



PayPal Holdings, Inc. (PYPL)

Updated February 3rd, 2020 by Josh Arnold

Key Metrics

Current Price:	\$114	5 Year CAGR Estimate:	11.6%	Market Cap:	\$133.6B
Fair Value Price:	\$98	5 Year Growth Estimate:	15.0%	Ex-Dividend Date:	N/A
% Fair Value:	116%	5 Year Valuation Multiple Estimate:	-3.0%	Dividend Payment Date:	N/A
Dividend Yield:	N/A	5 Year Price Target	\$197	Years Of Dividend Growth:	N/A
Dividend Risk Score:	N/A	Retirement Suitability Score:	N/A	Last Dividend Increase:	N/A

Overview & Current Events

PayPal Holdings is a leader in the digital and mobile payments industry. The company was originally a subsidiary of eBay but was spun off to become an independent company in 2015, when it went public. PayPal offers services to customers and merchants globally through PayPal, PayPal Credit, Xoom, and Venmo, among others. The company has just over 300 million users globally and completes more than 10 billion transactions annually across its platforms. PayPal has more than 20,000 employees and has a market capitalization of \$134 billion, while producing about \$21 billion in annual revenue.

PayPal reported Q4 and full-year earnings on January 29th, and while results beat expectations, guidance for 2020 disappointed investors. Revenue for the year came to \$17.8 billion, up 15% over 2018. The company noted that the sale of US consumer credit receivables to Synchrony in mid-2018 negatively impacted revenue growth for 2019 by about 3.5%. Operating margins were very strong again, rising to 23.2% on an adjusted basis, and sending operating income up 23% in dollar terms to \$4.1 billion for 2019. Adjusted earnings-per-share came to \$3.10 for 2019 on strength in revenue growth, margins, and share repurchases, which totaled \$1.4 billion for the year.

Net new active accounts were 37.3 million in 2019, bringing the total up 14% to 305 million. The company processed 12.4 billion payment transactions, an increase of 25% year-over-year, while total payment volume rose 23% to \$712 billion. Merchant Services volume grew 27% while Venmo processed \$102 billion, up a staggering 65%. Finally, payment transactions per active account rose 10% to 40.6 in 2019.

PayPal's guidance for 2020 slightly missed expectations, and our initial estimate is for \$3.50 in earnings-per-share for this year. We see continued growth in revenue as driving margin improvements, as well as the company's steady acquisition pipeline.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	---	---	---	---	---	\$1.00	\$1.15	\$1.47	\$1.71	\$3.10	\$3.50	\$7.04
DPS	---	---	---	---	---	---	---	---	---	---	---	---
Shares¹	---	---	---	---	---	1,224	1,207	1,200	1,174	1,187	1,200	1,100

We see an impressive growth track in front of PayPal, building upon years of already-strong top and bottom-line growth. PayPal should be able to deliver double-digit annual revenue growth for the foreseeable future driven by new accounts, higher transactions per account, and higher volumes per account. In addition, PayPal continues to acquire growth – with Honey being a recent example – and has stated it wants to spend \$1 billion to \$2 billion annually on acquisitions, on average.

This growth in the top line should lead to gradual margin improvements as costs are leveraged down, but we caution that PayPal's investment in its own business as well as acquisitions means that margin growth may be incremental in most years. In addition, heavy competition from other players in the very crowded payments space is curbing pricing

¹ Share count in millions

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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power, which could harm PayPal's margins over time. In total, we still see PayPal growing earnings-per-share at a very impressive rate of 15% annually in the coming years.

PayPal does not pay a dividend and we don't expect that it will anytime soon, so it is not an option for income investors.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2024
Avg. P/E	---	---	---	---	---	---	33.2	37.8	48.2	33.9	32.5	28.0
Avg. Yld.	---	---	---	---	---	---	---	---	---	---	---	---

PayPal has traded for very high P/E multiples since going public, with the lowest average annual value being its first full year as a public company – 2016 – which saw an average P/E of 33. Given 15% projected earnings-per-share growth, as well as concerns that mounting competition in the payments industry will crimp margins over time, in addition to the potential for PayPal to lose part of its significant market share, we see 28 times earnings as fair value. PayPal has a very strong growth outlook but concerns over pricing power and additional competition have us being a bit cautious with the multiple, and we cannot justify 32.5 times earnings. Should the stock revert to 28 times earnings, it would introduce a -3% annual headwind to total returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	---	---	---	---	---	---	---	---	---	---	---	---

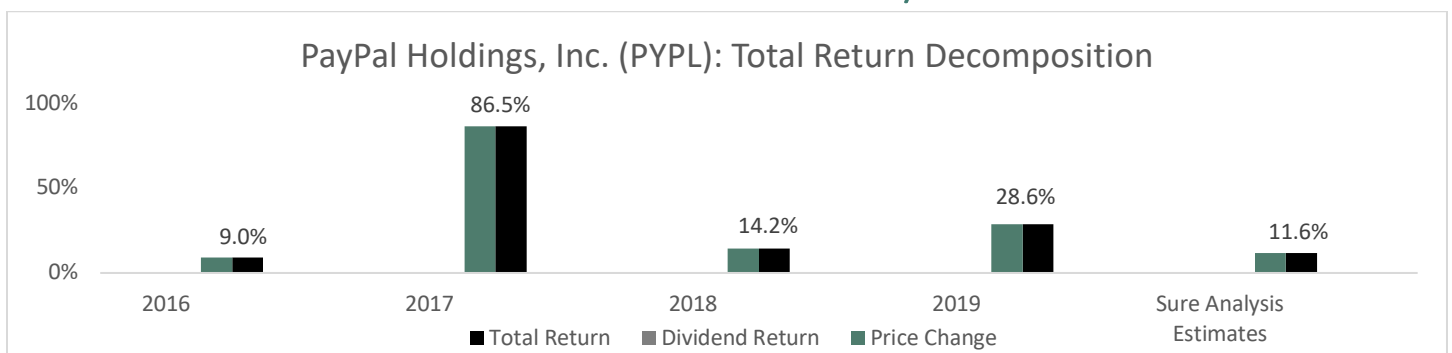
PayPal's main competitive advantage is its first mover status in the payments industry. PayPal has been around much longer than most of its competitors and has built an enormous customer base. However, PayPal's product is very similar to any other payment company, so we don't see its advantage as having a significant moat against new entrants. PayPal relies upon the hassle of switching payment providers as being a deterrent for customers to go to a different provider, and we don't necessarily see this as a strong advantage.

PayPal has only been public during a period of strong economic growth, so we have no data on how it would perform during a recession. However, we believe PayPal would suffer modestly during a recession given that there would be a slowdown in economic activity and thus, payments volume. We don't see recession as a large risk, but it is a risk.

Final Thoughts & Recommendation

PayPal is in an enviable position with its market share and growth track. However, we see the valuation as a headwind to total returns, offsetting a portion of our projection for 15% earnings-per-share growth. Even so, we see total annual returns at 11.6%, making the stock a buy. We think PayPal has a very long runway for growth and while the stock is expensive, it is closer to fair value today than any other point since it came public.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	---	---	5,662	6,727	8,025	9,248	10,842	13,094	15,451	17,772
Gross Profit	---	---	2,965	3,440	4,218	4,719	5,141	6,300	7,114	7,987
Gross Margin	---	---	52.4%	51.1%	52.6%	51.0%	47.4%	48.1%	46.0%	44.9%
SG&A Exp.	---	---	1,007	1,169	1,687	1,810	1,997	2,283	2,764	5,197
D&A Exp.	---	---	382	453	516	608	724	805	776	912
Operating Profit	---	---	899	1,091	1,268	1,509	1,586	2,259	2,503	2,790
Operating Margin	---	---	15.9%	16.2%	15.8%	16.3%	14.6%	17.3%	16.2%	15.7%
Net Profit	---	---	778	955	419	1,228	1,401	1,795	2,057	2,459
Net Margin	---	---	13.7%	14.2%	5.2%	13.3%	12.9%	13.7%	13.3%	13.8%
Free Cash Flow	---	---	1,054	1,602	1,728	1,824	2,489	1,864	4,660	3,857
Income Tax	---	---	113	129	842	260	230	405	319	539

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	---	---	19,160	21,917	28,881	33,103	40,774	43,332	51,333	19,160
Cash & Equivalents	---	---	1,604	2,201	1,393	1,590	2,883	7,575	7,349	1,604
Accounts Receivable	---	---	9,329	10,677	12,398	14,577	18,525	20,375	22,962	9,329
Inventories	---	---	---	---	---	---	---	---	---	---
Goodwill & Int. Ass.	---	---	---	3,445	3,345	4,427	4,270	4,507	7,109	6,990
Total Liabilities	---	---	---	11,770	13,669	15,122	18,391	24,780	27,946	34,404
Accounts Payable	---	---	---	9,350	10,727	12,406	15,355	19,999	21,843	24,759
Long-Term Debt	---	---	---	1,612	1,093	---	---	1,000	1,998	4,965
Shareholder's Equity	---	---	---	7,390	8,248	13,759	14,712	15,994	15,386	16,885
D/E Ratio	---	---	---	0.22	0.13	---	---	0.06	0.13	0.29

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	---	---	---	---	2.0%	4.8%	4.5%	4.9%	4.9%	5.2%
Return on Equity	---	---	---	---	5.4%	11.2%	9.8%	11.7%	13.1%	15.2%
ROIC	---	---	---	---	4.6%	10.6%	9.8%	11.3%	12.0%	12.5%
Shares Out.	---	---	---	---	---	1,224	1,207	1,200	1,174	1,187
Revenue/Share	---	---	4.61	5.47	6.56	7.52	8.90	10.72	12.84	14.96
FCF/Share	---	---	0.86	1.30	1.41	1.48	2.04	1.53	3.87	3.25

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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