

Earnings Revised — July 28, 2021

Transaction Processing

PayPal Holdings, Inc. (PYPL)

PYPL: Quicker eBay Transition Caps '21 Upside, Sets Stage for Accelerating Growth in '22; Underlying Performance Robust

Our Call

Summary: An acceleration in the eBay transition proved to be a larger headwind for PYPL during Q2, suppressing strong underlying performance (revenue up 32% excluding eBay) and capping 2021 upside (revenue and EPS guidance unchanged), in our view. PYPL now expects a 7% headwind to 2021 revenue growth from the eBay transition, up from 6% after Q1 (and 4% at the start of 2021). Nevertheless, given its numerous growth and monetization initiatives, which are in the early stages, we remain confident in PYPL's ability to achieve or modestly exceed its long-term targets of 25% TPV and 20% revenue growth. **Estimates Higher.** Our 2021E revenue/EPS move up to \$25.75B/\$4.73 from \$25.74B/\$4.70. Our 2022E revenue/EPS move up to \$31.56B/\$5.90 from \$31.15B/\$5.76. Following Q3 (the most difficult eBay compare), we expect revenue growth to accelerate as eBay headwinds lessen and new initiatives begin monetizing. **Our 2022 revenue estimate implies 23% growth.**

Bullish Points: (1) TPV of \$311B was up 40% (36% FXN) and exceeded our \$297B estimate; excluding eBay, TPV increased 48%; (2) OVAS revenue of \$441MM, up 40%, was well ahead of our \$359MM estimate; and (3) PYPL raised its 2021 TPV guidance and left its revenue outlook unchanged despite the greater anticipate headwind from the eBay transition. **Bearish Points:** (1) net new actives (NNAs) increased by 11.4MM during Q2, a bit below our estimate; and (2) the transaction take rate of 1.86% was below our 1.98% estimate and down from 2.23% during the prior year; although we believe eBay was the largest contributor to the decline, PYPL also called out hedging (\$122MM headwind versus prior year), lower FX volatility, and greater bill pay volume, which carries a lower take rate.

Q2 Recap: Revenue of \$6.24B, up 19% (up 17% FXN), essentially matched our estimate as lower transaction revenue was offset by higher OVAS revenue. Transaction revenue of \$5.8B (up 17%) was a touch below our \$5.9B estimate as higher TPV was more than offset by a lower take rate. We would note PYPL's guidance for the remainder of 2021 implies a modest decline in the transaction take rate from Q2 to Q3 before strengthening from Q3 to Q4 as the eBay headwind lessens, new monetization initiatives take hold, and PYPL recognizes a modest benefit from upcoming pricing adjustments. OVAS revenue of \$441MM exceeded our \$359MM estimate as PYPL noted strengthening credit performance. **As mentioned previously, excluding eBay, Q2 revenue was up 32%.** PYPL's operating profit of \$1.65B was a touch above our \$1.62B estimate as higher transaction expense (higher TPV and a slightly higher transaction expense rate) was more than offset by lower transaction and loan less expense and lower non-transaction-based expenses, which still grew 27% as PYPL invests to capture opportunities created by the accelerated shift to digital payments. Operating margin of 26.5% was 50 bps above our estimate but down 170 bps from the prior year. PYPL noted a \$360MM decline in transaction margin dollars from the eBay transition during Q2. EPS of \$1.15, up 8%, modestly exceeded our \$1.12 estimate.

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Rating	Overweight
Ticker	PYPL
Price Target/Prior:	\$350.00/NC
Upside/(Downside) to Target	15.9%
Price (07/28/2021)	\$301.98
52 Week Range	\$171.63 - 310.16
Shares Outstanding	1,174,728,054
Market Cap (MM)	\$354,744
Enterprise Value (MM)	\$351,294
Average Daily Volume	5,197,553
Average Daily Value (MM)	\$1,570
Dividend (NTM)	\$0.00
Dividend Yield	0.0%
Net Debt (MM) - last reported	\$(3,450)
ROIC - Current year est.	19%
3 Yr EPS CAGR from current year (unless otherwise noted)	25%

	2020E	2021E	2021E	2022E	2022E
EPS		Curr.	Prior	Curr.	Prior
Q1 (Mar)	0.66 A	1.22 A	NC	1.38 E	1.40 E
Q2 (Jun)	1.07 A	1.15 A	1.12 E	1.46 E	1.42 E
Q3 (Sep)	1.07 A	1.06 E	1.13 E	1.42 E	1.41 E
Q4 (Dec)	1.08 A	1.30 E	1.23 E	1.63 E	1.53 E
FY	3.88 A	4.73 E	4.70 E	5.90 E	5.76 E
P/E	77.9x	63.9x		51.2x	

Source: Company Data, Wells Fargo Securities estimates, and Refinitiv.
NA = Not Available, Volatility = Historical trading volatility

Figure 1 - Q2 2021 Variance Analysis

\$ in millions, except where noted		Q2 2020 - Actual		Q2 2021 - Estimate		Q2 2021 - Actual		Change
Transaction revenue		\$4,945	94.0%	\$5,885	94.2%	\$5,797	92.9%	17.2%
Value-added services revenue		316	6.0%	359	5.8%	441	7.1%	39.6%
Total net revenues		\$5,261	100.0%	\$6,245	100.0%	\$6,238	100.0%	18.6%
Transaction expense		\$1,843	35.0%	\$2,341	37.5%	\$2,524	40.5%	37.0%
Transaction and loan loss expense		440	8.4%	294	4.7%	169	2.7%	-61.6%
Non-transaction-based		1,493	28.4%	1,986	31.8%	1,891	30.3%	26.7%
Total operating expenses		\$3,776	71.8%	\$4,621	74.0%	\$4,584	73.5%	21.4%
Operating income		\$1,485	28.2%	\$1,623	26.0%	\$1,654	26.5%	11.4%
Other income (expense), net		(57)	-1.1%	(50)	-0.8%	(61)	-1.0%	NME
Income before income taxes		\$1,428	27.1%	\$1,573	25.2%	\$1,593	25.5%	11.6%
Income tax expenses		(165)	-3.1%	(236)	-3.8%	(230)	-3.7%	39.4%
Net income		\$1,263	24.0%	\$1,337	21.4%	\$1,363	21.8%	7.9%
EPS - Diluted		\$1.07		\$1.12		\$1.15		7.7%
Average diluted shares outstanding		1,184		1,191		1,186		0.2%
Effective tax rate		11.6%		15.0%		14.4%		
EBITDA		\$1,667	31.7%	\$1,823	29.2%	\$1,861	29.8%	11.6%
Key metrics								
Active customer accounts		346		406		403		16.5%
Total payment volume		\$221.7		\$296.5		\$311.0		40.3%
Number of payment transactions		3,742		4,721		4,735		26.5%
Volume per transaction		\$59.25		\$62.81		\$65.68		10.8%
Transaction take rate		2.23%		1.98%		1.86%		-16.4%
Transaction expense rate		0.83%		0.79%		0.81%		-2.4%
Transaction margin		56.6%		57.8%		56.8%		

Source: Company reports and Wells Fargo Securities, LLC estimates

Financials

Figure 2 - Summary Earnings Model

\$ in millions, except where noted

	2020	2021E					2022E				
	FY	Q1	Q2	Q3E	Q4E	FYE	Q1E	Q2E	Q3E	Q4E	FYE
Net revenues	\$21,454	\$6,033	\$6,238	\$6,232	\$7,249	\$25,752	\$7,144	\$7,727	\$7,832	\$8,856	\$31,559
Transaction expense	7,934	2,275	2,524	2,544	2,861	10,204	2,838	3,120	3,229	3,630	12,816
Transaction and loan loss expense	1,741	273	169	328	344	1,114	334	366	414	436	1,550
Customer support and operations	1,519	430	441	442	507	1,821	486	525	525	585	2,120
Sales and marketing	1,507	503	536	511	631	2,181	543	587	595	709	2,434
Technology and development	1,840	507	531	523	609	2,170	579	626	627	700	2,531
General and administrative	1,525	372	383	374	457	1,586	407	433	431	496	1,767
Total operating expenses	\$16,066	\$4,360	\$4,584	\$4,723	\$5,408	\$19,075	\$5,187	\$5,656	\$5,820	\$6,555	\$23,218
Operating income	\$5,388	\$1,673	\$1,654	\$1,509	\$1,841	\$6,677	\$1,957	\$2,070	\$2,012	\$2,302	\$8,341
Other income (expense), net	(155)	(50)	(61)	(50)	(50)	(211)	(50)	(50)	(50)	(50)	(200)
Income before income taxes	\$5,233	\$1,623	\$1,593	\$1,459	\$1,791	\$6,466	\$1,907	\$2,020	\$1,962	\$2,252	\$8,141
Income tax expenses	(627)	(168)	(230)	(204)	(251)	(853)	(267)	(283)	(275)	(315)	(1,140)
Net income	\$4,606	\$1,455	\$1,363	\$1,255	\$1,540	\$5,613	\$1,640	\$1,737	\$1,688	\$1,936	\$7,001
EPS - Diluted	\$3.88	\$1.22	\$1.15	\$1.06	\$1.30	\$4.73	\$1.38	\$1.46	\$1.42	\$1.63	\$5.90
Average diluted shares outstanding	1,188	1,190	1,186	1,186	1,186	1,187	1,186	1,186	1,186	1,186	1,186
Effective tax rate	12.0%	10.4%	14.4%	14.0%	14.0%	13.2%	14.0%	14.0%	14.0%	14.0%	14.0%
EBITDA	\$6,127	\$1,867	\$1,861	\$1,721	\$2,058	\$7,507	\$2,178	\$2,294	\$2,239	\$2,541	\$9,253
Change											
Net revenues	20.7%	30.6%	18.6%	14.2%	18.5%	20.0%	18.4%	23.9%	25.7%	22.2%	22.6%
Transaction expense	16.8%	30.8%	37.0%	25.8%	22.8%	28.6%	24.8%	23.6%	26.9%	26.9%	25.6%
Transaction and loan loss expense	26.2%	-53.8%	-61.6%	-4.7%	-6.0%	-36.0%	22.3%	116.3%	26.3%	26.9%	39.1%
Customer support and operations	7.9%	26.5%	23.2%	14.6%	16.6%	19.9%	13.0%	19.1%	18.6%	15.2%	16.5%
Sales and marketing	33.7%	78.4%	67.5%	33.8%	20.6%	44.7%	7.9%	9.6%	16.5%	12.3%	11.6%
Technology and development	17.0%	23.4%	22.6%	10.9%	16.2%	18.0%	14.1%	17.9%	19.7%	14.9%	16.6%
General and administrative	11.9%	7.2%	0.3%	1.6%	6.7%	4.0%	9.5%	13.0%	15.2%	8.6%	11.4%
Total operating expenses	17.8%	17.5%	21.4%	18.9%	17.4%	18.7%	19.0%	23.4%	23.2%	21.2%	21.7%
Operating income	30.4%	84.3%	11.4%	1.6%	21.9%	23.9%	17.0%	25.2%	33.4%	25.0%	24.9%
Income before income taxes	24.5%	80.9%	11.6%	1.1%	22.2%	23.6%	17.5%	26.8%	34.5%	25.7%	25.9%
Net income	30.8%	85.1%	7.9%	-1.6%	20.1%	21.9%	12.7%	27.5%	34.5%	25.7%	24.7%
EPS - Diluted	30.8%	84.3%	7.7%	-1.3%	20.6%	21.9%	13.1%	27.5%	34.5%	25.7%	24.9%
Average diluted shares outstanding	0.0%	0.4%	0.2%	-0.3%	-0.4%	-0.1%	-0.3%	0.0%	0.0%	0.0%	-0.1%
EBITDA	26.8%	71.8%	11.6%	3.0%	20.9%	22.5%	16.7%	23.3%	30.1%	23.4%	23.3%
Transaction-based expenses	18.4%	9.4%	18.0%	21.4%	18.9%	17.0%	24.5%	29.4%	26.8%	26.9%	26.9%
Non-transaction-based expenses	16.8%	31.3%	26.7%	15.1%	15.4%	21.4%	11.2%	14.8%	17.6%	12.9%	14.1%
Percent of net revenues											
Transaction expense	37.0%	37.7%	40.5%	40.8%	39.5%	39.6%	39.7%	40.4%	41.2%	41.0%	40.6%
Transaction and loan loss expense	8.1%	4.5%	2.7%	5.3%	4.7%	4.3%	4.7%	4.7%	5.3%	4.9%	4.9%
Customer support and operations	7.1%	7.1%	7.1%	7.1%	7.0%	7.1%	6.8%	6.8%	6.7%	6.6%	6.7%
Sales and marketing	7.0%	8.3%	8.6%	8.2%	8.7%	8.5%	7.6%	7.6%	7.6%	8.0%	7.7%
Technology and development	8.6%	8.4%	8.5%	8.4%	8.4%	8.4%	8.1%	8.1%	8.0%	7.9%	8.0%
General and administrative	7.1%	6.2%	6.1%	6.0%	6.3%	6.2%	5.7%	5.6%	5.5%	5.6%	5.6%
Total operating expenses	74.9%	72.3%	73.5%	75.8%	74.6%	74.1%	72.6%	73.2%	74.3%	74.0%	73.6%
Transaction-based expenses	45.1%	42.2%	43.2%	46.1%	44.2%	43.9%	44.4%	45.1%	46.5%	45.9%	45.5%
Non-transaction-based expenses	29.8%	30.0%	30.3%	29.7%	30.4%	30.1%	28.2%	28.1%	27.8%	28.1%	28.0%
Margin analysis											
Operating income	25.1%	27.7%	26.5%	24.2%	25.4%	25.9%	27.4%	26.8%	25.7%	26.0%	26.4%
Income before income taxes	24.4%	26.9%	25.5%	23.4%	24.7%	25.1%	26.7%	26.1%	25.1%	25.4%	25.8%
Net income	21.5%	24.1%	21.8%	20.1%	21.2%	21.8%	23.0%	22.5%	21.5%	21.9%	22.2%
EBITDA	28.6%	30.9%	29.8%	27.6%	28.4%	29.2%	30.5%	29.7%	28.6%	28.7%	29.3%

Source: Company reports and Wells Fargo Securities, LLC estimates

Price Target Basis and Risk

Price Target for PYPL: \$350.00 from NC

Our \$350 price target implies PYPL trades at about 22x our 2022E revenue, net of transaction expense. This represents about 0.9x our 2020-2025E revenue CAGR of 23%. While this is at the upper-end of its high-growth FinTech and software peers, we believe it is justified given our confidence in the strength and durability of PYPL's organic growth profile.

Risk for PYPL

Potential risks to our estimates, price target and rating include: (1) increased competition; (2) an increase in funding costs; (3) increased regulatory scrutiny; and (4) a security breach.

Investment Thesis

PYPL

We rate shares of PYPL Overweight. Given the strength of PYPL's competitive position and the significant tailwinds behind global e-commerce, we believe the company is in a position to generate attractive earnings and free cash flow growth for a sustained period of time. Although traditional valuation multiples may appear somewhat expensive on a near-term basis, when judged against the potential durability of PYPL's growth opportunities, we believe they are reasonable.

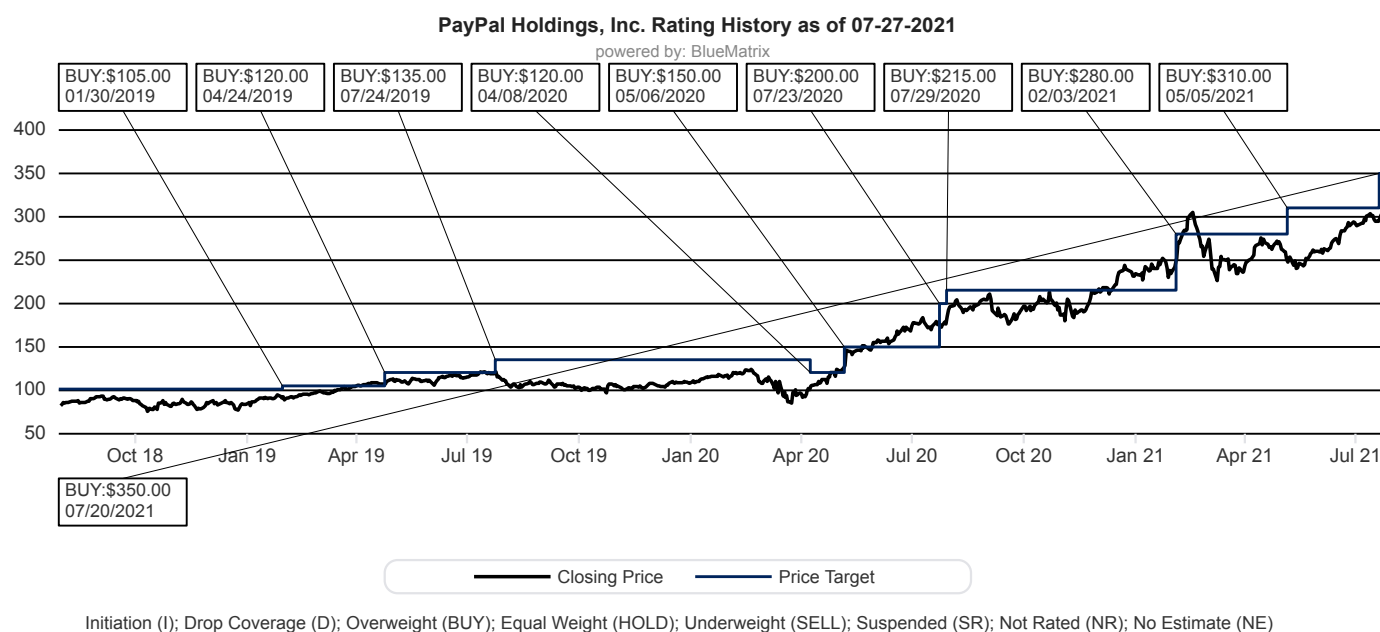
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2=Equal Weight: Total return on stock expected to be 0-10% over the next 12 months. HOLD

3=Underweight: Total return on stock expected to lag the Overweight- and Equal Weight-rated stocks within the analyst's coverage universe over the next 12 months. SELL

As of July 28, 2021

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