

Equity Research

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Mark Palmer

(212) 588-6582

mpalmer@btig.com

Giuliano Bologna

(212) 588-6583

gbologna@btig.com

Financials

PayPal Holdings, Inc.

Market Unimpressed by 2Q18 Beat-and-Raise, New \$10bn Buyback = PYPL Shares Priced for Perfection

PayPal Holdings (PYPL) today after the market close posted a 2Q18 earnings beat-and-raise that was essentially business as usual for the payments giant inasmuch as the company has regularly exceeded consensus expectations in each of the 13 quarters it has reported since it spun off from eBay (EBAY, Not Rated) in 2015.

- More noteworthy was PYPL's announcement that its board of directors had authorized a \$10bn share buyback program which, if fully deployed, would use all of the \$6.9bn in proceeds from its sale of its consumer credit portfolio to Synchrony Financial (SYF, Buy, \$44 PT) plus half of the \$6.3bn of cash it had on its balance sheet at June 30. That would be in addition to the \$2.7bn in buybacks remaining under its existing repurchase program.
- Also noteworthy, in our view, was the sell-off in PYPL shares during extended trading after those seemingly stock-friendly announcements. We believe that negative reaction was due in part to the company's weaker-than-expected 3Q18 revenue guidance of \$3.62bn to \$3.67bn versus the consensus estimate of \$3.71bn.
- We also believe the decision by PYPL's board to approve such a large share buyback may have been disconcerting to some investors who recalled management's stated priorities for cash deployment would be internal investment and M&A first, with buybacks to come into play if capital could not be deployed efficiently through those means.
- **We reiterate our Neutral recommendation on PYPL.** While the company's operating performance continues to be impressive, we believe it is close to fully baked into its shares and that the market's poor reaction to positive news indicates that the stock may be range-bound for some time. As such, we are comfortable remaining on the sidelines.
- **Valuation:** Based on our valuation analysis of PYPL which is focused on EV/EBITDA, we believe its shares will remain within +/- 15% of current levels over the next 12 months. BTIG does not assign price targets to Neutral-rated stocks.

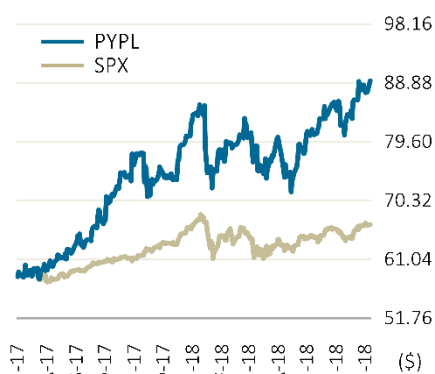
PYPL **\$91.41**

NEUTRAL

52 week range \$58.02 - \$89.24

Market Cap (m) \$107,266

Price Performance



Source: IDC

Estimates

	1Q17 A	2Q17 A	3Q17 A	4Q17 A	FY17 A	1Q18 A	2Q18 A	3Q18 E	4Q18 E	FY18 E	FY19 E
EBITDA	766	824	838	988	3,548	938	994	895	1,123	4,218	4,870
Diluted EPS (Adj.)	0.44	0.46	0.46	0.55	1.90	0.57	0.58	0.54	0.62	2.32	3.01

Source: BTIG Estimates and Company Documents (\$ in millions, except per share amount)

Please Read: Important disclosures and analyst's certification appear in Appendix

- ▶ PYPL reported 2Q18 non-GAAP earnings per share of \$0.58, outpacing the consensus estimate of \$0.57 and our estimate of \$0.56. The company during the quarter also reported \$3.86bn in revenue (22% FX-neutral growth), exceeding the consensus estimate of \$3.81bn and the upper end of management's forecast of \$3.78bn to \$3.83bn.
- ▶ PYPL's 2Q18 total payment volume of \$139bn, which represented FX-neutral growth of 27%, was essentially in line with consensus expectations. The company also reported 2.3bn payment transactions (up 28%) and added 7.7mm net new active accounts (up 18%) bringing its total active accounts to 244mm. Additionally, payment transactions per active account on a TTM basis increased by 9% to 35.7.
- ▶ While those figures are impressive, PYPL trades at almost 22x FY19E adjusted EBITDA versus Visa (V, Not Rated) at 18.2x, Worldpay (WP, Not Rated) at 17.1x and Global Payments (GPN, Not Rated) at 14.9x. PYPL's growth rate may merit some premium over those stocks – a point that is debatable given the company's place within the global payments food chain – but we believe the valuation gap is still too wide.
- ▶ We believe that after PYPL's 2Q18 acquisition spree, during which it agreed to buy iZettle, Hyperwallet, Simility and Jetlore, many investors had been expecting the company to use the proceeds from the SYF transaction to pursue additional deals, and perhaps a large acquisition of a firm such as Stripe (Private). However, the company's large buyback authorization may signal that its pace of M&A may be more moderate and that a large acquisition may not be in management's plans.
- ▶ Management boosted their FY18 non-GAAP EPS guidance to a range of \$2.32 to \$2.35 from a range of \$2.31 to \$2.34. The consensus estimate is \$2.33.
- ▶ Venmo volume increased by 78% during 2Q18 to \$14.2bn, bringing the social peer-to-peer payment app's volume to \$46.4bn on a trailing 12-month basis. While we appreciate the enthusiasm for PYPL's efforts to monetize the app through its Pay with Venmo initiative, we remain concerned about the sustainability of the app's future growth trajectory given the rapid adoption of Zelle, the peer-to-peer app offered by more than 60 other banks, as well as alternatives such as the Square Cash App (SQ, Sell, \$30 PT).

Income Statement

PayPal Holdings - Operating Mode	Dec-14	Dec-15	Dec-16	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Dec-19	Dec-20
\$ millions	2014A	2015A	2016A	2017A	1Q18A	2Q18A	3Q18E	4Q18E	2018E	1Q19E	2Q19E	3Q19E	4Q19E	2019E	2020E
Net Revenues	8,025.0	9,248.0	10,842.0	13,094.0	3,685.0	3,857.0	3,706.6	4,281.5	15,530.2	4,183.7	4,378.2	4,430.8	5,118.1	18,110.9	20,397.5
Transaction expense	2,170.0	2,610.0	3,346.0	4,419.0	1,275.0	1,362.0	1,413.1	1,623.6	5,673.7	1,514.1	1,617.7	1,678.7	1,928.6	6,739.1	7,870.2
Transaction and loan loss	646.0	809.0	1,088.0	1,011.0	305.0	334.0	271.3	312.7	1,222.9	306.2	325.7	338.4	394.9	1,365.2	1,692.8
Customer support and operations	1,055.0	1,220.0	1,267.0	1,364.0	351.0	357.0	385.6	407.6	1,501.1	391.5	398.1	453.2	479.1	1,721.8	1,862.2
Sales and marketing	998.0	985.0	969.0	1,128.0	285.0	313.0	318.1	375.1	1,291.2	317.9	349.0	373.9	440.9	1,481.7	1,602.6
Product development	890.0	947.0	834.0	953.0	258.0	255.0	267.4	297.3	1,077.8	287.8	284.4	314.4	349.5	1,235.9	1,336.7
General and administrative	482.0	560.0	1,028.0	1,155.0	339.0	368.0	373.6	378.0	1,458.6	389.9	423.2	429.6	434.7	1,677.4	1,845.1
Depreciation and amortization	516.0	608.0	724.0	805.0	185.0	180.0	220.1	257.3	842.4	210.0	204.3	263.1	307.6	985.0	1,110.4
Restructuring	-	48.0	-	132.0	153.0	116.0	-	-	269.0	-	-	-	-	-	-
Total operating expenses	6,757.0	7,787.0	9,256.0	10,967.0	3,151.0	3,285.0	3,249.2	3,651.5	13,336.8	3,417.3	3,602.5	3,851.2	4,335.2	15,206.2	17,320.0
Adjusted EBITDA	2,076.0	2,490.0	2,793.0	3,548.0	938.0	994.0	894.6	1,122.7	4,218.3	1,217.3	1,215.8	1,087.0	1,349.5	4,869.6	5,339.1
Operating income	1,268.0	1,461.0	1,586.0	2,127.0	534.0	572.0	457.4	630.0	2,193.4	766.4	775.7	579.7	782.9	2,904.7	3,077.4
Other income (expense)	(7.0)	27.0	45.0	73.0	14.0	37.0	-	-	51.0	-	-	-	-	-	-
Income (loss) before income taxes	1,261.0	1,488.0	1,631.0	2,200.0	548.0	609.0	457.4	630.0	2,244.4	766.4	775.7	579.7	782.9	2,904.7	3,077.4
Income tax expense	842.0	260.0	230.0	405.0	37.0	83.0	64.0	88.2	272.2	107.3	108.6	81.2	109.6	406.7	430.8
Net income	419.0	1,228.0	1,401.0	1,795.0	511.0	526.0	393.4	541.8	1,972.2	659.1	667.1	498.5	673.3	2,498.1	2,646.6
Diluted EPS - GAAP	\$0.34	\$1.00	\$1.15	\$1.47	\$0.42	\$0.44	\$0.33	\$0.47	\$1.66	\$0.57	\$0.58	\$0.44	\$0.60	\$2.20	\$2.41
Diluted EPS - Adjusted	\$1.10	\$1.29	\$1.50	\$1.90	\$0.57	\$0.58	\$0.54	\$0.62	\$2.32	\$0.76	\$0.72	\$0.58	\$0.96	\$3.01	\$3.32
Diluted shares outstanding	1,222.0	1,227.5	1,217.5	1,220.5	1,217.0	1,202.0	1,179.5	1,157.0	1,188.9	1,149.0	1,141.0	1,133.0	1,125.0	1,137.0	1,100.0
Revenue growth	19.3%	15.2%	17.2%	20.8%	23.9%	23.0%	14.4%	14.4%	18.6%	13.5%	13.5%	19.5%	19.5%	16.6%	12.6%
Operating margin	15.8%	15.8%	14.6%	16.2%	14.5%	14.8%	12.3%	14.7%	14.1%	18.3%	17.7%	13.1%	15.3%	16.0%	15.1%
EBITDA margin	25.9%	26.9%	25.8%	27.1%	25.5%	25.8%	24.1%	26.2%	27.2%	29.1%	27.8%	24.5%	26.4%	26.9%	26.2%
Net income margin	5.2%	13.3%	12.9%	13.7%	13.9%	13.6%	10.6%	12.7%	12.7%	15.8%	15.2%	11.3%	13.2%	13.8%	13.0%
Tax rate	66.8%	17.5%	14.1%	18.4%	6.8%	13.6%	14.0%	14.0%	12.1%	14.0%	14.0%	14.0%	14.0%	14.0%	14.0%

Source BTIG Estimates and Company Reports

BTIG Covered Companies Mentioned in this Report

PAYPAL HOLDINGS, INC. (PYPL, Neutral, \$N/A PT; Current Price: \$91.41; Analyst: Mark.Palmer)

SYNCHRONY FINANCIAL (SYF, Buy, \$44.00 PT; Current Price: \$33.82; Analyst: Mark.Palmer)

SQUARE INC. (SQ, Sell, \$30.00 PT; Current Price: \$69.36; Analyst: Mark.Palmer)

Appendix: Analyst Certification and Other Important Disclosures

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I, Giuliano Bologna, hereby certify that the views about the companies and securities discussed in this report are accurately expressed and that I have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

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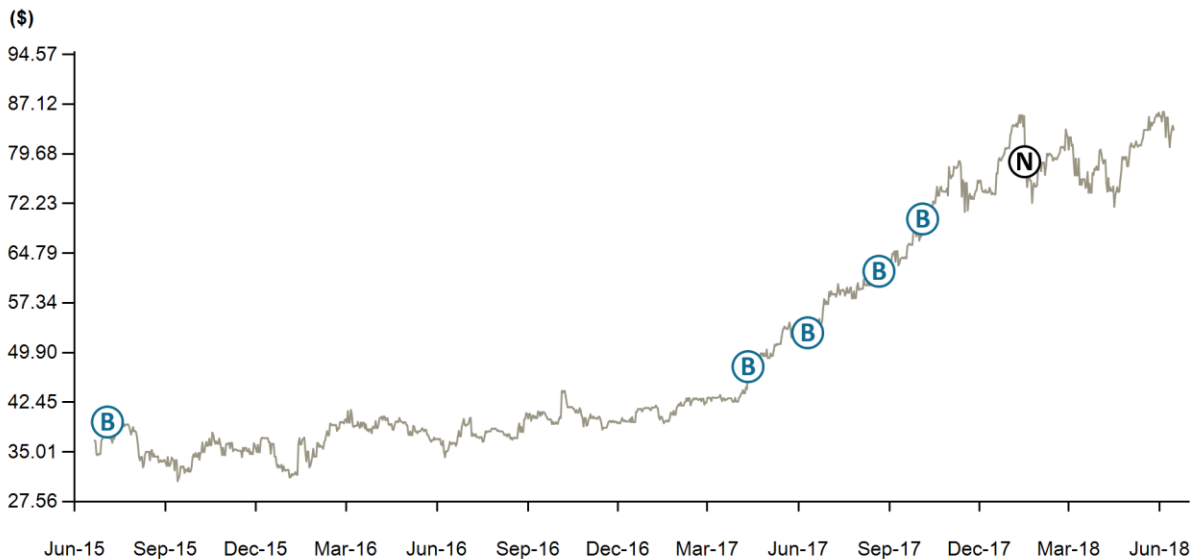
Company Valuation and Risk Disclosures

PayPal Holdings, Inc. (PYPL, Neutral)

Valuation: Based on our valuation analysis of PYPL, we believe its shares will remain within +/- 15% of current levels over the next 12 months. BTIG does not assign price targets to Neutral-rated stocks.

Risks: The primary risks to PayPal include: competition from mobile wallet offerings and others, pressure on take rates, security risks, regulatory risks, regulatory risks and reliance on third-party banks for credit-product issuance. Upside risks: continued growth above expectations and an acquisitions of the company.

PayPal Holdings, Inc. (PYPL)



Note: Closing Price and Target Price have been adjusted for corporate actions.

Date	Closing Price (\$)	Target Price (\$)	Analyst	Rating
20-Jul-15	39.35	48	Mark Palmer	Buy
27-Apr-17	47.72	53	Mark Palmer	Buy
26-Jun-17	52.73	63	Mark Palmer	Buy
06-Sep-17	62	70	Mark Palmer	Buy
20-Oct-17	69.80	81	Mark Palmer	Buy
31-Jan-18	78.40	N/A	Mark Palmer	Neutral

Other Disclosures

Additional Information Available Upon Request

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