

## Equity Research

January 30, 2019

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## Financials

### PayPal Holdings, Inc.

#### PYPL Fails to Exceed High Expectations Bar with 4Q18 Report, But Growth Story on Track; Reiterate Buy

Judging from the negative reaction to PayPal's (PYPL) 4Q18 earnings report during extended trading today, investors had set a high expectations bar for the company heading into the print such that a good-but-not-great report was not sufficient to buoy the stock. With that said, we saw much in PYPL's report to support our view that the company's growth story remains very much on track.

- ▶ While PYPL posted a 4Q18 adjusted earnings per share beat – \$0.69 versus the consensus estimate of \$0.67 and our estimate of \$0.66 – some investors were apparently disappointed that the company's revenue of \$4.23bn fell short of the consensus estimate of \$4.24bn even as it was near the midpoint of management's guidance range. The main culprit was eBay (EBAY, Not Rated); management noted that if EBAY's 4Q18 contribution had matched that of 3Q18, then PYPL would have collected an incremental \$32mm of revenue.
- ▶ With shares of PYPL having surged by 20.5% since December 24 and outperforming Visa (V, Not Rated) and Mastercard (MA, Not Rated) which rose by 13.0% and 16.5%, respectively, during that span, we believe a minor miss versus expectations was likely to trigger a retreat.
- ▶ **We are reiterating our Buy recommendation on PYPL and price target of \$95** based on 17x the company's FY20E adjusted EBITDA of \$5,891mm. We believe PYPL's shares continue to warrant a premium multiple in light of its growth trajectory (as well as the \$10.1bn in cash on its balance sheet at YE18) and that investors should view a pullback in the company's share price tomorrow as a buying opportunity.
- ▶ Our focus heading into PYPL's 4Q18 print had been on total payment volume (TPV), payment transaction volume, monetization of social peer-to-peer app Venmo and new account growth, and the digital payments network shined in all four.
- ▶ **Valuation:** Our \$95 price target for PayPal is based on 17x the company's FY20E adjusted EBITDA of \$5,891mm. The multiple we employ is based on comparable-company analysis.

**PYPL** **\$92.42**

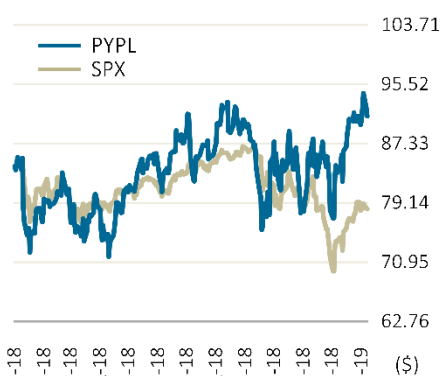
12-month target \$95.00

### BUY

52-week range \$71.73 - \$94.28

Market Cap (m) \$110,812

#### Price Performance



Source: IDC

## Estimates

	1Q18 A	2Q18 A	3Q18 A	4Q18 A	FY18 A	1Q19 E	2Q19 E	3Q19 E	4Q19 E	FY19 E	FY20 E
Sales	3,685	3,857	3,683	4,226	15,451	4,132	4,366	4,476	5,094	18,067	21,504
EBITDA	938	1,012	940	1,146	4,036	1,102	1,146	1,128	1,488	4,864	5,891
Diluted EPS (Adj.)	0.57	0.58	0.58	0.69	2.42	0.68	0.68	0.66	0.89	2.91	3.51

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

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

- ▶ PYPL's TPV increased by 25% year-over-year on an FX-neutral basis to \$164bn while payment transaction volume increased by 28% to 2.87bn. That rate of growth was down from the 28% rate of TPV growth that the company had posted in 4Q17 which management attributed in large part to zero growth from EBAY (EBAY, Not Rated) PYPL's TPV ex.-EBAY was up 29% during the quarter.
- ▶ We believe PYPL's lack of TPV growth from EBAY during 4Q18 and the fact that the company's Merchant Services revenue has grown at a rate 6x that of its revenue from EBAY since 2015 should help to ease whatever sting remains from EBAY's decision announced last January to replace PYPL with Adyen (ADYEN NA) as its primary payments provider in 2020. Management noted that Venmo during 4Q18 surpassed EBAY in terms of TPV on PYPL's platform.
- ▶ Meanwhile, PYPL during 4Q18 added a record 13.8mm new active accounts, up 58% versus the prior year period, including 2.9mm stemming from the company's 2018 acquisitions. Management attributed the surge in growth to its partnerships including 40 bank-led marketing campaigns to drive consumers to PYPL's platform, and they said they see significant runway ahead in that metric.
- ▶ Perhaps most encouraging among PYPL's 4Q18 highlights was that 29% of Venmo's users had engaged in a monetizable experience through December, up from 24% in 3Q18, 17% in 2Q18 and 13% in May. That figure made even more meaningful the 80% increase in volume to \$19bn that Venmo reported during 4Q18, in our view.
- ▶ Management during today's conference call said Venmo had a revenue run-rate greater than \$200mm at YE18. They noted that the figure was split between Instant Cash Out and commerce-related revenue.
- ▶ PYPL's number of payment transactions per active accounts on a trailing 12-month basis increased 9% year-over-year to 36.9. This increase is important inasmuch as a key part of the company's growth strategy is to increase engagement among existing customers with a goal of motivating users to engage its platform 2-3 times a week versus 2-3 a month.

## Income Statement

PayPal Inc. - Operating Model	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	Mar-20	Jun-20	Sep-20	Dec-20	Dec-20	Dec-21	Dec-22
\$ millions	2015A	2016A	2017A	1Q18A	2Q18A	3Q18A	4Q18A	2018A	1Q19E	2Q19E	3Q19E	4Q19E	2019E	1Q20E	2Q20E	3Q20E	4Q20E	2020E	2021E	2022E
Net revenues	9,248	10,842	13,094	3,685	3,857	3,683	4,226	15,451	4,132	4,366	4,476	5,094	18,067	4,929	5,209	5,340	6,026	21,504	25,070	28,853
Transaction expense	2,610	3,346	4,419	1,275	1,362	1,366	1,578	5,581	1,565	1,645	1,667	1,909	6,786	1,882	1,978	2,004	2,277	8,141	9,455	10,999
Transaction and loan losses	809	1,088	1,011	305	334	295	340	1,274	334	352	362	411	1,460	401	423	435	490	1,748	2,062	2,402
Customer support and operations	1,110	1,267	1,364	351	357	367	407	1,482	426	436	448	444	1,754	483	492	506	493	1,974	2,180	2,367
Sales and marketing	937	969	1,128	285	313	326	389	1,313	320	352	394	390	1,456	375	416	466	457	1,715	1,974	2,243
Product development	792	834	953	258	255	269	289	1,071	289	286	325	322	1,222	339	338	383	376	1,436	1,637	1,841
General and administrative	873	1,028	1,155	339	368	354	390	1,451	380	414	428	424	1,647	441	484	500	490	1,915	2,170	2,440
Depreciation amortization	608	724	805	185	180	188	223	776	207	218	224	255	903	242	255	256	289	1,042	1,171	1,300
Restructuring and other charges	48	0	132	153	116	28	12	309	0	0	0	0	0	0	0	0	0	0	0	0
<b>Total operating expenses</b>	<b>7,787</b>	<b>9,256</b>	<b>10,967</b>	<b>3,151</b>	<b>3,285</b>	<b>3,193</b>	<b>3,628</b>	<b>13,257</b>	<b>3,521</b>	<b>3,704</b>	<b>3,847</b>	<b>4,156</b>	<b>15,228</b>	<b>4,162</b>	<b>4,386</b>	<b>4,550</b>	<b>4,872</b>	<b>17,971</b>	<b>20,650</b>	<b>23,593</b>
<b>Operating income</b>	<b>1,461</b>	<b>1,586</b>	<b>2,127</b>	<b>534</b>	<b>572</b>	<b>490</b>	<b>598</b>	<b>2,194</b>	<b>610</b>	<b>662</b>	<b>629</b>	<b>938</b>	<b>2,839</b>	<b>766</b>	<b>823</b>	<b>789</b>	<b>1,154</b>	<b>3,533</b>	<b>4,420</b>	<b>5,260</b>
Other income (expense)	27	45	73	14	37	43	88	182	0	0	0	0	0	0	0	0	0	0	0	0
<b>Income before income taxes</b>	<b>1,488</b>	<b>1,631</b>	<b>2,200</b>	<b>548</b>	<b>609</b>	<b>533</b>	<b>686</b>	<b>2,376</b>	<b>610</b>	<b>662</b>	<b>629</b>	<b>938</b>	<b>2,839</b>	<b>766</b>	<b>823</b>	<b>789</b>	<b>1,154</b>	<b>3,533</b>	<b>4,420</b>	<b>5,260</b>
Income tax expense	260	230	405	37	83	97	102	319	91	98	93	139	422	114	122	117	172	525	657	782
<b>Net income</b>	<b>1,228</b>	<b>1,401</b>	<b>1,795</b>	<b>511</b>	<b>526</b>	<b>436</b>	<b>584</b>	<b>2,057</b>	<b>520</b>	<b>564</b>	<b>535</b>	<b>798</b>	<b>2,417</b>	<b>652</b>	<b>701</b>	<b>672</b>	<b>983</b>	<b>3,008</b>	<b>3,763</b>	<b>4,478</b>
<b>Diluted EPS - GAAP</b>	<b>\$1.00</b>	<b>\$1.15</b>	<b>\$1.47</b>	<b>\$0.42</b>	<b>\$0.44</b>	<b>\$0.36</b>	<b>\$0.49</b>	<b>\$1.71</b>	<b>\$0.43</b>	<b>\$0.47</b>	<b>\$0.45</b>	<b>\$0.67</b>	<b>\$2.02</b>	<b>\$0.55</b>	<b>\$0.59</b>	<b>\$0.57</b>	<b>\$0.83</b>	<b>\$2.54</b>	<b>\$3.19</b>	<b>\$3.81</b>
<b>Diluted EPS - Adjusted</b>	<b>\$1.29</b>	<b>\$1.50</b>	<b>\$1.90</b>	<b>\$0.57</b>	<b>\$0.58</b>	<b>\$0.58</b>	<b>\$0.69</b>	<b>\$2.42</b>	<b>\$0.68</b>	<b>\$0.68</b>	<b>\$0.66</b>	<b>\$0.89</b>	<b>\$2.91</b>	<b>\$0.79</b>	<b>\$0.83</b>	<b>\$0.81</b>	<b>\$1.08</b>	<b>\$3.51</b>	<b>\$4.28</b>	<b>\$5.02</b>
Shares outstanding - Basic	1,222	1,210	1,203	1,192	1,187	1,181	1,177	1,184	1,180	1,178	1,176	1,172	1,177	1,169	1,166	1,163	1,159	1,164	1,158	1,156
Shares outstanding - Diluted	1,229	1,218	1,221	1,217	1,202	1,199	1,196	1,203	1,200	1,197	1,195	1,192	1,196	1,189	1,186	1,183	1,178	1,184	1,178	1,177
<b>GAAP operating income</b>	<b>1,461</b>	<b>1,586</b>	<b>2,127</b>	<b>534</b>	<b>572</b>	<b>490</b>	<b>598</b>	<b>2,194</b>	<b>610</b>	<b>662</b>	<b>629</b>	<b>938</b>	<b>2,839</b>	<b>766</b>	<b>823</b>	<b>789</b>	<b>1,154</b>	<b>3,533</b>	<b>4,420</b>	<b>5,260</b>
Stock based compensation expense and related employer payroll taxes	356	455	761	241	223	219	237	920	285	266	275	296	1,122	320	317	328	350	1,315	1,534	1,765
Amortization of acquired intangible assets	85	133	129	29	25	33	59	146	55	52	49	47	202	44	42	40	38	165	134	109
Restructuring	48	0	40	25	0	28	12	65	0	0	0	0	0	0	0	0	0	0	0	0
Other	25	0	-302	0	0	17	7	24	40	0	0	0	40	0	0	0	0	0	0	0
<b>Total non-GAAP operating income adjustments</b>	<b>514</b>	<b>588</b>	<b>628</b>	<b>295</b>	<b>248</b>	<b>297</b>	<b>315</b>	<b>1,155</b>	<b>380</b>	<b>317</b>	<b>324</b>	<b>343</b>	<b>1,364</b>	<b>365</b>	<b>359</b>	<b>368</b>	<b>388</b>	<b>1,480</b>	<b>1,668</b>	<b>1,875</b>
<b>Non-GAAP operating income</b>	<b>1,975</b>	<b>2,174</b>	<b>2,755</b>	<b>829</b>	<b>820</b>	<b>787</b>	<b>913</b>	<b>3,349</b>	<b>990</b>	<b>980</b>	<b>953</b>	<b>1,281</b>	<b>4,203</b>	<b>1,131</b>	<b>1,182</b>	<b>1,158</b>	<b>1,542</b>	<b>5,013</b>	<b>6,088</b>	<b>7,135</b>
Non-GAAP operating margin	21.4%	20.1%	21.0%	22.5%	21.3%	21.4%	21.6%	21.7%	24.0%	22.4%	21.3%	25.1%	23.3%	23.0%	22.7%	21.7%	25.6%	23.3%	24.3%	24.7%
Stock based compensation as a % of revenue	3.8%	4.2%	5.8%	6.5%	5.8%	5.9%	5.6%	6.0%	6.9%	6.1%	6.1%	5.8%	6.2%	6.5%	6.1%	6.1%	5.8%	6.1%	6.1%	6.1%
<b>GAAP income before income taxes</b>	<b>1,488</b>	<b>1,631</b>	<b>2,200</b>	<b>548</b>	<b>609</b>	<b>533</b>	<b>686</b>	<b>2,376</b>	<b>610</b>	<b>662</b>	<b>629</b>	<b>938</b>	<b>2,839</b>	<b>766</b>	<b>823</b>	<b>789</b>	<b>1,154</b>	<b>3,533</b>	<b>4,420</b>	<b>5,260</b>
GAAP income tax expense	260	230	405	37	83	97	102	319	91	98	93	139	422	114	122	117	172	525	657	782
<b>GAAP net income</b>	<b>1,228</b>	<b>1,401</b>	<b>1,795</b>	<b>511</b>	<b>526</b>	<b>436</b>	<b>584</b>	<b>2,057</b>	<b>520</b>	<b>564</b>	<b>535</b>	<b>798</b>	<b>2,417</b>	<b>652</b>	<b>701</b>	<b>672</b>	<b>983</b>	<b>3,008</b>	<b>3,763</b>	<b>4,478</b>
Non-GAAP operating income adjustments	514	588	628	295	248	297	315	1,155	380	317	324	343	1,364	365	359	368	388	1,480	1,668	1,875
Other	-12	0	224	3	32	14	-6	43	0	0	0	0	0	0	0	0	0	0	0	0
Tax effect on non-GAAP adjustment	-142	-164	-329	-117	-103	-53	-69	-342	-79	-70	-70	-81	-300	-80	-81	-82	-93	-336	-389	-444
<b>Non-GAAP net income</b>	<b>1,588</b>	<b>1,825</b>	<b>2,318</b>	<b>692</b>	<b>703</b>	<b>694</b>	<b>824</b>	<b>2,913</b>	<b>820</b>	<b>811</b>	<b>789</b>	<b>1,060</b>	<b>3,481</b>	<b>937</b>	<b>979</b>	<b>959</b>	<b>1,277</b>	<b>4,152</b>	<b>5,042</b>	<b>5,909</b>
GAAP tax rate	17.5%	14.1%	18.4%	6.8%	13.6%	18.2%	14.9%	13.4%	14.9%	14.9%	14.9%	14.9%	14.9%	14.9%	14.9%	14.9%	14.9%	14.9%	14.9%	14.9%
Non-GAAP effective tax rate	20.2%	17.8%	18.2%	18.2%	20.9%	17.8%	17.2%	18.5%	17.2%	17.2%	17.2%	17.2%	17.2%	17.2%	17.2%	17.2%	17.2%	17.2%	17.2%	17.2%
<b>Diluted EPS - Adjusted</b>	<b>\$1.29</b>	<b>\$1.50</b>	<b>\$1.90</b>	<b>\$0.57</b>	<b>\$0.58</b>	<b>\$0.58</b>	<b>\$0.69</b>	<b>\$2.42</b>	<b>\$0.68</b>	<b>\$0.68</b>	<b>\$0.66</b>	<b>\$0.89</b>	<b>\$2.91</b>	<b>\$0.79</b>	<b>\$0.83</b>	<b>\$0.81</b>	<b>\$1.08</b>	<b>\$3.51</b>	<b>\$4.28</b>	<b>\$5.02</b>
Shares outstanding - Diluted	1,229	1,218	1,221	1,217	1,202	1,199	1,196	1,203	1,200	1,197	1,195	1,192	1,196	1,189	1,186	1,183	1,178	1,184	1,178	1,177
<b>Net income</b>	<b>1,228</b>	<b>1,401</b>	<b>1,795</b>	<b>511</b>	<b>526</b>	<b>436</b>	<b>584</b>	<b>2,057</b>	<b>520</b>	<b>564</b>	<b>535</b>	<b>798</b>	<b>2,417</b>	<b>652</b>	<b>701</b>	<b>672</b>	<b>983</b>	<b>3,008</b>	<b>3,763</b>	<b>4,478</b>
Income tax expense	260	230	405	37	83	97	102	319	91	98	93	139	422	114	122	117	172	525	657	782
Depreciation and amortization	608	724	805	185	180	188	223	776	207	218	224	255	903	242	255	256	289	1,042	1,171	1,300
Stock based compensation	346	438	738	205	223	219	237	884	285	266	275	296	1,122	320	317	328	350	1,315	1,534	1,765
Other	0	0	-322	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
<b>Adjusted EBITDA</b>	<b>2,442</b>	<b>2,793</b>	<b>3,416</b>	<b>938</b>	<b>1,012</b>	<b>940</b>	<b>1,146</b>	<b>4,036</b>	<b>1,102</b>	<b>1,146</b>	<b>1,128</b>	<b>1,488</b>	<b>4,864</b>	<b>1,328</b>	<b>1,395</b>	<b>1,374</b>	<b>1,793</b>	<b>5,891</b>	<b>7,125</b>	<b>8,326</b>
Adjusted EBITDA margin	26.4%	25.8%	26.1%	25.5%	26.2%	25.5%	27.1%	26.1%	26.7%	26.3%	25.2%	29.2%	26.9%	26.9%	26.8%	25.7%	29.8%	27.4%	28.4%	28.9%

Source: BTIG Estimates and Company Documents

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## BTIG Covered Companies Mentioned in this Report

PAYPAL HOLDINGS, INC. (PYPL, Buy, \$95.00 PT; Current Price: \$92.42; Analyst: Mark.Palmer)

## Appendix: Analyst Certification and Other Important Disclosures

### Analyst Certification

I, Mark Palmer, 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.

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.

### Regulatory Disclosures

#### Ratings Definitions

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**BUY** – A security which is expected to produce a positive total return of 15% or greater over the 12 months following the recommendation. The BUY rating may be maintained as long as it is deemed appropriate, notwithstanding price fluctuations that would cause the target to fall outside of the 15% return.

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**Distribution of BTIG's Research Recommendations (as of December 31, 2018):**

**BUY: 59.8%; NEUTRAL: 38.1%; SELL: 2.1%**

**Distribution of BTIG's Investment Banking Services (as of December 31, 2018):**

**BUY: 27.3%; NEUTRAL: 11.1%; SELL: 0.0%**

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### Company Valuation and Risk Disclosures

#### PayPal Holdings, Inc. (PYPL, Buy, \$95.00 PT)

**Valuation:** Our \$95 price target for PayPal is based on 17x the company's FY20E adjusted EBITDA of \$5,891mm.

**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.

## 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	40.47	48	Mark Palmer	Buy
27-Apr-17	47.15	53	Mark Palmer	Buy
26-Jun-17	53.74	63	Mark Palmer	Buy
06-Sep-17	61.24	70	Mark Palmer	Buy
20-Oct-17	70.97	81	Mark Palmer	Buy
31-Jan-18	85.32	N/A	Mark Palmer	Neutral
19-Oct-18	84.78	95	Mark Palmer	Buy

## Other Disclosures

Additional Information Available Upon Request

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