PayPal

Portfolio Management

Equity Portfolio: Bottom-Up Approach

By: Ikaum Bawa

PayPal Holdings operates as a technology platform and digital payments company that enables digital and mobile payments on behalf of consumers and merchants worldwide. The company had 267 million active accounts at the end of 2018, including 22 million merchant accounts. The company also owns Xoom, an international money transfer business, and Venmo, a person-to-person payment platform. Its payment solutions include PayPal, PayPal Credit, Braintree, Venmo, Xoom, and iZettle products.

The company's payments platform allows consumers to send and receive payments, withdraw funds to their bank accounts, and hold balances in their PayPal accounts in various currencies. It also offers gateway services that enable merchants to accept payments online with credit or debit cards, as well as digita l wallets.

PayPal Holdings, Inc. was founded in 1998 and is headquartered in San Jose, California. PayPal was spun off from eBay in 2015 and provides electronic payment solutions to merchants and consumers, with a focus on online transactions.

Forecasted data ranges from 2014 to 2022

Revenue

- Revenue: Paypal's revenue has grown an average of 17.3% per year over the past five years. During this time, PayPal's revenue growth has been consistent, with the smallest revenue growth coming from 2014 to 2015 (15.2%) and the largest revenue growth coming from 2016 to 2017 (20.8%). In the next 3 years, forecast predicts PayPal's revenue to grow 17.6%, annually. This projected revenue growth is slightly higher than PayPal's average revenue growth in the past 5 years but makes sense given PayPal's growth trajectory in the past 3 years.

Turnover Ratios

- Days Sales Outstanding: is a measure of the average number of days that it takes a company to collect payment after a sale has been made. Over the past 5 years, PayPal's DSO has averaged 11.9; however in the next 3 years, PayPal's forecasted DSO is 7.6, each year.
- Days Inventory Outstanding: This metric is used to measure the average number of days a company holds inventory before selling it. For PayPal, this metric is 0 days because it is a service based company.

- Days Payment Outstanding: is an efficiency ratio that measures the average number of days a company takes to pay its suppliers. Over the past 5 years, PayPal has had a Days Payment Outstanding around 350, always greater than the number of sales days. In the next 3 years, PayPal predicts its Days Payment Outstanding to rise to near 700 and to remain greater than sales days.
- Cash Conversion Cycle: PayPal's Cash Conversion Cycle has averaged -351 over the past five years. In the next 3 years, the company's Cash Conversion Cycle is expected to be nearly -690 per year. This is promising for PayPal because the more negative this metric is, the better for the company.
- Asset Turnover: Historical asset turnover for PayPal, over the past five years, has been consistently 0.3 or 0.4. The forecasted asset turnover for each of the next three years is 0.3, this forecasted asset turnover is strong.

Financial Leverage: refers to the use of debt to acquire additional assets. The use of financial leverage to control a greater amount of assets (by borrowing money) will cause the returns on the owner's cash investment to be amplified. Over the past 5 years, PayPal has had an average Financial leverage of 2.7%. In the next 3 years, PayPal is forecasted to have a Financial Leverage of 3.8% each year, noticeably higher than the 2.7% average over the previous 5 years

Debt Ratios

- Debt Ratio: is a financial ratio that indicates the percentage of a company's assets that are provided via debt. Over the past 5 years, PayPal's average debt ratio has been 4%.However, in the coming 3 years the company's debt ratio is expected to be between 8-9% each year. While the rising Debt Ratio is not great, PayPal still, even with an 8- 9% Debt Ratio, is in great shape.
- Capacity to Service Debt: PayPal has had a strong Capacity to Service Debt for each year after 2014. The company is expected to still have a strong Capacity to Service Debt in each of the next three years.
- Effective Debt Cost: A company's cost of debt is the effective interest rate a company pays on its debt obligations, including bonds, mortgages, and any other forms of debt the company may have. Over the past 5 years, PayPal has had a low Effective Debt Cost, well below the average benchmark of 5% each year. PayPal is forecasted to continue having a low Effective Debt Cost over the next three years, too.

ROA and ROE

- Return on Equity Dupont: In the past 5 years, PayPal's average ROE Dupont has been 10%. The company has a forecasted ROE Dupont of 14%, in the next three years. Which is below the benchmark of industry average of 15%
- Return on Assets: In the past 5 years, PayPal's ROA has averaged 5.2%, and the company is forecasted to have a ROA of 5% in the next 3 years.
- EV/EBITDA: From 2016 to 2019, PayPal's EV/EBITDA has averaged 25.6%. In the coming three years, the forecast projects PayPal's EV/EBITDA to average 24.2.
- Price to Earnings: The price-earnings ratio, helps one understand company's share price to the company's earnings per share. Currently, Paypal's PE ratio is 50.28.
- Price to book value: The price to Book Value ratio, also known as P/BV ratio, is the ratio of a company's market cap to the company's book value of equity. Currently, Paypal's PBV ratio is 6.5. The book value of Paypal is projected to increase from $16,929 million to $19,769 million in 2020, which will lead to a decrease in the P/BV ratio from 6.5 to 5.5.

Conclusion

Based on the analysis, I would not invest in PayPal as the companies forecasted Liquidity Ratios are weak and worrisome for the future of the company. The Current Ratio, Treasury Ratio, and Shareholders Equity/Total Liabilities do not look promising at all and are extremely weak compared to the industry average.

PayPal now has a much higher PE Multiple, EV/EBITDA ratio than it has historically had. Both PayPal's current PE ratio and EV/EBITDA are significantly higher than other competitors in the industry, such as Visa, MasterCard, and Discovery, suggesting that PayPal currently is an overvalued security as companies like Visa and MasterCard have much stronger fundamentals than PayPal.

While PayPal's Margin Ratios and Net Profit/Revenues are somewhat strong, forecasted EBITDA Margin is still weak compared to the industry average. PayPal's Turnover Ratios, Financial Leverage, and Debt Quality Ratios are strong; as the company does not have a lot of debt and should be able to repay the debt easily.

However, PayPal's Self Financing Ratios, Return of Assets, and Return on Equity are rather worrying as PayPal's expected ROA is not going to be greater than 6% in the next three years. The low ROA suggests that PayPal may have already peaked its growth and expansion and is now unable to reap some of the same returns it had achieved in the past. PayPal's forecasted Return on Equity over the next three years, while not horrible, is also not super promising, as it falls below the benchmark of 15%.

After analyzing these ratios, we believe that we should not invest in PayPal. Several of the ratios suggest that PayPal is currently overvalued and may have already experienced its glory days of growth

References

https://investor.paypal-corp.com/