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September 2, 2009

## In a Sale, Skype Wins a Chance to Prosper

By [BRAD STONE](#)

SAN FRANCISCO — With its sale to private investors, the online calling service [Skype](#) has thrown off the last of the shackles that limited its growth and potential as a unit of [eBay](#). Now its challenge is to turn its global popularity into bigger profits.

eBay announced on Tuesday that it was selling Skype to a group led by Silver Lake Partners, a [private equity](#) firm in Silicon Valley. As part of the deal, which values Skype at \$2.75 billion, the buyers agreed to pay \$1.9 billion in cash, which includes a loan from eBay of \$125 million, for 65 percent of the company. eBay, which is based in San Jose, Calif., will retain a 35 percent stake.

Skype offers free software for computers and smartphones that lets people make free voice and video calls to other Skype users over the Internet. It makes money primarily by charging for calls to landlines and cellphones around the world, although its rates are generally far below those of traditional phone companies.

When it acquired Skype in 2005, eBay said it hoped the service would support its auctions and its PayPal payment service by letting buyers and sellers discuss transactions. But eBay users were not so chatty.

The deal announced Tuesday would essentially allow Skype to go back into start-up mode. For example, it will be able to conceal investments in projects and new technologies from the public — and from rivals — instead of disclosing them in eBay's public regulatory filings.

The company will also be able to lure new employees with its own stock, which could become valuable if Skype's buyers decide to sell shares in an initial public offering.

"This gives us a great set of investors who are going to add a lot of value to the business," said Josh Silverman, Skype's chief executive. "And as a stand-alone company we are focused solely on communications, and there is always benefit to focus."

The group buying Skype includes the London [venture capital](#) firm Index Ventures and Andreessen Horowitz, a new venture capital firm co-founded by [Marc Andreessen](#), the Netscape co-founder.

The deal completes a journey that began early last year, when [Meg Whitman](#), eBay's longtime chief executive, left the company and her deputy, John Donahoe, took over. Mr. Donahoe moved Mr. Silverman over from Shopping.com, another eBay division, and gave Skype, which is based in Luxembourg, wide latitude to operate independently.

"All the previous presidents had a really short leash back to San Jose, and the company was basically a bureaucratic mess," said Phil Wolff, editor of [Skype Journal](#), a blog covering the service. "With the changes last year, the company got a strong leadership team and a strong sense of direction."

The result has been steady, solid growth, even as competing Internet calling services like [Google](#) Voice came on the scene. Skype, which had 276 million registered users in the first quarter of last year, ended July with 480 million.

Revenue rose to \$170 million in the second quarter of this year from \$136 million in the same quarter a year earlier. EBay does not break out Skype's profits but says it has been profitable for 10 consecutive quarters.

In a sign that Skype may have discovered new opportunities outside the personal computer, the Skype application for the [iPhone](#) has been one of the most popular programs for the device since it was released in March. Skype has also struck deals to place its service on [Nokia](#) phones.

Egon Durban, managing director at Silver Lake Partners, said the iPhone application was "a great example of what we feel are the attractive opportunities for the company to develop."

"This is one of the leading Internet franchises with terrific growth prospects," Mr. Durban said. He gave no specifics on features Skype might offer, but said it was easy to imagine possibilities. He also said the buyers had no plans for a public offering.

Some of Skype's newest features may suggest directions for the company. The latest version of its software, released this year, emphasizes face-to-face video chats. Skype now says that 34 percent of calls between Skype users include video, and such chats have become a popular way for people around the world to connect with one another.

In addition to working on allowing outside programmers to weave Skype's features and infrastructure into their own programs or Web sites, the company is also working on replacing the service's underlying peer-to-peer technology. That is partly out of legal necessity. The rights to that technology remain with Skype's founders, Niklas Zennstrom and Janus Friis, who have sued eBay in a British court over some changes eBay made to it. That case is to go to trial next year.

For eBay, selling Skype — particularly at a valuation higher than many analysts had thought possible — offers partial redemption for a deal that many Internet analysts said was an awkward fit. EBay paid \$2.6 billion for Skype, and performance incentives lifted the final price to \$3.1 billion.

“The purchase was a serious mistake by Meg Whitman. It was an attempt to buy growth, which investors saw through instantly,” said Jeffrey Lindsay, an analyst at Sanford C. Bernstein. The new eBay management found ways for Skype to generate revenue, he said, “and now they sold it at a great price.”

Mr. Donahoe said eBay did not regret having bought Skype when company executives believed eBay was in a mortal struggle with Google, which was also pursuing the service. He said the spinoff would allow eBay to focus on its core e-commerce and online payment businesses and avoid extra distractions.

“We don’t regret having done this at all. We compete in a dynamic market, and you have to move quickly and take risks,” Mr. Donahoe said. “When we bought Skype we thought it had synergies with our other two businesses, and it turns out it did not. But it also turned out that it’s a great stand-alone business.”

Ashlee Vance contributed reporting.

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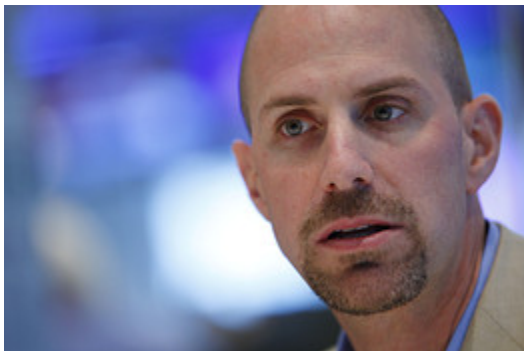
## EBay Sells Skype to Investor Group

By [GEOFFREY A. FOWLER](#) and [CASSELL BRYAN-LOW](#)

[EBay](#) Inc. said it will sell a 65% stake in its Skype Internet-phone business to private investors, in a deal that marks the end of an unhappy marriage in the technology arena.

An investment group led by private-equity firm Silver Lake Partners and including venture-capital firms Index Ventures and Andreessen Horowitz, as well as the Canada Pension Plan Investment Board, agreed to pay \$1.9 billion in cash, plus a \$125 million note, for the Skype holding.

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*Bloomberg News*

Josh Silverman, Skype's chief executive





eBay will retain a 35% stake in Skype and a seat on its board, but will no longer run the business.

The deal values Skype at \$2.75 billion, close to the \$2.6 billion eBay paid for it in 2005 under former Chief Executive Meg Whitman, a price many investors regarded as too expensive.

The agreement "realizes a very strong valuation for Skype now, while also retaining a share in the future upside as it achieves its potential," said eBay CEO John Donahoe.

eBay has conceded that Skype -- which uses a technology called voice-over-Internet protocol to route voice and video calls over the Internet, instead of a traditional phone network -- was a poor fit with its core e-commerce business.

In 2007, eBay took a \$1.4 billion write-down on the phone business, which dragged down its overall results. eBay also split publicly with the Skype's founders, who departed with a \$530 million payout and are currently in a dispute with eBay over a technology-licensing agreement.

Brian Flanagan, a senior equity-portfolio manager at money manager Thrivent Financial in Minneapolis, which owns about one million eBay shares, said the valuation for Skype was higher than he expected and a "good deal" for eBay. "It shows management is focused back on the core business [of e-commerce], and that they're making the right moves," he said.

In 4 p.m. trading on the Nasdaq Stock Market Tuesday, eBay's shares were down 46 cents, or 2.1%, at \$21.68.

The Skype deal, which was reported earlier on the Web site of the New York Times, is expected to close in the fourth quarter. The new owners said they plan to keep Skype's president, Josh Silverman, in place and its headquarters in London.

Michelangelo Volpi, a general partner at London-based Index Ventures -- which funded Skype before eBay bought it four years ago -- said his investment group based its valuation of Skype on accelerating growth in users and revenue.

"We feel like there's still enormous potential for this company going forward," he said.

In the second quarter, Skype's revenue was up 25% from a year earlier at \$170 million, as its number of registered users topped 480 million world-wide, up from 338 million.

Mr. Volpi acknowledged Skype's monthly revenue per user is low compared with traditional telecom companies, since many Skype users make calls free of charge. Nonetheless, he said Skype is growing faster than those traditional telecoms, and the average revenue for paying users is high. Mr. Volpi added that the buyers see opportunities for Skype with mobile business users, as well as hardware makers developing appliances to make Skype easier to use.

But the deal doesn't resolve an outstanding intellectual-property dispute with Joltid Ltd., a company owned by Skype founders Niklas Zennstrom and Janus Friis that holds the rights to some of Skype's core technology. Joltid alleged earlier this year that Skype and eBay violated its licensing agreement for the technology and has threatened to end the agreement.

eBay has asked a U.K. court to find that it isn't in breach of the license, but proceedings could stretch on for months.

Meanwhile, eBay has said it is undertaking an "expensive" effort to develop a work-around for the Joltid software.

eBay's Mr. Donahoe said that the sale doesn't affect the lawsuit. Joltid declined to comment.

The Skype sale came together after Mr. Donahoe, who took over as eBay CEO last year, said in January that eBay and Skype were a poor match. After a group of private-equity firms and Skype's founders failed in a bid to buy the company this spring, Mr. Donahoe announced plans to spin it off in an initial public offering.

The group including Silver Lake and Index Ventures subsequently approached eBay and later asked venture capitalist Marc Andreessen's fund to join the bid. Mr. Andreessen, an eBay director, recused himself from his position on eBay's board, said Mr. Donahoe.

Andreessen Horowitz invested \$50 million in the Skype deal from a \$300 million fund that the venture-capital firm closed in June.

—*Scott Morrison, Peter Lattman and Pui-Wing Tam contributed to this article.*

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