

eBay: Innovation is key

Summary:

- eBay is a large ecommerce business, headquartered in California. In 2013 it enabled \$212bn of ecommerce transactions through its various online Marketplaces and its online payments business, PayPal.
- Thus eBay is an e-commerce enabler in an era when retail sales are increasingly moving to the internet.
- We think this trend likely has some way to go — global ecommerce sales still only account for c. 5% of total global store-based sales and are growing between 15-20% p.a. Growth of traditional retail is significantly below this level indicating to us that any decent business operating in this field deserves attention from investors.
- Although it is no longer a fast growing company but is growing more in the 10-15% range (EPS growth of 12-14% is expected in 2014, according to *Bloomberg* consensus estimates), it operates in the fast-changing ecommerce industry, where it has a powerful position with a large installed customer base.
- There was a period in the mid-to late-2000s when eBay's Marketplace growth slowed noticeably. Buyers and sellers were clearly less interested in using eBay at that stage and this was a big wake-up call for the company demonstrating that a marketplace business needed ongoing innovation to stimulate business activity.
- Since then there has been a change (a credit to former Bain management consultant, John Donahoe who became CEO in 2008), and growth in Marketplaces has improved (although it is still modest). With Marketplaces likely to grow in-line or slightly above overall ecommerce rates, eBay is now also trying to add a new growth leg by helping large national offline retailers become omnichannel retailers (i.e. sell more online).
- So far a few have signed up but it has been a slow process. It is probably also too early to say if this initiative will succeed but at least the innovation levels have improved dramatically and eBay currently has a lot to offer. This is a key area (i.e. Enterprise division) for eBay as it could boost growth rates for the company as well as drive earnings and the share price, in our view.
- The outlook for eBay is for revenue growth of c. 12-14% in FY14 (management guidance) and for EPS growth to December 2014 of 11-12%. We believe margins are likely to decline slightly going forward as the take-rate comes under some pressure as PayPal grows in terms

of its earnings contribution from the current c. one-third of group earnings.

- We recommend investors **BUY** eBay and we believe it is a good company with above average growth prospects. The core business is solid and secure assuming innovation levels remain high and the company does not fall asleep as it did in the mid 2000s. However, the Enterprise segment will be a tough area for the company to succeed in, but if it does we are of the view that it will add greatly to its growth.

eBay metrics:

Spot (\$)	54.45
Mkt Cap (\$bn)	69.1
12M trailing P/E	25.56
12M fwd P/E	18.25
10-year average P/E	27.4
FYE	31-Dec
P/Book	2.98
12M fwd DY	0

Source: Bloomberg, Anchor Capital



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We scan the globe looking for good opportunities. We provide our model portfolios, as well as news and views on our watchlist, which is continually reviewed and updated.



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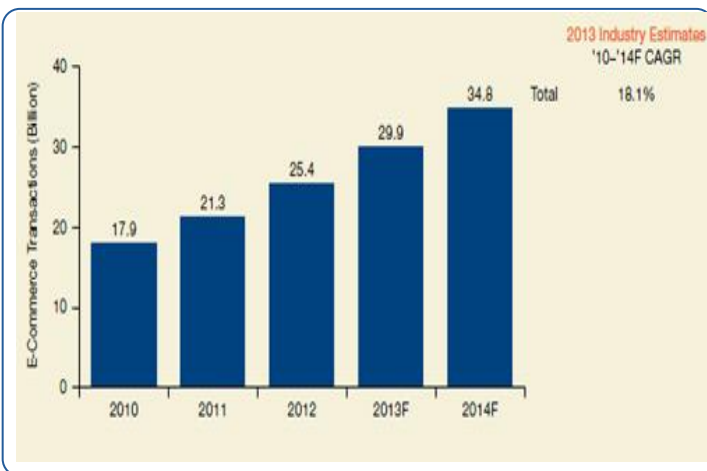
What it does:

eBay is a large ecommerce business, and in 2013 it enabled \$212bn of ecommerce transactions through the various online Marketplaces it operates and its online payments business, PayPal. This would give it a market share of c. 16-18% of the US ecommerce market (Marketplaces + PayPal, with no double counting). If we ignore PayPal for a moment due to lack of data, eBay is also a significant ecommerce company in the UK, Germany, South Korea, Australia, France and Italy. Thus the company has a reasonable spread of business in the developed world. However, it is not big in emerging markets (EMs) although it does do a fair amount of cross-border trade in these markets (i.e. sells to them).

Background:

For us the attraction of a business such as eBay is that it is an e-commerce enabler in an era when retail sales are increasingly moving to the Internet. This long-term trend probably has some way to go, in our view, with global ecommerce sales still only c. 5% of total global store-based sales. Here we note that in a wired country such as, for example, South Korea this number is over 15%. With global ecommerce sales growing between 15-20% p.a. and traditional retail growing well below this, any decent business operating in this field deserves some attention from investors.

Number of global ecommerce transactions, 2010-2014F (bn):



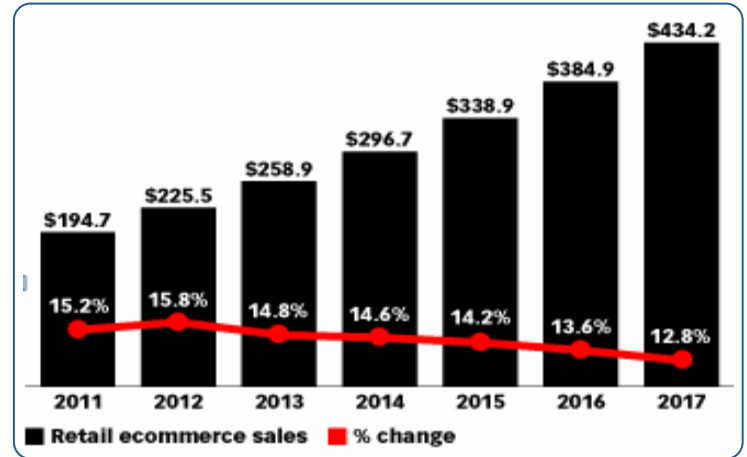
Source: World Payments Report 2013, Capgemini and RBS
Note: Ecommerce includes retail Sales, travel sales, digital downloads purchased via any digital channel and sales from businesses that occur over primarily C2C platforms such as eBay; Chart numbers and quoted

Outlook:

We believe eBay is a good business. It operates in a fast-changing ecommerce industry but it does have a powerful position with a large installed base of customers. eBay is one of the oldest ecommerce companies, having evolved from an online auction business to a primarily fixed-price business plus a very successful online payments business - PayPal. It is not a retailer like Amazon, but rather an ecommerce enabler that provides online marketplaces for buyers and sellers to transact. eBay is no longer a fast-growing company but grows more in the 10-15% range – EPS growth of 12-14% is expected in 2014, according to Bloom-

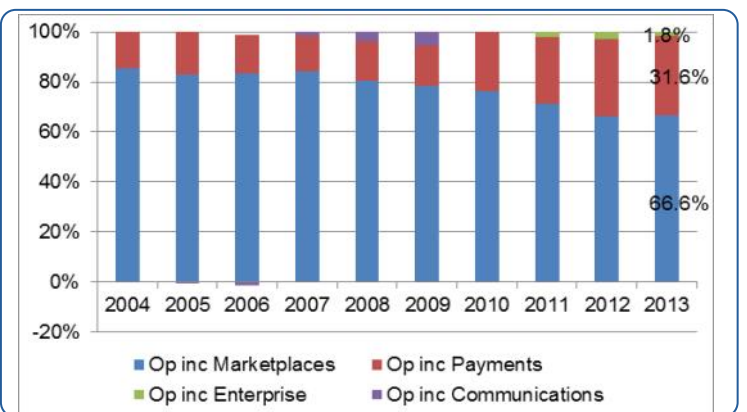
berg consensus estimates. Although this is lower than Amazon, it is probably more difficult to grow a marketplace rather than an e-retailer because it has to attract sellers as well as buyers. Amazon only has to attract buyers. However this also possibly means that the business is more stable because of the network effect.

US retail ecommerce sales, 2011-2017, bn:



Source: eMarketer, April 2013
Note eMarketer benchmarks its US ecommerce sales figures against US Department of Commerce data for which the last full year measured was 2012; includes products or services ordered using the internet via any device, regardless of the method of payment or fulfilment; excludes travel and event tickets

eBay operating income split:



Source: Bloomberg, Anchor Capital

There was a period in the mid-to late-2000s when eBay's Marketplace growth slowed noticeably. This was just before John Donahoe (the former Bain management consultant) became CEO in 2008. Buyers and sellers were clearly less interested in using eBay at that stage. This was a big wake-up call for the company, and it demonstrated that a marketplace business needed ongoing innovation to stimulate business activity. In the period since there has been a change - a credit to Donahoe. Although he isn't a visionary like Koos Bekker at Naspers, he has displayed the paranoia that all tech CEOs need in spades. Growth in Marketplaces has improved although it is still modest (note as mentioned the company is not big in EMs). PayPal has continued to do well but that period of low innovation a few years ago opened up the market to new entrants, particularly in terms of new forms of mobile payments. Over the past two years, PayPal has been scrambling to get back on top in mobile payments. A bit more vision may have helped, in our view.

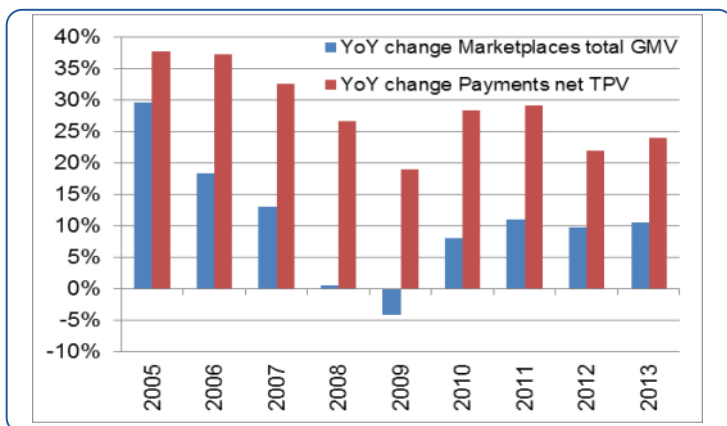
With two TRICKS to the eBay PONY – Marketplaces and PayPal – the company is now trying to use these to win business from offline retailers. With Marketplaces likely to grow in-line or slightly above overall ecommerce rates, eBay is now also trying to add a new growth leg by helping large national offline retailers become omnichannel retailers (i.e. sell more online). This is a big ask in our opinion and thus far the Enterprise division isn't going as well as they had anticipated. Nevertheless there is no doubt in our minds that offline retailers need help in becoming omnichannel retailers. eBay has a lot to offer them from web platforms, customer care, fulfilment, payment systems etc. and eBay would charge a take-rate (i.e. a fee based on transaction values) in much the same way as Marketplaces and PayPal do in the traditional business. However the question arises whether large retailers will go with the company? Thus far a few have signed up but has been a slow process. It is probably also too early to say if this initiative will succeed but at least the innovation levels have improved dramatically and eBay currently has a lot to offer. This is a key area (i.e. Enterprise division) for eBay as it could boost growth rates for the company as well as drive earnings and the share price, in our view.

on adjusted EPS (adjusted mostly for stock-option costs). Analysts tend to refer to adjusted EPS although the former is more correct. The P/E's seem reasonable considering the above average growth of the company.

We recommend investors **BUY** eBay. We believe it is a good company with above average growth prospects. The core business is solid and secure assuming innovation levels remain high and the company does not fall asleep as it did in the mid 2000s. However, the Enterprise segment will be a tough area for the company to succeed in, but if it does we are of the view that it will add greatly to growth.

David Gibb

eBay YoY % change :



Source: Bloomberg, Anchor Capital

Conclusion:

The outlook for eBay is for revenue to grow at c. 12-14% in FY14 (according to management guidance) and for EPS growth to December 2014 of 11-12%. We believe margins are likely to decline slightly going forward as the take-rate comes under some pressure as PayPal grows in terms of its earnings contribution from the current c. one-third of group earnings. PayPal is also at its most profitable when it is tied to eBay TPV (total payment volumes) as opposed to Merchant services TPV - presumably because credit card usage is lower on eBay TPV. For the next few years we expect EPS growth in the 10-13% range p.a. If the Enterprise segment gains traction with large retailers, then this could increase, in our opinion.

We calculate a discounted cash flow (DCF) of \$82 for eBay. This assumes a decline in margins to 18% over time (from 21% in FY13), and a capex/sales level of 11%. This represents potential upside of 45% from the current share price of around \$55. This looks attractive enough to us. The P/E ratio to December is 22.5x on unadjusted EPS or 18.4x



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