

September 22, 2006

#### Rating Information

Sector Rating	Market Weight
Target Price YE '07	\$33.00
Long-Term Growth	24.15%

#### Trading Data

52-Wk Range	\$22.83 - \$47.86
Market Cap.	\$36,724 MM
Shares Out.	1,415.2 MM
Dividend Yield	0.0%
Avg Daily Vol.	16,960,000
Float	1,146.0 MM

Source: FactSet

#### Fundamental Data

EV/EBITDA	17.5x
Enterprise Value	\$36,724.0 MM
LT Debt to Total Cap.	0.0%
Book Value	\$8.00

Source: FactSet

#### Price Performance Chart



Source: FactSet

Securities in this report priced as of:  
September 21, 2006 16:00 ET

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## Ebay Inc. (EBAY-\$26.08-Outperform)

### Top 5 Takeaways From Power Seller Conference

- On Wednesday night we gave a keynote presentation on some of our thoughts on eCommerce to a group of 200-300 eBay power sellers at the PESA conference in San Francisco. Throughout the myriad of conversations that we had, we drew several thematic conclusions that we think will set the tone for the coming months on eBay's key metrics: listings, activity, GMV, ASPs, and revenues.
- The Five Major Themes we took away were: 1) FEE INCREASES WON'T DISSUADE SELLERS, SHORT TERM; 2) BUYER ACTIVITY / DEMAND REMAINS TOP CONCERN; 3) STORE LISTINGS WILL DECLINE - BUT REDUCE CLUTTER; 4) OTHER 'FRICTIONS' NEED ADDRESSING; 5) EBAY EXPRESS NON-IMPACT IN 4Q, BUT HAS POTENTIAL
- Further, we think eBay is listening more. We think eBay has opened up more to the community and is taking their suggestion more to heart. Lastly, Google and Amazon were present to explain some of their new undertakings to work with sellers, including a new front end coming for Google Base / Froogle.
- Our net takeaway from our meetings is positive. We caution that we do see longer term issues for eBay should it not address the concerns of the community shortly. However, we believe that management is embracing the community's ideas more than ever. The rest will be up to execution.

**Sector View:** We are positive on the growth prospects of the eCommerce industry

#### GAAP Estimates Post Option Expense †(All values are in USD)

	Q1 Mar	Q2 Jun	Q3 Sep	Q4 Dec	Year	P/E
2005	0.19	0.21	0.18	0.20	0.78	33.4x
2006	0.17	0.17	0.18E	0.21E	0.73E	35.7x
2007					0.89E	29.3x

#### Revenue (All values are in USD)

	Q1 Mar	Q2 Jun	Q3 Sep	Q4 Dec	Year	P/S
2005	1,032.0	1,086.0	1,106.0	1,329.0	4,552.0	8.1x
2006	1,390.0	1,411.0	1,430.0E	1,674.0E	5,905.0E	6.2x
2007					7,488.0E	4.9x

† All numbers are after stock based compensation expense. Beginning with 2006 estimates, this expense will be normalized consistent with BSC option expense policy. Prior years are not necessarily normalized. Outside data provider may not conform to this policy.

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## LESSONS FROM the PESA CONFERENCE

On Wednesday night we gave a keynote presentation on some of our thoughts on eCommerce to a group of 200-300 eBay power sellers at the Professional eBay Sellers Alliance (PESA) conference in San Francisco. After our presentation, we spent the night and following day speaking with many sellers, vendors, and other industry participants. Throughout the myriad of conversations that we had, we drew several thematic conclusions that we think will set the tone for the coming months on eBay's key metrics: listings, activity, GMV, ASPs, and revenues. Below are some of our conclusions:

### 1) POSITIVE: FEE INCREASES WON'T DISSUADE SELLERS, SHORT TERM

- a) While sellers acknowledged that there should continue to be a growing percent of each seller's GMV migrating to other distribution platforms (i.e. paid search), sellers can't economically leave eBay, at least in the short term.
- b) With the critical 4th quarter approaching, even the most disgruntled sellers can not afford to leave. We think this will support eBay's 3Q and 4Q metrics for Wall Street.
- c) Due to the low ROI for many sellers on eBay (vs. other platforms), some sellers view eBay merely as a customer acquisition tool. The steady cash flow and customer leads are acceptable (but not necessarily as desirable as they'd like them to be) to many sellers.
- d) Many sellers are frustrated with eBay even though they are not leaving. Hence, while we see minimal risk in the short term, if these issues are not addressed we still think there could be longer term risk. We therefore believe management is looking closely at them.
- e) A recent AuctionBytes poll indicated that more than 50% of current eBay sellers (from their sample) would not be on the platform in 6 months. While this is staggering and shocking, we believe from our conversations with sellers that it was more of a voicing of frustration by some sellers, and lacks any real teeth (although we do expect some defections).
- f) We point out that most sellers we spoke to were core only or core & store, which are less affected by the store fee increase. However, the few store only sellers we spoke to were not planning on leaving eBay either - however, our data could be slightly skewed, as store only sellers that are planning on leaving shortly probably did not make the trip to SF.

### 2) NEUTRAL: BUYER ACTIVITY / DEMAND REMAINS TOP CONCERN

- a) From our conversations we continue to believe that this remains the top concern (not the store fee increase). As depicted in our quarterly notes, buyer activity has waned. Many sellers feel there are multiple issues here that need to be resolved, including a needed improvement in the ease of use and searching on the main site.
- b) Trust and Safety was discussed quite frequently from many angles. Sellers suggested that having buyers AND sellers verified on the site would discourage fraud, improve buyer experience, and drive buyer activity.
- c) The new "deal of day" has a lot of potential according to sellers. Due to the prominence, sellers can offer even better prices, if viewed as a customer acquisition tool.
- d) Egregious shipping is the scourge of eBay (and something we believe Bill Cobb is working on). Some sellers said it's the only place to make margin. Others stated that until eBay cracks down across the board, that they individually can't cut back shipping as their competitors would have a pricing edge (lower margins on products are made up for in the shipping, since buyers sort on price).

**\*\*\*\* OUR SUGGESTION TO EBAY is that eBay should set up a positive feedback loop that distinguishes good sellers from the bad ones. This could be done by defaulting search results to sort by Seller Feedback Rating Percent. This would give buyers more exposure to the best sellers (fostering a good experience), reward good sellers, and encourage other seller to get better. Further, eBay's mantra of keeping "a level playing field for all sellers" could stay in tact by sorting on the Percentage rating, not the Absolute rating – this would be fair for all. This would probably be even more important for screening out the more fraud based international sellers. \*\*\*\***

### 3) POSITIVE: STORE LISTINGS WILL DECLINE - BUT REDUCE CLUTTER

- It was pretty uniform that store listings will decline starting today, as we hit the month anniversary of the store fee increase (when sellers would need to decide to re-list at the new fees). However, most agreed that this would reduce the clutter on Store that made the buyer experience unsatisfactory. This could also raise ASPs (less supply).
- A side effect of the move, is the reduction of the long tail of items that stores used to be able to supply. For instance men's size 11 shoes will probably remain on Stores, but size 14EEEs won't make economic sense due to the lower conversion rates of more obscure items at the new fee levels.
- Many sellers wished there was a better way to reduce the clutter and poor buyer experience in Stores, without throwing the baby out with the bath water.

#### 4) NEUTRAL: OTHER 'FRICTIONS' NEED ADDRESSING

- This is probably the most under-addressed issue on Wall Street, as it is a true economic cost that lowers margins to sellers further, but isn't truly appreciated. The biggest complaint was automatic deletion of seller listings (which can be in the thousands) for any minor (and honestly unknown to the seller) violation. Reestablishing listings of that magnitude by the seller is time consuming and a true cost. If eBay is at fault, it can reinstate listings, but all bids will be lost, and the email notifications sent by eBay to the bidders about the cancellation can cast doubt on the quality of the seller (which may be irreparable).
- COMMUNICATION. We believe that this top complaint can be eradicated by better communication from eBay to the seller. For instance, if eBay is planning on pulling thousands of listings from a highly ranked power seller for a minor infraction (i.e. too many links on his listing), contacting the trusted seller first would be helpful to avoid this friction.
- We believe this is eBay's policy, but there appears to be occasional faults in the execution procedure. In fact, eBay assigns personal reps to large sellers to augment communication; however, it appears the ball is sometimes dropped, causing more frustration. Our takeaway here is this is a solvable problem.

#### 5) NEUTRAL: EBAY EXPRESS NON-IMPACT IN 4Q, BUT HAS POTENTIAL

- We think the lack of traction at Ebay Express is widely disseminated. The platform is relatively nascent (ad campaign has just launched 2 weeks ago), and most sellers have seen negligible sales. We think the Street's expectation of a non-impact of Ebay Express for 4Q is accurate.
- However, we would point out that many sellers are optimistic about the potential for Express, even if it might take longer. Many sellers feel the ad campaign does not explain what Express is well, or how it is different than core eBay. We agree. The upside to this concern is that it is fixable and we agree with management's purpose of the platform: to target incremental buyers / activity. We do not have as bleak an outlook on the platform long term as the Street at this point.

#### BIG POSITIVE - EBAY LISTENING MORE.

We think this is maybe the most important theme from our meetings. We think eBay has opened up more to the community and is taking their suggestion more to heart. We also believe that eBay is at a crossroads and that the moves the company makes over the coming months will have long term repercussions, as alternative distribution channel choices grow for sellers. We believe that eBay has met / is meeting with organizations like PESA to gauge what needs to be done to reinvigorate the marketplace. From what we understand, these efforts have been turbo charged vs. a year ago. We encourage management down this path.

#### AMAZON AND GOOGLE SAYING THE RIGHT THINGS

Both Amazon and Google were present at the event (as was eBay). We think that both companies see value in relationships with the major sellers and have been saying the right things to encourage multiple distribution points for sellers.

#### Google to Launch New Product Search Feature Using Google Base Listings

A representative from Google Base presented at the PESA Conference yesterday. She affirmed that Google Base is not meant as a front-end application but rather as a back-end infrastructure whose inputted results will be filtered throughout Google.com. The site will not be promoted as a consumer site and will not be on the main Google.com page.

However, Google will be launching product search on Google.com in the coming months in time for the 4Q holiday shopping season. The new product search will use only results from Google Base. When users conduct a product search on Google.com they will be represented with an additional search box where they can refine their search. When the user refines the search, Google takes the user to a second page which will be filled with product results only from Google Base. The second page will have the look and feel of the Google.com search results page and not the results page the we currently see on base.google.com or on Froogle.com. Ranking will be determined by the attributes that the sellers listed for the product as well as by relevancy.

Google has no current plans to monetize that second product page either through listing fees or via paid advertising. However, we were led to believe that the model could change in the future. Focus right now is on improving the customer experience rather than driving monetization.

So What Happens to Froogle? Google is deemphasizing Froogle as a destination site and will be moving that experience to Google.com. They found that most product searches were being conducted on Google.com rather than on Froogle.

## CONCLUSION - POSITIVE EVENT

Our net takeaway from our meetings is positive. While we think that there isn't any material short term upside into some of the Street's negative expectations (Express, Trust and Safety issues, some store seller defections), we don't believe that eBay's short term key metrics will be negatively impacted, as sellers can't afford to leave ahead of the big 4Q season. We caution that we do see longer term issues for eBay should it not address the concerns of the community shortly. However, we believe that management is embracing the community's ideas more than ever. The rest will be up to execution.

We remain positive on eBay's stock due to our conservative model projecting north of 20% annualized return upside and the fact that we think expectations are overly negative. Hence we maintain our Outperform rating.

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Robert Peck

### Companies Analyzed

\* Ebay Inc. (EBAY) - \$ 26.08 (as of September 21, 2006 16:00 ET) - Outperform

Price Target ('07) : \$ 33.00

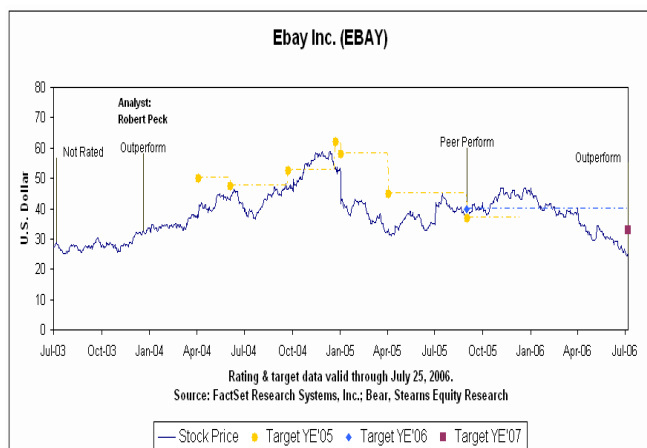
Risk(s) to Price Target- Competition from Amazon and Google as well as other eCommerce players.

Valuation Methodology- DCF and Sum-of Parts

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#### Ratings for Sectors (vs. regional broader market index):

Market Overweight (MO) - Expect the industry to perform better than the primary market index for the region (S&P 500 in the US) over the next 12 months.

Market Weight (MW) - Expect the industry to perform approximately in line with the primary market index for the region (S&P 500 in the US) over the next 12 months.

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Outperform (Buy): 45.6 / 10.0

Peer Perform (Neutral): 45.7 / 9.4

Underperform (Sell): 8.7 / 2.0

Robert Peck, Consumer Internet

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