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**Ebay, Inc. (NASDAQ: EBAY)**

**The second quarter earnings release, acquisition of Half.com, and expanded site capabilities**

**Rating: BUY**

August 08, 2000

**KEY CONSIDERATIONS**

- Acquired Half.com in order to add fixed-price functionality to its e-commerce platform.
- Registered users increased to 15.8 million by second quarter end, an increase of 183 percent from 5.6 million on June 30, 1999.
- Expanded site capabilities to include used cars, real estate, and upscale items to its auction-style format.
- Declared a two-for-one stock split effected in the form of a stock dividend on May 25, 2000.
- Competitors such as Yahoo, Amazon, and Microsoft continue to threaten eBay's market shares.

**ONE-YEAR PRICE AND VOLUME GRAPH**



Recent Price	\$50.75
52WK Low	\$39.13
52WK High	\$127.50
P/E	576.71
P/Book	13.77
P/Sales	44.26
Market Capitalization	\$13,320.10 M
Shares Outstanding	262.47 M
Float	120.70 M
Daily Volume (3-month Average)	3.74
<b>EPS</b>	
1999A	\$0.08
2000E	\$0.20
2001E	\$0.25
Current Ratio	3.32
Total Debt to Equity	0.03
LT Debt	0.02
Total Cash	\$135.6 M

**COMPANY PROFILE**

eBay Inc. operates an online person-to-person trading community. eBay pioneered online person-to-person trading by developing a Web-based community in which buyers and sellers are brought together in an auction format to trade personal items such as antiques, coins, collectibles, computers, memorabilia, stamps, and toys. The eBay service permits sellers to list items for sale, buyers to bid on items of interest, and all eBay users to browse through listed items in a fully-automated, topically arranged service that is available online 24-hours-a-day, seven-days-a-week. eBay also engages in the traditional auction business through its subsidiaries Butterfield & Butterfield and Kruse International, and in online payment processing through their Billpoint, Inc. Additional information about eBay Inc. can be found on its web site at <http://www.ebay.com>

This report was prepared by Scott Lawrence, and David R. Rivas, Ph.D.

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## **THE COMPANY**

eBay Inc. was incorporated in California in May 1996, and reincorporated in Delaware in April 1998. eBay pioneered the first Internet-based person-to-person trading community in 1995 and is currently the largest and the leading personal trading community on the Internet, based on the number of items listed, number of users, and minutes of usage per month. The eBay service permits sellers to host items for sale, buyers to bid on items of interest, and all eBay users to browse through listed items. The company's 24-hour-a-day, seven-day-a-week service is fully automated, topically arranged, intuitive, and easy to use. Browsers and buyers can search auction listings for specific items or search by category, key word, seller name, recently commenced auctions, or auctions about to end. By accepting multiple bids at increasing prices, its auction format provides sellers a more efficient means of obtaining a maximum price for their products. On any given day, there are millions of items for sale on the site across thousands of categories. eBay enables trade on a local, national and international basis with local sites in 53 markets in the U.S. and country specific sites in the United Kingdom, Canada, Germany, Japan and Australia. With the acquisition of Half.com in July 2000, eBay's community now benefits from a marketplace combining traditional auction and fixed-price trading.

eBay's auction format and community-oriented structure require little intervention from the Company. Procedural rules designed to facilitate trade and communication, along with the Company's Feedback Forum that allows eBay users to provide comments and feedback on other eBay users, help make the eBay community self-policing. In addition, the Company offers user verifications, insurance, integrated escrow, direct credit card purchasing, and authentication and appraisals to bolster eBay's reputation as a safe place to trade. To list an item in eBay, sellers pay only a nominal placement fee, ranging from \$0.25 to \$2.00, and then pay an additional success fee that steps down from 5% to 1.25% of the transaction value only if an auction is concluded with a successful bid. Buyers are not charged for trading through eBay. eBay does not take ownership of any products sold over its site, eliminating the need for capital associated with inventory financing.

By second quarter end 2000, eBay expanded the number of registered users to 15.8 million, an increase of 183 percent from 5.6 million on June 30, 1999. Through its domestic and international sites, eBay hosted 62.5 million auctions during the second quarter, compared to 29.3 million during the same period last year. This represents year-over-year growth of 113 percent.

## **INDUSTRY OUTLOOK AND COMPETITION**

The market for person-to-person trading over the Internet is rapidly evolving and intensely competitive. Barriers to entry are relatively low, and current and new competitors can launch new sites at relatively low cost using commercially available software. eBay currently or potentially competes with a number of other companies. It directly battles with all e-businesses because a buyer can buy the same product being auctioned off at eBay at an e-commerce web site. Furthermore, eBay directly competes with all other e-auctions including Amazon.com, Yahoo!, Onsale Exchange, a division of Onsale, Inc.; Auction Universe, a Times-Mirror Company; Excite, Inc. and a number of other small services, including those that serve specialty markets. eBay continues to keep its majority of market share through expansion into new markets as well as offering new services. For this reason we believe the Company will continue to maintain its dominant position in the e-auction market space despite growing competition.

## **STRATEGY FOR GROWTH**

We believe that membership retention and expansion are crucial for staying competitive in the person-to-person auction sector. This important factor allows companies to have numerous item categories, which attract buyers, and efficiently higher bid prices, which attract sellers. To date, eBay successfully continues in executing membership retention and expansion, and has remained significantly ahead of its competitors. On July 25, 2000, eBay reported having 15.8 million registered users, a 183 percent increase from June 30, 1999. Further evidence of eBay's continued expansion is the increase of the second quarter 2000's Gross

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Merchandise Sales (the value of the goods traded on the eBay site) by 108 percent over the second quarter of 1999. eBay continues to use various strategies to increase its customer base:

**Mergers and Acquisitions.** On July 11<sup>th</sup> 2000 eBay completed the acquisition of Half.com, which will add fixed priced functionality to the expanding eBay trading platform, in an all-stock transaction valued between \$313 million and \$374 million. Half.com lists books, CDs, videos and movies on its site, and requires sellers to list these items at fixed prices that cannot exceed half of the original price. While the Half.com users will only marginally expand eBay's existing community of registered users, we believe that the addition of a fixed price medium is valuable to eBay's future growth. Although we think that the immediate effects of this costly acquisition are likely to be dilutive, as Half.com is not yet profitable, eBay claims that contributions to earnings will be seen during 2001. eBay notes that it would take more than six months to develop this service itself (an eternity in the online realm), further leading us to believe that this acquisition was necessary to maintain the growth that keeps the Company ahead of its competitors.

**New Services.** Through its acquisition of Billpoint in 1999 and its alliance with Wells Fargo in March 2000, eBay has been able to offer several online payment options that are reliable and secure. Wells Fargo will deploy its highly regarded payment processing and customer care infrastructure. New services include person-to-person credit card payments, and electronic check transactions. This service is in response to user requests and could help promote brand loyalty through ease of use. However, it is still unclear whether the user community is willing to pay for this service.

eBay moved its high-end offline auction Butterfield & Butterfield online in order to jumpstart their upscale online auctions. Butterfield is well known in the art world but is generally less well known to the online community. eBay will probably face stiff competition for upscale items as more recognizable traditional auction houses move online.

eBay has also added a marketplace for used cars as well as real estate (see ALLIANCES AND PARTNERSHIPS below).

**Expansion.** Due to intense competition, eBay is continuing its expansion into international markets. eBay recently launched in Japan and initiated listing fees for eBay U.K. These new venues will add to eBay's international presence that includes Canada, Germany, Australia, and China. eBay has also increased the number of its domestic local sites enabling community members to find items of local interest or that are too difficult to ship long distances, such as cars, furniture, and sporting goods. As well, eBay has introduced the special interest site 'Korean City' to provide a domestic marketplace for Korean Culture and Interests. We feel that these expansions will further promote member loyalty and retention.

**Marketing.** In order to drive a higher return on investment for advertising, eBay undertook a five-year agreement with Mediaplex to use its MOJO technology to serve, manage, and optimize eBay's online banner advertising. This technology can be spread to most digital platforms including cellular phones, PDAs, and interactive TV. We believe this will increase site traffic and keep eBay abreast of new advertising techniques.

eBay and Go.com also launched the co-branded site (<http://ebay.go.com>) designed to make it easier for Go.com's 18 million users to visit eBay. This should further help eBay by significantly increasing site traffic and the number of registered users.

**Technology.** In the past eBay experienced system outages from time to time that adversely affected revenues. We believe that eBay has solved this problem as the Company reported that system uptime was over 99 percent for the second quarter 2000.

**Safety and Trust Program.** eBay uses various forms of safety and trust. It uses its partner I-Escrow to make sure wanted items are received. Furthermore, it has free insurance for all its members and finally,

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they have a feedback forum where members leave comments about each other's buying and selling. To date eBay has only had minor problems with the safety and trust of its buyers and sellers.

## **ALLIANCES AND PARTNERSHIPS**

On March 7<sup>th</sup> 2000, eBay and AutoTrader.com announced an agreement that created the Internet's largest auction-style marketplace for consumers and dealers to buy and sell used cars. A co-branded site ([www.ebay-autotrader.com](http://www.ebay-autotrader.com)) was launched that will bring together eBay's trading community with AutoTrader.com's 5 million monthly visitors and more than 40,000 participating auto dealers and 250,000 private sellers that provide the 1.5 million used vehicles offered for sale. The site had some initial problems with ease of use and was re-launched in late June. We believe that the problems have been solved and that the service will positively contribute to eBay's bottom line. Financial terms were not disclosed.

On August 3<sup>rd</sup> 2000, eBay announced the addition of houses, land and commercial real estate to its online auction format through its partnership with the online real estate brokerage [zipRealty.com](http://zipRealty.com), which will provide some related services like licensed brokers, required by some state laws to oversee real estate transfers. eBay will not charge commission fees opting to charge only a \$50 listing fee. By putting the entire process of real estate purchasing online, eBay should be able to drive more traffic to its site. Potential problems may arise without options for financing and mortgages.

## **KEY RISK FACTORS**

- **Acquisitions could result in dilution, operating difficulties and other harmful consequences.** The process of integrating an acquired business into their business and operations may result in unforeseen operating difficulties and expenditures. In addition, expansion into international markets will require management attention and resources. They have limited experience in localizing their service to conform to local cultures, standards and policies.
- **Pending legal proceedings could damage its reputation and business.** As a result of legal action, eBay may have to implement other protective measures that could require them to spend substantial resources and/or to reduce revenues by discontinuing certain service offerings. These proceedings could be costly and eBay's business would be harmed if they were to lose. Possible consequences could include service upgrade delays and forced entry into royalty or licensing agreements. These proceedings could also cause negative publicity that could damage the Company's reputation and diminish the value of its brand name. It also could make users reluctant to continue to use their services.
- **Billpoint is subject to unique risks as a provider of Internet payment solutions.** Businesses that handle consumers' funds are subject to numerous regulations, including those related to banking, credit cards, escrow, fair credit reporting and others. Billpoint is a new business with a relatively novel approach to facilitating payments. It is not yet known how regulatory agencies will treat Billpoint. The cost and complexity of Billpoint's business may increase if certain regulations are deemed to apply to its business. In addition to the need to comply with these regulations, Billpoint's business is also subject to risks of fraud, the need to grow systems and processes rapidly if its product is well received, a high level of competition, including competitors who are currently not charging for their product offerings and are offering significant promotional incentives, and the need to coordinate systems and policies among itself, eBay, and Wells Fargo Bank, which will be the provider of payment services.
- **Failure to manage growth could harm its business.** To manage the expected growth of the operations and personnel, eBay will need to improve its transaction processing, operational and financial systems, procedures and controls. The company's current and planned personnel, systems, procedures and controls may not be adequate to support its future operation. The company may be unable to hire, train, retain and manage required personnel or to identify and take advantage of existing and potential strategic relationships and market opportunities.

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- **New and existing regulations could harm its business.** Due to the increasing popularity and use of the Internet and online services, it is possible that laws and regulations will be adopted with respect to the Internet or online services. These laws and regulations could cover issues such as online contracts, user privacy, freedom of expression, pricing, fraud, content and quality of products and services, taxation, advertising, intellectual property rights and information security. Any of these new legislation or regulation, or the application of laws or regulations from jurisdictions whose laws do not currently apply to eBay's business, could harm its business.
  - **The online auction market is intensely competitive.** The market for person-to-person trading over the Internet is relatively new, rapidly evolving and intensely competitive, and competitors can launch new sites at relatively low cost using commercially available software. The Company currently or potentially competes with a number of other companies. eBay's direct competitors include various online person-to-person auction services including Yahoo! Auctions, Amazon.com, and a number of other small services, including those that serve specialty or regional markets. The Company also competes indirectly with business-to-consumer online auction services as well as traditional bricks and mortar auction companies who may launch Internet auction sites.
  - **System failures could lead to inefficiencies in terms of time and money loss.** eBay's success, and in particular its ability to facilitate trades successfully and provide quality customer support, depends on the efficient and uninterrupted operation of its computer and communications hardware systems. It seeks to generate a high volume of traffic and transactions on the eBay service. Accordingly, the satisfactory performance, reliability and availability of eBay's web site, processing systems and network infrastructure are critical to the company's reputation and its ability to attract and retain large numbers of users who bid for or sell items on its service while maintaining adequate customer support levels. Any failures in the day-to-day operations of its site and any failure to expand or upgrade its systems sufficiently to accommodate growth could have a material adverse effect on its business, results of operations and financial condition.
  - **eBay's business may be harmed by fraudulent activities on its website.** Any negative publicity generated as a result of fraudulent or deceptive conduct by users of their service could damage their reputation and diminish the value of its brand name. eBay may in the future receive additional requests from users requesting reimbursement or threatening legal action against them if no reimbursement is made. Any resulting litigation could be costly for eBay, divert management attention, result in increased costs of doing business, lead to adverse judgments or could otherwise harm their business.

## FINANCIALS

**Revenue.** The company generated net revenues of \$85.8 million for the first quarter and \$97.4 million for the second quarter of 2000. While the company is still growing rapidly, the rate of growth appears to be stabilizing. As a result, we are lowering our year-end revenue projections for 2000 and 2001. Revenues are primarily driven by the result of increased use of the eBay site. The growth in the eBay site is predominantly attributable to the growth in the number of registered users, listings, and gross merchandise sales.

**Gross Profit.** Person-to-person online auctions have high gross margins due to non-existent costs of inventory management and shipping. We expect eBay's gross profit to continue its positive growth.

**Sales and Marketing.** eBay's sales and marketing expenses for both the online and traditional auction businesses are comprised primarily of compensation for sales and marketing personnel, advertising, tradeshow and other promotional costs, expenses for creative design of the website and shared employee and facilities costs. We expect the continued increase of these costs as the Company further promotes its agreements with Autotrader.com, zipRealty.com and Go.com, expands its international and local advertising as these markets grow, and promotes its new acquisition Half.com.

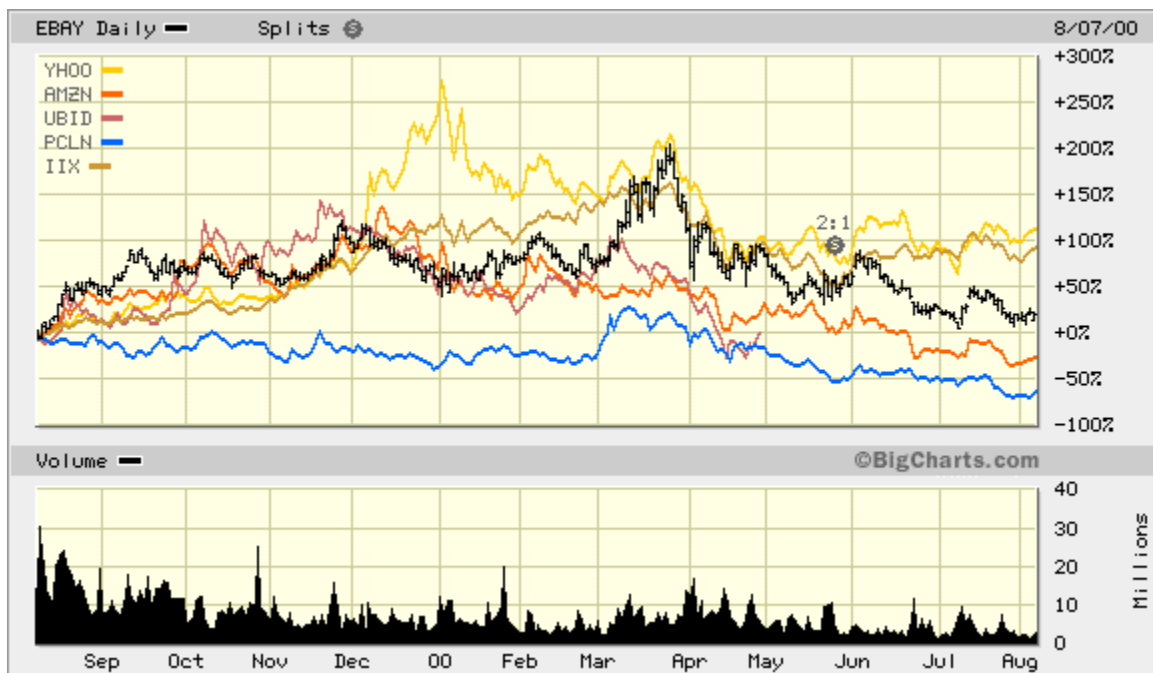
**General and Administrative.** General and administrative expenses are expected to increase as the Company adds additional support as a result of its expansion.

**Product Development.** Product development expenses are expected to increase in absolute dollars during future periods primarily from personnel additions, the continued impact of Billpoint product development, and additional depreciation costs as eBay continues to purchase equipment to improve and expand operations both domestically and internationally. We also expect the movement of Butterfield online and the development of the Company's fixed price platform through Half.com will cause further increases.

**Net Income.** Net Income has remained positive since the company's inception and we expect that it will continue to grow rapidly as the company expands into new markets.

## VALUATION

**Internet Sector.** eBay's stock price is significantly off its higher end price as it seems to have been following the recent downward trend present for its competitors and the Internet industry over all. The Internet sector has been volatile relative to the rest of the stock market. eBay's recent decline can be traced to fears of the Fed raising interest rates, that eBay generally experiences slower revenue growth in the summer months, and that fears of overvaluation of Internet stocks may be coming to fruition.



**Margins.** eBay's gross margin grew to 76 percent in the second quarter from 73 percent reported in the prior quarter. The Company's gross margin has remained significantly higher than those of its potential competitors except for Yahoo, and we expect them to remain constant for the rest of 2000 and 2001 as eBay continues its expansion. eBay's gross margin is high due to its non-existing inventory management and shipping costs. All eBay needs is a reliable automated website.

Value Comparison 8/08/00					
	<i>\$ Price</i>	<i>Market Cap. (Millions)</i>	<i>P/S</i>	<i>Gross Margin</i>	<i>Key Metric</i>
EBay, Inc.	<b>50.75</b>	<b>13,320.10</b>	<b>44.26</b>	<b>72.43</b>	<b>15.8 million users</b>
Amazon	<b>32.50</b>	<b>11,565.58</b>	<b>5.08</b>	<b>19.35</b>	<b>over 20 million users</b>
Yahoo!	<b>133.94</b>	<b>73,577.10</b>	<b>94.88</b>	<b>84.85</b>	<b>680 page views per day</b>
Ubid	<b>15.81</b>	<b>183.86</b>	<b>0.75</b>	<b>9.33</b>	<b>over 1.03 million users</b>
Priceline	<b>24.25</b>	<b>4,144.91</b>	<b>3.26</b>	<b>13.54</b>	<b>over 6.5 million customers</b>

**Price to Sales.** In comparison with its competitors (except for Yahoo), eBay has a high P/S. This high valuation can be justified by the following factors: (1) eBay is profitable with high gross margins, unlike many Internet companies, (2) it has a first-mover advantage in the person-to-person auction business with strong brand recognition and over 70 percent of the market and (3) it has an increasing customer base and an increasing (and largest) number of categories and services.

**Cash.** eBay has \$135.6 million of cash and marketable securities. This represents a 62 percent decrease in cash reserves from the \$219.7 million posted at year-end 1999. While the Company has more cash than its competitors, except for Yahoo, we believe that eBay should continue increasing its cash reserves in order to continue entering into new markets and agreements with other companies.

**Customer Base.** The Company has expanded the number of registered users to 15.8 million by second quarter end, an increase of 183 percent from 5.6 million on June 30, 1999. We believe that eBay's customer base will continue to expand rapidly because of international and local expansion as well as new services offered.

### **INVESTMENT OPINION**

We are maintaining our BUY recommendation for eBay, setting a target price of \$58. Revenue and EPS growth, while not spectacular, have continued to remain strong. Since the Company's price is on the relatively low end, eBay currently represents a good investment opportunity. As the Internet index increases, we believe eBay's price will follow. We are expecting stock price to recover and continue to appreciate in line with its revenue growth.

eBay also continues to grow at a significant rate. We believe that recent international and domestic expansion, coupled with the introduction of new services, will help eBay remain ahead of its competition in number of users and will allow the Company to continue showing strong earnings increases.

**Amounts in thousands except per share data**

	<b>Year ended Dec. 31</b>				
	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000E</b>	<b>2001E</b>
<b>Net Revenue</b>	<b>5,140</b>	<b>86,129</b>	<b>224,724</b>	<b>421,016</b>	<b>673,626</b>
<b>Cost of Revenues</b>	713	16,094	57,588	105,254	134,725
<b>Gross Profit</b>	4,427	70,035	167,136	315,762	538,901
<b>Operating Expenses:</b>					
Sales and marketing expenses	1,647	35,976	95,956	140,183	243,137
General and administrative expenses	855	15,849	43,055	73,032	125,252
Amortization of Acquired Intangibles		805	1,145	1,474	2,358
Merger Related Cost			4,359	824	
Product Development	773	4,640	23,785	50,522	80,835
Payroll taxes on option exercises				3,470	5,389
<b>Total Operating Expenses</b>	<b>3,275</b>	<b>57,270</b>	<b>168,300</b>	<b>269,504</b>	<b>456,971</b>
<b>Income (Loss) from Operations</b>	1,204	12,765	(1,164)	46,258	81,930
<b>Interest and Other Income</b>	54	(703)	21,377	46,312	40,418
<b>Net Income (loss) before income taxes</b>	1,206	12,062	20,213	92,569	122,347
<b>(Provision) benefit for income taxes</b>	(525)	(4,789)	(9,385)	(37,028)	(48,939)
<b>Net Income (loss)</b>	<b>681</b>	<b>7,273</b>	<b>10,828</b>	<b>55,542</b>	<b>73,408</b>
<b>Fully Diluted EPS</b>	<b>0.03</b>	<b>0.06</b>	<b>0.08</b>	<b>0.20</b>	<b>0.25</b>
<b>Shares Outstanding (Diluted)</b>	27,553	116,759	135,910	275,365	289,133
<b><u>Margin Analysis (% of Revenue)</u></b>					
Gross Margin	86%	81%	74%	75%	80%
Sales & Marketing	32%	42%	43%	33%	36%
General & Administrative	17%	18%	19%	17%	19%
Product Development	15%	5%	11%	12%	12%
Operating Margin	23%	15%	-1%	11%	12%
Net Margin	13%	8%	5%	13%	11%
<b><u>Growth</u></b>					
Total Revenue	N/A	1575.66%	160.92%	87.35%	60.00%
Gross Profit	N/A	1482.00%	138.65%	88.93%	70.67%
Operating Expenses	N/A	1648.70%	193.87%	60.13%	69.56%
Operating Income	N/A	960.22%	-109.12%	-4074.0%	77.12%
Net Income	N/A	967.99%	48.88%	412.94%	32.17%
Fully Diluted EPS	N/A	107.64%	27.90%	153.17%	25.87%