

eBay (NASDAQ:EBAY) – Long

11/29/09 | Price: \$23.22 | Market Cap: \$30.4B | 12-month price target: \$30 (29% premium)

Summary Investment Thesis:

1. eBay will grow faster than in recent quarters as new initiatives to attract buyers and sellers increases the number of online auctions and the conversion rate of those auctions. Consensus estimates suggest that growth in eBay's Marketplace segment will be ~10% in 2010. Given the new initiatives I forecast that Marketplace revenues will increase 21% in 2010 which is close to the Marketplace segment's average annual growth rate of 25%.
2. eBay's Payments segment will also experience an above consensus growth rate of 31% as PayPal's penetration in international auctions increases and as non-auction transactions continue to grow at their Q2 and Q3 rates of 43% Y/Y. Consensus estimates for the Payments segment currently suggest an 18% growth rate in 2010 while the historical growth of the Payments segment was 30-40% until the slowdown in 2009.
3. The recently announced sale of Skype will be accretive to investors as it will focus management on building out the Marketplace and Payments segments and will provide eBay with US dollars which they can use to buy back shares. eBay's share buyback program was halted in Q4 2008 as most of their cash was located internationally and subject to a tax penalty if it was brought into the US – traditionally eBay has purchased 2-5% of fully diluted shares per year until 2009. Most analysts have not built a share buyback program into their models.
4. eBay's valuation is lower than of its e-commerce peers because its revenues have grown at a slower rate in 2008 and 2009. eBay's revenue growth slowed because competition in the e-commerce space intensified and consumer spending slowed. This low valuation creates an attractive investment opportunity because as revenue and EPS growth returns, eBay's valuation should return to their historical averages generating increased returns for investors.
 - a. Currently eBay is valued at 9x trailing EV/EBITDA; 7.8x forward EV/EBITDA; 12.8x forward P/E and 3.1x forward sales.
 - b. Historically eBay was valued at 12x trailing EV/EBITDA; 8x forward EV/EBITDA, 14x forward P/E and 4.8x forward sales.
 - c. eBay's e-commerce peers (e.g., AMZN, OSTK, GSIC) are trading at 22x trailing EV/EBITDA; 27x forward EV/EBITDA, 50x forward P/E and 3x forward sales.
 - d. eBay has a high ROA of 10% and a ROE and ROIC of around 12%.
5. eBay is a one-of-a-kind asset with an e-commerce platform that is extremely hard to replicate – it is the 9th most visited site on the web with a network of ~200M active users who transact ~\$60B worth of auctions and ~\$80B of online payments per year. New management is in place as of mid-2008 with a focus on rapid growth by improving key metrics such as listed items and conversion rates. Despite the company having demonstrated positive trends in the last few quarters the street does not fully appreciate the impact management's efforts will have on the business.
6. Recommendation: I recommend a long position in eBay as the street is underestimating the Marketplace segment's ability to grow auction volume in 2010 and the Payment segment's ability to increase transaction volume in 2010. The effect of these underestimations suggests an appropriate target price for eBay is \$30 which is a 29% premium to the current stock price.
7. Catalyst: eBay's shares should appreciate in the next 2-3 quarters as the company demonstrates a sustainable increase in the volume of auctions, the conversion rate of those auctions and an increase in the number of PayPal transactions. eBay shares should appreciate to the target price within the next 9-12 months.

Company Overview:

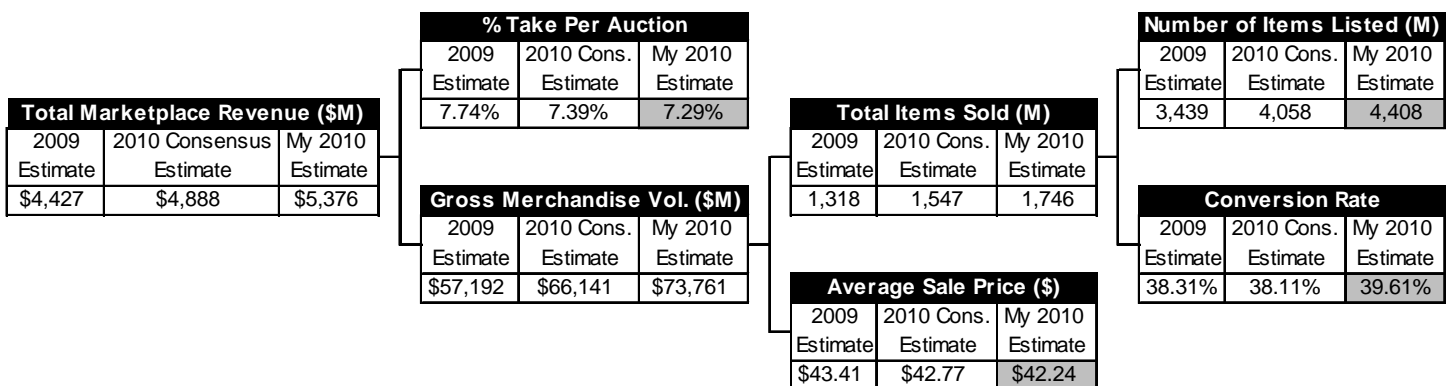
eBay provides online marketplaces for the sale of goods and services (e.g., collectibles, electronics, memorabilia, toys), and other online commerce solutions. The company operates two main segments: Marketplace (65% of revenues) and Payments (35% of revenues). The Marketplace segment includes the eBay.com auction platform and other specific online platforms such as Rent.com and Shopping.com. The Payments segment, PayPal, provides an online payment gateway enabling individuals and businesses to securely send and receive payments online. eBay also had a Communications segment consisting of the Skype business which was recently sold to a consortium of private equity firms.

Investment Merits:

1) Marketplace revenues will be higher than consensus estimates as user experience enhancements currently underway drive growth in listed items and an improved conversion rate

- a) Through 2006 the number of items listed on eBay.com grew at ~45% per year, however in 2007 and 2008 listed item growth stalled as competition in the e-commerce market increased. In 2008, eBay's new CEO re-focused the company on improving the buyer experience. His intention was to improve the way buyers interfaced with eBay.com to drive an increased conversion rate (the percent of listed items that are sold) and subsequently encourage sellers to list more items on eBay as their likelihood of selling increased. These initiatives include:
 - i) Variation style listings (allowed buyers to select specific sizes/colors of an item from one auction page as opposed to having separate auctions for each style).
 - ii) Improving the search algorithm to increase the likelihood of finding appropriate items.
 - iii) Encouraging sellers to offer free shipping and other promotions (some of which is subsidized by eBay). Currently 30-50% of items on eBay offer free shipping while competitors like Amazon.com offer free shipping on items over \$25.
 - iv) Creating a loyalty program to reward frequent buyers.
 - v) Rewarding better sellers with more exposure and higher rank in search results. This ensures buyers are introduced to the sellers with the highest quality and customer satisfaction ratings.
- b) Although the roll out of these initiatives are still in preliminary phases and will only be complete in 6-12 months, eBay has begun to experience growth in the number of items listed on its site. Consensus estimates indicate that listed items will grow 18% in 2010, however given the observable data I forecast that listed items will grow 28% in 2010 to ~4.4M items. The historical average annual increase in listings was 25-30% and the 2009 growth rate was 25%.
 - i) In Q3 2009 listed items grew 30% year-over-year and indications are that Q4 2009 looks to have similar growth. Data in Appendix 1 from company records and medved.com, a 3rd party auction monitor, shows the exponential growth in listed items eBay has recently experienced.
 - ii) International expansion will be a large driver of growth in listed items. In 2009 international listings increased by 45% and in 2010 and 2011 international listings will likely continue to increase >40% per year. To drive international expansion eBay has been acquiring assets and creating local sites for different countries/regions. eBay's April 2009 acquisition of Gmarket, an auction site which has dominant share in South Korea, demonstrates this commitment to international expansion.
 - iii) Used car sales will also increase in the coming quarters after bottoming in Q2 2009. Traditionally used car sales were 20% of the gross merchandise sold on eBay's site. In 2009 used car sales decreased significantly as the economy plummeted and as the US offered a "cash-for-clunkers" program to take older cars off the road. Now that the "cash-for-clunkers" program is over the number of used car listings on the site has increased suggesting the used car market has bottomed and will begin to rebound in the coming quarters.

- c) Historically eBay’s conversion rate was 41.6% and in 2008 this dropped to a low of 36.3%. As a result of management’s efforts eBay’s conversion rate has increased to 38.4% in Q3 and is improving on a monthly basis. Consensus estimates suggest that eBay’s conversion rate in 2010 will be 38.1% which is lower than the currently observed rate. My forecast is that eBay’s conversion rate will continue to improve in 2010 reaching 39.5% which reflects a positive effect from the improvement initiatives. Appendix 2 details conversion rates over time.
- d) eBay’s Marketplace division makes money by charging a fee per auction based on the total sale price. This “take rate” has been coming down of late as eBay attempts to lure sellers and drive greater quantity to the site. Forty percent of eBay’s sales come from their top sellers, most of whom enjoy volume discounts which lowers the average take rate. Consensus estimates suggest that the take rate will decrease 40bps in 2010 to 7.4% from 7.8%. To be conservative I have forecasted the take rate will decline 50bps to 7.3%, under the assumption that eBay will continue to reduce fees on certain items to drive seller volume.
- e) The average sale price (ASP) of items on eBay is another driver of Marketplace revenue. Historical data indicates that ASPs decrease 3-6% per year. In 2009 ASPs dropped 18% and have flattened in recent quarters indicating that ASPs in 2010 will not drop at their historic levels. Consensus estimates suggest ASPs will only decline 1% next year. To be conservative I’ve assumed that ASPs decline at a rate of 3% per year in 2010 and 6% per year going forward.
- f) Together the above mentioned drivers will increase Marketplace revenues by 21% in 2010 vs. consensus estimates of a 10% increase. Market place revenues typically grew ~25% until the 2007 slowdown. A graphical representation of how Marketplace revenues are driven by the above mentioned underlying drivers is below and includes 2009 observed figures, 2010 consensus estimates and my estimates for 2010 performance:



2) Payments revenue will be higher than consensus as international sellers offer PayPal checkout to buyers and non-auction transactions increase

- a) The Payments division is critically important to eBay’s growth as it is the fastest growing division of eBay. Management has repeatedly said they intend to double PayPal’s business over the next three years.
- i) The payments division is composed of two units:
- (1) PayPal – an online portal which allows users to send money to other users and enables online merchants to provide credit card payment options to their clients.
 - (2) BillMeLater – an online site that provides instantaneous financing to online customers.
- ii) Revenue in the payments division is composed of transactions from eBay auctions (43% of payments volume) and transactions from non-auction sources (53% of payments volume) such as consumer-to-consumer transfers or online merchant sales.
- iii) Historically the Payments division grew revenue at 25-30% per year, however, in 2009 revenue growth slowed to 19% as the economic slowdown reduced transaction volumes and transaction sizes.

- b) Consensus estimates suggest that PayPal's use in eBay auctions will drop to 32% of total auctions in 2010 from a currently observable rate of 36%. However, given the international expansion efforts of PayPal's management and the observed increase in international transactions, I anticipate this penetration will actually increase to ~38% in 2010 which is closer to the historical average penetration of 40%. Appendix 3 details historical and forecasted penetration rates.
- i) The 400bps drop off in penetration started as eBay expanded internationally and PayPal was not able to add countries fast enough to keep up. US penetration of PayPal on eBay.com has generally stayed constant at ~80% over the last few years.
 - ii) On recent earnings calls management has made it clear they are focused on increasing international penetration of PayPal for eBay auctions. After modifying their international presence in Q1 and Q2 to address cultural and awareness issues that were preventing PayPal's growth, international accounts grew 30% Y/Y and international payments grew >35% Y/Y. There is little indication that this penetration rate will slow down in coming quarters given management's focus on international expansion.
- c) Non-auction payments revenue growth is another growth driver for the Payments segment. Consensus estimates indicate non-auction payments will grow 25% in 2010 while I forecast non-auction payments will grow ~38% in 2010. Appendix 4 has additional detail on currently observed and forecasted transaction volumes.
- i) Currently PayPal has only ~4.2% of the total market of off online transactions. To promote non-auction payments PayPal has taken several steps to increase its share of online payments:
 - (1) Opened up its API to allow 3rd party developers to interface with its site
 - (2) Started developing relationships with large online merchants who drive a majority of non-auction online transactions (traditionally PayPal was focused on the smaller sellers). Currently ~26% of major online merchants accept PayPal which is higher than it was in prior years.
 - ii) The historical average growth rate for non-auction payments was 45% Y/Y and the currently observed growth rates in Q2 and Q3 is 43% Y/Y.
 - iii) Given PayPal's focus on increasing non-payment revenue, the large market opportunity and the currently observed growth rates, a 25% growth rate is too low. I forecast non-auction payments will continue to grow at the current rate of 35-40% in 2010.
- d) The two key drivers of the Payments segment that aren't doing as well is the average payment size and the percent charged per transaction (the "take-rate"). I anticipate that these will continue to decline at close to their historical averages.
- i) PayPal's take rate is currently 3.71% which is higher than other large payment processors (American Express, Visa, MasterCard) who charge 1.5-2% for transaction processing. PayPal is able to charge a high rate because it primarily works with smaller merchants who are not served by the large processors. I anticipate the take rate will continue to drop as PayPal looks to gain market share and increase the size of the merchants it works with. Thus while consensus estimates suggest a 5bps drop in the take rate for 2010, I anticipate the take rate will decline ~20bps to 3.5%.
 - ii) PayPal's average payment size also dropped 6% in 2009 compared to the historical trend of 2-8% increases in payment sizes per year. Consensus estimates suggest that the average payment size will increase 2% in 2010. Since transaction data is well protected by PayPal it was hard to find near term data to indicate a specific trend, as such I've elected to conservatively estimate that payment sizes will be flat in 2010 at \$63.71.
- e) Consensus estimates suggest that payments revenue will grow 18% in 2010, however using the above forecasts I anticipate payments revenue will actually grow 31% in 2010. A detailed breakdown of key revenue drivers for the Payments division is below:

Total Payments Revenue (\$M)			% Take Per Transaction			Number of Payments (M)			Auction Payments (M)			Total Items Sold (M)			% Using Paypal		
2009 Estimate	2010 Consensus Estimate	My 2010 Estimate	2009 Estimate	2010 Cons. Estimate	My 2010 Estimate	2009 Estimate	2010 Cons. Estimate	My 2010 Estimate	2009 Estimate	2010 Cons. Estimate	My 2010 Estimate	2009 Estimate	2010 Cons. Estimate	My 2010 Estimate	2009 Estimate	2010 Cons. Estimate	My 2010 Estimate
\$2,614	\$3,080	\$3,414	3.71%	3.67%	3.49%	1,106	1,289	1,536	474	499	664	1,318	1,547	1,746	36%	32%	38%
Total Payment Volume (\$M)			Average Payment Size (\$)			Non-Auction Payments (M)											
\$70,414	\$83,920	\$97,832	\$63.68	\$65.10	\$63.70	631	790	872									

3) Recent Skype sale was a great value for eBay and will enable share buyback program to resume

- a) The \$3B valuation of the business was higher than most estimates of the fair value for the business.
- b) The \$1.9B cash consideration will be useful for eBay as it will give them flexibility to buy back shares. Historically eBay had aggressive share buyback programs. Recently these efforts slowed because most of eBay's cash was in international accounts and they were unable to bring this money back to the US without paying significant taxes. Thus, the \$1.9B consideration paid domestically will allow eBay to re-start its share buyback program.
- c) The Skype business did not fit with the Marketplace and Payments segments and instead of providing synergies was a distraction to management
 - i) Skype's previous owners had filed suit against eBay over intellectual property issues.
 - ii) Skype's contribution margin of 20-25% was much lower than the contribution margins for the Marketplace and Payments segments and was depressing eBay's overall margins.
- d) Skype financials are not part of my Q4 estimates as the transaction is expected to close mid-quarter.

4) Network effect helped eBay create a business with large free cash flows and resilient margins

- a) eBay's website enjoys significant network benefits which creates a large barrier of entry for potential competitors. The more buyers and sellers trade on eBay, the more valuable the site becomes to its users and the less inclined users are to go someplace else. This has helped eBay quickly develop into a dominant player in the e-commerce arena with the 9th most visited website in the US (source: Alexia.com).
- b) Recently gross margins fell to 73% from an average of 80% and I anticipate they will stay around this level going forward. As eBay expands internationally the requirements on their core web infrastructure will increase reducing any benefit eBay might have enjoyed from achieving operational scale.
- c) Operating expenses have been fairly constant at 42-44% of total revenue and will stay at this level going forward.
 - i) Half of the operating expenses, 20% of revenues, are for sales and marketing support to drive users. A big driver of this expenditure is advertising rates which are forecasted to be flat or slightly up in 2010.
 - ii) On the R&D side (10% of revenues, 15% of operating expenses) eBay will need to increase R&D expenditure as it looks to re-vamp its website. eBay's recent weekend outage (November 23, 2010) caused by a surge in listings indicates that their infrastructure has some bugs and will need to be improved. For forecasting purposes I've increased R&D expenditures to 9.5% of revenue vs. consensus estimates of 8.75%.
- d) Most of eBay's expenses are relatively constant and the overall business is very asset light (PP&E is only 6% of revenue). This helps eBay generate free cash flow margins of 25% and a 10% free cash flow yield. eBay also enjoys a strong ROA of 10% and a ROE and ROIC of around 12%.

- 5) Management has relevant experience and has demonstrated strength through economic downturn
- a) PayPal's CEO, John Donahoe, was CEO of management consulting firm Bain and Company and ran the Marketplace division for a while before taking the CEO title
 - b) All other executives have been with the firm for a while and have relevant experience. The President of PayPal, Scott Thompson, was responsible for Visa's payment processing system before coming to eBay.
 - c) Despite the recent economic downturn and the slow-down in business management has remained focused on increasing shareholder value (sold Skype) and reigning in margins (sales and marketing spend decreased 2009).
 - d) Throughout 2009 management was able to beat revenue guidance and quarterly expectations as observed in Appendix 5.

Investment Risks:

- 1) E-commerce competition is significant from both large and small players – eBay has created strong barriers to entry by building a large network and hard to replicate user base
- a) The e-commerce market is rife with competition all of which threatens eBay's business
 - i) Amazon.com has built the Amazon market place for users to buy/sell books and other items directly from each other. Amazon is also growing revenue at 25-30% per year which causes analysts to like their business more than eBay's business which had revenue growth of 11% in 2008 and 1% in 2009.
 - ii) Inventory liquidations are a large business for eBay which is coming under increased competition. Overstock.com is a site built to help large retailers get rid of inventory very quickly. Walmart and Target are increasingly using their website to get rid of inventory at cheap prices.
 - iii) Craigslist and other community based websites allow people to post items for sale at no cost
 - b) Recently eBay has lost some market share to these players but with the new seller developments they are in a position to recapture share in the near- to mid-term. Furthermore they are making accretive acquisitions (bought Gmarket in Korea, took a 20% stake in craigslist) to ensure their offerings stay competitive.
 - c) To combat the competitive threats, the network effects inherent in eBay's business model provide a significant barrier to entry for other players. Buyers and sellers will always be attracted to the largest online marketplace because they would have a higher likelihood of getting the best prices and selection.
- 2) Financial transaction vendors are increasingly competing with PayPal, but PayPal has created strong barriers to entry by building large networks and retaining key IP
- a) In the online payments space competition is heating up as well. American Express recently purchased Revolution Money and Visa/Mastercard have also been expanding their online presence. These large transaction vendors dwarf PayPal in terms of transaction volumes and sizes.
 - b) Other online companies are also putting pressure on PayPal including Google Checkout and Checkout by Amazon. Each of these vendors charges fees similar to PayPal.
 - c) PayPal has been able to retain a strong presence online because they have 95% market share of online consumer-to-consumer transactions and have a large and active user base of ~400M accounts of which 90M are active users. This user network is a barrier to entry because merchants will look to join sites that have a large number of established users. Users themselves will look to join the network with the largest number of merchants because then fewer websites will have access to their bank accounts.
 - d) PayPal also has several key patents which increases the barriers to entry for other potential competitors.

- 3) Recent outages indicate eBay will have to improve their website
- a) On November 23 eBay went down for a few hours because too many listings went live at the same time. This type of outage should not happen within a large website – while this indicates users are actively using the site it could also drive users to other websites because the ability to switch to a different website is very easy.
 - b) Customers also complain that eBay's website is too cumbersome, cluttered and error prone when compared to other leading websites. While eBay has made changes to address these issues there is still more effort needed.
 - c) To combat these issues, eBay began to increase R&D spend as a percent of revenue – growing to 8.5% in 2009 from 7.4% in 2008. I forecast eBay will continue to increase R&D spend to ~9.5% in 2010.
- 4) BillMeLater has experienced higher than average losses which depress PayPal margins
- a) The new BillMeLater division purchased by PayPal provides instant credit to users. This feature is useful for online merchants who would like to offer credit to their customers.
 - b) In the recent downturn most credit providers suffered losses and BillMeLater experienced charge offs of 11.2% in Q2 and 11.5% in Q3 compared to typical credit card charge offs of 10.03% (source: Moody's). If BillMeLater continues to see high charge-offs it will depress PayPal's margins.
- 5) eBay is a transaction business with no recurring revenue or backlog, if economic conditions slow down or something happens to their website the business could be significantly impaired
- a) Since eBay has little revenue visibility there is no way to accurately predict future earnings – to combat this and prevent significant impairment to their business, eBay retains a significant amount of cash (\$3B or \$2.40 per share). This cash can be used to cover any expense shortfall should revenue drop off or to make accretive acquisitions to grow market share.

Financials and Valuation:

- 1) Revenue and margin estimates are detailed above
- a) I did not make significant changes to consensus estimates for Q4 – although many of the above investment merits and risks apply to Q4, I chose to focus on the growth and differences between 2010 and 2009.
- 2) eBay currently trades at a valuation below its comps and lower than its historic multiples
- a) eBay has recently exhibited slower EPS growth than its peers and as such its valuation has fallen recently. In creating a comp set I looked at e-commerce companies in the same business with little leverage and companies exposed to broader internet trends.
 - i) E-commerce peers trade at 21-25x forward EV/EBITDA while eBay is currently trading at 7.8x my forward EV/EBITDA.
 - ii) On a P/E basis the average e-commerce comp trades at a ~40x forward multiple while eBay is currently at a 12.8x forward multiple.
 - b) Looking at historical multiples on eBay is deceiving because eBay has enjoyed many years with extremely high valuations (particularly 2000, 2001 and 2005). As such I limited my historical data set to 2006-2009 during which time eBay enjoyed a period of steady growth (2006-2007) followed by a period of muted growth (2008-2009). I've elected to use these in the spirit of being conservative. Historically eBay traded at a 8x forward EV/EBITDA and a 14x forward P/E while it is currently trading at a 7.7x forward EV/EBITDA and 12.8x forward P/E.
 - c) The low multiples eBay is currently trading at indicate eBay is a valuable buying opportunity right now. The issues eBay has faced recently are a large but solvable problem creating an ideal opportunity for investment.

EBAY Comps								
	P / Sales		EV / EBITDA		P / Earnings		P / Book	
	LFY	NFY	LFY	NFY	LFY	NFY	LFY	NFY
<u>e-Commerce Competitors</u>								
Amazon.com	3.0x	2.4x	40.5x	35.3x	88.4x	70.0x	21.3x	14.4x
Overstock.com	0.4x	0.4x	23.6x	11.8x	nm	50.1x	17.9x	73.4x
GSI Commerce	1.3x	1.2x	22.3x	16.3x	nm	nm	4.9x	2.8x
Blue Nile	2.8x	2.7x	38.9x	35.1x	75.3x	65.2x	42.6x	20.4x
Digital River	2.5x	2.5x	5.2x	5.6x	16.6x	14.9x	1.7x	1.4x
Mercadolibre	4.9x	11.9x	15.0x	31.9x	35.6x	65.7x	6.7x	16.8x
Drugstore.com	0.8x	0.7x	nm	49.3x	nm	nm	3.1x	2.9x
Netflix	2.3x	1.9x	8.1x	13.6x	43.8x	30.7x	9.1x	14.6x
Average	2.2x	3.0x	21.9x	24.9x	52.0x	49.4x	13.4x	18.3x
Median	2.4x	2.1x	22.3x	24.1x	43.8x	57.6x	7.9x	14.5x
<u>e-Commerce Competitors</u>								
Yahoo	2.9x	4.5x	19.4x	14.8x	51.7x	35.4x	1.9x	1.7x
Google	6.5x	8.1x	16.2x	10.9x	43.6x	25.5x	5.0x	5.2x
Valueclick	1.3x	1.6x	nm	6.6x	nm	12.9x	2.3x	2.0x
Average	3.6x	4.7x	17.8x	10.8x	47.6x	24.6x	3.1x	2.9x
Median	2.9x	4.5x	17.8x	10.9x	47.6x	25.5x	2.3x	2.0x
eBay - Current	3.5x	3.1x	9.0x	7.8x	15.2x	12.8x	2.4x	2.0x
eBay - Average ('06-'09)	5.8x	4.8x	12.0x	8.0x	66.7x	14.4x	5.7x	nm

3) My price target of \$30 was derived in several ways

- Discounted cash flow using conservative discount rate of 13% and reasonable free cash flow growth rate of 5.5% yields a share price of \$30.72.
- 8x 2011 EBITDA implies a \$28 share price where 8x is eBay's historical average forward EV/EBITDA.
- 14x 2011 earnings implies a \$31 share price where 14x is eBay's historical average forward P/E multiple.
- I chose to use historical averages because assuming eBay performs as outlined, its valuation should revert to its historical averages.

4) \$19 downside assumes core businesses shrink and multiples contract

- To create my downside case I assumed that eBay's core businesses shrank in 2010 and 2011 yielding \$1.45 per share (from a current run rate of \$1.52 per share. At these levels eBay would not warrant a premium valuation and as such I applied a low multiple of 13x P/E to arrive at a \$19 share price.

5) Pair trades could provide additional benefits

- Since eBay trades at a significant discount to its direct competitors (AMZN, OSTK, and GSIC) – one might want to consider a pair trade going long eBay and shorting a competitor. This would provide upside as eBay grows faster than its peer while limiting downside if a broader economic downturn that hampers e-commerce growth.

Due Diligence Issues / Next Steps:

1) Currently unanswered questions

- a) The average amount eBay and PayPal will charge users per transaction – Since this rate is different on a user-by-user basis it will be important to poll the top sellers to get a sense of what rates they are seeing and also monitor any e-mails/communications eBay has with regular sellers about transaction fees.
- b) The average selling price on eBay and the average payment size on PayPal – Since these vary over time it might be useful to either build a database that pulls in pricing information on a subset of eBay items or subscribe to data sources (e.g., Channel Advisor) which monitors and publishes information about eBay sales on a weekly/monthly basis.

2) Next steps in due diligence – get additional clarity on current forecasts

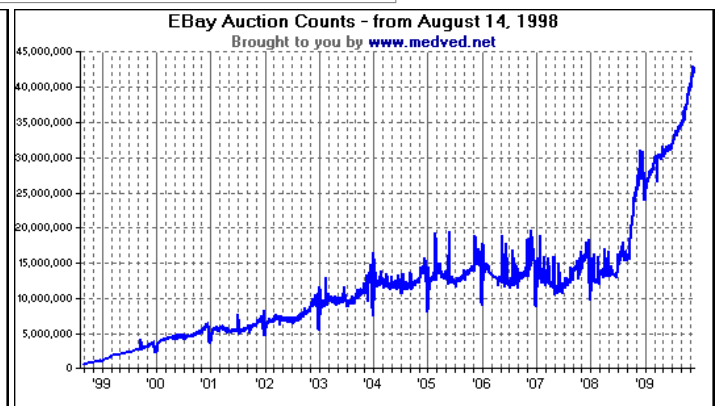
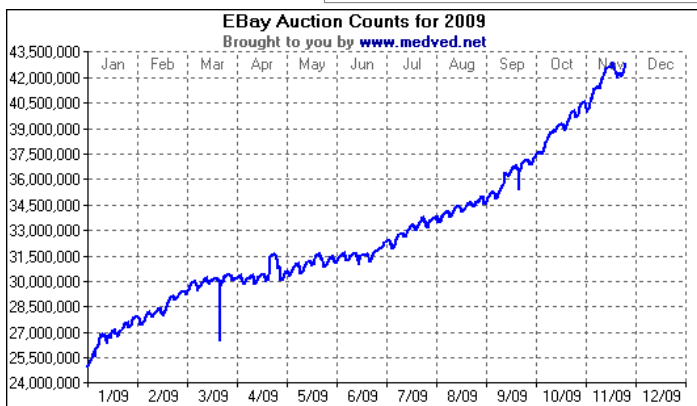
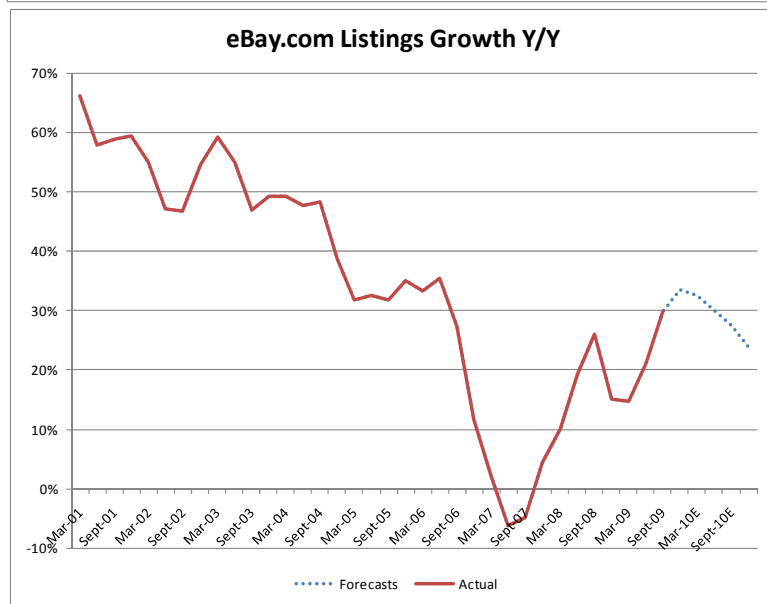
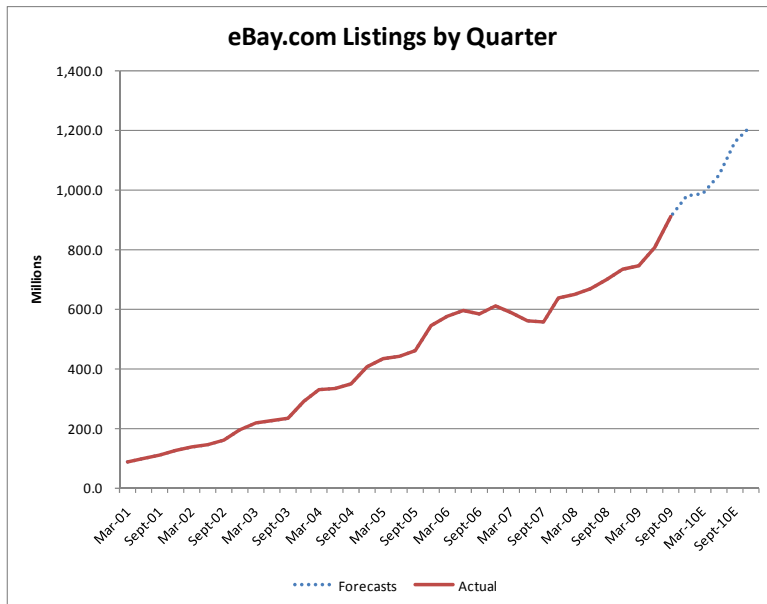
- a) Talk to the larger sellers – Since the top sales people account for 40% of the sales revenue and since their contact information is provided on the auction sites it will be useful to speak with a subset to get a sense of how eBay's new initiatives are working in terms of increasing the number of listings and the conversion rates of those listings. Also these conversations will be useful to get an understanding of the competitive dynamics in terms of how sellers choose to sell things on eBay versus the other sites available (Amazon, Craigslist, etc.).
- b) Poll large sellers on a weekly basis – A survey could quickly be developed which asks targeted questions about average fees and is e-mailed on a bi-weekly or monthly basis to a handful of top sellers.
- c) Monitor transaction sizes – Create a database which pulls in closing prices for eBay auctions on a subset of commonly purchased items (e.g., books, electronics) to monitor the price fluctuations over time.
- d) Visit with management – A large part of this thesis is about management succeeding in implementing new initiatives and driving users to eBay. To understand the initiatives, their timing and how successful they have been to date I would look to interview eBay management with a specific focus on getting additional insights into the user enhancement efforts. Also, I would look to understand at a more detailed level how the current management team differs from the previous management team to get a sense of the effectiveness of leadership's efforts.
- e) Subscribe to data sources – During the course of my due diligence I noticed several potential data sources that track information related to eBay (Channel Advisor, medved.net, Alexia). Some of these will be more useful than others so I'd want to get a better sense of who provides what data and how accurate that data is. If the data is useful and differentiated in terms of providing information about eBay or PayPal I would consider purchasing a subscription.

3) Several key metrics should be monitored to assess the performance of this thesis

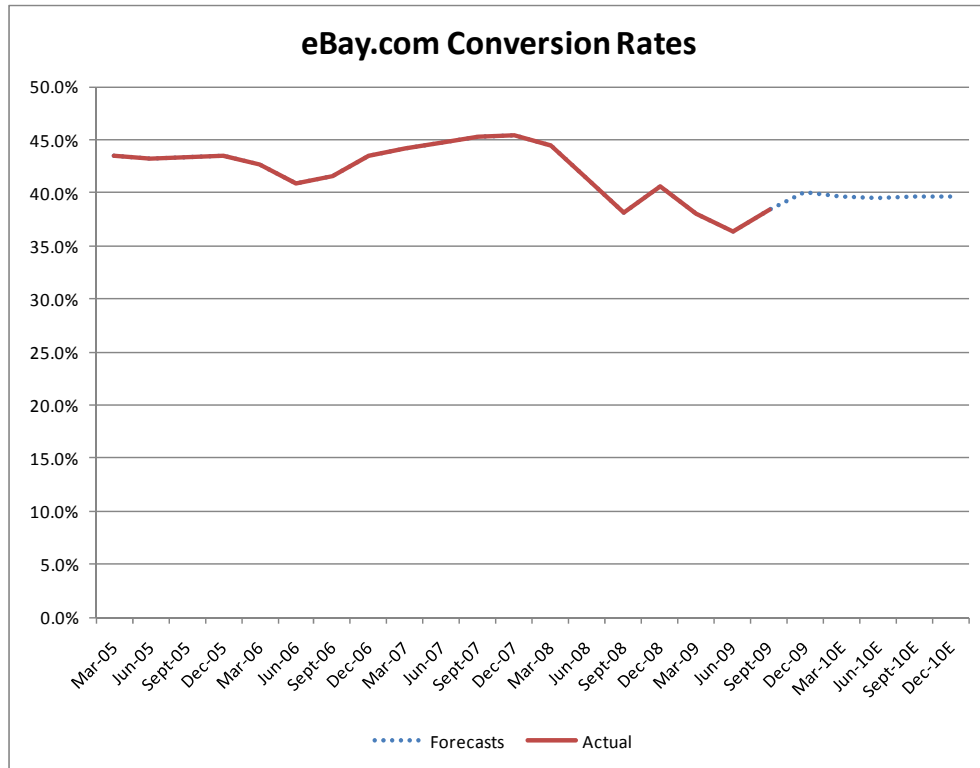
- a) Items listed and conversion rate – medved.com tracks a subset of items listed and their conversion rates on a daily basis. One should monitor this information over time to ensure that eBay is achieving the forecasted growth rate in listings and conversion rates.
- b) Average sale price – it is possible to monitor all recent eBay transactions, one could create a database of closed transactions to monitor the average sale price of the items to infer eBay's potential revenue for the quarter.
- c) International PayPal expansion – to monitor PayPal's international expansion one should track the number of languages and countries which paypal supports. The information listed at <https://www.paypal.com/worldwide/> provides a quick resource to assess the international reach of PayPal.
- d) Monitoring percent take – to monitor the fees that eBay and PayPal are charging users one might consider doing a survey of leading sales people on eBay.com as described above.

Appendix:

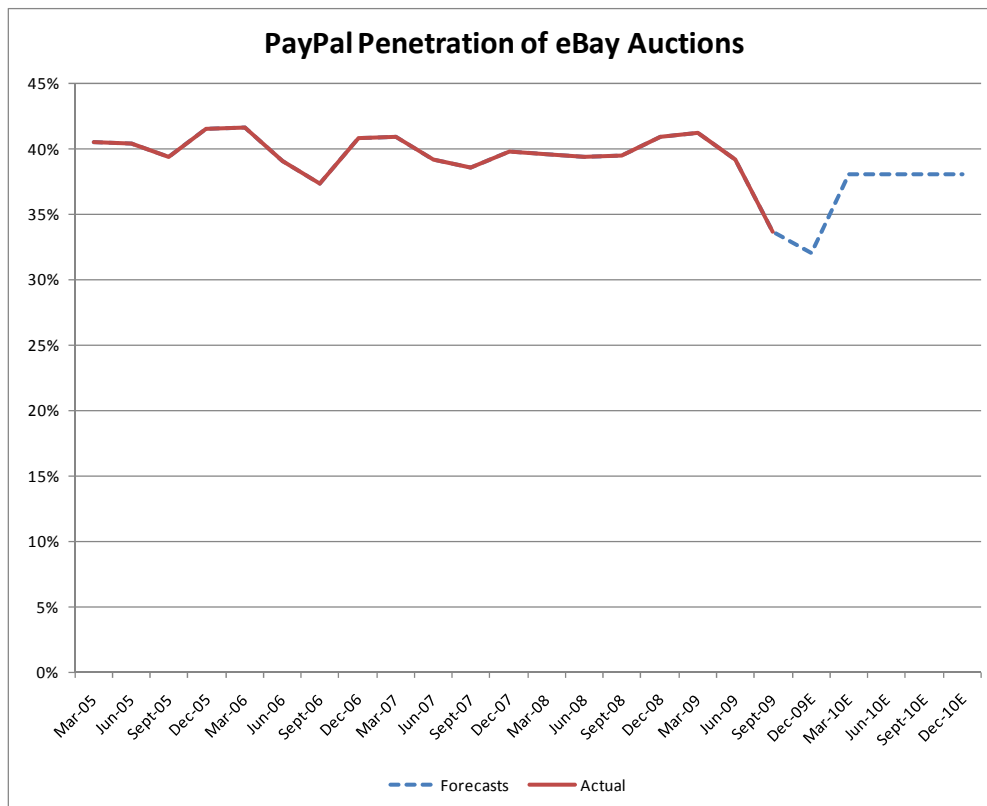
1) Growth in listed items will grow rapidly in 2010 after stalling in 2007 and 2008



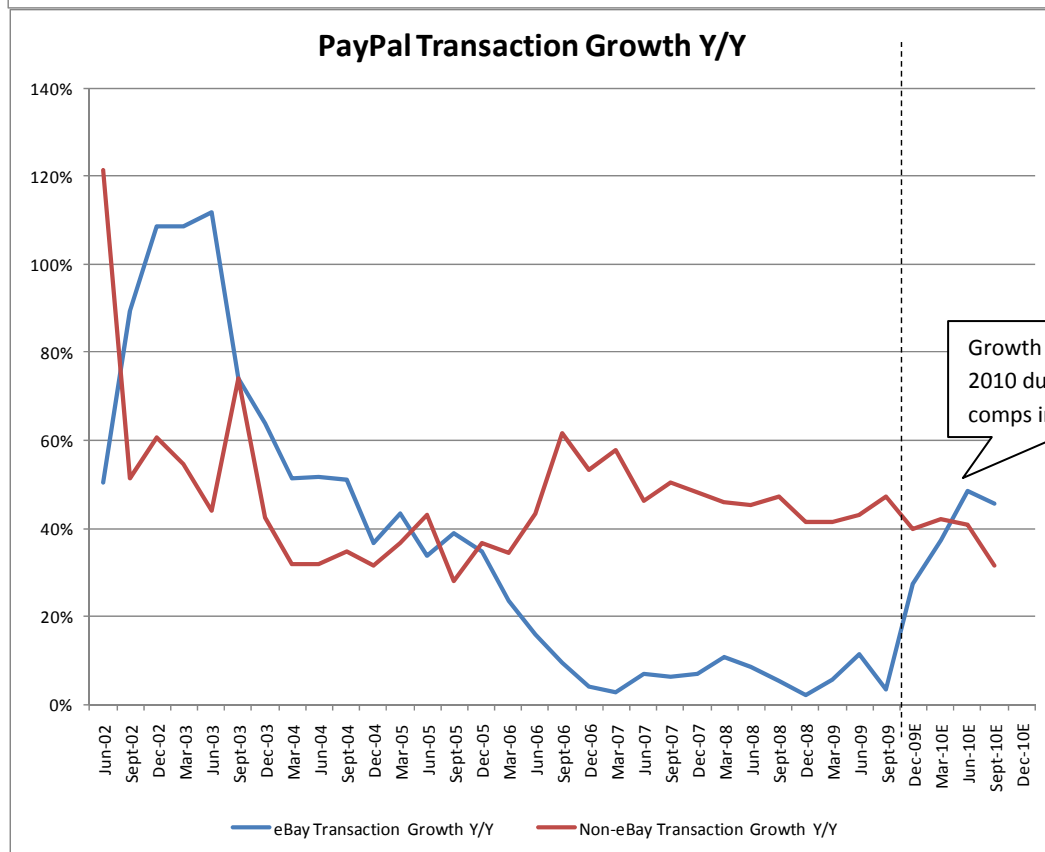
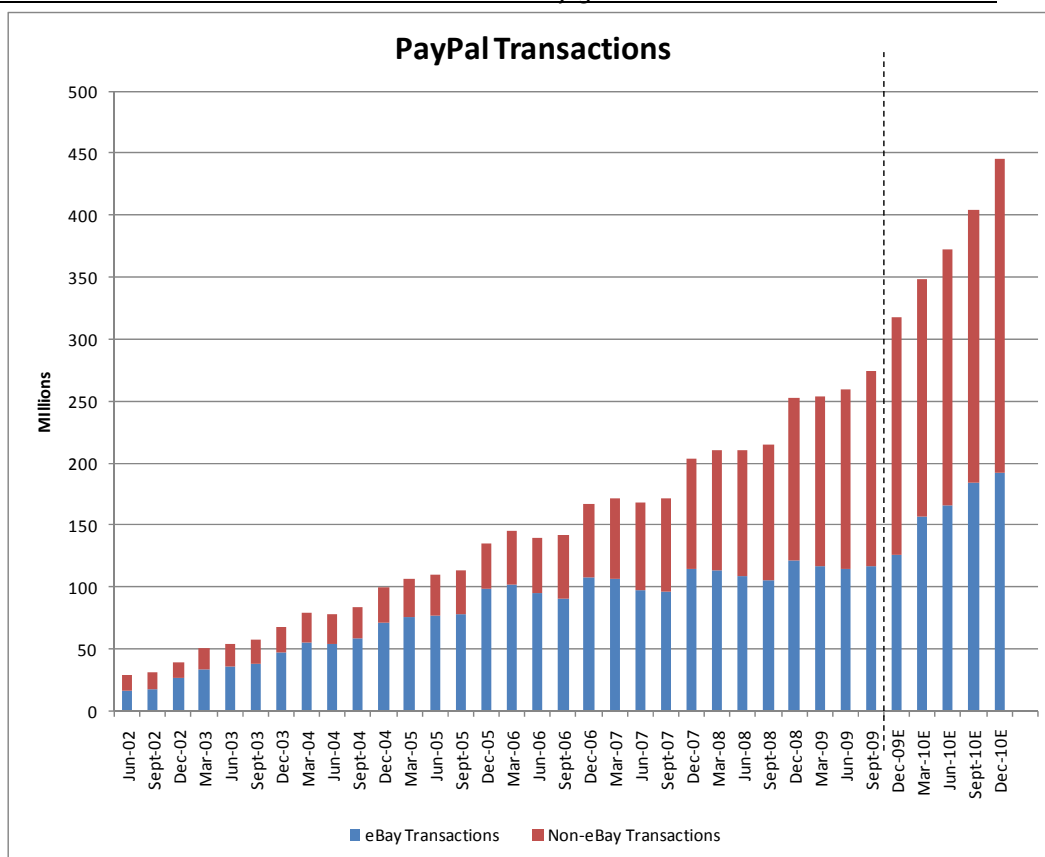
2) Conversion rates on eBay.com has improved in recent quarters



3) PayPal's penetration on auction growth will increase through international expansion



4) PayPal transaction volumes will continue to increase driven by growth in non-auction transactions



5) eBay consensus history

