capital expenditures from the prior year and in 2002, our highly scalable e-commerce platform should help us to grow while holding capital expenditures relatively flat.

3. Expand our operating margins by increasing efficiencies. We've increased gross margins beyond originally anticipated levels and have revised our long-term operating model to show a measurable improvement in operating profits. We're already benefiting from technology investments made in our customer service area, and we'll continue to leverage our network and infrastructure in 2002.

4. Manage our operating expenses. We continue to manage our operating expense base downward while growing our revenue. Last year, while we nearly doubled our revenue base from the prior year, we held operating expenses flat, on an absolute basis.

Technology Platform

One of our top priorities at Digital River last year was to commence development of our next generation e-commerce platform named Digital River X-Stream™. These efforts focus on two key initiatives. The first is to build a new e-commerce system based on J2EE compliant technology, which is scheduled to be completed in the summer of 2002. We believe that X-Stream™ will allow us to develop and implement newer, higher quality functionality that will result in quicker time-to-market.

Our second initiative involves transforming our e-commerce platform to a packaged application. By offering prospective clients the option of outsourcing our e-commerce system while running our packaged application, we can offer greater flexibility. And since clients will be able to transition to either system, they will have more deployment options. We believe this will become a significant competitive advantage for Digital River.

To Our Stockholders

Growth Drivers

In 2002, our growth will be supported by four key drivers. They are:

• *Increasing the value of customer orders through focused e-marketing*. We intend to continue growing with our current clients' businesses and generate more sales for them and us through our e-marketing efforts. Last year we successfully executed thousands of e-direct marketing campaigns for our clients. Our proven results are tied to our ability to apply solid analytical skills and merchandising expertise to a deep base of transactional data.

• *Attract new clients*. We believe we will continue to attract new clients. Digital River has already established its leadership position in the first vertical market that we served, software and digital commerce, and will continue to build market share among a broader base of manufacturers, distributors and retailers.

• *The organic growth of the Internet*. Year-after-year, the Internet continues to gain in popularity as a more secure and convenient channel for purchasing. Digital River will continue to benefit from the paradigm shift that end customers are now buying on both business-to-business and business-to-consumer platforms.

• *Take advantage of industry consolidation*. As of April 2002, we have completed eleven acquisitions in the the past three years. In conjunction with acquisitions, we demonstrated an expertise in integrating clients, assimilating cultures, consolidating operations and increasing efficiencies. We intend to continue to take advantage of the consolidation occurring in the industry and to selectively acquire other business service providers considering exit strategies. We will continue to focus on opportunities that are accretive to earnings, augment our technology platform and open up new market opportunities.

Staying Focused for the Future

In the coming year, we will remain committed to growing our company and helping our clients achieve their e-commerce objectives. We will also continue to differentiate ourselves within an industry that is redefining itself during rapid consolidation.

We are excited about the prospects of taking this business forward as we provide established companies with world-class e-commerce systems that offer a low-risk business opportunity and a high return on investment. Certainly outsourcing is a market trend that continues to ramp up as more and more companies conclude that it is too inefficient and capital intensive to implement e-commerce on their own. These same companies continue to show interest in the Internet as a direct sales channel that offers closer customer relationships and increased efficiencies and revenues.

Despite all the events that happened in the past year, we emerged a strong company in an enviable market position. We have a world-class infrastructure and a strong management team that continues to fly in tight formation in a very challenging economic environment. We've accomplished our goals by sticking to business fundamentals, generating new sales opportunities and taking advantage of market consolidation. And we've been recognized for our ability to perform by media, analysts, clients and competitors.

We firmly believe that Digital River is a strong, healthy and growing business. We thank our clients for their loyalty. We thank our associates for their contributions and dedication. And, we thank our stockholders for their support.

We will remain focused for what lies ahead...

Joel A. Ronning - Chief Executive Officer

A company unlike the rest

It is easy to remember life before the Internet, and then overnight, how it changed everything. Hundreds of companies rushed to the Internet hoping that it would mean greater profits and success. However, soon thereafter many of these companies failed, thinking all they needed to do was set up a Web site, warehouse some products, push a few buttons and wait for the profits to start flowing in. Too often, as companies and investors have witnessed, it hasn't worked out that way. We've learned that, "e" or no "e," the centuries-old rules of business still apply. The Internet may be in the process of changing the playing field of commerce, but it isn't changing the time-honored rules of business.

Unlike many, Digital River is one of the few companies that continues to thrive in the new e-world economy. Digital River saw the Internet not as an end in itself, but as a revolutionary means for businesses to interact with, and sell to, their customers and business partners. Our business model uses the Internet to enable our clients to open new markets, communicate and work with their partners and customers, and add value to their partner and customer relationships. In doing so, we help them generate revenue and cost-savings for their businesses.

In fact, by following this sound business model and having a plan that guides our future transactions and business decisions, we have achieved exceptional revenue growth while controlling expenses, managing cash flow and increasing our operational efficiencies. Digital River's growth has been driven by four key strategies: taking advantage of the organic growth of the Internet; winning new clients; executing revenue-generating e-marketing campaigns to grow our clients' businesses and acquiring companies.

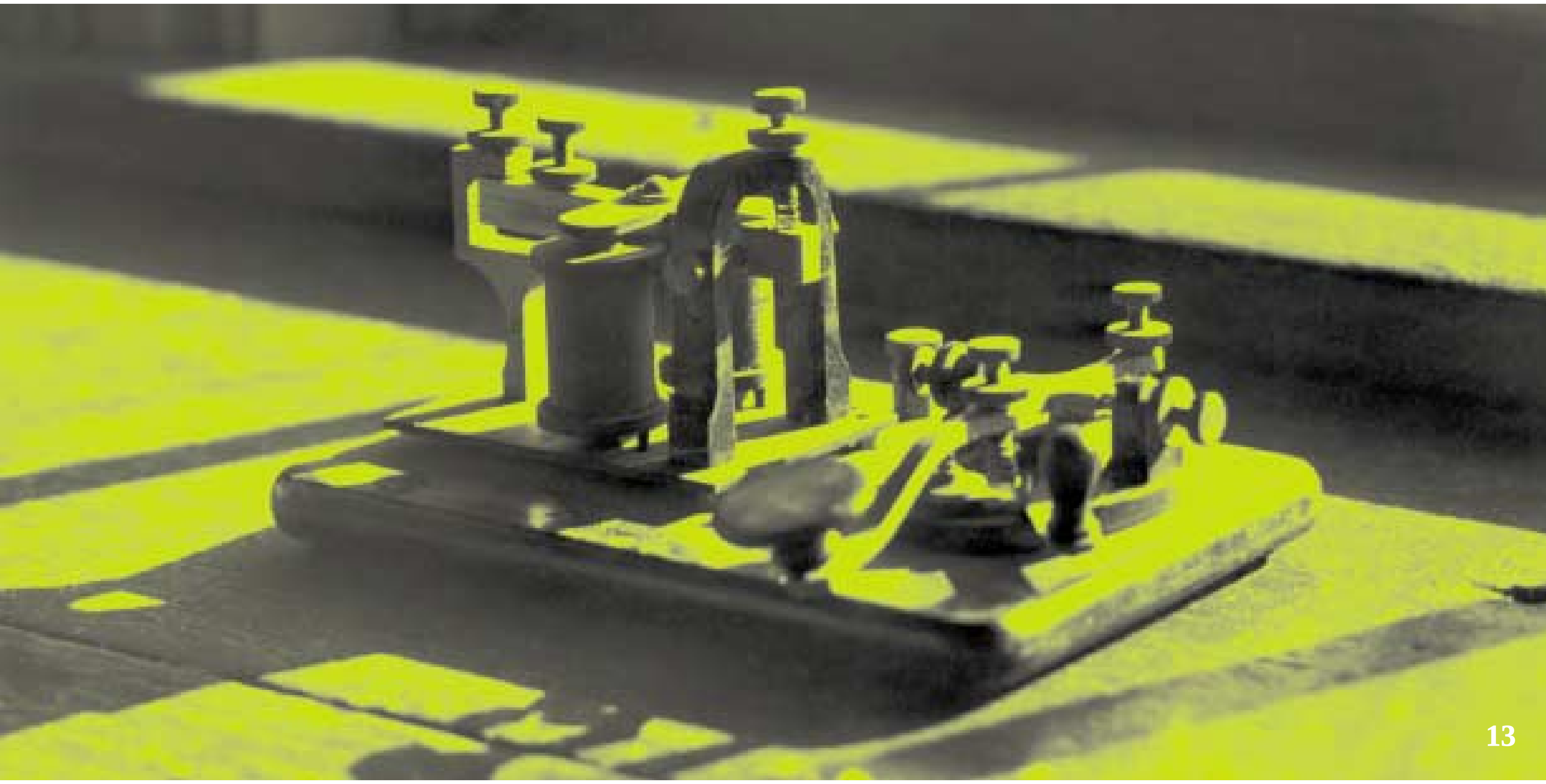
The rising tide of the Internet

Lawrence Roberts, credited as one of the Internet's founders, has examined its growth since its origination. Through his studies, he has seen peaks and valleys in Internet use, but over time, one thing remains constant: Internet traffic is growing, and it's growing very rapidly.

Along with more traffic comes more online shoppers, a study by the Pew Internet and American Life Project confirms. This increase was most evident in the 2001 holiday online shopping season when, according to the study, 29 million U.S. Internet users bought holiday gifts online in November and December 2001, compared to 20 million users in 2000, with an average order size increasing to $392 compared to $330 in 2000.

The largest revenue growth is expected within the business-to-business (B2B) market, with the worldwide value of goods and services purchased by businesses increasing from $282 billion in 2000 to $4.3 trillion by 2005, according to a study by International Data Corp. U.S. businesses will represent the largest segment of these shoppers, with their online purchases expected to increase at an annual rate of 68 percent from 2001 to 2005.

To help our clients maximize this growth, Digital River offers numerous traffic and revenue-generating services. Our B2B services include techniques to encourage targeted users to accept new, online processes. For the business-to-consumer (B2C) segment, we offer creative ways to entice users to shop online, such as permission-based e-mail marketing. When customers are online, we employ purchasing techniques such as site merchandising to make it easy for them to shop and buy, and 24x7 on- and off-line customer service to answer customers' questions.



Samuel Morse's Telegraph was first used on May 24, 1844.

New companies join Digital River as clients

Our world-class e-commerce products and services and our reputation for having sophisticated digital download technologies attract a client base of highly successful companies. This year, we were pleased to add a number of premier clients to the more than 32,000 companies whose e-commerce needs we serve. Some of our key clients include Autodesk, Major League Baseball Advanced Media, MicroWarehouse, SONICblue and Symantec.

For these clients and many others, Digital River provides enterprise-wide e-commerce solutions with pre-integrated capabilities such as e-marketing and customer relationship management. For example, the online specialty gift stores we host and manage for large consumer goods manufacturers use advanced database management tools to target audiences and merchandise stores. In the sporting industry, Digital River creates and manages apparel and accessories stores that incorporate features like online auctions and balloting for an avid fan base. In the wireless communications industry, our ability to host multiple stores allows companies to offer the latest in software and accessories from a variety of manufacturers in a single shopping environment.

To serve our largest industry, software and digital product manufacturers, we've created a number of tools and services to help clients leverage our vast client network through joint sales and marketing efforts. We also expanded our international capabilities to handle money orders, wire transfers and AccepGiro payment options, and to display localized languages and currencies based on the user's URL. With these tools, Digital River clients are well-positioned to succeed in a global market.

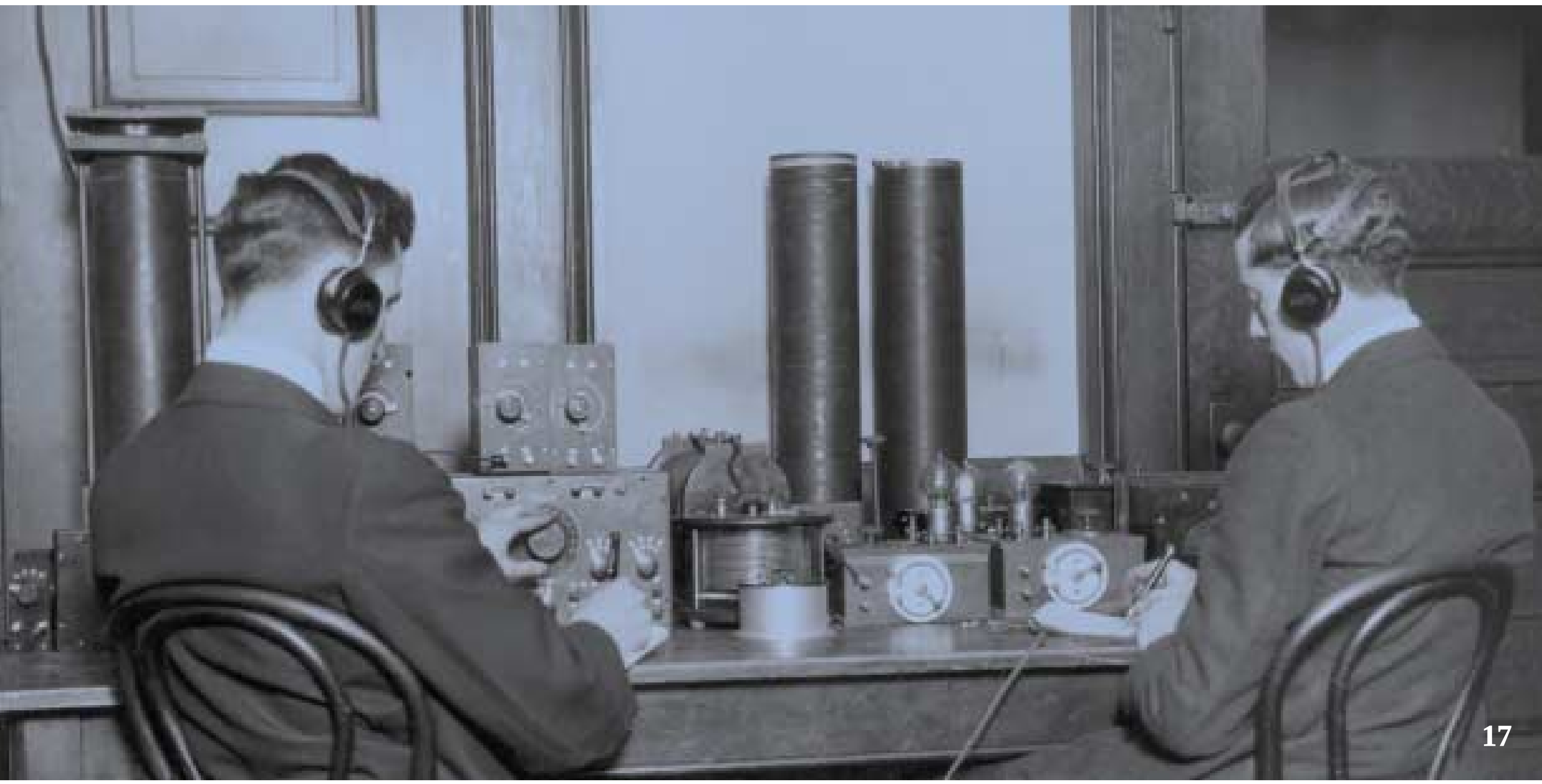
The first call on Alexander Graham Bell's Telephone was made June 3, 1875.

Growing revenue through e-marketing

With a virtual flood of e-commerce sites competing for attention, it takes more than just luck to get customers to choose one site over another. It takes marketing, and marketing is something at which Digital River excels. Our E-Marketing Services group (EMS) is comprised of talented professionals who are adept at making the Internet produce for our clients. EMS partners with our clients to create and implement strategic e-promotions that combine proven tactics for driving e-commerce traffic, turning site visitors into buyers, and getting buyers to spend more money more often. These tactics utilize a wealth of e-marketing tools, including tools designed to increase average order sizes and close sales ratios.

Another key player in this team is the Digital River Account Development Manager (ADM). The ADM is the primary resource our clients go to for everything they do or need at Digital River, including all e-marketing and merchandising activities. As ADMs help clients use e-marketing to maximize their online revenue potential, they also help Digital River maximize its revenue-generating opportunities due to our revenue-sharing model.

When this team is in action, Digital River generates real, quantifiable results for clients. An analysis of transactions in the Digital River commerce system shows that clients who use our e-marketing services have increased their revenue by an average of 6 percent monthly, which compounds to a more than 100 percent annual revenue increase. These figures compare to the only 2 percent monthly or less than 30 percent annual growth earned by clients who do not use our e-marketing services. These statistics have helped our e-marketing capabilities earn the same world-renowned reputation we enjoy for our e-commerce operations.



Nikola Tesla's experiments with high frequency electric currents in 1893 are the first demonstration of wireless communication.

Acquiring companies offers Digital River multiple benefits

In pursuing our mission to be the leading global e-commerce provider, we have made acquisitions an important part of our long-term growth strategy. With eleven acquisitions behind us in the last three years (as of April 2002), we have shown that we know how to efficiently integrate clients and cultures, consolidate operations and increase efficiencies to make acquisitions accretive to our bottom line.

Last year, we reinforced our strong e-commerce leadership position by acquiring RegSoft.com, Inc., Calico Commerce, Inc.'s Market Maker business, certain assets of Orbit Commerce, Inc. and Network Commerce Inc.'s FreeMerchant.com. These acquisitions have supported our growth, leveraged our world-class scalable e-commerce system and fixed infrastructure across thousands of new clients to generate incremental earnings and further extended our market potential in the small to mid-sized enterprise (SME) market.

Our acquisition of the Market Maker business significantly contributed to the accelerated development of our next-generation e-commerce platform, Digital River X-Stream™.

With our acquisition of certain Orbit Commerce assets, we established channel partnerships with industry leaders such as Gateway, Inc., Cincinnati Bell, VeriSign, Inc. and other large enterprises. These relationships, along with our acquisition of RegSoft.com and certain assets of Network Commerce's FreeMerchant.com, are helping us extend our presence in the SME market and generate new opportunities. They also bring to Digital River new service capabilities and give us the ability to offer lower-cost and self-directed services to the SME market. As a result, we meet a broad range of e-business and commerce needs ranging from enterprise-wide solutions for Fortune 1000 corporations to solutions for the SME market.

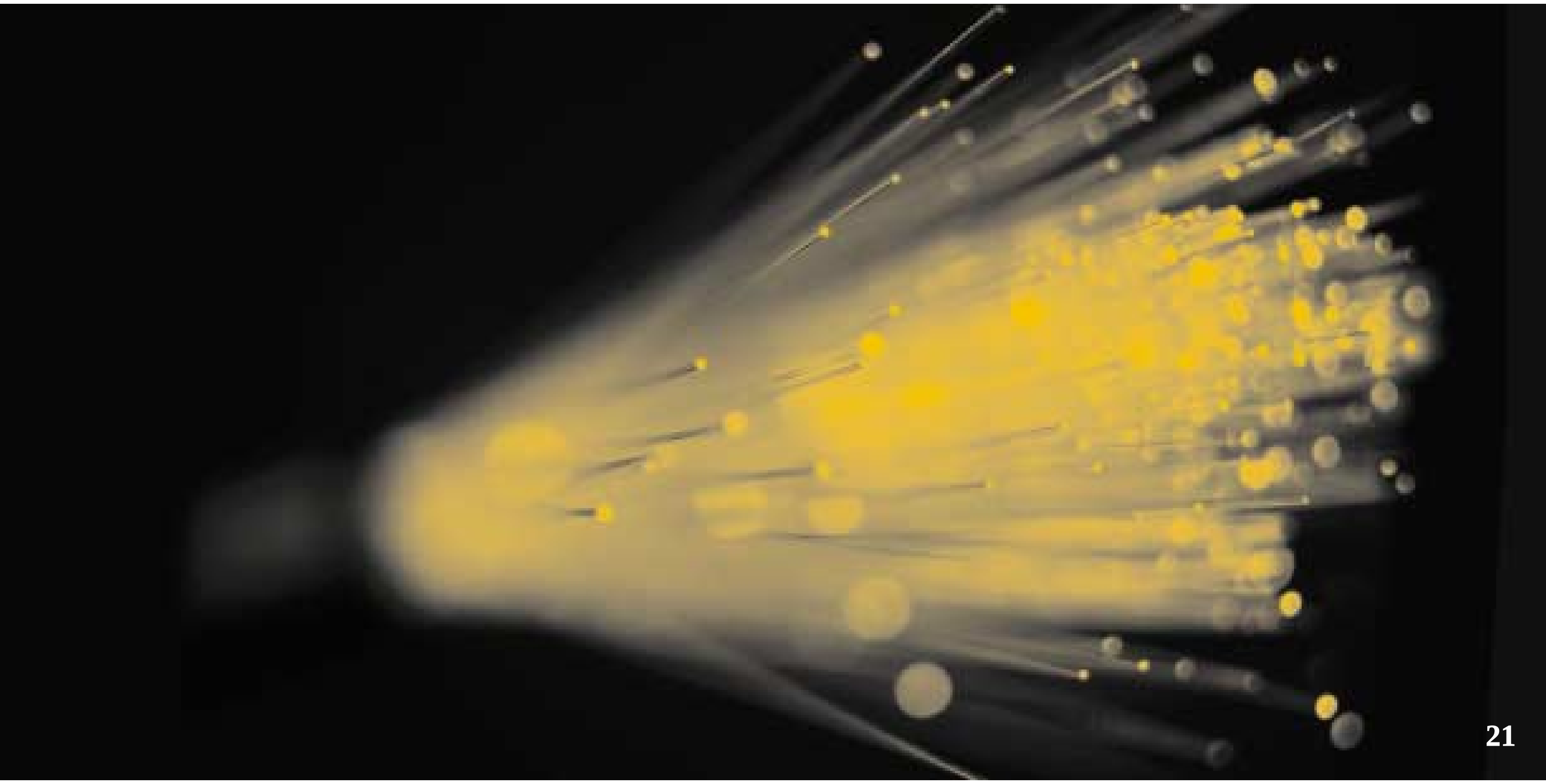
Early computer users c. 1946.

A new platform to serve companies with varying e-commerce needs

This year, we invested substantial resources in developing, refining and enhancing our world-class e-commerce platform. Our next generation platform, Digital River X-Stream™, is completely J2EE compliant and leverages the latest standards in the areas of content caching, database access and thin client capabilities that allow the system to be managed from any browser, anywhere, anytime. The X-Stream commerce system also provides our clients with the full spectrum of options in deploying their e-commerce initiatives with complete outsourcing on one end and in-house deployment on the other. Digital River's X-Stream allows our clients and their business partners and customers to conduct both Internet and mobile based buy- and sell-side sales processes online, incorporating browsing and shopping, product catalog management, order management, user management, merchandising and campaign management, product searching, contract pricing, quoting, payment processing, customer service and payment settlement.

By adding a packaged solution to our core offering, we can now offer any company the option to buy our solution and manage it in-house by themselves or outsource their entire e-commerce operation to us, leveraging our scalable infrastructure. And if at some point companies that have chosen to utilize the advantages of Digital River's outsourced commerce services decide to manage their e-commerce operations in-house, the hosted application can be quickly and seamlessly migrated to the clients' servers. This choice gives our clients a long-term plan for protecting the integrity of their e-commerce solution and investment.

We are excited for the growth opportunities our broadened capabilities present. We expect that these capabilities combined with our plans to add new clients, grow our existing clients' e-businesses, leverage the Internet's organic growth and pursue acquisitions will help ensure that Digital River's best days are ahead of us.



In 1926, Clarence W. Hansell experimented with the use of quartz fibers to transmit light. His experiments are the basis for modern fiber optics.

Financial Section

Digital River 2001 Annual Report

Selected Financial Data

Year Ended December 31,

(In thousands, except per share data)	2001	2000	1999	1998	1997
Revenue	$ 57,825	$ 31,181	$ 14,507	$ 3,424	$ 420
Costs and expenses (exclusive of depreciation and amortization expense shown separately below):					
Direct cost of services	2,710	1,477	801	116	23
Network and infrastructure	10,200	7,867	4,434	1,836	580
Sales and marketing	27,489	25,693	17,383	9,310	1,446
Product research and development	11,192	13,063	10,251	3,140	877
General and administrative	4,701	4,628	4,001	3,111	837
Depreciation and amortization	4,627	3,178	1,552	604	195
Amortization of goodwill and other intangibles and acquisition related costs	17,009	15,387	6,886	–	–
Total costs and expenses	77,928	71,293	45,308	18,117	3,958
Loss from operations	(20,103)	(40,112)	(30,801)	(14,693)	(3,538)
Interest income	881	1,966	3,148	895	53
Net loss	$(19,222)	$(38,116)	$(27,653)	$(13,798)	$ (3,485)
Basic and diluted net loss per share	$ (0.79)	$ (1.78)	$ (1.36)	$ (1.01)	$ (0.46)
Shares used in per share computation	24,285	21,413	20,312	13,691	7,514

December 31,

(In thousands)	2001	2000	1999	1998	1997
Cash and cash equivalents	$ 21,677	$ 16,920	$ 15,120	$ 63,503	$ 2,126
Short-term investments	9,978	14,977	24,387	10,894	–
Working capital	14,024	17,038	28,777	70,563	1,244
Total assets	78,227	69,403	87,142	80,328	3,405
Accumulated deficit	(103,114)	(83,892)	(45,776)	(18,123)	(4,325)
Total stockholders' equity	$ 50,422	$ 48,518	$ 73,077	$ 74,587	$ 2,329

(Unaudited, in thousands except per share data)

2001	**Quarter ended** March 31	June 30	September 30	December 31
Revenue	$ 13,047	$ 13,055	$ 13,991	$ 17,732
Gross profit **(a)**	9,526	9,906	11,069	14,414
Loss from operations **(b)**	(6,589)	(5,324)	(4,548)	(3,642)
Net loss	(6,241)	(5,062)	(4,374)	(3,545)
Net loss per share **(c)**	$ (0.28)	$ (0.21)	$ (0.18)	$ (0.14)

2000	**Quarter ended** March 31	June 30	September 30	December 31
Revenue	$ 6,883	$ 6,635	$ 7,607	$ 10,056
Gross profit **(a)**	4,798	4,403	5,298	7,339
Loss from operations **(b)**	(12,675)	(13,187)	(8,456)	(5,793)
Net loss	(11,991)	(12,633)	(8,074)	(5,418)
Net loss per share **(c)**	$ (0.58)	$ (0.60)	$ (0.37)	$ (0.24)

(a) Gross profit is calculated as revenue less direct cost of services and network and infrastructure expenses and excludes depreciation and amortization expense.

(b) Loss from operations includes amortization of goodwill and other intangibles and acquisition related costs of $4,644, $3,839, $3,912 and $4,614 in the quarters ended March 31, June 30, September 30 and December 31, 2001, respectively and includes amortization of goodwill and other intangibles and acquisition related costs of $5,394, $4,334, 2,603 and $3,056 in the quarters ended March 31, June 30, September 30 and December 31, 2000, respectively.

(c) Net loss per share is the same for both basic and diluted.

The Company notes that, except for the historical information contained herein, the matters discussed below contain forward-looking statements which involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. The Company expressly disclaims any obligation to update this information or publicly release any revision or reflect events or circumstances after the date of this report. Such factors include, among others: the Company's limited operating history and variability of operating results, expectation of future losses, risks associated with electronic software delivery, dependence on the Internet and growth in electronic commerce and internet infrastructure development, dependence on software publishers, dependence on online retailers, system development and electronic commerce security risks, rapid technological changes, competition in the electronic commerce industry, the importance of attracting and retaining personnel, management of the Company's growth, integration of acquired companies, dependence on key employees and other risk factors referenced in the Company's Form 10-K for the year ended December 31, 2001.

Overview

The Company is a leading provider of comprehensive electronic commerce outsourcing solutions. The Company was incorporated in February 1994 and commenced offering products for sale through its clients' Web stores in August 1996. From inception through August 1996, the Company had no sales, and its activities related primarily to the development of its Commerce Network Server ("CNS") technology related to electronic commerce. In 1996, the Company began to focus its business development efforts on the software industry, building its inventory of software products through contracts with software publishers. In 1997, the Company began to develop software distribution relationships through contracts with online retailers. As of December 31, 2001, the Company had approximately 10,000 software publisher clients and online retailer clients served by the Software and Digital Commerce Services Division. In late 1998, the Company began to offer its comprehensive electronic commerce outsourcing services in the form of a transaction fee-based e-commerce service to clients outside of the software industry. As of December 31, 2001, the Company was operating approximately 11,000 sites under its E-Business Services Division.

The Company has a limited operating history upon which investors may evaluate its business and prospects. Since inception, the Company has incurred significant losses, and as of December 31, 2001, had an accumulated deficit of approximately $103.1 million. The Company intends to expend financial and management resources on the development of additional services, sales and marketing, technology and operations to support larger-scale operations and greater service offerings. Although the Company expects to generate positive cash flow from operations in 2002, there can be no assurance that the

Company's revenue will increase or even continue at its current level or that the Company will achieve or maintain profitability or generate cash from operations in future periods.

The Company's prospects must be considered in light of the risks, expenses and difficulties frequently encountered by companies in their early stage of development, particularly companies in new and rapidly evolving markets such as electronic commerce. To address these risks, the Company must, among other things, maintain existing and develop new relationships with software publishers, online retailers and E-Business Services clients, implement and successfully execute its business and marketing strategy, continue to develop and upgrade its technology and transaction-processing systems, provide superior customer service and order fulfillment, respond to competitive developments, and attract, retain and motivate qualified personnel. There can be no assurance that the Company will be successful in addressing these risks, and the failure to do so would have a material adverse effect on the Company's business, financial condition and results of operations.

The Company's current and future expense levels are based largely on its planned operations and estimates of future revenue. Revenue and operating results generally depend on the volume and timing of orders received, which are difficult to forecast. The Company may be unable to adjust spending in a timely manner to compensate for any unexpected revenue shortfall. Accordingly, any significant shortfall in revenue would have an immediate adverse effect on the Company's business, financial condition and results of operations. The Company is also likely to continue to see revenue in its Software and Digital Commerce Services Division fluctuate on the seasonal basis typical for the software publishing market in general. The Company believes that its fiscal first and fourth quarters are seasonally stronger than its second and third quarters due to the timing of demand for tax preparation software and the holiday season selling period. In addition, it is the Company's belief that software publishers avoid new product releases in the summer months. In view of the rapidly evolving nature of the Company's business and its limited operating history, the Company is unable to accurately forecast its revenue and believes that period-to-period comparisons of its operating results are not necessarily meaningful and should not be relied upon as an indication of future performance.

Critical Accounting Policies

We prepare our consolidated financial statements in conformity with accounting principles generally accepted in the United States of America. As such, we are required to make certain estimates, judgments and assumptions that we believe are reasonable based upon the information available. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the periods presented. The significant accounting policies which we believe are the most critical to aid in fully understanding and evaluating our reported financial results include the following:

Revenue Recognition.

The Company recognizes revenue from services rendered once all the following criteria for revenue recognition have been met: 1) Pervasive evidence of an agreement exists, 2) the services have been rendered, 3) the fee is fixed and determinable and not subject to refund or adjustment and 4) collection of the amounts due is reasonably assured. The Company derives its revenue primarily from transaction and service fees associated with the e-commerce services provided to its clients. These services include Web commerce hosting, transaction processing, digital and physical fulfillment services, fraud screening, customer service and merchandising and analytical marketing services. The Company reports its revenue on a net basis and therefore records only the net transaction fees and service fees as its revenue. The Company acts as the merchant of record on the majority of the transactions processed and has contractual relationships with its clients, primarily software publishers and online retailers, which obligate the Company to pay to the client a specified percentage of each sale. The Company retains its transaction fee and also charges for various service fees. The Company also derives revenue from providing clients the right to use its software applications along with integration, development and consulting services. Signed contracts are obtained from clients prior to recognition of these revenues. Fees for the use of software applications and any integration and development work required to provide on-going hosting services for the client are recognized ratably over the term of the contract once collection is reasonably assured. Clients do not have the right to take possession of the software applications used in the delivery of services. Payments received in advance of revenue recognition, even if non-refundable, are recognized as deferred revenue. Revenues from consulting services are recognized using the percentage-of-completion method for fixed-fee arrangements or as the services are provided for time-and-materials arrangements. If the Company does not accurately estimate the resources required or the scope of work to be performed, or does not manage its projects properly within the planned periods of time or satisfy its obligations under the contracts, then future margins may be negatively affected.

Allowance for Doubtful Accounts.

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amount of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates are used in determining our allowance for doubtful accounts and are based on our historical experience and current trends. Management makes an estimate of anticipated future chargebacks and product returns related to current period revenue by analyzing the timing of historical chargebacks and applying anticipated percentages to current period revenues. Similarly, management must make estimates of the uncollectability of our billed accounts receivable. Management specifically analyzes accounts receivable and historical bad debts, customer credit-worthiness, current economic trends and changes in our customer payment terms when evaluating the adequacy of the allowance for doubtful accounts. Significant management judgments and estimates must be made and used in connection with the allowance in any accounting period. Material differences may result in the amount and timing of our revenue for any period if management makes different judgments or utilizes different estimates.

Goodwill, Intangibles and Other Long-Lived Assets.
Property, plant and equipment, goodwill, intangibles, and certain other long-lived assets are amortized over their useful lives. Useful lives are based on management's estimates of the period that the assets will generate revenue. Intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The Company's evaluation considers nonfinancial data such as changes in the operating environment and business strategy, competitive information, market trends and operating performance. Future events could cause us to conclude that impairment indicators exist and that goodwill and other intangibles associated with our acquired businesses is impaired. Any resulting impairment loss could have a material adverse impact on our financial condition and results of operations. The Company expects amortization of goodwill and other intangibles and acquisition related costs to decrease in 2002 due to the adoption of Statement of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations" and SFAS No. 142, "Goodwill and Intangible Assets".

Results Of Operations

The following table sets forth certain items from the Company's consolidated statements of operations as a percentage of total revenue for the years indicated.

	2001	2000	1999
Revenue	100.0%	100.0%	100.0%
Costs and expenses:			
Direct cost of services	4.7	4.7	5.5
Network and infrastructure	17.6	25.2	30.6
Sales and marketing	47.5	82.4	119.8
Product research and development	19.4	41.9	70.7
General and administrative	8.1	14.9	27.6
Depreciation and amortization	8.0	10.2	10.7
Amortization of goodwill and other intangibles and acquisition related costs	29.4	49.3	47.4
Total costs and expenses	134.7	228.6	312.3
Loss from operations	(34.7)	(128.6)	(212.3)
Interest income	1.5	6.4	21.7
Net loss	(33.2)%	(122.2)%	(190.6)%

Years Ended December 31, 2001, 2000 and 1999

The Company has two operating segments, Software and Digital Commerce Services and E-Business Services, which have been identified as components of the Company that are reviewed regularly by management to determine resource allocation and assess performance. The Company began presenting the E-Business Services Division as a separate segment in 2000. Prior to that, substantially all revenue and related expenses were associated with the Company's Software and Digital Commerce Services Division.

Revenue.

The Company's revenue increased to $57.8 million in 2001 from $31.2 million in 2000 and $14.5 million in 1999. The revenue increase in 2001 resulted from the expansion of the Company's client relationship with Symantec Corporation, increasing market acceptance of electronic software downloading, merchandising activities that increased the average sales generated by the Company's software publisher clients and the four acquisitions completed by the Company in 2001. The entities acquired during 2001 generated approximately 7% of the Company's total revenue during the year. The revenue increases in 2000 and 1999 resulted from significant growth in the number of Company clients, the increasing market acceptance of electronic software downloading and merchandising activities that increased the average sales generated by the Company's software publisher clients. International sales represented approximately 22%, 25% and 22% of revenue in the years ended December 31, 2001, 2000 and 1999, respectively. In 2001, revenue for the Software and Digital Commerce Services Division was $44.9 million, up from $25.2 million in 2000. Revenue for the E-Business Services Division was $12.9 million in 2001, up from $6.0 million in 2000.

Gross Profit.

Cost of revenue consists of direct cost of services and network and infrastructure expenses and is composed of direct labor costs related to revenue and the costs to operate and maintain the CNS, as well as customer service and operations functions. Such amounts are shown exclusive of depreciation and amortization expense. Cost of revenue increased substantially in all years presented, reflecting the Company's growth in revenue. During 2001, 2000 and 1999, the Company's gross profit margins were 77.7%, 70.0%, and 63.9%, respectively. The gross profit margin increases in 2001, 2000 and 1999 were primarily due to leveraging the Company's infrastructure over significantly more revenue and clients. In 2001, the gross profit margin for the Software and Digital Commerce Services Division was 80.6%, up from 71.8% in 2000. The gross profit margin for the E-Business Services Division was 67.4% in 2001, up from 62.4% in 2000. The Company believes that Internet commerce and related services may become more competitive in the future. Accordingly, the Company may reduce or alter its pricing structure and policies in the future and any such change could reduce gross margins.

Sales and Marketing.

Sales and marketing expense consists primarily of personnel and related expenses, advertising and promotional expenses, credit card chargebacks and bad debt expense, and credit card transaction fees. Sales and marketing expense increased to $27.5 million in 2001, from $25.7 million and $17.4 million in 2000 and 1999, respectively, resulting from increased credit card transaction fees and bad debt expense due to increased revenue as well as additional sales and marketing personnel and related expenses. The increase in 2001 from 2000 resulted from an increase in credit card transaction fees of $3.3 million. The increase in 2000 from 1999 resulted from an increase in wages, benefits and consulting fees of $4.3 million and an increase in credit card chargebacks, bad debt expense and credit card transaction fees of $2.7 million. As a percentage of revenue, sales and marketing expense decreased to 47.5% in 2001 from 82.4% in 2000 and 119.8% in 1999, primarily reflecting the Company's increased revenue. In 2001, the sales and marketing expense related to the Software and Digital Commerce Services Division was $17.5 million, up from $14.7 million in 2000. The sales and marketing expense related to the E-Business Services Division was $10.0 million in 2001, down from $11.0 million in 2000. The Company expects that sales and marketing expense will continue to increase in absolute dollars as the Company continues to build its sales and marketing infrastructure and develops marketing programs and volume-driven credit card expenses increase. As a percentage of revenue, these expenses are expected to decrease as revenue increases.

Product Research and Development.

Product research and development expense consists primarily of personnel and related expenses and consulting costs associated with developing and enhancing the Company's CNS and related internal systems. Product research and development expense was $11.2 million in 2001, compared to $13.1 million and $10.3 million in 2000 and 1999, respectively. The decrease in 2001 from 2000 resulted from a decrease in consulting costs of $5.0 million, partially offset by an increase in wages and benefit costs of $2.6 million. The increase in 2000 from 1999 resulted from an increase in wages, benefits and temporary employee costs of $1.4 million and an increase in consulting costs of $1.1 million. As a percentage of revenue, product research and development expense decreased to 19.4% in 2001 from 41.9% in 2000 and 70.7% in 1999, primarily reflecting the Company's increased revenue. In 2001, the product research and development expense related to the Software and Digital Commerce Services Division was $4.8 million, down from $5.8 million in 2000. Product research and development expense related to the E-Business Services Division was $6.4 million, down from $7.2 million in 2000. The Company expects that product research and development expenses will continue to decrease as a percentage of revenue as revenue increases.

General and Administrative.

General and administrative expense consists principally of executive, accounting and administrative personnel and related expenses, including deferred compensation expense, professional fees and investor relations expenses. General and administrative expense increased to $4.7 million in 2001, from $4.6 million and $4.0 million in 2000 and 1999, respectively. The increase in 2001 from 2000 resulted from an increase in professional fees of $108,000. The increase in 2000 from 1999 resulted from an increase in professional fees and investor relations-related expense of $332,000. As a percentage of revenue, general and administrative expense decreased to 8.1% in 2001 from 14.9% in 2000 and 27.6% in 1999, primarily reflecting the Company's increased revenue. In 2001 and 2000, general and administrative expense related to the Software and Digital Commerce Services Division was $3.2 million. In 2001, general and administrative expense for the E-Business Services Division was $1.5 million, up from $1.4 million in 2000. The Company expects general and administrative expense to increase in absolute dollars in the future, particularly as the Company continues to build infrastructure to support its growth. As a percentage of revenue, these expenses are expected to decrease as revenue increases.

Amortization of Goodwill and Other Intangibles and Acquisition Related Costs.

Amortization of goodwill and other intangibles and acquisition related costs consists of the amortization of goodwill and other intangible assets recorded from the Company's nine acquisitions in the past three years, as well as other acquisition related costs such as earn-out payments. Amortization of goodwill and other intangibles and acquisition related costs increased to $17.0 million in 2001 from $15.4 million in 2000 and $6.9 million in 1999. The increase in 2001 from 2000 related to the amortization of goodwill and other intangibles from the four acquisitions consummated during 2001. The increase in 2000 from 1999 related to a full year of amortization of goodwill and other intangibles in 2000 from the four 1999 acquisitions as well as two earn-out payments totaling $5.1 million made in 2000. The Company expects amortization of goodwill and other intangibles and acquisition related costs to decrease in 2002 due to the adoption of SFAS No. 141 and 142.

Loss from Operations.

The Company's loss from operations decreased to $20.1 million in 2001 from $40.1 million in 2000 and $30.8 million in 1999, resulting primarily from increased revenue without commensurate increases in operating expenses. In 2001, the Software and Digital Commerce Services Division generated income from operations of $10.7 million compared to a loss of $5.6 million in 2000. In 2001, the loss from operations related to the E-Business Services Division was $9.1 compared to a loss of $15.9 million in 2000. In calculating segment losses, the Company does not include depreciation and amortization nor amortization of goodwill and other intangibles and acquisition related costs.

Interest Income.

Interest income consists of earnings on the Company's cash and cash equivalents and short-term investments. Interest income decreased to $881,000 in 2001 from $2.0 million in 2000 and $3.1 million in 1999, resulting from changes in average cash and cash equivalent balances and decreases in interest rates.

Income Taxes.

The Company paid no income taxes in any of the years presented. The Company has incurred a net loss for each year since inception. As of December 31, 2001, the Company had approximately $82.4 million of net operating loss carryforwards for federal income tax purposes, which expire beginning in 2009. Due to the uncertainty of future profitability, a valuation allowance equal to the deferred tax asset has been recorded. Certain changes in ownership that resulted from the past sales of capital stock will limit the future annual realization of the tax net operating loss carryforwards to a specified percentage under Section 382 of the Internal Revenue Code.

Liquidity and Capital Resources

Net cash provided by operating activities in 2001 was $547,000 and net cash used in operating activities $17.0 million in 2000 and $13.6 million in 1999. The net cash provided by operating activities in 2001 and used in operating activities in 2000 and 1999 was primarily the result of net losses, offset by goodwill and other intangibles amortization and earn-out charges, increases in accounts payable and increases in depreciation and amortization.

Net cash used in investing activities was $2.4 million in 2001 and was the result of purchases of equipment of $5.9 million and net cash paid for acquisitions of $1.5 million, offset in part by net sales of investments of $5.0 million. Net cash provided by investing activities was $14.9 million in 2000 and was the result of net sales of investments of $24.4 million partially offset by purchases of equipment of $9.4 million. Net cash used in investing activities was $37.5 million in 1999 and was primarily the result of the purchases of equipment totaling $4.8 million, the net purchase of investments of $28.5 million and net cash paid for acquisitions of $4.1 million.

Net cash provided by financing activities in 2001, 2000 and 1999 was $6.6 million, $3.9 million, and $2.7 million, respectively. The cash provided by financing activities in each year was mainly the result of proceeds from the exercise of stock options and warrants. In April 2001, the Company initiated a share repurchase program of up to $5.0 million of its outstanding shares of Common Stock. Repurchases will be at the Company's discretion based on ongoing assessments of the capital needs of the business and the market price of its shares. No time limit was set for the completion of the repurchase program. In 2001, the Company expended $267,000 to repurchase its shares.

As of December 31, 2001, the Company had approximately $21.7 million of cash and cash equivalents and $10.0 million of short-term investments. The Company's principal commitments consisted of obligations outstanding under operating leases. On February 1, 2002, the Company paid off the $2.5 million note payable related to its August 2001 acquisition of RegSoft. Although the Company has no material commitments for capital expenditures, it anticipates an increase in the rate of capital expenditures consistent with its anticipated growth in operations, infrastructure and personnel. The Company anticipates that it will expend approximately $15.0 million over the next 24 months on capital expenditures based on the Company's current anticipated growth rate. The Company further anticipates that it will expend approximately $22.0 million over the next 24 months on product research and development based on the Company's current anticipated growth rate in operations. The Company may also use cash to acquire or license technology, products or businesses related to the Company's current business. The Company also anticipates that it will continue to experience growth in its operating expenses for the foreseeable future and that its operating expenses will be a material use of the Company's cash resources.

The Company believes that existing sources of liquidity and the results of its operations will provide adequate cash to fund its operations for at least the next 24 months, although the Company may seek to raise additional capital during that period. In January 2002, the Company filed a universal shelf registration statement with the SEC pursuant to which the Company will be permitted to issue up to $100.0 million in common stock, preferred stock, debt securities and warrants. The sale of additional equity or convertible debt securities could result in additional dilution to the Company's stockholders. There can be no assurances that financing will be available in amounts or on terms acceptable to the Company, if at all.

Recent Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 141, "Business Combinations" and SFAS No. 142, "Goodwill and Intangible Assets". Major provisions of these statements are as follows: all business combinations initiated after June 30, 2001, must use the purchase method of accounting and the pooling of interest method of accounting is prohibited except for transactions initiated before July 1, 2001; intangible assets acquired in a business combination must be recorded separately from goodwill if they arise from contractual or other legal rights or are separable from the acquired entity and can be sold, transferred, licensed, rented or exchanged, either individually or as part of a related contract, asset or liability; goodwill and intangible assets with indefinite lives are not amortized but tested for impairment annually, except in certain circumstances, and whenever there is an impairment indicator; all acquired goodwill must be assigned to reporting units for purposes of impairment testing; and effective January 1, 2002, goodwill from acquisitions initiated prior to July 1, 2001, is no longer subject to amortization.

These new Statements were applicable to the Company's acquisitions of RegSoft.com, Orbit Commerce, Inc., and Network Commerce, all of which occurred after the July 1 effective date for new acquisitions. Accordingly, goodwill totaling $3,615,000 resulting from these acquisitions was not amortized during 2001. The Company will adopt the provisions of SFAS No. 142 related to all other acquisitions on January 1, 2002. The adoption of these statements is not expected to result in any transitional goodwill impairment losses on our unamortized goodwill balances, which totaled $11,273,000 at December 31, 2001, and for which we recorded amortization expense of $10,769,000 in the year ended December 31, 2001. Other identified intangibles with determinable lives, which totaled $8,934,000 at December 31, 2001, will continue to be amortized pursuant to the new standards.

In July 2001, the FASB issued SFAS No. 144, "Impairment or Disposal of Long-Lived Assets", which is effective for fiscal years beginning after December 15, 2001. The provisions of this statement provide a single accounting model for impairment of long-lived assets. The Company anticipates that this new standard will not have a material impact on its financial position or results of operations.

Consolidated Balance Sheets as of December 31,

(In Thousands, Except Share Data)	2001	2000
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$21,677	$16,920
Short-term investments	9,978	14,977
Accounts receivable, net allowance of $839 and $975	8,719	4,903
Prepaid expenses and other	1,455	1,123
Total current assets	41,829	37,923
PROPERTY AND EQUIPMENT:		
Property and equipment	25,374	18,369
Less accumulated depreciation	(9,228)	(4,799)
Net property and equipment	16,146	13,570
GOODWILL, net of accumulated amortization of $22,455 and $11,686	11,273	13,206
INTANGIBLE ASSETS, net of accumulated amortization of $8,858 and $4,134	8,934	4,628
OTHER ASSETS	45	76
	$78,227	$69,403
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Notes payable	$ 2,500	$ -
Accounts payable	19,360	14,339
Accrued payroll	2,803	2,287
Deferred revenue	1,106	1,833
Other accrued liabilities	2,036	2,426
Total current liabilities	27,805	20,885
COMMITMENTS AND CONTINGENCIES (Notes 2 and 4)		
STOCKHOLDERS' EQUITY:		
Preferred Stock, $.01 par value; 5,000,000 shares authorized; no shares issued or outstanding	-	-
Common Stock, $.01 par value; 60,000,000 shares authorized; 26,462,905 and 22,275,317 shares issued and outstanding	265	223
Additional paid-in capital	153,308	132,403
Deferred compensation	(37)	(194)
Accumulated other comprehensive loss	-	(22)
Accumulated deficit	(103,114)	(83,892)
Total stockholders' equity	50,422	48,518
	$78,227	$69,403

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

Consolidated Statements of Operations for the Years Ended December 31,

(In Thousands, Except Per Share Data)	2001	2000	1999
REVENUE	$57,825	$ 31,181	$ 14,507
COSTS AND EXPENSES (exclusive of depreciation and amortization expense shown separately below):			
Direct cost of services	2,710	1,477	801
Network and infrastructure	10,200	7,867	4,434
Sales and marketing	27,489	25,693	17,383
Product research and development	11,192	13,063	10,251
General and administrative	4,701	4,628	4,001
Depreciation and amortization	4,627	3,178	1,552
Amortization of goodwill and other intangibles acquisition related costs (Note 2)	17,009	15,387	6,886
Total costs and expenses	77,928	71,293	45,308
LOSS FROM OPERATIONS	(20,103)	(40,112)	(30,801)
INTEREST INCOME	881	1,996	3,148
NET LOSS	$(19,222)	$(38,116)	$(27,653)
BASIC AND DILUTED NET LOSS PER SHARE	$ (0.79)	$ (1.78)	$ (1.36)
BASIC AND DILUTED WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	24,285	21,413	20,312

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

Consolidated Statements of Stockholders' Equity for the Years Ended December 31

(In Thousands)	Common Stock		Additional Paid-In Capital
	Shares	Amount	
BALANCE, December 31, 1998	19,545	$195	$ 93,883
Common Stock issued for acquisitions and earn-out arrangements	777	8	22,801
Net Common Stock exchanged in Tech Squared transaction	(350)	(3)	235
Exercise of stock options and warrants	727	7	2,416
Deferred compensation related to stock options granted for services	-	-	110
Deferred compensation expense	-	-	-
Unrealized loss on investments	-	-	-
Net loss	-	-	-
BALANCE, December 31, 1999	20,699	207	119,445
Common Stock issued for acquisitions and earn-out arrangements	1,124	11	9,082
Exercise of stock options and warrants	339	4	3,585
Common Stock issued under the Employee Stock Purchase Plan	113	1	291
Deferred compensation expense	-	-	-
Unrealized gain on investments	-	-	-
Net loss	-	-	-
BALANCE, December 31, 2000	22,275	223	132,403
Common Stock issued for acquisitions and earn-out arrangements	2,817	28	14,351
Exercise of stock options and warrants	1,246	13	6,281
Common Stock issued under the Employee Stock Purchase Plan	182	2	539
Repurchase of Common Stock	(57)	(1)	(266)
Deferred compensation expense	-	-	-
Unrealized gain on investments	-	-	-
Net loss	-	-	-
BALANCE, December 31, 2001	26,463	$265	$153,308

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

Consolidated Statements of Stockholders' Equity for the Years Ended December 31

Deferred Compensation	Accumulated Other Comprehensive Loss	Accumulated Deficit	Total Stockholders' Equity	Comprehensive Loss
$(1,368)	$ -	$ (18,123)	$74,587	
-	-	-	22,809	
-	-	-	232	
-	-	-	2,423	
(110)	-	-	-	
841	-	-	841	
-	(162)	-	(162)	$ (162)
-	-	(27,653)	(27,653)	(27,653)
(637)	(162)	(45,776)	73,077	$ (27,815)
-	-	-	9,093	
-	-	-	3,589	
-	-	-	292	
443	-	-	443	
-	140	-	140	$ 140
-	-	(38,116)	(38,116)	(38,116)
(194)	(22)	(83,892)	48,518	$ (37,976)
-	-	-	14,379	
-	-	-	6,294	
-	-	-	541	
-	-	-	(267)	
157	-	-	157	
-	22	-	22	$ 22
-	-	(19,222)	(19,222)	(19,222)
$ (37)	$ -	$(103,114)	$50,422	$ (19,200)

Consolidated Statements of Cash Flows for the Years Ended December 31,

(In Thousands)	**2001**	**2000**	**1999**
OPERATING ACTIVITIES:			
Net loss	$ (19,222)	$(38,116)	$(27,653)
Adjustments to reconcile net loss to			
net cash provided by (used in) operating activities-			
Goodwill and other intangibles amortization and earn-out charges	17,009	13,354	6,606
Depreciation and amortization	4,627	3,178	1,552
Deferred compensation expense	157	443	841
Change in operating assets and liabilities:			
Accounts receivable and prepaid expenses	(3,056)	(2,691)	(1,226)
Accounts payable	2,916	3,319	5,122
Accrued payroll and other accrued liabilities	(1,884)	3,501	1,184
Net cash provided by (used in) operating activities	547	(17,012)	(13,574)
INVESTING ACTIVITIES:			
Purchases of investments	(13,000)	(12,034)	(106,487)
Sales / maturities of investments	17,999	36,416	78,000
Cash paid for acquisitions, net of cash received	(1,460)	(45)	(4,077)
Purchases of equipment	(5,890)	(9,380)	(4,783)
Patent acquisition costs	(7)	(26)	(117)
Net cash provided by (used in) investing activities	(2,358)	14,931	(37,464)
FINANCING ACTIVITIES:			
Net proceeds from sales of Common Stock	541	292	-
Exercise of stock options and warrants	6,294	3,589	2,423
Repurchase of Common Stock	(267)	-	-
Other	-	-	232
Net cash provided by financing activities	6,568	3,881	2,655
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	4,757	1,800	(48,383)
CASH AND CASH EQUIVALENTS, beginning of period	16,920	15,120	63,503
CASH AND CASH EQUIVALENTS, end of period	$ 21,677	$ 16,920	$ 15,120
NONCASH INVESTING AND FINANCING ACTIVITIES:			
Common Stock issued in acquisitions and earn-outs	$ 14,379	$ 9,093	$ 22,809
Issuance of note payable in acquisition	2,500	-	-

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

1. Nature of Operations and Summary of Significant Accounting Policies:

Digital River, Inc., a Delaware corporation, and its wholly owned subsidiaries (collectively, the Company) provide a suite of electronic commerce services to its clients, including web store development and hosting, transaction processing, electronic software delivery, fraud screening, customer service and analytical marketing. Through contractual relationships with software publishers and online retailers, the Company offers software products for sale via the Internet. Beginning in late 1998, the Company also began to offer electronic commerce services to companies outside of the software vertical market. The Company was incorporated in 1994 and conducted its first online sale through a client's Web store in August 1996.

The Company has experienced significant losses since inception ($103.1 million through December 31, 2001) and has, until the later stages of 2001, experienced significant negative cash flows from operations. The Company's prospects must be considered in light of the risks frequently encountered by companies in their early stage of development, particularly companies in new and rapidly evolving markets such as electronic commerce. To address these risks, the Company must, among others things, maintain existing and develop new relationships with independent software publishers, online retailers and other companies outside of the software market, maintain and increase its client base, implement and successfully execute its business and marketing strategy, continue to develop and upgrade its technology and transaction-processing systems, provide superior customer service and order fulfillment, respond to competitive developments, and attract, retain and motivate qualified personnel. There can be no assurances that the Company will be successful in addressing such risks, and the failure to do so could have a material adverse effect on the Company's business, financial condition and results of operations.

Principles of Consolidation

The consolidated financial statements include the accounts of Digital River, Inc. and its wholly owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

Cash and Cash Equivalents

The Company considers all short-term, highly liquid investments, primarily high grade commercial paper and money market accounts, that are readily convertible into known amounts of cash and that have original maturities of three months or less to be cash equivalents.

Investments

Investments held by the Company are classified as available for sale securities and are carried at their market value with cumulative unrealized gains or losses recorded as a component of accumulated other comprehensive losses within stockholders' equity.

The following is a summary of the Company's investment securities:

	Cost	Unrealized loss	Fair Value
December 31, 2001			
Commercial Paper	$ 9,978,000	$ -	$ 9,978,000
December 31, 2000			
U.S. Government securities	$14,999,000	$ 22,000	$14,977,000

As of December 31, 2001 and 2000, all securities are due in less than one year. The Company had proceeds from sales of investments of $17,999,000, $36,416,000 and $78,000,000 in the years ended December 31, 2001, 2000 and 1999, respectively. The cost basis of investments and gains and losses are based on specific identification. Realized gains and/or losses on sales of investments were not material in the years ended December 31, 2001, 2000 and 1999.

Property and Equipment

Property and equipment is stated at cost and is being depreciated under the straight-line method using lives of three to seven years and consists mainly of computer equipment and software licenses.

Goodwill and Other Intangibles

Goodwill and other intangible assets, consisting of customer base, non-compete agreements, and technology /tradename have been recorded as a result of certain acquisitions made by the Company and are being amortized under the straight-line method using a life of two to three years.

Impairment losses are recorded on goodwill and long-lived assets in operations when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets' carrying amount. The Company regularly performs reviews to determine if indicators of impairment of its goodwill and other long-lived assets exist. The Company's evaluation considers nonfinancial data such as changes in the operating environment and business strategy, competitive information, market trends and operating performance. Impairment losses are measured by comparing the fair value of assets, as determined by discounting the future cash flows at a market rate of interest, to their carrying amount. Based upon regular reviews, management believes that no conditions that would require impairment charges have arisen through December 31, 2001.

Patents

The costs of developing patents are amortized over a three-year period utilizing the straight-line method of amortization once the patent application is filed. Patents are included in other assets on the accompanying consolidated balance sheets, net of accumulated amortization of $400,000 and $352,000 as of December 31, 2001 and 2000.

Fair Value of Financial Instruments

The carrying amount of cash and cash equivalents, accounts receivable, notes payable and accounts payable approximates fair value because of the short maturity of these instruments.

Revenue Recognition

The Company recognizes revenue from services rendered once all the following criteria for revenue recognition have been met: 1) Pervasive evidence of an agreement exists, 2) the services have been rendered, 3) the fee is fixed and determinable and not subject to refund or adjustment and 4) collection of the amounts due is reasonably assured. The Company derives its revenue primarily from transaction and service fees associated with the e-commerce services provided to its clients. These services include Web commerce hosting, transaction processing, digital and physical fulfillment services, fraud screening, customer service and merchandising and analytical marketing services. The Company acts as the merchant of record on the majority of the transactions processed and has contractual relationships with its clients, primarily software publishers and online retailers, which obligate the Company to pay to the client a specified percentage of each sale. The Company retains its transaction fee and also charges for various service fees. The Company also derives revenue from providing clients the right to use its software applications, integration, development and consulting services provided to clients. Signed contracts are obtained from clients prior to recognition of these revenues. Fees for the use of software applications and any integration and development work required to provide on-going hosting services for the client are recognized ratably over the term of the contract once collection is reasonably assured. Clients do not have the right to take possession of the software applications used in the delivery of services. Payments received in advance of revenue recognition, even if non-refundable, are recognized as deferred revenue. Revenue from consulting services are recognized using the percentage-of-completion method for fixed-fee arrangements or as the services are provided for time-and-materials arrangements.

Sales to foreign customers accounted for 22%, 25% and 22% of revenue for the years ended December 31, 2001, 2000 and 1999, respectively. In addition, in 2001, revenue from one software publisher accounted for approximately 15% of total Company revenue.

Advertising Costs

The costs of advertising are charged to sales and marketing expense as incurred. For the years ended December 31, 2001, 2000 and 1999, the Company incurred advertising expense of $2,084,000, $2,253,000 and $2,442,000, respectively.

Income Taxes

Deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities using currently enacted tax rates. No income taxes were paid in any of the years presented.

Net Loss per Share

Basic loss per common share is computed by dividing net loss by the weighted average number of shares of common stock outstanding during the year. The computation of diluted earnings per common share is similar to the computation of basic loss per common share, except that the denominator is increased for the assumed conversion of convertible securities and the exercise of dilutive options using the treasury stock method. The weighted average shares used in computing basic and diluted loss per share were the same in each of the three years ended December 31, 2001. Stock options and warrants totaling 5,947,790, 5,383,113 and 3,898,313 for the three years ended December 31, 2001, 2000 and 1999, respectively, were excluded from the computation of loss per share as their effect is antidilutive.

Use of Estimates

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

Recent Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards (“SFAS”) No. 141, “Business Combinations” and SFAS No. 142, “Goodwill and Intangible Assets”. Major provisions of these Statements are as follows: all business combinations initiated after June 30, 2001 must use the purchase method of accounting and the pooling of interest method of accounting is prohibited except for transactions initiated before July 1, 2001; intangible assets acquired in a business combination must be recorded separately from goodwill if they arise from contractual or other legal rights or are separable from the acquired entity and can be sold, transferred, licensed, rented or exchanged, either individually or as part of a related contract, asset or liability; goodwill and intangible assets with indefinite lives are not amortized but tested for impairment annually, except in certain circumstances, and whenever there is an impairment indicator; all acquired goodwill must be assigned to reporting units for purposes of impairment testing; and effective January 1, 2002, goodwill from acquisitions initiated prior to July 1, 2001 is no longer subject to amortization.

These new Statements were applicable to the Company's acquisitions of RegSoft.com, Orbit Commerce, Inc., and Network Commerce, all of which occurred after the July 1 effective date for new acquisitions. Accordingly, goodwill totaling $3,615,000 resulting from these acquisitions was not amortized during 2001. The Company will adopt the provisions of SFAS No. 142 related to all other acquisitions on January 1, 2002. The adoption of these Statements is not expected to result in any transitional goodwill impairment losses on our unamortized goodwill balances, which totaled $11,273,000 at December 31, 2001, and for which we recorded amortization expense of $10,769,000 in the year ended December 31, 2001. Other identified intangibles with determinable lives, which totaled $8,934,000 at December 31, 2001, will continue to be amortized pursuant to the new standards.

In July 2001, the FASB issued SFAS No. 144, "Impairment or Disposal of Long-Lived Assets", which is effective for fiscal years beginning after December 15, 2001. The provisions of this Statement provide a single accounting model for impairment of long-lived assets. The Company anticipates that this new standard will not have a material impact on its financial position or results of operations.

2. Acquisitions and Purchases of Assets:

In December 2001, the Company acquired the customer assets of FreeMerchant.com from Network Commerce, Inc. ("Network Commerce") in exchange for $875,000. The Company will amortize intangible assets acquired, consisting of customer base, non-compete agreements, and technology/tradename over a three-year period. Under the agreement, Network Commerce has an opportunity for an additional earn-out of up to $870,000 based upon revenue generated from the acquired assets over the succeeding ten-month period. Such amounts will be recorded as additional goodwill.

In September 2001, the Company acquired substantially all of the assets and related liabilities of Orbit Commerce, Inc. ("Orbit") in exchange for 727,939 shares of Common Stock valued at $4,301,000 plus $964,000 in cash. The value of the Common Stock was based on the closing market price on the date the transaction was consummated. The Company will amortize intangible assets acquired, consisting of customer base, non-compete agreements, and technology/tradename over a three-year period. Under the agreement, Orbit has an opportunity to earn up to 4,800,000 additional shares of Common Stock based on revenue contribution over the succeeding 12-month period. The value of such shares issued will be recorded as additional goodwill.

In August 2001, the Company acquired all of the outstanding stock of RegSoft.com ("RegSoft") in exchange for $750,000 and a $2,500,000 note paid in full on February 1, 2002. The Company will amortize intangible assets acquired, consisting of goodwill, customer base, non-compete agreements, and technology/tradename over a three-year period. The agreement also includes an opportunity for an earn-out of up to $2,750,000 based on RegSoft's ongoing performance. Such amounts will be recorded as additional goodwill.

In March 2001, the Company purchased the Market Maker assets of Calico Commerce, Inc. ("Calico") in exchange for 1,630,368 shares of Common Stock valued at $7,846,000 plus direct expenses. The value of the Common Stock was based on the closing market price on the date the transaction was consummated. The Company amortizes intangible assets, consisting of goodwill, customer base, non-compete agreements, and technology/tradename over a three-year period. Under the agreement, Calico also has an earn-out arrangement whereby it can earn up to an additional 2,971,347 shares of Common Stock upon attaining certain business goals for a period of 13 months following the acquisition. In November 2001, the former owners of Calico received an earn-out payment of 59,740 shares of Common Stock valued at $314,000. The Company recorded such amount as additional goodwill.

In August 2000, the Company purchased certain assets of NetSales, Inc. ("NetSales") for 1,000,000 shares of Common Stock valued at $6,000,000 plus transaction expenses. The Company amortizes intangible assets acquired, consisting of goodwill, customer base and non-compete agreements over a two-year period. Under the agreement, NetSales has an earn-out arrangement whereby it can earn up to 350,000 additional shares of Common Stock upon attaining certain business goals for a six-month period following the close of the acquisition. In March 2001, NetSales received an earn-out payment of 84,000 shares of Common Stock valued at $404,000. The Company recorded such amount as additional goodwill.

The former owners of Maagnum Internet Group, Inc., a company purchased by the Company in April 1999, received earn-out payments of 314,531 shares of Common Stock valued at $1,514,000 in March 2001 and 124,349 shares of Common Stock valued at $3,093,000 in March 2000. The Company charged such amounts to compensation expense and included this amount as amortization of goodwill and other intangibles and acquisition related costs in the accompanying Consolidated Statements of Operations. This amount would have increased general and administrative expense had it been reported outside of that caption.

Each of the above transactions were accounted for using the purchase method. The excess of the purchase price over the tangible assets acquired in each transaction was allocated substantially to goodwill and other intangibles (consisting of customer base, non-compete agreements and technology/tradename).

Following is an allocation of the purchase price for the Company's 2001 acquisitions that were consummated subsequent to the July 1, 2001, effective date of SFAS No's. 141 and 142:

Tangible assets	$2,906,000
Liabilities acquired	(2,063,000)
Customer base	3,855,000
Non-compete agreements	850,000
Technology/tradename	425,000
Goodwill	3,615,000
Total purchase price	$9,588,000

The results of each of the acquisitions made in 2001 have been reflected in the Company's results beginning on the date of the respective acquisition. The following unaudited pro forma condensed consolidated results of operations for the three years ended December 31, 2001, have been prepared as if each of the 2001 acquisitions occurred on January 1, 2000, and the unaudited pro forma condensed consolidated results of operations for the year ended December 31, 1999, has been prepared as if the 2000 acquisition of NetSales occurred on January 1, 1999:

Year Ended December 31,	2001	2000	1999
Revenue	$ 66,131,000	$ 44,053,000	$ 16,743,000
Loss from operations	(31,453,000)	(72,126,000)	(42,242,000)
Net loss	(30,732,000)	(70,386,000)	(39,195,000)
Basic and diluted loss per share	$ (1.23)	$ (2.96)	$ (1.79)

This financial information does not purport to represent results that would actually have been obtained if the transactions had been in effect on January 1, 2001, 2000 or 1999, as applicable, or any future results that may in fact be realized.

In December 1999, the Company completed its acquisition of certain assets of Tech Squared Inc., whereby the Company purchased Tech Squared assets consisting of 3,000,000 shares of the Company's Common Stock and $1,200,000 in exchange for 2,650,000 shares of the Company's Common Stock. For financial statement presentation purposes, the impact of this transaction was to reduce Common Stock outstanding by 350,000 shares and is presented on the accompanying Consolidated Statement of Stockholders' Equity net of expenses incurred in conjunction with the transaction.

3. Income Taxes:

The reconciliation of the reported income tax expense to the amount the would result from applying the U.S. federal statutory rate of 35% to the net loss is as follows:

Year Ended December 31,	2001	2000	1999
Tax benefit at statutory rate	$(6,728,000)	$(13,341,000)	$(9,679,000)
State taxes, net of federal benefit	(1,000,000)	(1,982,000)	(1,438,000)
Stock compensation deductions	(258,000)	(1,339,000)	(3,343,000)
Non-deductible goodwill and earn-out compensation	3,255,000	3,453,000	1,783,000
Non-deductible expense and other	585,000	285,000	174,000
Change in valuation allowance	4,146,000	12,924,000	12,503,000
Total	$ -	$ -	$ -

As of December 31, 2001, the Company had net operating loss carryforwards of approximately $82,400,000. Included in this amount is approximately $16,700,000 of deductions resulting from disqualifying dispositions of stock options. When these deductions are realized for financial statement purposes they will not result in a reduction in income tax expenses, rather the benefit will be recorded as additional paid-in-capital. These income tax net operating loss carryforwards expire beginning in the year 2009. Because of the uncertainty of future realization, a valuation allowance equal to the deferred tax asset has been recorded.

The components of deferred income taxes are as follows:

	2001	2000
Net operating loss carryforwards	$ 32,136,000	$ 30,733,000
Nondeductible reserves and accruals	369,000	436,000
Depreciation and amortization	4,656,000	1,846,000
Valuation allowance	(37,161,000)	(33,015,000)
	$ -	$ -

Ownership changes resulting from the issuance of additional equity will limit future annual realization of the tax net operating loss carryforwards to a specified percentage of the value of the Company under Section 382 of the Internal Revenue Code.

4. Commitments and Contingencies:

Leases

The Company has six facility leases in addition to leasing certain computer equipment. Total rent expense, including common area maintenance charges, recognized under all leases was $1,367,000,

$839,000 and $558,000 for the years ended December 31, 2001, 2000 and 1999, respectively.

The minimum annual rents under long-term leases at December 31, 2001, are as follows:

Year ending December 31,	
2002	$ 1,161,000
2003	744,000
2004	106,000
	$ 2,011,000

Litigation

In August 2001, the Company and certain of its officers and directors were named as defendants in several class action shareholder complaints filed in the United States District Court for the Southern District of New York. These actions include (1) Whalen v. Digital River, Inc., et al., Case No. 01-CV-7355; and (2) Nicolois v. Digital River, Inc., et al., Case No. 01-CV-7992. Similar complaints were filed in the same Court against hundreds of other public companies that conducted IPOs of their common stock in the late 1990s. In each of these complaints, the plaintiffs allege that the Company, certain of its officers and directors and its IPO underwriters violated the federal securities laws because the Company's IPO registration statement and prospectus contained untrue statements of material fact or omitted material facts regarding the compensation to be received by, and the stock allocation practices of, the IPO underwriters. The plaintiffs seek unspecified monetary damages and other relief. The Company believes these lawsuits are without merit and intend to defend against them vigorously.

The Company is also party to patent litigation, along with other defendants, regarding United States Patent No. 6,014,651 owned by Christopher M. Crawford of Washington, D.C. The case was filed in August 2001 and is pending in the U.S. District Court in the District of Columbia. No substantive actions have taken place as yet in this case. The Company believes that it has meritorious defenses to, and intends to vigorously defend against, these claims.

Employee Benefit Plan

The Company has a defined contribution 401(k) retirement plan for eligible employees. Employees may contribute up to 15% of their pretax compensation to the plan, with the Company providing a discretionary match of the employee contribution of up to 50% of the total employee contribution. Amounts charged to expense related to the Company's matching contributions for the years ended December 31, 2001, 2000 and 1999 totaled $559,400, $408,100 and $274,000, respectively.

5. Stockholders' Equity:

Warrants

Warrants to purchase 106,087 and 356,087 shares of Common Stock issued principally in conjunction with sales of Common Stock at an exercise price of $3.00 per share were outstanding as of December 31, 2001 and 2000, respectively. The warrants expire at various dates between February and August 2003.

Share Repurchase Program

In April 2001, the Company announced a share repurchase program of up to $5,000,000 of its outstanding shares of Common Stock. Repurchases will be at the Company's discretion based on ongoing assessments of the capital needs of the business and the market price of its shares. During 2001, 57,500 shares were repurchased under the program for total consideration of $267,000.

6. Stock Options:

The Company's 1998 Stock Option Plan (the "SOP") provides for the granting of incentive or nonqualified stock options to purchase up to 3,983,333 shares of Common Stock. Options granted to employees typically expire no later than ten years after the date of grant. Incentive stock option grants must have an exercise price of at least 100% of the fair market value of a share of common stock on the grant date. Incentive stock options granted to employees who immediately before such grant owned stock directly or indirectly representing more than 10% of the voting power of the stock of the Company will have an exercise price of 110% of the fair market value of a share of common stock on the grant date and will expire no later than five years from the date of grant.

The Company's 1999 Non-Officer Stock Option Plan (the NOP) provides for the granting of non-qualified stock options to purchase up to 5,450,000 shares of Common Stock and has terms similar to those of the SOP.

In addition to shares granted under the SOP and NOP, the Company granted options to purchase 605,882 shares of Common Stock at an exercise price of $8.50 per share to certain members of management outside of both plans during 1998. At December 31, 2001, options outstanding outside of both plans totaled 13,529 shares.

A summary of the change in outstanding options under the SOP and NOP is as follows:

	Options Outstanding	**Option Price Per Share**
Balance, December 31, 1998	1,870,357	$ 0.38 - $23.40
Grants	2,131,636	19.56 - 31.13
Exercised	(601,172)	0.38 - 23.40
Cancelled	(308,035)	1.69 - 31.13
Balance, December 31, 1999	3,092,786	0.38 - 31.13
Grants	2,641,028	6.00 - 28.88
Exercised	(303,533)	0.38 - 23.40
Cancelled	(817,696)	1.69 - 31.13
Balance, December 31, 2000	4,612,585	1.13 - 31.13
Grants	3,631,533	0.01 - 6.74
Exercised	(679,336)	0.01 - 11.75
Cancelled	(1,736,608)	0.01 - 31.13
Balance, December 31, 2001	5,828,174	$ 1.69 - $31.13

A summary of information about total stock options outstanding at December 31, 2001, is as follows:

	Options Outstanding		**Options Exercisable**	
Exercise Price	Number Outstanding	Weighted Average Life Remaining	Number Exercisable	Weighted Average Price
$ 1.69 - $ 3.88	1,240,518	8.5 years	296,589	$ 2.97
4.45 - 6.74	3,476,754	9.0 years	557,518	5.68
8.50 - 12.50	105,248	6.5 years	91,849	9.70
$19.50 - 31.13	1,019,183	7.5 years	634,256	22.47
$ 1.69 - $31.13	5,841,703	8.5 years	1,580,212	$12.14

The Company recorded compensation expense for the difference between the grant price and the fair market value of the Company's Common Stock on options to purchase 30,533 shares at an exercise price of $.01 issued in January 2001. In addition, the Company recorded deferred compensation for the difference between the grant price and the deemed fair value of the Company's Common Stock on options to purchase 454,468 shares at exercise prices of $3.00 to $7.50 issued during May and June 1998. During 1999, the Company recognized $110,000 in expense related to options granted for consulting services.

The Company has elected to apply the disclosure-only provisions of SFAS No. 123, "Accounting for Stock-Based Compensation." Accordingly, the Company accounts for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion (APB) No. 25, "Accounting for Stock Issued to Employees", and related interpretations. Compensation cost for stock options is measured as the excess, if any, of the fair value of the Company's common stock at the date of grant over the stock option exercise price. Had compensation costs for these plans been determined consistent with SFAS No. 123, the Company's net loss would have been adjusted to the following pro forma amounts:

	2000	1999	1998
Net loss:			
As reported	$(19,222,000)	$(38,116,000)	$(27,653,000)
Pro forma	(41,082,000)	(56,482,000)	(35,204,000)
Basic and diluted loss per share:			
As reported	$ (0.79)	$ (1.78)	$ (1.36)
Pro forma	(1.69)	(2.64)	(1.73)

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions used: risk-free interest rates of 4.5%, 6%, and 6% in 2001, 2000, and 1999, respectively; no expected dividends; expected lives of five years; and a volatility factor of 1.1, 1.2, and 1.1 in 2001, 2000, and 1999, respectively. The weighted average fair value of the options granted in 2001, 2000, and 1999 was $3.56, $20.46, and $17.21, respectively.

The Company also sponsors an employee stock purchase plan under which 600,000 shares have been reserved for purchase by employees. The purchase price of the shares under the plan is the lesser of 85% of the fair market value on the first or last day of the offering period. Offering periods currently are each six months ending on June 30 or December 31. Employees may designate up to ten percent of their compensation for the purchase of shares under the plan. Total shares purchased by employees under the plan were 182,000 and 113,000 in the years ended December 31, 2001 and 2000, respectively.

7. Segment Information:

The Company has two operating segments, Software and Digital Commerce Services and E-Business Services, which have been identified as components of the Company that are reviewed regularly by management to determine resource allocation and assess performance. Unallocated corporate items consist of depreciation, goodwill and other intangibles amortization, acquisition related costs and interest income for operational results and consist of certain cash, investments and goodwill for total assets.

No disclosure of segment information for 1999 has been presented as Software and Digital Commerce Services represented substantially all operations in 1999. Segment information for 2001 and 2000 is as follows:

	Software and Digital Commerce Services Division	E-Business Services Division	Unallocated Corporate Items	Consolidated
Year Ended December 31, 2001				
Revenue	$44,914,000	$ 12,911,000	$ -	$ 57,825,000
Gross profit (excludes depreciation and amortization expense)	36,214,000	8,701,000	-	44,915,000
Income (loss) from operations	10,672,000	(9,139,000)	(21,636,000)	(20,103,000)
Net income (loss)	10,672,000	(9,139,000)	(20,755,000)	(19,222,000)
Total assets at December 31, 2001	20,858,000	9,159,000	48,209,000	78,227,000
Year Ended December 31, 2000				
Revenue	$25,221,000	$ 5,960,000	$ -	$ 31,181,000
Gross profit	18,119,000	3,718,000	-	21,837,000
Loss from operations	(5,611,000)	(15,936,000)	(18,565,000)	(40,112,000)
Net loss	(5,611,000)	(15,936,000)	(16,569,000)	(38,116,000)
Total assets at December 31, 2000	16,256,000	7,051,000	46,096,000	69,403,000

8. Related-Party Transactions:

In February 1998, two stockholders, one of whom was a director for the Company at the time, entered into an agreement with the Company whereby the stockholders helped establish and oversee the international operations for the Company for a term of three years. As consideration for entering into the agreement, the stockholders each received warrants to purchase 100,000 shares of Common Stock, exercisable at $3.00 per share. The warrants were 100% vested at the date of grant and expire in February 2003. At December 31, 2001, 100,000 warrants remain outstanding. The fair value of the warrants granted in 1998, determined to be $360,000, was based upon the value of the services to be provided. During the three years ended December 31, 2001, compensation expense of $20,000, $120,000, and $120,000, respectively, was recognized related to these warrants.

9. Subsequent Events (unaudited):

Results of Operations

In February 2002, ePedas Sdn Bhd initiated an arbitration before the American Arbitration Association against the Company. The demand for arbitration alleges breach of contract and tortious interference claims against the Company. The prayer for relief requests RM 28,809,137.09 (Ringit Malaysia or approximately US $7,581,150) plus pre-judgment interest, punitive damages, all legal costs and other unspecified fees and expenses. An arbitrator has not been selected and no arbitration date has been set. The Company believes this lawsuit is without merit and intends to defend against it vigorously.

On March 29, 2002, the Company announced that it would record a reserve for pending litigation of $2,300,000 in the first quarter of 2002. Additionally, the Company announced that it would take a charge of $200,000 in the first quarter of 2002 in connection with its decision during the quarter to consolidate one of its offices.

Acquisitions

On March 19, 2002, pursuant to an Asset Purchase Agreement between Digital River and Innuity Acquisition Corp. ("IAC"), the Company purchased certain assets and assumed approximately $3.6 million in merchant liabilities in exchange for approximately $2.4 million in cash. The agreement includes an opportunity for a cash earn-out based on revenue generated from the IAC assets during the 12-month period following the close of the transaction.

On March 31, 2002, pursuant to an Amended and Restated Asset Purchase Agreement (the "Agreement") dated February 9, 2002, between Digital River and Beyond.com Corporation ("Beyond.com"), in exchange for $2,910,311 in shares of our Common Stock (valued at the average of the closing price of our Common Stock for the 15 trading days ending on the second day prior to closing and the seven trading days immediately following the closing), the Company purchased those assets and assumed those liabilities of Beyond.com related to its eStores business, which manages online stores for clients. The purchase was approved by the U.S. Bankruptcy Court following Beyond.com's filing for Chapter 11 bankruptcy protection, and certain elements of the purchase remain subject to further approval by the court. The agreement includes contingent earn-out provisions whereby Beyond.com may receive (i) additional shares of Common Stock valued at $962,500 if specified customers of Beyond.com remain our customers for 90 days post closing, (ii) additional shares of Common Stock valued at $500,000 if 90% or more of specified customers of Beyond.com enter into 12 month contracts with the Company within 60 days of the closing and (iii) additional shares of Common Stock valued at approximately $1.35 million if specified customers enter into 12 month contracts with the Company within 60 days of the closing (with such shares valued as described above). Of the shares issued at closing, 70,000 shares were placed in an escrow to secure certain indemnification obligations contained in the Agreement. Subject to outstanding claims, the escrow will terminate 90 days following the closing.

Report of independent public accountants

To Digital River, Inc.:

We have audited the accompanying consolidated balance sheets of Digital River, Inc. (a Delaware corporation) and Subsidiaries as of December 31, 2001 and 2000, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Digital River, Inc. and Subsidiaries as of December 31, 2001 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2001, in conformity with accounting principles generally accepted in the United States.

Arthur Andersen LLP
Minneapolis, Minnesota,
January 28, 2002

Board of Directors

Timothy C. Choate
President and
Chief Executive Officer
Aptimus, Inc.

William J. Lansing (2,3)
Chief Executive Officer
NBC Internet, Inc.

Thomas F. Madison (1, 2)
President and
Chief Executive Officer
MLM Partners

Joel A. Ronning (3)
Chief Executive Officer
Digital River, Inc.

Frederic M. Seegal (2,3)
President
Wasserstein Perella Group, Inc.

Perry W. Steiner (1)
Managing Partner
Arlington Capital Partners

J. Paul Thorin (1)
Vice President and General Counsel
ArrayComm, Inc.

(1) Audit Committee member
(2) Compensation Committee member
(3) Finance Committee member

Executive Officers

Joel A. Ronning
Chief Executive Officer

Jay A. Kerutis
President Software and Digital
Commerce Services Division

Robert E. Strawman
Chief Financial Officer and Treasurer

Gary V. Howorka, Ph.D.
Chief Technology Officer

Corporate Headquarters

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Eden Prairie, MN 55344

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United Kingdom

Market Listing

Nasdaq National Market
Symbol: DRIV

Transfer Agent and Registrar

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S. St. Paul, MN 55075-0738
800.468.9716

Independent Public Accountants

Arthur Andersen, LLP
Minneapolis, MN

General Counsel

Cooley Godward LLP
San Francisco, CA

Form 10-K

A copy of the Company's Annual Report on form 10-K as filed with the Securities and Exchange Commission, will be sent to any stockholder without charge upon written request to Investor Relations at the corporate address or e-mail address.

Annual Meeting

The company's Annual Meeting of stockholders will be held at 3:30pm on Monday, May 20, 2002, at the Radisson Plaza Hotel 35 South 7th Street Minneapolis, MN.

Shareholders

As of March 22, 2002, the company had 483 shareholders of record and approximately 17,800 beneficial shareholders whose stock was held in street name by brokerage houses.

Investor Relations

Alfred A. Galgano
Vice President of Investor Relations
952-253-1234
investorrelations@
digitalriver.com

Common Stock Information

The Company's Common Stock has traded on the Nasdaq National Market under the symbol DRIV since August 11, 1998. Prior to that date there was no public market for Digital River Common Stock.

The quotations set forth below reflect the high, low and closing for the Company's Common Stock on the Nasdaq National Market for each of the identified periods.

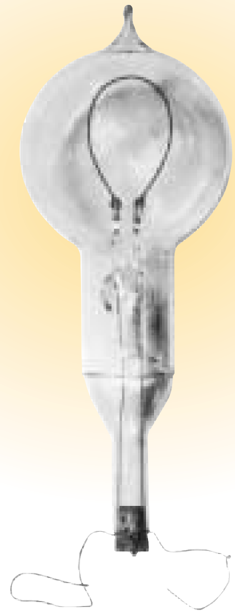
2000	High	Low	Close
Qtr. 1	$37.38	$21.00	$21.50
Qtr. 2	22.13	7.00	7.69
Qtr. 3	9.13	5.38	6.44
Qtr. 4	7.38	2.19	2.38
2001	**High**	**Low**	**Close**
Qtr. 1	9.50	2.50	4.81
Qtr. 2	7.50	3.50	4.50
Qtr. 3	7.93	4.00	7.45
Qtr. 4	19.60	6.26	15.92

Dividends

The Company has never declared or paid any cash dividends on its Common Stock. The Board of Directors currently intends to retain any future earnings to support operations and to finance the growth and development of the Company's business and does not anticipate paying cash dividends for the foreseeable future.

Designed by The Spangler Design Team

Digital River Inc.



Staying Focused for the Future

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