Seeking Alpha α

Short Ideas | Financials

PayPal Holdings: Buying This Dip Will Make You Pay Pal

Dec. 14, 2021 10:27 AM ET | **PayPal Holdings, Inc. (PYPL)** | MA, V | 94 Comments | 10 Likes

Summary

- PayPal Holdings has demonstrated weak returns on invested capital in 2021 relative to their peers.
- The company is currently trading at 53 times its GAAP forward earnings making shares egregiously over-priced.
- I believe that PayPal's FCF calculation is not a fair representation with transaction and credit losses being added to the company's cashflow.
- Advancement in financial technology will begin to reduce the benefit of PayPal's value proposition.

JasonDoiy/iStock Unreleased via Getty Images

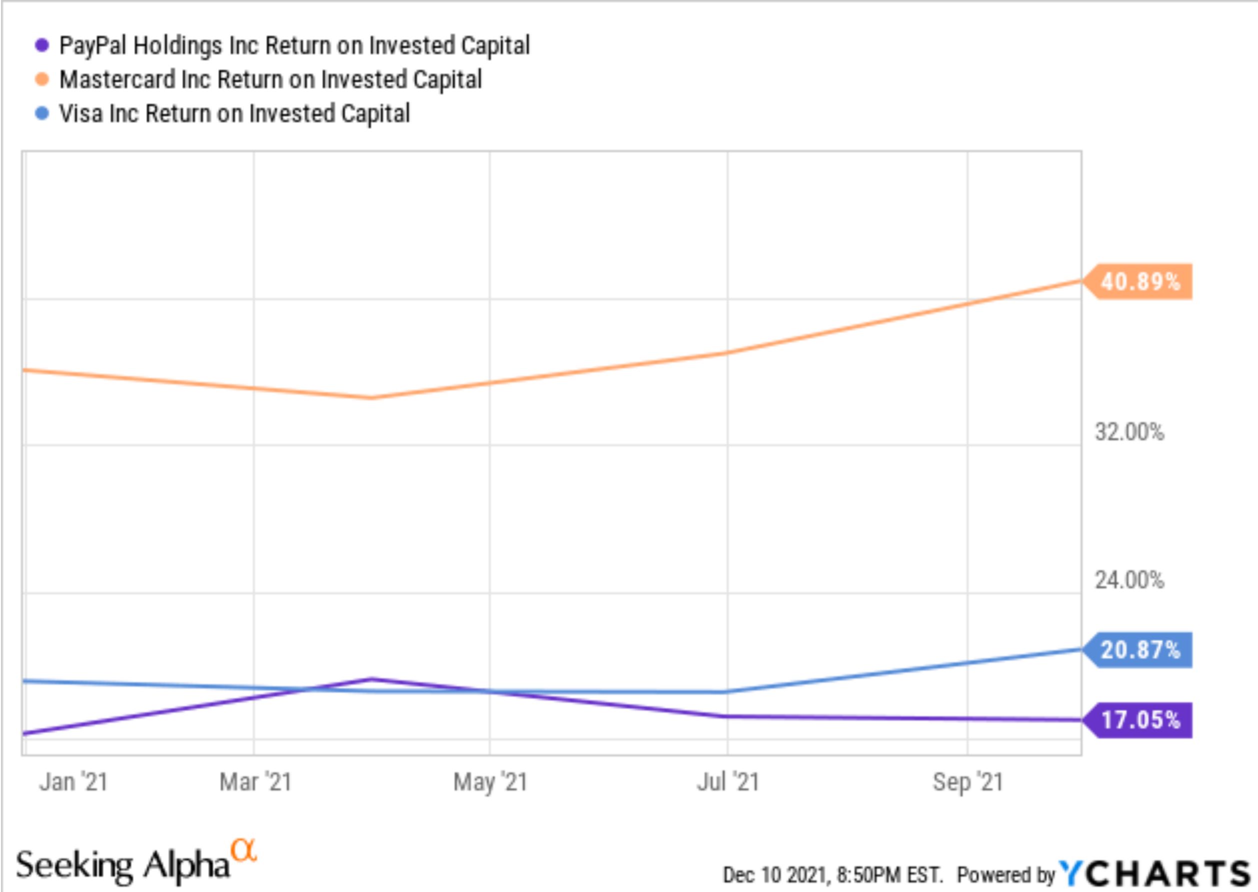
Investment Thesis

PayPal Holdings (PYPL), the household online payment firm with around 416 million active merchant accounts is currently gaining investors attention after sliding 30% over the last 6 months. The stock is extremely popular amongst American investors as approximately 245 hedge funds have it in their top 10 holdings. That being said, despite the large institutions and Wall Street's optimism around the stock, I fail to see what the majority of analysts see in PayPal. To begin with, despite the company's stock sliding 30% over the last 6 months, PayPal is still trading at a GAAP forward Price-to-earnings multiple of 53. Secondly, the company has had poor performance when looking at their return on invested capital. Thirdly, PayPal's FCF calculations in my opinion are inaccurate to the actual volume of cash the company is bringing in. Lastly, PayPal's business model appears to be fizzling out as India's FinTech expansion has shown that a transaction middleman is becoming increasingly redundant.

Data by YCharts

PayPal's Underperformance

In order for me to come to the conclusion that PayPal has under-performed this year, I had compared the returns on invested capital of PayPal versus peers Visa Inc (NYSE:V) and Mastercard Inc (NYSE:MA). The return on invested capital is a key metric measuring how well management is at deploying their capital profitably. The following are the three companies current ROIC.



Data by YCharts

One of the main reasons why Visa and Mastercard has and will continue to outperform PayPal in returns on invested capital is because their business models are much less risky. Visa and Mastercard are just payment processors who pass on any additional risks to retailers and banks, whereas PayPal has to endure the risk of a merchant either defaulting or not making a payment. That additional risk PayPal is forced to endure leads to transaction and credit losses which hurts their profitability. This ultimately gives PayPal's competitors a competitive advantage when looking through the lens of an investor.

Transaction And Credit Losses

From my perspective, the method in which is used to calculate PayPal's cashflows comes with some misrepresentations. The big problem with PayPal's FCF calculation is that they are able to add back all of their transaction and credit losses back onto their cashflow statement. This made up around 30% of PayPal's operating cashflow in 2020.

	31,		
	2020	2019	2018
	(In millions)		
Cash flows from operating activities:			
Net income	$ 4,202	$ 2,459	$ 2,057
Adjustments to reconcile net income to net cash provided by operating activities:			
Transaction and credit losses	1,741	1,380	1,274
Depreciation and amortization	1,189	912	776
Stock-based compensation	1,376	1,021	853
Deferred income taxes	165	(269)	(171)
Cost basis adjustments to loans and interest receivable held for sale	—	—	244
Net gains on strategic investments	(1,914)	(208)	(87)
Other	47	(149)	(85)
Changes in assets and liabilities:			
Accounts receivable	(100)	(120)	(59)
Changes in loans and interest receivable held for sale, net	—	4	1,407
Transaction loss allowance for cash losses, net	(1,120)	(1,079)	(1,046)
Other current assets and non-current assets	(498)	(566)	(93)
Accounts payable	(4)	4	26
Income taxes payable	(230)	(40)	(44)
Other current liabilities and non-current liabilities	1,000	722	428
Net cash provided by operating activities	5,854	4,071	5,480

Source: 10-k

As you can see, these transaction and credit losses have been making up a solid chunk of PayPal's annual free cashflow. These transaction and credit losses are simple to explain. PayPal provides loans to individuals with bad credit, and should they write off those bad loans (which they're in fact doing a lot of), the losses are added back on PayPal's cashflow statement. I am of the opinion that investors should be aware of the risks involved in this and be vigilant when accounting it in your analysis. PayPal even acknowledges the risk of these bad loans in their 10-k form.

impact on our borrowing base, which is primarily comprised of small and medium-sized merchants. For additional information, see "Note 11—Loans and Interest Receivable" in the notes to the consolidated financial statements, and "Item 1A. Risk Factors—*Our credit products expose us to additional risks*." included in this Form 10-K.

For this reason, the large amount of transaction and credit losses being added back onto PayPal's cashflow statement represent additional risk and also leads me to believe that their cashflow calculation is slightly misrepresented.

Valuation

In order to compute the intrinsic value of PayPal stock, I will provide a discount cashflow model. The following is a forecast of some key data points needed to compute the calculation (all figures in millions USD).

Assumptions	
2021 Forecast EBIT	$ 4,300.00
Tax Rate	25%
Average D&A	$ 434.33
Average CapEx	$ 830.33
Transaction&Credit Losses	$ 1,700.00
Perpetural Growth Rate	3%
Discount rate	8%

Source: Authors Calculations

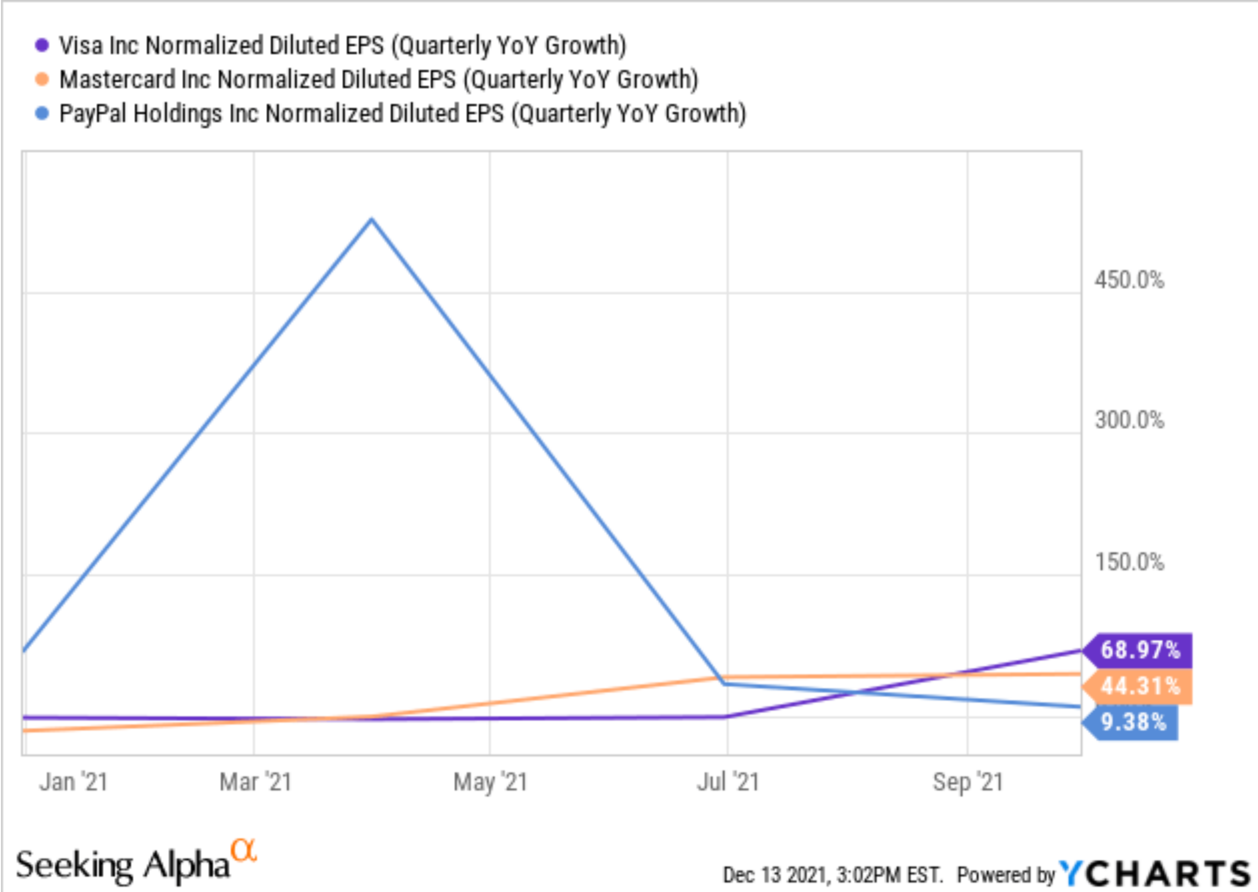
For this calculation, I will be subtracting PayPal's transaction and credit losses as I've earlier stated that they overstate the company's cashflow. Additionally, I used 3 year moving averages to forecast D&A and CapEx costs. Lastly, I chose a discount rate of 8% and a perpetual growth rate of 3%. The following is my discount cashflow model.

		4%	4%	4%	4%	
Discounted Cashflow Model		Period 1	Period 2	Period 3	Period 4	Period 5
	2021	2022	2023	2024	2025	2026
Earnings before taxes (EBT)	$ 4,300.00	$ 4,472.00	$ 4,650.88	$ 4,836.92	$ 5,030.39	$ 5,181.30
Less: Cash Taxes	$ 1,075.00	$ 1,118.00	$ 1,162.72	$ 1,209.23	$ 1,257.60	$ 1,295.33
Plus D&A	$ 434.33	$ 447.36	$ 460.78	$ 474.61	$ 488.85	$ 503.51
Capex	-	-	-	-	-	-
Less: Changes in NWC	$ 1,700.00	$ 1,717.00	$ 1,717.00	$ 1,717.00	$ 1,717.00	$ 1,717.00
Unlevered FCF	$ 1,959.33	$ 2,084.36	$ 2,231.94	$ 2,385.29	$ 2,544.64	$ 2,672.49
Terminal Value		$ 1,929.97	$ 1,913.53	$ 1,893.52	$ 1,870.39	$ 53,449.78
Enterprise Value	$ 43,984.43					
Plus Cash	13,292					
Less LT Debt	7,490					
Equity Value	$ 49,786.43					
Implied Shares outstanding	1,170					
Intrinsic Value	$ 42.55					
Share Price	$ 187.00					
Premium	77%					

My final consensus after computing my DCF model is that PayPal's intrinsic value is 77% lower than where shares are currently trading. This makes PayPal shares egregiously overvalued. Furthermore, looking deeper at PayPal's valuation using a comparable cost analysis, you can once again see by comparing the company's EV/EBITDA ratio to Visa and Mastercard, how overpriced PayPal shares are currently when compared to its peers.

Data by YCharts

I thought it would be important to add that PayPal's 1 year EPS growth rate is only about 4%, which compared to peers Visa and Mastercard is worse. Additionally, despite PayPal having a higher EV/EBITDA than both Mastercard and Visa, the company's YoY quarterly EPS growth has been lower and has shown a massive slowdown. Moreover, I don't expect PayPal's growth to pick up in the future as the industry moves away from their value proposition. The following is a chart representing quarterly YoY growth of the three companies.

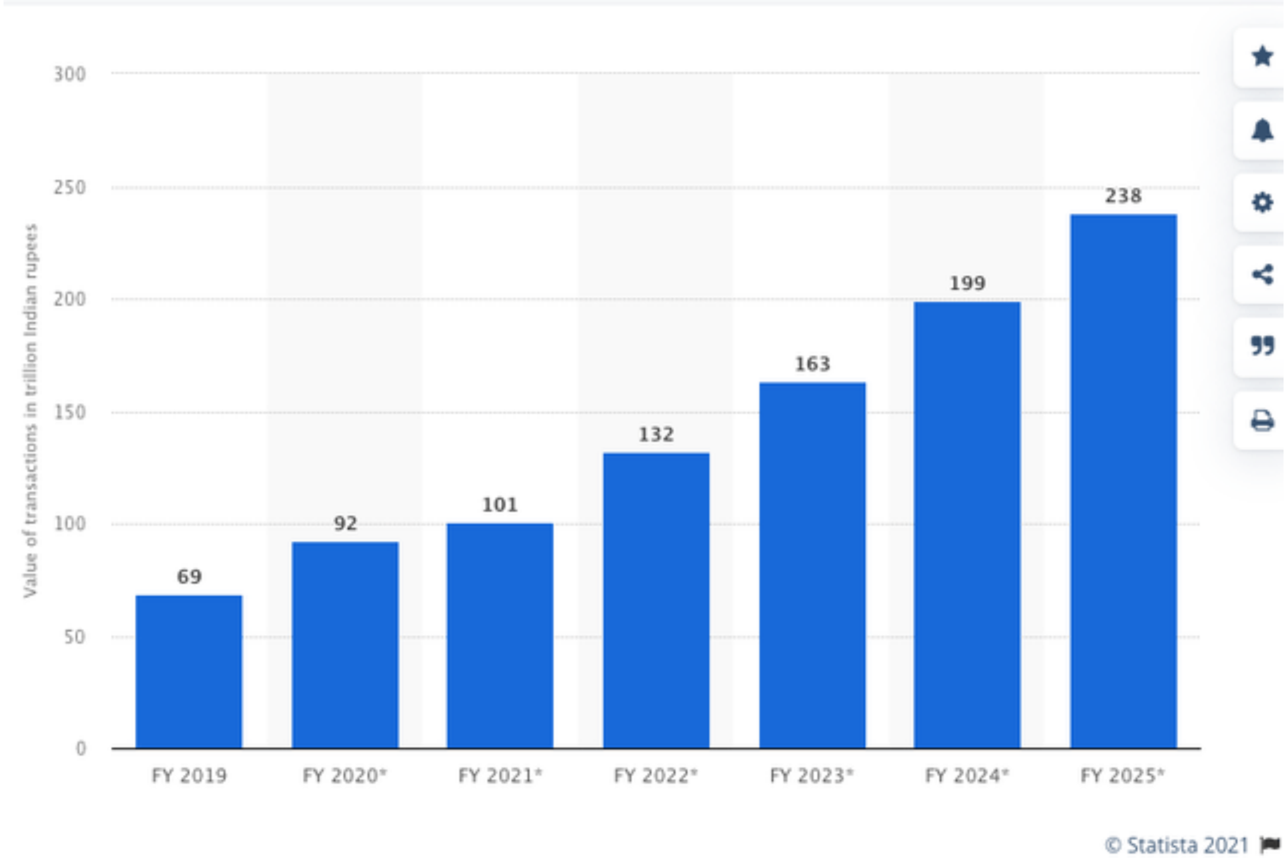


Data by YCharts

As you can see, PayPal's EV-to-EBITDA is higher, despite lower EPS growth then their two largest rivals. To conclude on PayPal's valuation, PayPal has the price of a growth stock however, the company's growth rate and growth catalyst closer resembles a retirement value stock. This further amplifies my conviction that in my opinion PayPal shares are overvalued.

FinTech Evolution Is Leaving PayPal Behind

When PayPal originally released its initial concept and value proposition, it took the world by storm as their business model was nothing others had seen before. That being said, the greatest risk PayPal faces in the future is that its clock may be ticking as banks and other new FinTech solutions change the market to where we just have bank-to-bank transactions, leaving less need for a middleman such as PayPal. You're already beginning to see this in countries such as China and now India. India specifically is set to have bank-to-bank digital payments increase rapidly over the next couple of years. The following is the forecasted dollar amount of digital payments in India in trillions of rupees.



Source: Statista

Between China and India's adoption of FinTech and digital payments, the countries are setting the stage as to where the payment market will be headed in the next couple of years. Unfortunately for PayPal, that seems to be a world without a middleman between a merchant and a bank. Mastercard and Visa don't carry this risk because both companies just process payments, leaving them to be much better alternative investments.

Why I Could Be Wrong And Final Thoughts

To conclude my bearish PayPal thesis, I would like to say that if PayPal is able to pull together a couple of decent quarters, then in the short-term I could be wrong about the stock price as Wall Street's fondness for the company could push the valuation a little bit higher. That being said, I have to say that longer-term this is definitely a position I would want to avoid. PayPal's FCF calculations in my opinion are questionable, the company is currently egregiously overpriced with little growth, and its business model could begin to be fazed out down the line. For these reasons, I believe that PayPal is poised to fall by an additional 30-40% over the next 1-2 years. As much as investors want to talk about the past performance for this company, past performance does not equate to future performance. Therefore, I have to say that if you decide to purchase some PayPal shares, I think you will certainly pay pal.

This article was written by

Alex Ponte
161 Followers

Long only, contrarian, and deep value ideas. My goal is to provide readers with insights to underpriced stocks which could yield a long-term upside. Additionally, I write about beaten up stocks in distraught se(

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Disclosure: I/we have no stock, option or similar derivative position in any of the companies mentioned, and no plans to initiate any such positions within the next 72 hours. I wrote this article myself, and it expresses my own opinions. I am not receiving compensation for it (other than from Seeking Alpha). I have no business relationship with any company whose stock is mentioned in this article.

10 Likes

94 Comments

Comments (94)

Sort by Newest

D **datakumari**
Today, 2:32 PM
Comments (1) | + Follow

Starting with Fin-tech and limiting to Visa and Mastercard is limited thinking. What about Stripe, Adyen, Square, all these other true Fin-tech players?

Reply   Like

Hopping Freights
Today, 10:36 AM
Premium Comments (559) | + Follow

Wow. This is an excellent analysis. Straight to the point and clear. PYPL bulls won't like it, but your FCF and your ROIC concerns are very valid.

Reply   Like (1)

D

Don't follow the herd

Today, 8:25 AM

Premium **Marketplace** Comments (6) | + Follow

The biggest advantage of PYPL is the trust it has garnered from customers. Many people are still wary of online payments, this trust will take time to replicate. You make some solid points and I agree it is overvalued, but it will likely remain so until this first mover advantage erodes... Long PYPL

Reply Like (1)

Hopping Freights

Today, 3:27 PM

Premium Comments (559) | + Follow

@Don't follow the herd I don't understand a need for trust. There is no liability for cardholder when a credit card is hacked. The bank merely reissues you a new card and you are good to go.

Reply Like

Trader of Orange

Today, 3:03 AM

Comments (151) | + Follow

Love the title ;-)

Reply Like

7422981

Yesterday, 5:08 PM

Comments (6.96K) | + Follow

I think the author called the bottom, even though he thought the bottom was a lot lower than we recently witnessed. The tax loss selling is peaking and PYPL looks to be heading higher.

Reply Like (5)

R

RonBJ

Yesterday, 11:32 AM

Comments (5) | + Follow

PayPal is just so utterly easy and efficient to move money safely from person to person! It literally takes seconds. It's now down but still way ahead of where I bought it.

Reply Like (2)

KingofKings

Yesterday, 10:05 AM

Comments (1.47K) | + Follow

Your thesis is flawed, big time. I lost you when you compared PYPL with MA and V. These are different sectors and businesses. Just continue your "bearish" thoughts and stay out of this leader in fintech. Long and largest position.

Reply Like (7)

Leo Imasuen

Yesterday, 9:40 AM

Contributor **Premium** Comments (1.97K) | + Follow

Award for best Seeking Alpha title of the year goes to you.

Reply Like (3)

Andres Rueda

Yesterday, 9:13 AM

Contributor Comments (2.1K) | + Follow

Paypal is a fintech dinosaur. It is a middle man where there need be none.

Reply Like (1)

---

msawi11

Yesterday, 9:31 AM

Premium Comments (519) | + Follow

@Andres Rueda for example?

Reply Like

Andres Rueda

Today, 3:50 AM

Contributor Comments (2.1K) | + Follow

@msawi11 Plain vanilla crypto.

Reply Like (1)

T

Trade-stocks-Drink-IPAs

Yesterday, 9:08 AM

Comments (104) | + Follow

Why no mention of the incredible Venmo opportunity?

Reply Like (3)

U

User 10342501

Yesterday, 8:43 AM

Premium Comments (1.52K) | + Follow

Clever headline, but please add a comma behind the last "pay"!

Reply Like (7)

Dividend Stream

Yesterday, 9:23 AM

Comments (3.16K) | + Follow

@User 10342501 This.

Reply Like

D

dcpope58

Yesterday, 8:25 AM

Comments (26) | + Follow

Interesting viewpoints from experienced investors who seem to have become a little biased in their views? It may be interesting to note that Morningstar rates PayPal a “2” star opportunity with a FMV in the $150’s per share vs. the present price in the $180’s. But also rates Paypal as a “buy”. I have never known PayPal to trade at it’s FMV or most technology companies for that matter. It’s also been years since PayPal was rated higher than a 2. The Morningstar analyst while noting their current problems, speaks highly about the growth opportunities they will report on in the next few quarters. Said another way, they are currently a below average investment unless you buy into their growth potential.

Reply Like (2)

Longbow Archer

Yesterday, 9:34 PM

Comments (1.33K) | + Follow

@dcpope58 Morningstar doesn't think Apple has a moat (narrow). Frankly they have as little credibility as any of the coke head "analysts" on the street. It ain't like the smart kids are turning down GS offers to go work at MStar.

Reply Like (1)

L

lotsamoney

Yesterday, 9:52 PM

Comments (416) | + Follow

@dcpope58 Yeah, I wouldn't make investment decisions on Morningstar reports.

Reply Like (1)

E **Elliottm346** Yesterday, 7:52 AM

Comments (54) | + Follow

Headline really needs a comma to land the joke

Reply Like (6)

mikenh Yesterday, 4:34 PM

Comments (343) | + Follow

@Elliottm346 You too educated. If you move your lips when you read, there's no problem.

Reply Like

Alex Ponte Yesterday, 7:30 AM

Contributor **Premium** Comments (59) | + Follow

Author's Reply To the people commenting saying that the transaction and credit losses are added back. I am completely aware of that, all I am saying is that there is a large portion of cashflow coming in from writing off bad debts. Just because school taught you to do it, doesn't mean it's accurate. If writing off bad debts was a real source of cashflow, we would all loan money to our friends, watch them default, and let the cashflow come in.

Reply Like (2)

L **lotsamoney** Yesterday, 9:57 PM

Comments (416) | + Follow

@Alex Ponte Your implying the non cash add back is incorrect. This is not a theoretical school thing. Example addback of depreciation is a non-cash item that was deducted from income and added back, its not a source of cash. Same as loan losses is not source of cash, its a non cash item provision, as the change in cash position is reflected in loan receivable asset, net of provsion *(edited)*

Reply Like (2)

the907man

Yesterday, 6:25 AM

Comments (2.74K) | + Follow

Paypal is a parasitic company with deplorable customer service that uses despicable tactics to screw their less intelligent customers.. They're like the paycheck loan guys of the payment industry. Similar in quality to Skype.. another worthless company.

Reply Like (4)

Joshua Hall

Yesterday, 12:12 AM

Contributor **Premium** Comments (1.76K) | + Follow

Alex,

The Transaction and Credit Losses (e.g., $1,741 for 2020) are added back to cash flow because the credit loss allowance portion is deducted from gross revenue (in other words, net revenue is after credit loss allowances) and the transaction loss portion shows up as a negative cash hit in the Transaction Loss Allowances for Cash Losses line item elsewhere in the Cash From Operations section. It is not a misrepresentation of cash flow.

Joshua

Reply Like (14)

Alex Ponte

Yesterday, 7:24 AM

Contributor **Premium** Comments (59) | + Follow

Author's Reply *@Joshua Hall* Than I'd guess we'd all a) lend money to people with bad credit. b) write off all those debts. c) Watch the cashflow pour in. I am not saying that it's not supposed to be added back, all I am saying is having that large portion of operating cashflow sourced from writing off bad debts is a problem.

Reply Like

C

Cozyhilly

Yesterday, 8:19 AM

Comments (438) | + Follow

@Alex Ponte The credit write-off results in a charge in P&L that reduces the net income, therefore increasing the PE multiple. That is the negative impact on the equity valuation. This however doesn't have a cash flow impact, and therefore needs be trued up in the cash flow statement. Nothing fancy here.

Reply Like (2)

C

Alex Ponte Yesterday, 8:29 AM

Contributor **Premium** Comments (59) | + Follow

Author's Reply *@Cozyhilly* Never said that you can't do that. All I'm saying is loan losses aren't cashflow, adjustment or not. It's a simple accounting tactic that works for PayPal. 1+1 = whatever you want it to be.

Reply Like

C

Cozyhilly Yesterday, 8:36 AM

Comments (438) | + Follow

@Alex Ponte True-up for the credit loss charge in the cash flow statement is not a tactic or choice. It is what you need to do to show the true level of cash flow from operating activities.

Reply Like

Joshua Hall Yesterday, 9:03 AM

Contributor **Premium** Comments (1.76K) | + Follow

@Alex Ponte Whether or not the bad debt is a problem depends upon context. Their loss ratios should be compared to credit card companies or similar Fintech lenders.

Reply Like (1)

L

lotsamoney Yesterday, 10:01 PM

Comments (416) | + Follow

@Alex Ponte What your saying is incorrect.

Reply Like

L

lotsamoney Yesterday, 10:03 PM

Comments (416) | + Follow

@Alex Ponte Its basic IFRS standards not PayPal standards or tactics.

Reply Like

L **lotsamoney** 14 Dec. 2021, 11:49 PM

Comments (416) | + Follow

PayPal is a threat to bank.Lofty valuation is due in part to its model as a tech company rather than bank. PayPal Holdings is the tech giant threatening not the has been. PayPal is building a super mobile app. Already, the app's users can transact with debit cards, borrow to make purchases, cryptocurrency, pay their bills, get paid by their employers, cash checks, make investments, send money to relatives overseas and more. PayPal is a collaborative partner of Visa and MC and extention of bank, they all benefit. PayPal added 72.7 million net new active accounts in 2020. Those numbers include accounts at Venmo and continue to grow. people are just starting to get use to using PayPal. Digital currency fits right into PayPal. Visa and MC Visa are so dominant in the payments market, real threat is payments reform like in India.

Reply Like (2)

Longbow Archer 14 Dec. 2021, 11:00 PM

Comments (1.33K) | + Follow

Respectfully, the author doesn't understand how to read a 10-K/Consolidated Statement of Cash Flows. Other commentators have gently pointed out the error.

The growth is about 20% per year and it is a network effect (two-sided).

Reply Like (11)

Alex Ponte Yesterday, 7:26 AM

Contributor **Premium** Comments (59) | + Follow

Author's Reply *@Longbow Archer* I know how to read a 10-K. I just don't get excited about a company who has a significant portion of cashflow pour in because they write off bad debts.

Reply Like (1)

Longbow Archer Yesterday, 2:29 PM

Comments (1.33K) | + Follow

@Alex Ponte Let's agree to disagree. Best to you.

Reply Like (1)

Karl Glazier 14 Dec. 2021, 8:26 PM

Premium Comments (553) | + Follow

Paypal assumes arrogantly that every one of their millions of customers worldwide has cell phone reception where they live. I and many I know don't, and cannot log in anymore. They are burning many customers. To hell with them.

Reply Like (1)

B **BudFox7911** 14 Dec. 2021, 8:59 PM

Comments (336) | + Follow

@Karl Glazier Karl; I am not familiar with the issue you are discussing. Has Pay Pal recently changed their procedures for users? You may have the big answer why PYPL has had such a big decline. Interesting divergence between this SA Author's view of PYPL versus The Street.Com and CFRA agency reports. Current stock price performance is on the side of this SA Author.

Reply Like

Alex Ponte 14 Dec. 2021, 9:36 PM

Contributor **Premium** Comments (59) | + Follow

Author's Reply *@BudFox7911* I hope I didn't upset the board being so opposite, lol.

Reply Like (1)

P **Phil Dumfee** 14 Dec. 2021, 10:17 PM

Comments (7.51K) | + Follow

Works for Istagram and Snapchat. Get fiber and turn on WiFi. 5G is coming.

Reply Like

L **lotsamoney** 14 Dec. 2021, 11:53 PM

Comments (416) | + Follow

@Karl Glazier Have no idea what your trying to say. Wtf, if you have no cell reception what the hell do you expect? Thats like saying to hell with Amazon,arrogant assuming you have a computer with no internet connection...

Reply Like (2)

7422981 14 Dec. 2021, 8:09 PM

Comments (6.96K) | + Follow

You call this a DIP? But, I do agree, a rally is coming.

Reply Like (3)

The Fox 14 Dec. 2021, 9:14 PM

Comments (1.02K) | + Follow

@7422981 $300 to $185....yeah bro...that's a dip by anyone's standards

Reply Like (2)

7422981 14 Dec. 2021, 9:25 PM

Comments (6.96K) | + Follow

@The Fox More like a collapse.

Reply Like (4)

S **SomeGuy14** 14 Dec. 2021, 7:06 PM

Comments (3.29K) | + Follow

This bubble has already popped. Retail just hasn't realized it yet. Dot com 2.0 has begun

Reply Like (2)

Kyle Fishman 14 Dec. 2021, 5:18 PM

Contributor Comments (2.64K) | + Follow

wrong. PYPL is solid.

Reply Like (6)

Orangejulius

14 Dec. 2021, 5:06 PM

Comments (3.83K) | + Follow

I've found more and more billing and utility payments direct users towards ACH transactions. My fiber internet company, water, electricity, and even some of the charities I give to are all recommending ACH or tacking on fees if I go with a credit card or similar payment provider. This has become increasingly common these past 2 years.

Those recurring payments are important to payment processors. A decidedly old-school method like ACH is an amusing threat to their growth narrative. I see expansion of free ACH transactions as a current and growing threat. After all, why would anyone want to waste 1.5% with a simple bank transfer from Venmo when it's free to do a standard ACH 1-3 day transfer? If Venmo forced users into the 1.5% fee, I guarantee you'd see half the users stop using it.

Reply Like (1)

W

Wadowedo

14 Dec. 2021, 4:14 PM

Comments (302) | + Follow

PayPal works great for me. I am not sure why Merchants are a risk for not paying PayPal. Aren't Merchants receiving payments? Are you talking about Merchants paying the service fee?

Reply Like (2)

Alex Ponte

14 Dec. 2021, 4:35 PM

Contributor **Premium** Comments (59) | + Follow

Author's Reply *@Wadowedo* Merchants aren't at risk, PayPal endures the risk being the middle man, making their business model riskier than Visa and Mastercard as those two companies pass on that additional risk of no payment to the merchants.

Reply Like (1)

B **BudFox7911** 14 Dec. 2021, 9:15 PM

Comments (336) | + Follow

@Alex Ponte Have you read agency reports published by The Street and CFRA on PYPL for example? Any comments on their reports? The market appears to agree with your analysis on PYPL. Incidentally thank you for publishing your report on PYPL.

Reply Like (1)

Alex Ponte 14 Dec. 2021, 9:37 PM

Contributor **Premium** Comments (59) | + Follow

Author's Reply *@BudFox7911* Not really, but I'm a value investor at my core, and don't like their future growth prospects so it was an easy decision for me. *(edited)*

Reply Like (2)

KingofKings Yesterday, 10:13 AM

Comments (1.47K) | + Follow

@Alex Ponte to use PayPal, you have to be linked to an account to pay. Not sure how payments to purchases or sends are not getting paid.

Reply Like

L **Lunle** 14 Dec. 2021, 4:05 PM

Premium **Marketplace** Comments (35) | + Follow

It is incorrect to add back the loss provision from your calculation to derive the free cash. From accounting point of view, when company book a loan transaction, they add loan asset on the asset side and reduce their cash. When they make loan loss provision, they deduct loan from their asset on balance sheet, and add a loss entry from profit loss account. But for this entry,there is no cash flow impact from their operation. It is correct that they add back the loan os's to their free cash flow as there is no cash impact from the cash generate from operation. It is purely balance sheet transaction. I'm qualified account.

Reply Like (6)

Alex Ponte 14 Dec. 2021, 4:31 PM

Contributor **Premium** Comments (59) | + Follow

Author's Reply *@Lunle* I did not add back the loan losses…

Reply Like (1)

L **lotsamoney** 14 Dec. 2021, 11:16 PM

Comments (416) | + Follow

@Alex Ponte That would be incorrect. Cashflow represents change in assets on balance sheet. Similarly they add back amortization expense. To exclude this would be error and changes cashflow. These are projections (guess), which I do not put much faith in, too many variables.

Reply Like

marriottmare 14 Dec. 2021, 4:03 PM

Comments (3.63K) | + Follow

Agree, it's a buy for this America 2.0 firm

Reply Like

J **jsj9s8xil2** 14 Dec. 2021, 2:31 PM

Comments (130) | + Follow

While this may be one of the best articles here this year, the title - without doubt - is the most clever title I've seen on this site (ok, the punctuation would have been nice, "Pay, Pal."). Cheers, and thanks for putting this together.

Reply Like (10)

Alex Ponte 14 Dec. 2021, 2:32 PM

Contributor **Premium** Comments (59) | + Follow

Author's Reply *@jsj9s8xil2* Haha, true. Thank you!

Reply Like

J **jsj9s8xil2** 14 Dec. 2021, 2:28 PM

Comments (130) | + Follow

Fantastic article. What I'm most amazed by however, is that no article here on S.A., every mentions the absolutely dreadful sentiment users have towards the company. One would think, how a company's users feel about the company, is of at least 'some' importance. ;) Look at TrustPilot reviews, and Paypal clocks in with a 'wonderful' 1.2 out of 5 star ratings (across more than 20,000 reviews), with the worst possible being 1 out of 5. Sure, the company still has the occasional cheerleader, but having been in online/ecommerce business since Elon still had pimples, I've experienced first hand the absolutely awful sentiment both merchants and buyers have towards this company as a result of policies so hostile towards their merchants it beckons one to wonder how the company can even be licensed to operate in regulated markets. Not to mention, the lawsuits they've faced over the years precisely over some of their 'wonderful' policies. I'm still invested in the stock (picked up shares just below 180) but, considering- the many years of experience I have, seeing this company alienate millions of it's users - I feel the writing is on the wall for this once innovative company. I'll wait for any negligible rise in the SP, take my profits, and bid them the same farewell so many others have.

Reply Like (2)

Alex Ponte 14 Dec. 2021, 2:45 PM

Contributor **Premium** Comments (59) | + Follow

Author's Reply *@jsj9s8xil2* I 100% agree, which is why I believe bank-to-bank transactions will become more prominent down the road. PayPal's future doesn't look bright!

Reply Like (2)

M **Martin Schaller** 14 Dec. 2021, 3:40 PM

Premium **Marketplace** Comments (7) | + Follow

@jsj9s8xil2 - I guess you think the same about Microsoft then:

de.trustpilot.com/...

or Apple (de.trustpilot.com/...) or Amazon (de.trustpilot.com/...)

I completely agree that failure to treat merchants well spells doom for Pay Pal, but I dont see meaningful data supporting this.

Reply Like (2)

L **lotsamoney** 14 Dec. 2021, 11:12 PM

Comments (416) | + Follow

@jsj9s8xil2 Trust pilot is is all bullshit, who goes out of their way to give companies a good review.May 2020, episode of Joe Lycett's Got Your Back ran experiment setup fake company created on Trustpilot, demonstrated ways of manipulating reviews, highlighting fraud on the site. If your a paid subscriber your 2.2 will be 4.4 within a month.

Reply Like (1)

V **Vegoose** 14 Dec. 2021, 11:32 PM

Marketplace Comments (5) | + Follow

@jsj9s8xil2 100% correct. No one ever talks about their policy of confiscating merchants' assets for imaginary "security" reasons. If you don't believe me, just Google "PayPal account limitation" for yourself. I can't believe this criminal practice is tolerated. Someday this evil company will be held accountable.

Reply Like

L **lotsamoney** Yesterday, 12:01 AM

Comments (416) | + Follow

@jsj9s8xil2 Added 72 million new net users in 2020, who is hating it? Merchants don't like it when consumers fraudulently make claims and PayPal takes the money back. They feel paypal being unfair to scammer consumers...same thing happens with CC companies. Online Merchants don't need to use PayPal, but would dumb not to use them.

Reply Like

L **lotsamoney** Yesterday, 12:07 AM

Comments (416) | + Follow

@Alex Ponte Doubt it, at least not on this continent, opposite might happen. Deposit insurance being lobbied to be lifted in US for payments offered exclusively by banks, will benefit PayPal if happens. Some of the Banks services are being threatened by digital payments offered by tech giants, like PayPal. The banks have been greedy pigs for years, new generation are not going to bank like grandparents.

Reply Like

L

lotsamoney

Yesterday, 12:08 AM

Comments (416) | + Follow

@Martin Schaller Trustpilot is all bullshit. A business will never get good reviews unless they subscribe to Trustpiolrt so they add a bunch of fake good reviews.

Reply Like (1)

M

Martin Schaller

14 Dec. 2021, 12:21 PM

Premium **Marketplace** Comments (7) | + Follow

Correct me if I am wrong, but arent you subtracting the 1.7 bn two times?:
They receive the cash on their bank accounts (5.8 bn) and then they make an allowance of the credit losses - i.e. cutting down their operating cash flow, which makes sense - eventually arriving after all the subtractions at the net-income?

So in your cashflow calculation (leading to 77 % overpriced stock) you end up subtracting the 1.7 bn too often from their operating cashflow of 5.9 bn, thus grossly underestimating the cashflow-generating capacity of the company.

Reply Like (14)

Dobbs99

14 Dec. 2021, 12:28 PM

Comments (209) | + Follow

@Martin Schaller You are right and it helps the author's biased view before righting the article . Pretty egregious

Reply Like (15)

Juglans

14 Dec. 2021, 12:58 PM

Comments (94) | + Follow

@Martin Schaller lol

Reply Like (2)

Alex Ponte 14 Dec. 2021, 1:02 PM

Contributor **Premium** Comments (59) | + Follow

Author's Reply *@Martin Schaller* Taking away the $1.7 Billion from being subtracted from the forecasted EBIT still leads to an intrinsic value of $67.39. Therefore, the premium being paid remains heavy. I appreciate you for pointing this out, but the facts remain the same, PayPal is still egregiously overpriced.

Reply Like

Alex Ponte 14 Dec. 2021, 1:06 PM

Contributor **Premium** Comments (59) | + Follow

Author's Reply *@Dobbs99* After removing the second 1.7 billion subtraction, I arrive at an intrinsic value of $67.39. Making PayPal trading at a heavy premium. I appreciate you for pointing this out and I want to correct it. I try to be as intellectually honest as possible and I deeply apologize for this confusion.

Reply Like (3)

M **Martin Schaller** 14 Dec. 2021, 1:42 PM

Premium **Marketplace** Comments (7) | + Follow

@Alex Ponte i really appreciate your candor and honesty! But i still have problems understanding your calculation. First: why do you assume a 4 percent growth rate until 2025? Paypal had much higher in the past. Conservatively you could see 10 or so. Second: What about your terminal value is from what i see much higher then the equity value? Shouldn't it be the reverse?

Reply Like (1)

Alex Ponte 14 Dec. 2021, 1:50 PM

Contributor **Premium** Comments (59) | + Follow

Author's Reply *@Martin Schaller* The terminal value is calculated at the future value, however we discount that and the future cash flows to the present to get a lower enterprise value. Secondly, I believe growth will slow down in the future due to the industry changes as I stated. I believe the 2021 EPS growth slowdown is a sign of things to come which is why I lowered the growth rate to 4%. The last 10 years aren’t the next 5.

Reply Like

M **Martin Schaller** 14 Dec. 2021, 1:59 PM

Premium **Marketplace** Comments (7) | + Follow

@Alex Ponte I completely agree that some headwinds might be on the road, but considering the consensus view on paypal is so far above 4 % annual growth, (e. g. for earnings it is at least 15 % annualy for the next years, seekingalpha.com/...), you should have a water-proof case and enough evidence that the growth rate drops so far from one year to the next. -

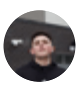
Reply Like (1)

M **Martin Schaller** 14 Dec. 2021, 2:05 PM

Premium **Marketplace** Comments (7) | + Follow

@Alex Ponte: If I discount the terminal value (53,4/(1,04^5)) I get roughly 43,9 bn + roughly 7 (discounted) from the years 2022-2025 and I add cash minus LT-debt and I arrive at 57 bn vs. your 49 bn. - That is still off, or am I doing it wrong ?

Reply Like



Alex Ponte 14 Dec. 2021, 2:06 PM

Contributor **Premium** Comments (59) | + Follow

Author's Reply *@Martin Schaller* That’s a fair statement. I hinted at this in my conclusion stating that PayPal could string together a couple good quarters of growth. However forecasting 15% growth is rather difficult and I don’t like to price to much of it in when doing my analysis

Reply Like (1)

M **Martin Schaller** 14 Dec. 2021, 2:08 PM

Premium **Marketplace** Comments (7) | + Follow

@Alex Ponte I agree - i am also conservative in that regard. I like to go with the lower end of forecasted growth values.

Reply Like

Alex Ponte 14 Dec. 2021, 2:09 PM

Contributor **Premium** Comments (59) | + Follow

Author's Reply *@Martin Schaller* What are you discounting by. I am using an 8% discount rate. It appears you are using 4%?

Reply Like

M **Martin Schaller** 14 Dec. 2021, 2:19 PM

Premium **Marketplace** Comments (7) | + Follow

@Alex Ponte Yes roughly, I go by this idea: = Cost of Equity = Risk Free Rate + (Levered Beta * Equity Risk Premium)
= -0.01% + (1.058 * 4.38%) (Equity Risk Premium: from simply-wall street - but you could also go with 5.5 (e. g. here: www.statista.com/...

I think, if you discount by a huge percentage (8 vs. 4-5) and reduce the growth rate simultaneously (from 12 to 4) you cut the cashflow forecast naturally into peaces (not even talking about the 1.7 bn situation, which seemed a high number, given the fact that PayPal reported a drop in 2021 against 2020 (s1.q4cdn.com/...

But at the end of the day investing is a personal choice and we can be as conservative as we want. ;)

Reply Like (1)

Alex Ponte 14 Dec. 2021, 2:31 PM

Contributor **Premium** Comments (59) | + Follow

Author's Reply *@Martin Schaller* In all of my calculations you'll see I don't use CAPM model to determine cost of capital, I always use a discount rate of 8-12%. I find this the most accurate range to discount equity cash flows. I do not price much growth in stocks, and I adjusted the calculation to add the 1.7 billion back which I admitted was a miscalculation at first. We can respectfully disagree on how one should calculate the value of a stock, I just wanted to ensure that I don't come off as intellectually dishonest. I do this for all the equities I analyze. Thank you for your questions!

Reply Like (1)

L

Lunle 14 Dec. 2021, 4:07 PM

Premium **Marketplace** Comments (35) | + Follow

Author treatment for loan loss to add them back to free cash flow is incorrect. Because it is purely balance sheet item. There is no cash movement company make loan loss provision.

Reply Like

Alex Ponte 14 Dec. 2021, 4:29 PM

Contributor **Premium** Comments (59) | + Follow

Author's Reply *@Lunle* I am not criticizing the accounting procedure or changing the rules, I am saying to be vigilant that a company who's 30% of their cashflow is derived from the add back of these loan losses.

Reply Like

S

sspencer 14 Dec. 2021, 11:57 AM

Premium Comments (199) | + Follow

I appreciate your article. Noticing an 'irregularity' in the CF statement is not normally an item that gets viewed.

Reply Like

Alex Ponte 14 Dec. 2021, 11:58 AM

Contributor **Premium** Comments (59) | + Follow

Author's Reply *@sspencer* Thanks, appreciate it!

Reply Like

buckiowa 14 Dec. 2021, 11:01 AM

Comments (1.32K) | + Follow

I have some shares… but I'm not real confident in this stock.

Reply Like

C **Chalmus0** 14 Dec. 2021, 10:44 AM

Comments (1.8K) | + Follow

Nice article, interesting read with some info that was new to me.

Unfortunately, even though the credit losses being added back to cash flow was supposed to be "simple to explain", I have to admit that I'm not sure I understand lol. Are you saying that adding LOSSES back into cash flow? So, they have $1.7 billion in loans to customers that don't get paid back, meaning that money is gone, and they get to add that onto the statement of cash flowing into the company?

Clearly, I'm not understanding something correctly

Long V and MA

Reply Like

Alex Ponte 14 Dec. 2021, 10:46 AM

Contributor **Premium** Comments (59) | + Follow

Author's Reply *@Chalmus0* PayPal writes off a lot of these bad loans which they can add back to their cash flow statement. I recommend you don't try this at home.

Reply Like (2)

msawi11 14 Dec. 2021, 2:47 PM

Premium Comments (519) | + Follow

@Alex Ponte because they're non-cash accounting items?

Reply Like (1)

Alex Ponte 14 Dec. 2021, 2:55 PM

Contributor **Premium** Comments (59) | + Follow

Author's Reply *@msawi11* yes, remember debt write-offs are a decrease in a company's accounts receivable. Therefore, although recorded as a loss on the income statement, it gets added back onto PayPal's cashflow. Now I know what your probably thinking, doesn't it balance each other out? Yes, but I would want to be vigilant on a cashflow calculation that has 30% bad debts. Additionally, the company acknowledges that there is great risk involved with these transaction and credit losses. *(edited)*

Reply Like (1)

T **Triple O.G. Investments** 14 Dec. 2021, 4:07 PM

Comments (1.74K) | + Follow

@Alex Ponte let us guess : you have no formal Accounting education aside from reading libertarian Blogs?

Reply Like (2)

L **lotsamoney** Yesterday, 12:11 AM

Comments (416) | + Follow

@Alex Ponte Its a non cash item, like the way depreciation is treated.

Reply Like

msawi11 Yesterday, 8:32 AM

Premium Comments (519) | + Follow

@Alex Ponte thank you. Makes me wonder about the credit risk of BNPL specialists: Affirm, AfterPay (being bought by Square), Klarna (pre-IPO BNPL giant) and many others...race to the bottom!

Reply Like (1)

Benjamin Graham Cracker 14 Dec. 2021, 10:40 AM

Comments (4.07K) | + Follow

Need a comment “Pay, Pal”

Reply Like

Benjamin Graham Cracker 14 Dec. 2021, 10:46 AM

Comments (4.07K) | + Follow

@Benjamin Graham Cracker Lol. As I call out grammar, I self own.

comma*

Reply Like (4)

M **MoGARP** 14 Dec. 2021, 10:31 AM

Comments (133) | + Follow

I agree. Plus: Among best article titles of the year.

Reply Like (5)