

PayPal: A High-Growth Play in the Digital Payments Space








PayPal (PYPL) is a market leading digital payments and commerce platform that has a powerful brand name, a well-diversified portfolio of offerings, strong partnerships and a massive total addressable market (TAM) opportunity. Furthermore, the company generates robust free cash flow to support ongoing growth. We believe PayPal will continue to grow rapidly for multiple years and expect it will also command a reasonably higher valuation multiple. This report reviews the health of the business, growth prospects, valuation, risks and concludes with our opinion on why long-term growth-oriented investors may want to consider the shares.

Overview

PayPal Holdings (Nasdaq: PYPL) is a digital payments company and a technology platform that enables digital and mobile payments on behalf of consumers and merchants worldwide. The company facilitates digital payments through its proprietary payment platforms, including the core PayPal, PayPal Credit, Braintree, Venmo, Xoom, Zettle and Hyperwallet products and services; person-to-person (P2P) payments through PayPal, Venmo and Xoom; and offers personalized shopping experiences for consumers through the Honey Platform. The following is a snapshot of the PayPal family of brands.

Key Takeaways:

- Strong competitive positioning
- Massive TAM
- Robust FCF generation
- Multiple growth levers - growing adoption of digital payments, acquisitions, product and geographic expansion

Brand	Description
	A mobile peer to peer payments app.
 <small>A PayPal Service</small>	A platform for fast, easy and secure international funds transfer.
 <small>A PayPal Service</small>	A full-stack payments platform to accept payments in a merchant's app or website.
 <small>by PayPal</small>	Solutions for small businesses to accept payments, ease day-to-day management and get funding.
 <small>A PayPal Service</small>	A full-stack payout platform that improves PayPal's mass payment capabilities for fast-growth global platforms and ecommerce marketplaces.
 <small>by PayPal</small>	A shopping rewards platform that automatically finds and applies coupon codes for users as they shop on select sites.
 <small>A PayPal Service</small>	A fraud protection and risk management platform for global businesses.

As of 2Q21, PayPal had 403 million active accounts, including 32 million active merchant accounts, on its platform. It processed more than \$1.1 trillion of total payment volume (TPV) and generated \$23.8 billion in revenues in the last twelve months to June 2021 (2020 revenues were \$21.5 billion). The company conducts its operations in more than 200 countries around the globe - the US and UK are its two largest geographies, accounting for 51% and 11% of its revenues.

Compelling, Two-Sided Network

Through a continuous focus on research and development and an aggressive approach to acquiring companies (that fit into its portfolio of offerings), PayPal has built a compelling two-sided network of end-to-end product offerings that enables it to offer a compelling value proposition to consumers and merchants alike. This is unlike most digital payments companies that cater to either the consumer or the merchant.

Our Two-sided Platform Serves Merchants and Consumers



Source: [PayPal 2020 Annual Report](#)

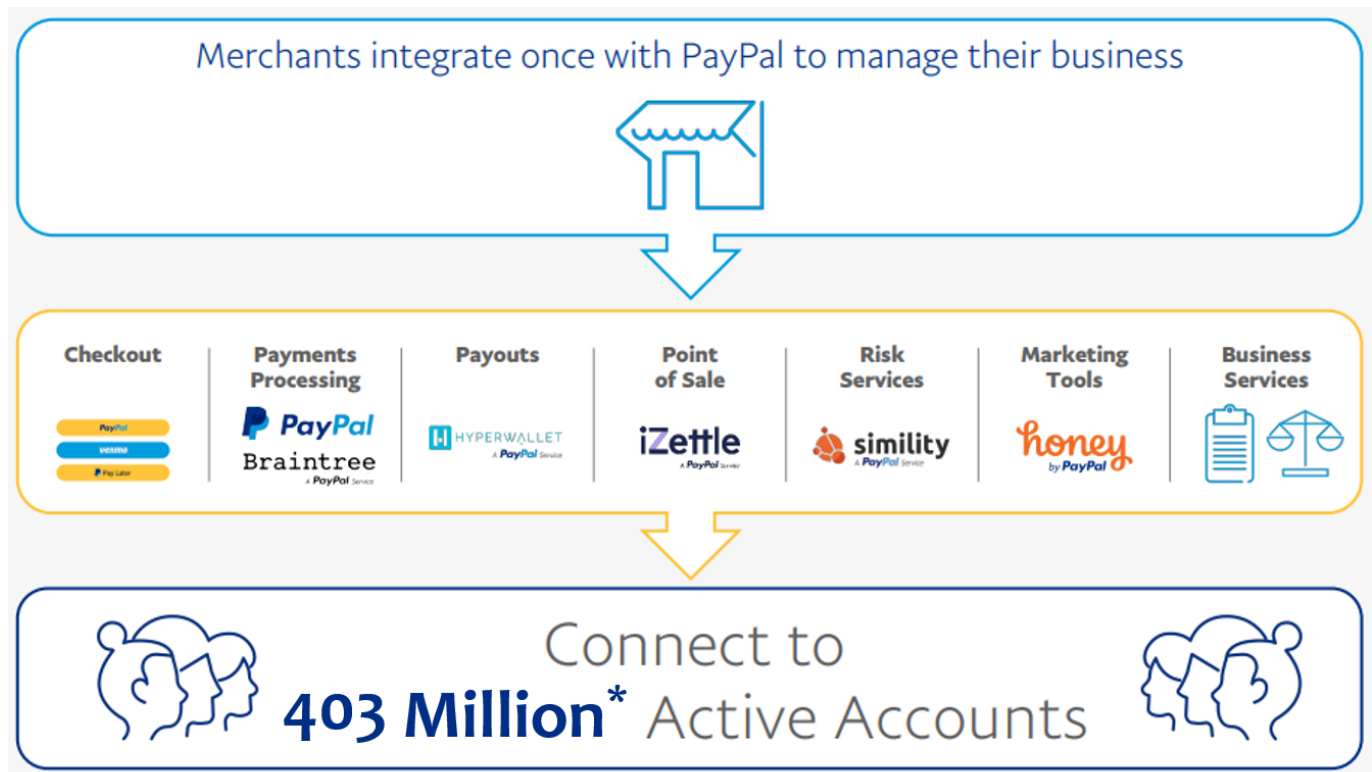
Consumers use PayPal's solutions to fulfill a variety of their digital, mobile and in-store payment needs. This includes safely sending payments for online and offline purchases to merchants using a variety of funding sources (such as bank account, PayPal Cash or Cash Plus account balance, Venmo account

balance, consumer credit products, debit or credit cards, or other stored value products such as coupons, gift cards and eligible credit card rewards), as well as domestic and international P2P fund transfers. Consumers in certain markets such as the US, UK, France and Germany also have access to PayPal

Credit products, which they can use as potential funding source for payments at checkout. The Credit products allow the company to increase engagement with consumers and merchants on its two-sided network.

Merchants, on the other hand, get access to a fully integrated omni-channel digital commerce experience. The platform powers all aspects of a merchants' digital checkout capability, and as it employs a technology

and platform-agnostic approach, merchants of all sizes can easily provide digital checkout online, on mobile devices and in-store across all platforms and devices, and can securely receive payments from their customers. Merchants also benefit from other helpful tools and services such as access to credit solutions, fraud prevention and risk management solutions, proprietary protection programs against losses, and data analytics that help them attract new customers and improve sales conversions.



* Updated to reflect the most recent number of active accounts
Source: [Investor Day Presentation, 2021](#)

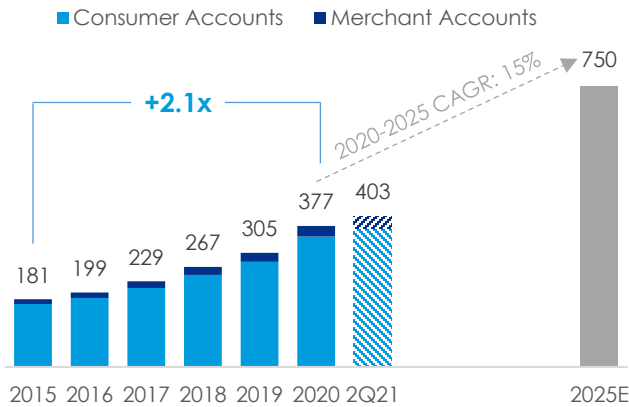
Having such a two-sided network brings in immense benefits to PayPal, of which the most important is the visibility that the company has over both parties in every transaction. This enables PayPal to gain critical insights into both the demand side of consumers and the supply side of merchants,

and it helps PayPal cross sell a-number-of products and services by matching their individual needs. Further, having millions of users on both the sides of the network creates a magnetic effect of attracting even more new consumers and new merchants on the platform, making it all the more valuable. For

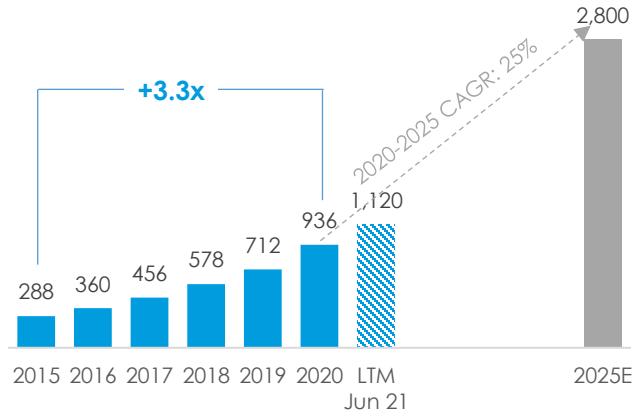
that matter, the number of active users, both consumers and merchants, as well as the TPV on PayPal's platform has grown at a staggering pace over the years, and are

expected keep up the pace of growth in the future, as we can see from the following charts.

Active Accounts (Millions)



TPV (\$ Billions)

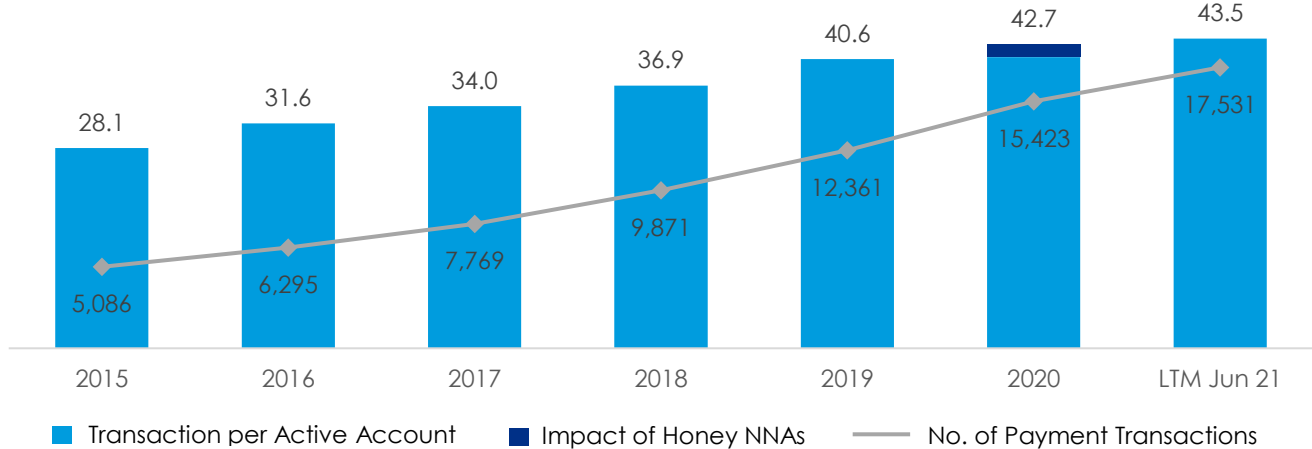


Source: [Investor Day Presentation, 2021](#), [2Q21 10Q](#)

Worth noting, the number of payment transactions per active account has also continued to increase, showcasing the

enhanced levels of customer engagement on PayPal's platform (all as a result of the platform's strong value proposition).

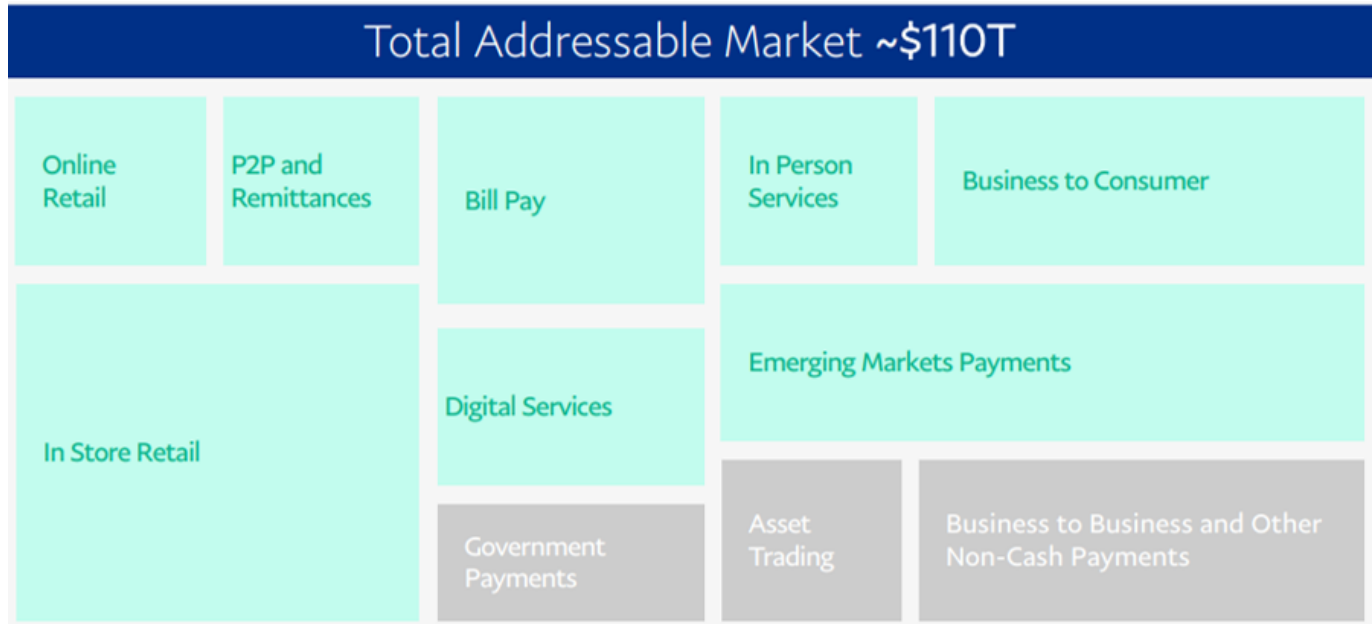
Growing Customer Engagement



Source: [Investor Day Presentation, 2021](#), [2Q21 10Q](#)

Massive TAM, Robust Growth Roadmap

PayPal estimates that it has a massive Total Addressable Market (TAM) opportunity of ~\$110 trillion in TPV, spread across a broad spectrum of service areas, including online and in-store retail, P2P, B2C, etc.



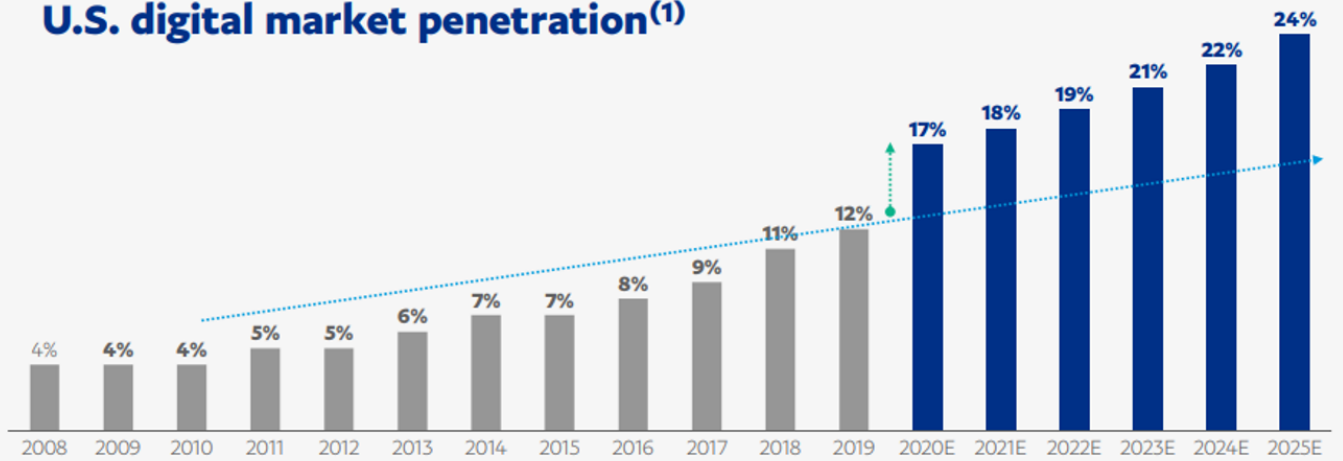
Source: [Investor Day Presentation, 2021](#)

The growth of e-commerce and the increasing merchant adoption of new modes of payments such as e-wallets, QR codes and mobile apps, have caused the use of cash to decline steadily over the past decade. This trend was further accelerated in 2020 (as we can see from the chart below)

as the COVID-19 pandemic advanced digital penetration by a few years and caused an unprecedented increase in online spending. PayPal, with its technology, massive scale and brand image has been at the forefront of cashing in on this trend.

Secular tailwinds accelerated in 2020 by 3-5 years

U.S. digital market penetration⁽¹⁾



Source: [Investor Day Presentation, 2021](#)

Looking ahead, PayPal has a number of opportunities to keep benefiting from the aforementioned secular trend and to grow in its massive market to keep its robust growth intact. Driving the longer-term growth would be the consumer super app, through which PayPal aims to offer a host of consumer services under one roof, beyond just mobile payments. To name a few, these would include basic consumer financial services such as high-yield savings, bill pay, subscription management, budgeting tool sets, and direct deposit capabilities, to name a few.; enhanced commerce facilities for merchants; as well as crypto support, subscription management, and buy now, pay later (BNPL) functionality.

Venmo, PayPal's P2P payments app, which currently accounts for only under 4% of the company's total revenues, has been rapidly evolving into a multifaceted platform with the introduction of a number of new offerings such as credit card, business card, as well as share and crypto trading. Venmo primarily targets the millennial population and already

has a high market share of this demographic area. As it becomes the digital wallet of the future, it has immense opportunities to monetize the new functionalities, and have a higher share in PayPal's total revenues and contribute more to the bottom line in the future. At the [Bank of America Merrill Lynch 2021 Global Technology Conference](#), the company's CEO Dan Schulman pointed out:

“Venmo is like a nascent PayPal of like 5 or 6 years ago. If you look at a TPV annualized of Venmo and you look at the TPV of PayPal 5 or 6 years ago, they are equivalent. And the ability to monetize that user base, that growth rate is so exciting for us. I mean, we are just scratching the surface right now.”

Pay-in-4, PayPal's BNPL product, which lets consumers pay for any item priced between \$30 and \$600 in four installments in six weeks, without interest, is another offering that provides immense growth opportunities for PayPal, partly due to the sheer number of users on PayPal's platform. Since its initial launch in mid-2020, 650k merchants and 7

million consumers have taken part in more than 20 million BNPL transactions, generating ~\$3.5 billion of TPV for the company.

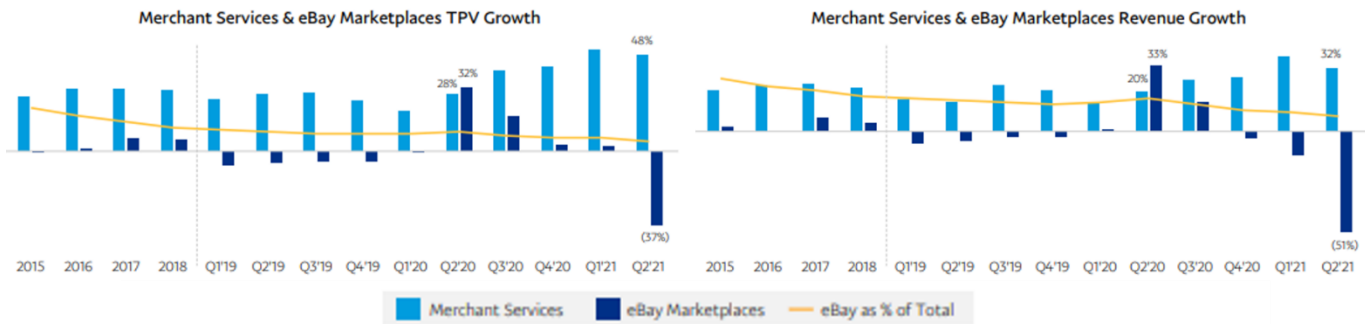
To further bolster its BNPL offering, PayPal recently [announced the acquisition of Paidy](#), a pioneer of buy now, pay later in Japan, for \$2.7 billion. The acquisition puts PayPal in a very strong position to capture additional market share in this evolving space, while also expanding PayPal's capabilities, distribution and relevance in the domestic payments market in Japan, the third largest ecommerce market in the world. Paidy already has over six million registered users, more than 700K merchants, and is accepted by most e-commerce sites including Amazon, Shopify and Rakuten in Japan.

Additionally, PayPal is the first foreign payments company to 100% own domestic payments license inside China. It has already built productive relationships with financial institutions and players inside China, such as China Post, China UnionPay, some of the banks, as well as with tech companies such as Alibaba (BABA). Given the sheer volume of e-commerce in China, PayPal has an immense growth opportunity in the largest retail market in the world.

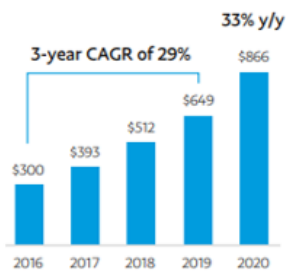
e-Bay Migration a Long-Anticipated One-Off Negative Impact, Core Growth Metrics and Margins on Track

The e-Bay marketplace is exiting from the PayPal platform as it has been migrating to its own payment solutions, with Adyen as its primary payments processing partner. PayPal stopped serving the e-Bay marketplaces during 2Q21, and has now become just one of the payment options on e-Bay. While PayPal has always accounted for the impact of the loss of business from e-bay, the loss was larger than anticipated during 2Q21 (e-bay had ~8 percentage point headwind on 2Q21 revenue growth). Even the outlook for the next quarter is pointing towards a deceleration in revenue growth - e-Bay is expected to have a meaningful 8.5 percentage point headwind to revenue growth in 3Q21.

Nonetheless, the company's core growth metrics remain strong, as it raised its TPV growth outlook for 2021 to 33% to 35%, and continues to expect a robust 20% revenue growth in 2021 (despite ~7 percentage point headwind to revenue growth from e-Bay). For that matter, the TPV from e-Bay is now under 4% of PayPal's total TPV vs. over 17% in 2016, and is expected to fall to less than 3% by the end of the year. Given the already low volumes, any further declines in volumes, if at all, will have minimal impact on PayPal's revenues. Also worth noting, e-Bay has been a drag on PayPal's growth historically, as shown by the following charts.



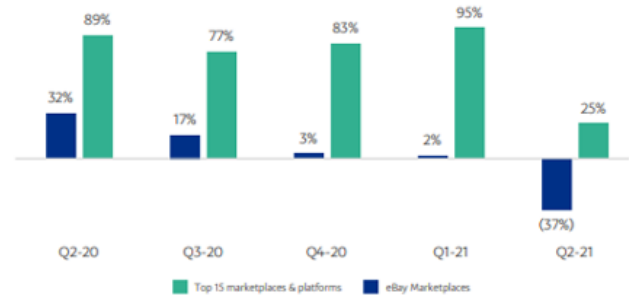
Merchant Services TPV (\$B)



eBay Marketplaces TPV (\$B)



Top 15 marketplaces and platforms TPV growth vs. eBay Marketplaces TPV growth



Source: [2Q21 Investor Presentation](#)

On the margin front, migration from e-Bay has had a positive impact on the operating margins, as noted by management in [2Q21 earnings call](#):

“As eBay’s contribution to our revenue declined from 22% to 13%, we’ve expanded our operating margin 500 basis points given the accelerated pace of migration in 2021. There is a more pronounced effect on our operating margin and earnings growth profile this year.”

Going forward, PayPal continues to expect flat to marginal improvements in its operating margins, as investing for growth remains its key focus area.

“We said this year that we expect to have flat, maybe some marginal improvement in our margins. But as we noted at our Investor Day earlier this year, our margins will go up over

time, but we want to invest for growth and invest to be that leading digital company, payments company that we know we can be.”

Solid Balance Sheet, Robust Free Cash Flows

PayPal has a solid balance sheet with \$19.4 billion of cash and \$8.9 billion long-term debt as of the end of 2Q21. Despite the headwinds from the loss of e-Bay business, it continues to expect to generate more than \$5 billion in free cash flows in 2021, and double it to \$10 billion in 2025. This strong financial position allows it to not only invest incrementally to become an integrated platform in digital commerce, but also to pursue acquisitions that nicely fit into its business model. It also uses its solid cash position to return capital to shareholders in

the form of share buybacks. In fact, it has returned over \$10 billion in capital to

shareholders since its separation from e-Bay in 2015.

Capital Allocation (\$B)



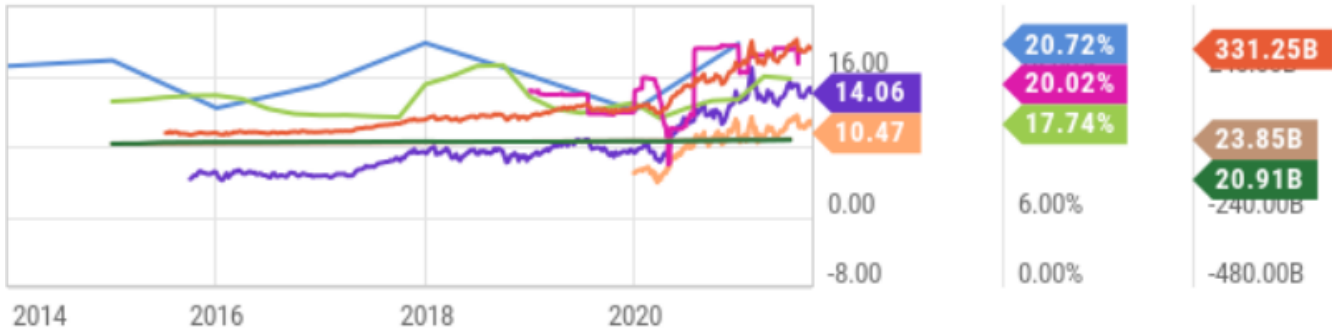
Source: [2Q21 Investor Presentation](#)

Valuation

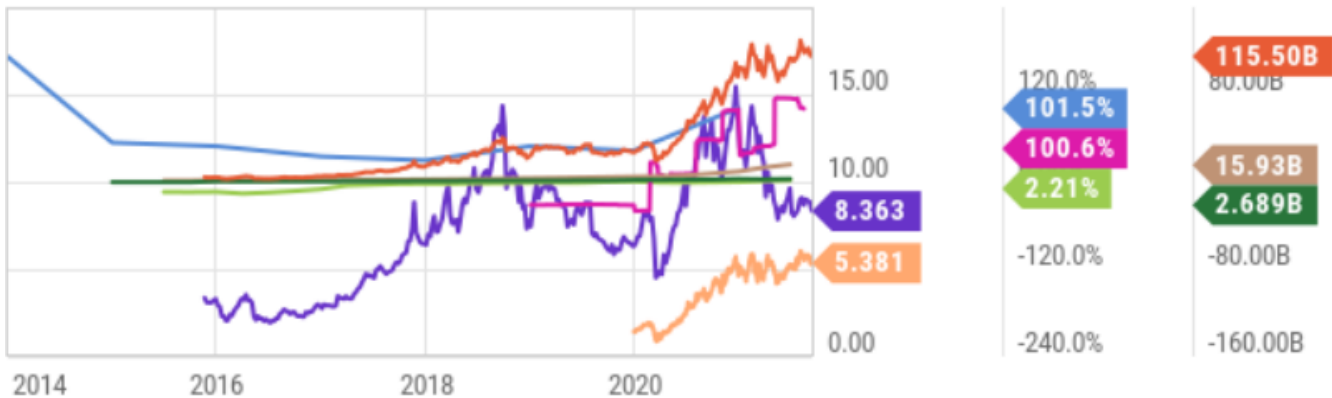
PayPal currently trades at 10.5x forward sales, which we view as very reasonable as compared to its long-term high-growth opportunities.

For comparison, we have compared PayPal to another attractive digital payments company, Square (SQ), as you can see in the following charts.

- PayPal Holdings Inc PS Ratio
- PayPal Holdings Inc PS Ratio (Forward 1y)
- PayPal Holdings Inc Revenue (Annual YoY Growth)
- PayPal Holdings Inc Operating Margin (TTM)
- PayPal Holdings Inc Revenue Growth Estimate for Current Fiscal Year
- PayPal Holdings Inc Revenue (TTM)
- PayPal Holdings Inc Book Value (Quarterly)
- PayPal Holdings Inc Market Cap



- Square Inc PS Ratio
- Square Inc PS Ratio (Forward 1y)
- Square Inc Revenue (Annual YoY Growth)
- Square Inc Operating Margin (TTM)
- Square Inc Revenue Growth Estimate for Current Fiscal Year
- Square Inc Revenue (TTM)
- Square Inc Book Value (Quarterly)
- Square Inc Market Cap



Both stocks are attractive, but PayPal is the more established player with higher margins (especially after the change in eBay business), higher book value and revenues and market cap.

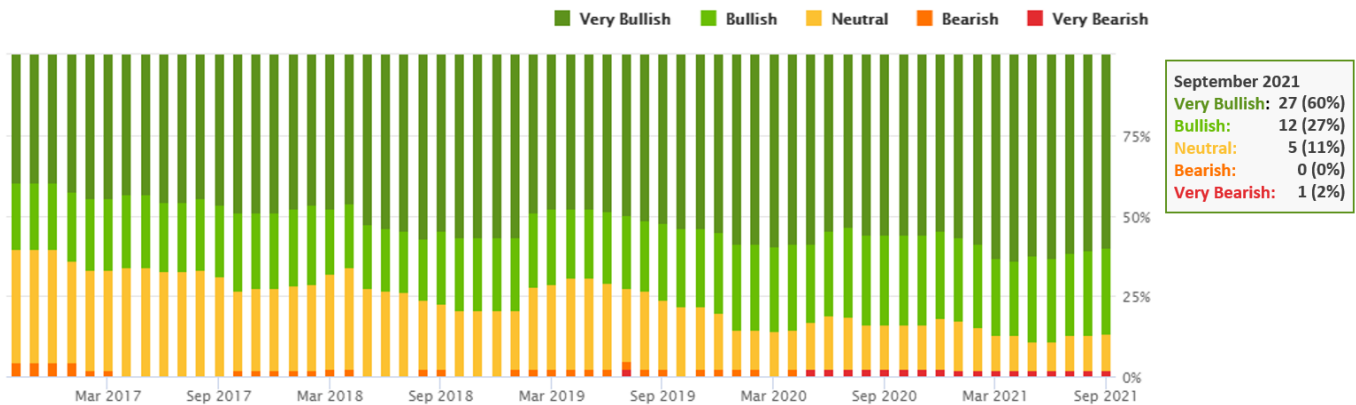
Like many tech stocks, PayPal experienced a price surge over the past eighteen months. And after relatively subdued performance in 2Q21 (due e-Bay headwinds), its share price still sits below previous highs.



Source: Yahoo Finance

Wall street analysts also have a bullish outlook on PayPal, with 87% assigning it a buy or an equivalent rating. The Street's consensus

price target of \$330 represents ~14% upside potential from the current price.



Source: Seeking Alpha

Risks

Competition: PayPal faces fierce competition from a number of companies in the global payments industry, including established large tech conglomerates such as Google (GOOGL), Apple (AAPL), Amazon (AMZN), and Facebook (FB), as well as from

digital payment tech companies like Square (SQ) and Stripe (private) to name a few. Despite the competition, PayPal enjoys a strong competitive position due to its massive scale of operations focused on online payments and digital wallets, plus its strong financial profile.

Extensive Government Regulations and Oversight: Given the nature and geographic reach of PayPal's business, it is subject to complex regulatory requirements, including for banking, credit, deposit taking, cross-border and domestic money transmission, digital payments, cryptocurrency, data protection and AML. Any failure to comply with the laws and regulations may subject it to significant fines and penalties.

Risks from Credit Products: As PayPal offers various credit products to a wide range of consumers and merchants in a number of geographies, it is exposed to the risk of default. Should some of the consumers/merchants default on payment, PayPal's revenues and profits would be negatively impacted.

Conclusion

PayPal is a strong business with a powerful brand name, well-diversified portfolio of offerings, strong partnerships and a massive addressable market. It generates robust free cash flows that not only supports its growth investments, but also enables it to acquire companies that fit in its portfolio in order to gain market share in new geographies. We believe, PayPal will continue to grow at a rapid pace, given the tremendous growth opportunities it has in the next few years and should command a reasonably higher valuation multiple. Long-term, growth-oriented investors may want to consider owning shares of this attractive secular growth business.