

eBay Inc. (EBAY): Hold @ \$32.00

Hold Thesis: We are downgrading our rating on EBAY from Buy to Hold and reducing our PT from \$40.00 to \$32.00. Our rating is based on: 1) the soft 4Q16 revenue guidance (3% y/y growth) on what is supposed to be the busiest shopping season of the year, and 2) the lack of visibility as to when SDI (Structured Data Initiative) will begin to catalyze top-line growth – especially since this project has been ongoing for 5 consecutive quarters (since 3Q15). We will become more positive once we see a re-acceleration of GMV growth, which has stalled at the low-\$20B level since 4Q13 (for 12 consecutive quarters.) While we agree with management’s view that eBay’s core business remains stable, we are nonetheless concerned that competition from other online retailers like Walmart, Target and Amazon will start to take share from eBay in the short term. eBay also needs to fix its brand image, which is often perceived as an auction site for used goods and frequently overlooked by Millennials who are shopping for new items.

TABLE 1: EBAY 3Q16 Results

3Q16 Results			4Q16 Guidance			3Q16 Results			4Q16 Guidance		
EPS	Cons.	Result	EPS	Cons.	Result	Total Rev.	Cons.	Result	Total Rev.	Cons.	Result
0.45	0.44	beat	0.53	0.54	miss	2.22B	2.18B	beat	2.39B	2.40B	miss

Source: eBay Inc. and Estimote.com

EBAY reported 3Q16 with revenue of \$2.22B beating estimate of \$2.18B and EPS of 45 cents beating estimate of 44 cents. However, the market was not expecting both revenue and EPS guidance for 4Q16 to come in light, especially since last quarter’s results gave the impression that the long-awaited turnaround was finally taking hold. Given the disappointment, the stock was down over 10% in next day’s trading.

3Q16 Highlights

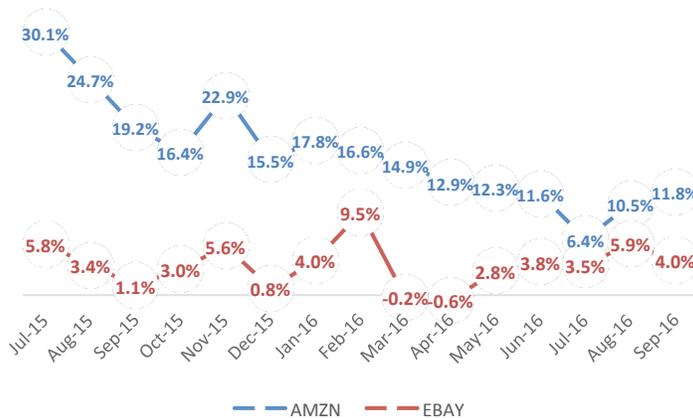
- Reports 3Q GMV of \$20.1B, up 5% on FX-neutral basis and 3% on an as-reported basis
- Added over 1M active buyers across its platforms to a total of 165M global active buyers
- Marketplace platforms delivered \$19.0B of GMV and \$1.8B of revenue
- Marketplace revenue up 5% on FX-neutral basis and 2% on as-reported basis, driven by GMV growth of 4% on FX-neutral basis and 2% on as-reported basis as well as growth in Marketing Services & Other revenue
- *StubHub* had another strong quarter with GMV of \$1.1B, up 23%, and revenue of \$263M, up 32%, aided by strength across concerts, theater and baseball as well as the continued benefit from ongoing product innovation
- Classifieds platforms delivered another quarter of good performance with revenue of \$197M, up 14% on FX-neutral basis and 11% on as-reported basis, primarily driven by Automotive and Real Estate verticals across several key geographies

- GAAP operating margin fell to 24.4% in 3Q16 vs. 27.5% for the same period last year
- Non-GAAP operating margin dropped to 29.9% in 3Q16 vs. 31.9%
- Generated \$802M of operating cash flow from continuing operations and \$617M of free cash flow from continuing operations
- Repurchased ~\$500M of common stock or 16.5M shares in 3Q16; total repurchase authorization remaining as of September 30, 2016 was \$2.3B
- Cash, cash equivalents and non-equity investments portfolio totaled \$10.4B as of Sept. 30, 2016;
- FY16: Expects net revenue between \$8.95-9.0B, representing FX-neutral growth of 6-7%, with non-GAAP diluted EPS from continuing operations in the range of \$1.85-1.90 and GAAP diluted EPS from continuing operations in the range of \$2.22-2.32

I. eBay Lost Market Share to Amazon in 3Q16

We believe eBay may have lost some share to Amazon in 3Q16 as evidenced by SSS data for both Amazon and eBay. Between July to September, Amazon’s SSS grew from 6.4% to 11.8%, a growth rate of ~84.3% (see Figure 1). During the same period, eBay’s SSS also grew from 3.5% to 4.0%, a much slower growth rate of ~14.3%. While one quarter does not establish a trend, eBay’s monthly SSS trendline since July 2015 shows the company is having difficulty sustaining monthly sales growth since its separation from PayPal.

FIGURE 1: Same Store Sales – Amazon vs. eBay: July 2015 to September 2016



Amazon’s monthly SSS trendline has also shown a gradual decline since its high in July 2015. This could be due to the increased competition from new entrants in the online marketplace as well as from large retail stores like Walmart and Macy’s that are also developing their own online platforms and making strong gains in improving their mobile shopping experience.

Source: Channel Advisor, September 2016

II. SDI Execution – Slow to Ramp Up

Figure 2 below shows the company’s “internals” or the various metrics that make up and drive overall same store sales growth. Of particular interest is the fixed price trend, since 86% of eBay’s goods are sold on a fixed price basis. The fixed price trend can also be used as a proxy to track how well the SDI initiatives are having on sales growth. It’s encouraging to see that the fixed price trend line has been growing since March, when SSS was at a negative 5.2%, to a positive 2.0% in September (see Figure 2). This indicates that management’s implementation of the SDI initiatives is having a positive effect, albeit on a very gradual basis.

FIGURE 2: eBay Same Store Sales Breakdown: July 2015 to September 2016

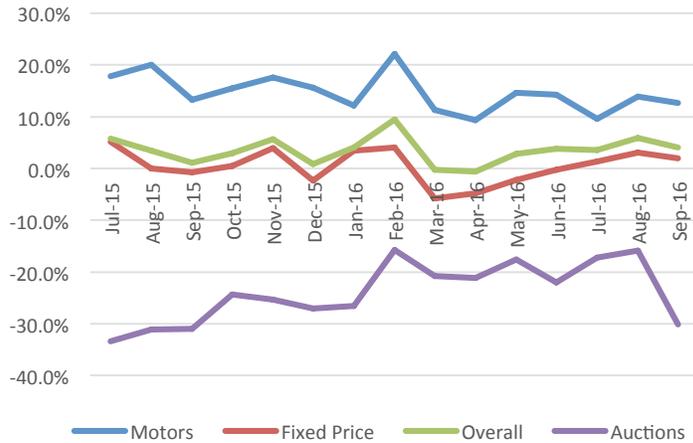
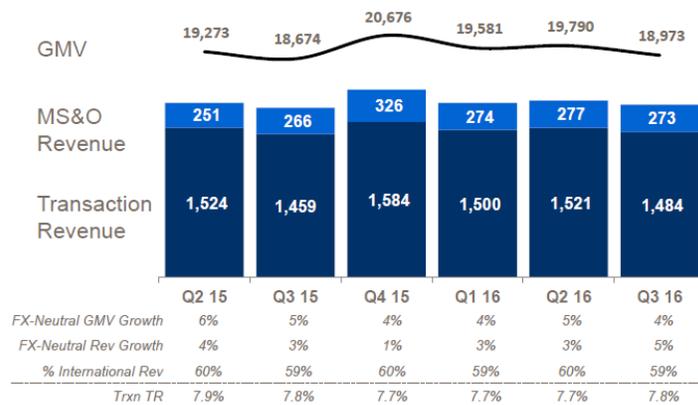


Figure 2 also shows that eBay’s automotive and auto parts division (grouped under “Motors”) is the highest growth area, although SSS growth has moderated from 20% in August 2015 to 12.6% in September 2016. Also noteworthy is the “Auctions” division, whose growth has been consistently negative. While mostly due to the company placing less emphasis on auctioned goods, the sudden one-month drop in SSS growth from negative 15.9% to negative 30.1% from August to September 2016 is a red flag – are auction sellers leaving in droves?

Source: Channel Advisor, September 2016

Lastly, Figure 3 shows the stability of eBay’s core marketplace, which management frequently mentions in its earnings calls. Marketplace GMV decelerated gradually from 6% in 2Q15 to ~4% in 3Q16. The sluggish growth probably explains why management guided for a soft 4Q16 holiday quarter. Given the past growth trend from 3Q15 to 4Q15, we are projecting 4Q16 transaction revenue to be ~\$1.87B for a y/y growth rate of ~3.0%, roughly in line with management’s 4Q16 total revenue guidance of 3% y/y growth.

FIGURE 3: eBay Marketplace GMV and Revenue (\$ Million)



Nonetheless, transaction revenue growth from marketplace sales has shown great stability since 2Q15, averaging ~7.8% y/y. This indicates that the take rate accrued by sellers has been strong enough to offset the decline in GMV. This is positive news, since existing sellers will be incentivized to stay with eBay and new sellers will be tempted to join the platform, which will then increase the breadth and depth of eBay’s product categories.

Source: eBay Inc.

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