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PRESENTATION

Operator

Welcome to the PayPal Virtual Fireside Chat conference call. At this time, all participants are in listen only mode. Please be advised that today's conference is being recorded. If you require any further assistance, please press star zero. I would now like to hand the conference over to your speakers today, James Faucette, please go ahead.

James Faucette

Hey everybody. And thanks for joining us today in this conversation with John Rainey, CFO of PayPal. We also have Gabrielle Rabinovitch from the IR team, who's now doing more work within operations itself [corporate finance], so she can provide some color there as well. Look, as we go through, I've got prepared list of questions here. Honestly, we've got 45 minutes. Hopefully, we can get through a big part of those. I think that we actually could do a Joe Rogan podcast if we want, John, but I won't subject you to that. As we're going along, if anybody does have anything that they want to make sure that we hit on,

feel free to email me here at james.faucette@morganstanley.com, and we'll try to incorporate that as well. So John, big quarter, a lot of growth, TPV growth at 50% or 46% FXN, was obviously excellent. Would love to dissect that a bit. And I guess starting here, and this was something that we got a lot of input from people wanting to get a little more color. What was the biggest contributor to the upside there? Was it core TPV? Ex-Venmo on eBay growth was stronger in Q1 or even looking at a two-year CAGR basis. So just give us as much color as you can on kind of what you're seeing and what's driving that.

John Rainey

Sure, James, and it's always a pleasure and a lot of fun to be able to do this with you. You're right. I mean the year over year numbers are kind of eye-popping. We obviously benefited from softer comps in March last year. But even then, if you look at your over two-year numbers or even quarter over quarter, you saw that there was really strong TPV growth, and that obviously falls to revenue and the bottom line. There are a few things that stand out, and one is, we just started off the quarter really, really strong, and getting to sort of your question around where that's coming from, the thing that stands out the most is just the strength of our core markets and just this continuing pull forward of e-commerce where we're seeing this persistence in some of the trends around people and their behaviors

in terms of using digital payments. But the holiday period at the end of 2020 was more challenging to predict, because there was concern that there may have been pulled forward in some of the holiday sales, and we certainly saw an elongated holiday shopping season, but getting to your question, it extended on the tail end as well. The first 10 to 15 days of January were exceedingly strong relative to the normal low that you'll see after the holiday shopping season. You then go to the stimulus payments. We had that modeled in our guidance that we gave, and it generally tracked pretty close to what we expected. And were able to isolate the impact of stimulus pretty well, particularly as welook

at what happened last year. We talked a little bit about that on the call yesterday, but that was not something that I think was an outsize or driver of the results or the outperformance because we did model that pretty closely to what actually happened. And then we get to March, and March has softer comps. And there's a number of things there, but like just take Venmo. Venmo was really strong in March, and it always is around March Madness, which if you didn't follow, Baylor ended up winning it all. But Venmo is used a lot in the March Madness timeframe. And remember that last year that was canceled, incidentally when Baylor was also number one in the nation. But anyway, as we look at the quarter in total, just really strong growth across all parts of our platform, and a lot of these behaviors that are displacing cash are persisting, and that really plays into the increase in guidance for the back half of the year.

James Faucette

That makes sense. And John, at some point, Arizona's going to be back, I promise, but that's neither here nor there. But when you look at Venmo, one of the things that I wonder, and you mentioned kind of easier comps and kind of like some of the impact there, but what about other metrics that you're looking at, whether it be frequency of engagement or other things that could be telling and help you kind of sort out really what's happening there, particularly on a go-forward basis?

John Rainey

Well, remember at our Investor Day, we talked about this idea of increasing the ARPU, the average revenue per user, 2X for PayPal [from a medium engaged to high engaged user] and 10X for Venmo. And what really underlies that is an increase in engagement. And perhaps one of the more exciting things internally that we rally around is the strong correlation that we see and increases in level of engagement with additional experiences that we're providing to our customers that provide more utility to that wallet.

I'm looking more closely at engagement lift than I am at the monetization efforts around things like buy now, pay later or crypto or other things like that, because all of this plays to this thesis of the ascendancy of the digital wallet over the next three to five years, which we firmly believe in. And if we can increase these levels of engagement, which directly flows to increased levels of revenue in there and then to the bottom line. It's sort of following suit to what the thesis is around what we're going to do over the next five years.

James Faucette

Yeah. And when you look at that point around increased use of wallet, etc., how much benefit were you getting from things like Paymentus or Bill Pay generally, or even things like crypto wallet funding? Were those enough to move the needle in any of, whether it be TPV or other financial metrics?

John Rainey

I wouldn't say that any one of those individually moves the needle. I think the collective impact of all of them probably move the needle a little bit. Let me give you a couple of data points there: around net new actives, one of the primary activation channels for net new actives is P2P, and that's been consistent for some period of time, but in the most recent quarter, one of the things that was at the very top of driving net new actives was what we call recurring payments or subscriptions. And so that's again something that we're really excited about that it is improving our financials and creating a stickiness to the platform. Paymentus is driving more volume. We certainly had a full quarter of Paymentus being effectively a hundred percent ramped. And you see a little bit of the impact of that in our take rate, but you also see it in our transaction expense. And again, this goes back to this idea of creating utility in the digital wallet with things like Bill Pay, subscriptions, all these things that are inherently very sticky versus someone just using PayPal to pay at a website.

James Faucette

Got it. John, you cut out right before and you came back right before you started talking about Paymentus, etc. So if there are any secrets of the universe that you disclosed, then maybe you should revisit those really quickly.

John Rainey

Sorry. We did hear a little static. I apologize about that. The only thing I was saying is that recurring payments or subscriptions was one of our largest activation channels for net new actives for the quarter. Think of that as something like vaulting a PayPal instrument into Uber that is just sort of opaque and happening in the background there, but it's a recurring type payment.

James Faucette

Got it, got it, got it. Now on the outlook itself, obviously you seem very confident and one of the questions we've gotten not just about PayPal, but generally is, and concerns even better said, is people worried that the stimulus may be distorting current activity and then making forecasting that much more unpredictable. Are you able to isolate stimulus impact within what you're seeing very well? And then how are you adjusting as you build plans for a more normalized environment?

John Rainey

Yeah, it's a great question. Let me pull that apart in a couple of different directions. One is, this is a challenging time to forecast. There's a lot of variability given with vaccine rollouts, how quickly people are returning to physical experiences. And so I don't want to suggest that we have a crystal ball and we know exactly how this was going to play out. That's not the case at all, but that said, that should not

take away from our conviction and what we're seeing around our business longer term. And the pull forward is e-commerce and the growth of digital payments. And I gave the example yesterday of, let's call it, a newer digital payment experience where I'm paying with a QR code at a restaurant. Those types of things are going to persist. So if there is nothing about that experience of pain with a credit card in a restaurant that is fundamentally better than being able to pay with your phone right there at your table and not needing to wait on that credit card. It's those types of experiences that we fundamentally believe are going to take over, over the coming years. And look, this is not like speculation or conjecture on our part. You can look at markets in the world like China, where they're not turning back, you've reached saturation or ubiquity around digital payments with QR code. You go to Shanghai, and literally there's a QR code on a vending machine, there's a QR code on the bus station, there's a QR code at the grocery store. There's even the street vendor that's selling food, has a placard with a QR code out there. Why? It's just fundamentally easier than paying in any other form. And so this may take years to actually sort of sweep these established markets like the US that we're in, but we don't believe that we're turning back here. And that's why we have the conviction that we do around the growth opportunity for PayPal long-term.

James Faucette

Got it, got it. And you touched on international markets, and that was one of the things that we noticed was that the TPV volumes were obviously good in the US, but we were also seeing improvement internationally. Can you provide a little more color there, like what you're seeing, maybe in different regions and like how that's varying with the ebbs and flows of pandemic, etc.? I guess, tied into that Visa and MasterCard themselves talked about a lot of growth in international e-commerce and just wondering if you're seeing that and how you're thinking about sustainability of those trends.

John Rainey

Sure. And as you asked that question, I realized that I didn't answer the entirety of the previous question around stimulus. These might tie together. We certainly saw a benefit from stimulus checks. I would not say that that was a key driver of our results. That said, if you get to the reason behind the stimulus checks and sort of getting into your international question, there is a correlation in so far as like some of the strength internationally that we saw were in markets like the UK, which is having a more pronounced impact from the pandemic right now than what we see in the US. We saw a benefit from that, but that's not what I would refer to as a benefit from stimulus. It's sort of the lack of mobility that people have and the resulting increase in e-commerce shopping. So that was a key driver. And getting into cross-border activity, intra Europe was certainly the area that probably stood out as being the strongest around cross-border. Asia is another area that I would mention, but all of this is, I think really speaks to the reach and scale of our platform and the relevance of PayPal in these markets. You take a market like Germany, we are very highly penetrated into digital users there. And as we continue to provide additional use cases, we only expect that to increase. Germany, it's an interesting market because some of the things we talked about at Investor Day, like around, tap & pay, and [we've] seen an incremental 50 transactions of someone that's using this offline, we see an incremental 50 transactions online. And so that's where I think our value proposition really shines in a lot of those markets, but to be clear, we did benefit from some of the difficulties that people are going through by not having the normal mobility that they do.

Gabrielle Rabinovitch

Yeah. James, one other point last year, we did call out Q1 was particularly hit on the China seller side, given the initial wave of COVID in market there, and so February was hit in Asia as well as March, kind of a Q1 impact and lapping of that also very much benefited our Asia comps.

James Faucette

Got it, got it, got it. I appreciate that Gabrielle. So talking about specifically comps and guidance, et cetera, what kind of assumptions are you making for the 2Q TPV guide, particularly the second half of the quarter? If we take kind of what you'd said about thus far or through April, etc., it seems like you're building in some deceleration there, but I don't know if we're interpolating correctly. So just any help on that topic.

John Rainey

Yeah. Well, 2Q is obviously going to be the most difficult comp for us of any quarter in 2021. That's where we saw the bulk of the pantry packing, the people getting various goods to protect themselves from COVID-19. And May, last couple of weeks of April, beginning of May were really, really strong periods of growth last year. And so the lapping of that is a difficult comp, but sort of offsetting some of that is we also expect to see a continuation of the trends around an increase in travel and events [T&E]. We

saw a little bit of that in the first quarter and we called that out yesterday, but just as a comparison, we were seeing 50% declines around T&E throughout the last several quarters of last year. That was only 24% down in the first quarter. And we'd expect it to kind of ratably increase throughout the year. So that will offset some of that because those were- in fact, not only was the volume declining last year, it was actually negative volume in some cases where people were getting refunds more than they were buying new things like on Airbnb and items like that. So, T&E [Travel & Events] is something that I would call out for the second quarter. Then getting to the back half of the year, you get to a slightly more normalized growth rate. And this is when we're going to launch a lot of the new experiences that we're rolling out around the digital wallet, things like that, that we're quite excited about.

James Faucette

And on that kind of new experiences, etc., any previews, like what we should anticipate there, like streamlined, updated look, additional functionality, and what's the timeframe we should be kind of anticipating those to start to roll out?

John Rainey

Sure. Well, to be clear this is going to be an effort that rolls out over several quarters. I don't want to overstate this. This is not going to be something that, along the initial rollout just blows people away. I mean, we're going to add additional experiences, improve the functionality of the wallet, and it will get better and better over the coming quarters. And we're quite excited about that because I think most would recognize that the PayPal app is in need of a refresh. It's a little bit tired right now. And in fact, you could look to some of our competitors and have a lot better fit and form and functionality in their wallets where they are able to navigate that as much easier and more intuitive for what people are actually trying to use the wallet for. So all of these are things that we're doing, rolling out experiences, but also improving the ability to use the app, the way that one navigates through there. And then over the coming years, we'll continue to add additional features to the wallet that we think the consumer wants. And one of the things that's been talked about is you can now buy and sell crypto, why not buy and sell stocks. Certainly, others are doing that. So we're exploring that, savings accounts, other things like that, that really create a digital wallet that is kind of a destination for people where they don't need to toggle back between other apps, and they can do all of this in one place.

James Faucette

Got it. And last, obviously we've been hitting a lot of top line topics to start here, but last one, would

love to spend just a few minutes on the Alibaba announcement. Can you explain quickly what is this relationship and how is it different than the other marketplace partnerships you have, and I guess maybe most importantly, how are you sizing the opportunity with them?

John Rainey

Sure. So appreciate the opportunity to talk about that because being able to partner with what is one of the largest marketplaces, if not the largest in the world is pretty exciting for us and the largest digital market in the world. To be clear, this is - and let me start, James, by saying, there are limitations to what we can disclose around the specifics of this at the request of the partners that we are operating with. But this is not something that we could have done when we were operating under the operating agreement with eBay. So the type of agreement that we have with Alibaba was specifically prohibited under that agreement. We were asked about partnership opportunities once we sort of rolled off of the eBay operating agreement. This is one that we'd been intimating would be coming, and we're quite excited about that. Is it going to be a meaningful driver of our results in 2021? No. All these things take time, but this is a first step to us partnering with Alibaba and AliPay where, when you think about the addressable market in China, this could be very, very meaningful over time. And Gabrielle perhaps can provide some of the specifics around the first steps here with Alibaba and what we're doing.

Gabrielle Rabinovitch

It's really just an expansion of presentment on both sides, both on the wholesaler side, as well as the B2C side. And so in the past few months, what we've done is sort of meaningfully increase the number of countries where we have presentment for consumers in those markets to be buying from Alibaba merchants on the B2C side and then on the B2B side, on the wholesaler side. And so now it's in

approximately 30 different markets, which is a meaningful expansion of the relationship, and we're excited to see how it builds over time.

James Faucette

Got it, got it. So let's turn to other aspects of the report take rate. We talked about take rate a lot, that came in a little bit lighter than we had expected. Can you break down some of the components of this take rate compression and how we should think perhaps more importantly about the sequential take rate compression through the year and what those drivers are?

John Rainey

Sure. So take rate declined whether you're looking at transaction take rate or total take rate 24 to 31 basis points. About 15 basis points of that was related to mix in our business, and most notably among the mix is the decline in eBay volumes that we had. The take rate decline was exacerbated by the change in our hedge position year over year, where we had a hedge loss this year versus a gain last year. That was about four or five basis points as well. The rest is I would just kind of call noise. There's some onesies, twosies there, but nothing really to call out, but fundamentally the mix change, and part of the mix change is related to things like more volume from Paymentus. Paymentus has a lower take rate, but it's I think, improper to talk about that without also talking about transaction expense, because the same things that affect take rate affect transaction expense. And that's why Paymentus having much lower transaction expenses [was] one of the reasons why we were able to have a transaction expense of 80 BPS [basis points]. So if we pull back from all of that, so explaining the variance in the first quarter, you think that okay, what does this mean longer term for PayPal? The right way to think about 2021 in terms of take rate decline is probably pretty similar to what you saw in 2020. There's really not a lot of good reasons to suggest it would be very different from that. And then when you get into 2022 and beyond, the rate of

take rate [decline] that we've experienced over the past several years should abate in part, because most of that volume was sort of ripping off the Band-Aid with eBay, and so that's not going to impact that to the extent that it has before. Moreover, a lot of the things that have been drags on take rate, like Venmo volumes growing 63% in the most recent quarter but not monetizing that as much. That's a drag on take rate. Well, we're beginning to monetize Venmo more as we're expecting, again as we said, $900 million of revenue this year and that'll be growing next year. And so all of these things actually sort of buoy this decline, if you will, that we've seen in take rate. So you should get to a lower level of take rate decline than what we've seen historically.

James Faucette

And I guess it's a little hard to say because you're continually adding new products and there can be some different elements to that, but is there a point that you anticipate that you get to a baseline level where it stops going down first? But from my perspective, the bigger question is always how much underlying like for like take rate compression is there? That is, if you look at a transaction today and a similar transaction a year ago or two years ago, is that being compressed at all?

John Rainey

Yeah. And let me just be very, very clear on that point. If you compare same store sales pricing, we're not seeing any change there. I mean, sure, there's some onesies, twosies here, but there's as many that go up as go down. And that's been very consistent. That hasn't changed. On a same store sales basis, we're not seeing any take rate degradation, but we see mix changes as we get into larger merchants, and look, that's something we want to do. We want to expand our footprint and that's why we haven't been probably as focused on take rate as what others tend to fixate on. We always focus on transaction margin because that's what matters. That's adding the dollars to the bottom line. And if you look at our

57.8% transaction margin for the quarter, one of the strongest we've ever had, if not the strongest that we've had as a public company, and that's what we're focused on, because those are the dollars that are adding to the bottom line. And to be very clear, what we focus on is, is the growth in the absolute dollars of transaction margins because that's what's generating free cash flow that we can then use to create shareholder value.

James Faucette

Got it, got it. And so let's talk about transaction expenses as you tied into to margins, etc. Those came in at roughly 80 basis points as a percentage of TPV and certainly a lot lower than they have been in the past on that very, I guess, brute calculation. What are the factors that are lowering that part of the expenses and what kind of impact can like a recovery and normalization of travel and events have? And I guess really the question is, is there a sufficient change in mix and behavior, et cetera that we should think about PayPal keeping in its transaction expenses, at least around these levels, or are they going to bounce back to where they had been before?

John Rainey

Yeah. So let me start with the headline, then I'll give a little bit of color on why I feel that way. So transaction expense, I think, will settle in at a place that is lower than where we entered the pandemic. Now whether it it's 80 BPS [basis points] forever, that's probably on the low side, but that mid eighties range is something that when we look at our business, we think is pretty sustainable. Now there's a number of factors that play into that. One of the reasons that transaction expense has declined so much, it has

been because of the growth of what we call PayPal Core, the branded checkout button, where that's

used to a lower funding mix [mix of lower cost funding sources]. We believe that's going to persist. E-commerce has been pulled forward, and so you're going to continue to see more of this PayPal branded checkout, which benefits our funding mix. Related to that, Venmo tends to carry a lower funding cost. And so with Venmo continuing to grow, that puts pressure there. Adding just a third thing like Paymentus. I mentioned that, but that's an exceedingly low funding cost as well. And so all of those things depressed the transaction expenses rate. On the flip side, there are items that I think will create some inflation there, and you mentioned travel and events. That's a very good example because that tends to be more card- based processing, which has a higher cost. As travel and events come back, we should see some increase in that rate for transaction expense, but we should also see more revenue and more volume related to that as well. And so those are, I think the major puts and takes. I would say that where that levels out is- we can't be overly precise here, but that the low to mid eighties is probably a good way to think about that. But fundamentally James, like getting back to kind of the long-term thesis around this, we're talking about cash displacement, and when people are using a digital payment instead of cash, that usually comes in with a lower funding cost like ACH or like debit. And so those are things that we think are durable and sustainable, and we'll see impacting our numbers for a very long time.

James Faucette

Good. Well, I mean, it certainly feels like, as you highlight, whether it be Paymentus and Bill Pay or even just what people are willing to keep on platform, etc., that there are some more permanent parts there. So it's good to hear that at least you're able to corroborate some of that thinking. Expenses. Look, overall, the EPS guide up for the year was a little bit smaller than the magnitude of Q1 being that stood out to people, and it seems like op ex and you're kind of pushed to reinvest upside, if you will, is part of that. Let's start with Op Ex. Sales and marketing grew almost 80% this quarter. So how does that look for the rest of 2021, and beyond 2021, how do we think about the rate of Op Ex growth? Or I

guess maybe the bigger question is like, are you just kind of managing all the different pieces, whether it be the costs or transaction costs and op ex and other items to make sure you're getting to that target of slow margin expansion? Just wondering, like how we should be thinking about these different inputs and impacts on the expense lines.

John Rainey

Sure. There's a lot that I want to discuss here. Let me start with saying, my bias right now is to invest heavily. This is a seminal moment in our industry's history. And we think we have to capture this. We've never invested more heavily from a discretionary perspective than we are right now. And you're right. We've elected to invest a lot of the earnings beat rather than roll that through and raise our guidance by a commensurate amount, because we think that that's the most important thing for us to achieve our vision, which results in much greater shareholder value creation. Let me just be real clear about that. With respect to some of the individual line items and how to think about that for the year, maybe the right way to sort of give some context to this is that we said last year in the second half of the year, we were going to invest an additional $300 million. And most of that skewed towards the fourth quarter. That level of investment is really what's persisting as we go through 2021. And so you see the large year over year growth numbers for sales and marketing will begin to lap that as we get to the tail end of the year. The other area is technology and development, and that's one where there's not going to be the same lapping effect. You'll see higher year over year growth rates as we go through the year. But to be very clear, we believe that this is the best way to create shareholder value at PayPal. And we want to invest heavily into this opportunity. Now, all that said, given the scalability of our platform and the unit economics around which we grow, we're still able to achieve margin expansion and in fact, significant margin expansion and balance those. I think that's something that you should continue to expect going forward, meaning that we're going to have margin expansion, but we're

also going to invest very heavily. And I mean, I guess getting to the reason behind investing heavily is we think growth is the best thing for us. We've demonstrated that by these incremental margins that we're able to put up when we grow at the rate that we are. And there's a huge opportunity in front of us, whether it's displacement of cash or what the physical world presents in terms of an addressable market. And so our bias is very much around growth that we're investing in.

James Faucette

Got it. Well, and on that point, when you think about investing and the like, how do you think about- like PayPal at least over the last decade has had such a big lead from an acceptance perspective in digital wallets, and according to our latest quarterly tracker we published earlier this week that that lead is still growing versus most of the other digital wallets, at least online. But when we look at like a lot of the new services, let's just take crypto trading, for example, like lots and lots of people are trying to add that or featuring that as a core part of their capabilities and services today. So should we anticipate like cost of customer acquisition and some of those things going up in that competitive environment, and that's going to end up being a destination for that incremental investment beyond just like the technology and other things? Or how's that going to factor into? Because like I said, PayPal seems to have had a real advantage from a customer acquisition cost perspective over the last, at least five, 10 years.

John Rainey

Yeah. There are pockets where customer acquisition costs go up, but it's also muted by the relatively low customer acquisition cost that comes through other channels like P2P. So net-net, I don't see that going up appreciably. I think there'll be inflation there, but not appreciably over the coming years. We think that we can continue to grow our relevance and grow our share of checkout. Now, do we think that we're going to be the only digital wallet that people use? No. I think there'll be many other

opportunities for people to use competitors, whether it be with crypto trading or buying and selling stocks or paying digitally. But what we want to do is provide a suite of services that are very related in terms of how customers think about their financial lives, and that may even branch out a little bit from further afield from what we think of as payments. And I'll give you an example of what I'm talking about there in a second, but our focus is on providing the very best experiences in the safest way for our customers. And again, you see our risk numbers- our loss numbers for the quarter at all time lows. Our capabilities around this, I just think are fundamentally better than the competition. And look, if we want to talk about what's important to customers and moving and managing money, providing protection and security is very clearly number one. And we've demonstrated that we can do that as well as anyone in the world. But as we think about some of these other suites of services- we're not going to go crazy with providing things in the wallet like music, as an example. I don't think that's something we want to do, but there are other products like sports betting and that's something that has a very high stickiness, something like 43 million people in the US last year placed a bet on sports games. And if you think about like what that means, or what goes on in that type of transaction, well, you've got a two-sided network. You want to protect the credentials, the payment credentials of the people involved. So risk is very important there, and that has a stickiness to it as well. And so it's not to suggest that this is something that we're plowing ahead and trying to do right now. I don't mean to imply that at all, but I think it serves as a relevant example of how we're thinking about the utility of the wallet. And if we can provide all these types of experiences that people value in one place that has more acceptance than any other digital wallet in the world- has better security and safety than any other digital wallet in the world and have more users using it, I think it's a destination for people. And I really fundamentally believe in our chances of success here.

James Faucette

And I want to pivot a little bit just to obviously- look, we have nearly 400 million active accounts, that makes sense in the wallet, and that's where we spend a lot of focus, but what about the merchant facing products, whether it be iZettle or Braintree, etc.? What are the things that we should be watching there, if anything, and tracking?

John Rainey

Well, Zettle is one I want to talk about because we made that acquisition a couple of years ago and when things were really starting to gel there, COVID-19 hit and we saw sharp declines in the volume because those are physical experiences. But Zettle is something that for many of us on the call being more US-based, we're going to begin to see here in the United States in 2021, and excited about what this, what this means and the addressable market for us. This is a point of sale for an everyday seller, and we're going to provide desktop and mobile friendly solutions for these customers. And very importantly, Zettle has a solution that easily integrates into the things that SMBs are using today. Things like QuickBooks or BigCommerce. It's a seamless integration that provides these merchants, the ability to accept all forms of payments, including digital payments or contactless payments. And importantly for us, when we think about the growth opportunities, half of SMBs in the US today don't have an online presence. We're really targeting this group that is physical first, if you will, and then help bring them into the fold in the e-commerce world, where we can complement the Zettle offering with what we're already doing online. And look, I'm really excited about bringing this to the US. These are going to be merchants that are the backbone of the economy, the hair salons, the restaurants, the main street retailers. This is something that hopefully all of you will get to experience more of going forward.

James Faucette

So, John, we're kind of coming down towards the end of our time. I want to talk about buy now pay later. You gave some pretty impressive stats on adoption of that new product, and obviously you guys have trumpeted how you're buying for it. You're not having to surcharge the merchants for that at all. But how do we think about that in the long run? If you decide to go up ticket size to longer duration, can you maintain that same kind of pricing or you become really tied to interest rates? I'm just wondering how we should think about the evolution of that from a pricing and capability and offer standpoint. And I guess tied to that, where's the appetite or why the appetite for extending credit to consumers, especially after the sale of the [U.S. consumer] credit portfolio to Synchrony, and is there any tie between those two

things?

John Rainey

Sure. Part of this answer dovetails into your previous question about our increasing share of e-commerce activity. And I've talked about this in the past, but we consistently have maintained a really strong share of checkout over time. There are exceptions to that. And some of those exceptions where we were going head-to-head with a buy now pay later option and installment pay option. We would see consumer preference for these other options that were out there. And so that really informed our strategy on this, where we thought, to continue that growing share of checkout or that growing share of e-commerce. We can price this for free and just get people to use PayPal and monetize it that way. There's no plans right now to change the pricing on this. And in fact, I would suggest that competitors are probably going to have to move their pricing closer to where we are to be successful because when you consider the size of our platform, the fact that the merchant bears no risks that we're bringing almost 400 million customers around the world to a merchant to have the ability to check out with Buy Now, Pay Later with PayPal and it's free for them. It's a value proposition that is unparalleled

in the market. Longer term, yeah. I mean, we could see some longer duration or higher pricing around that. Those are absolutely things that we're talking about and exploring, but where we are right now, two quarters into Buy Now, Pay Later, this is kind of like wading into the shallow end of the pool. We're testing our risk capabilities around this. We're experimenting with the offerings. We're trying to get upstream presentment with merchants. And so all of this will take time. And I think it's very reasonable to assume that over time, we'll get to a place where we do have higher AOVs [average order values] or longer duration. But getting to the last part of your question, James, we will continue to remain an asset-light company. We think that that's important. People aren't buying us because of the credit profile of the company, they're investing in PayPal because of the growth in margin dynamics. And we don't want to

do anything that changes the durability of our free cash flow and earning streams. And so I think we've been able to demonstrate that over the last couple of years, even through sort of some of the credit situation that we saw in 2020. As Buy Now, Pay Later grows, we might get to a place where again, we think that we are too asset intensive there, too credit intensive, and we will look to externalize some of the other parts of our portfolio, like the international consumer book or like the merchant lending portfolio, both of which are highly coveted from some of the other issuers that we've talked to.

James Faucette

I guess when you look at the users that you're looking at or you're seeing use it, how do they fit with the rest of the PayPal base? Is there a greater adoption among a particular user type or are they representative? Just any insight there.

John Rainey

No doubt that the demographic that uses this skews heavily towards the younger demographic, the millennials, those that don't have that revolving- existing revolving credit relationship. This is clearly sort of a preference for some in terms of how they choose to associate with credit in today's world. But we are seeing it spread out across existing users as well, where, maybe they're tapped out on their existing revolving credit, and they want to use this instead. And what's really curious about this is it's not so much sort of thought of as it appears as credit versus delayed debit, because the funding mix- I've talked about this, the funding mix of our Buy Now, Pay Later customers is over 80% debit payments. It's where someone may have the money, but needs to stretch that out over a matter

of weeks versus really putting it on a revolving credit card.

James Faucette

Yeah. Well, I think that makes a lot of sense. Last question, I promise John. QR codes. From my perspective, we've been- I think we've always felt like there's good optionality there, but I didn't want to get too excited too quickly about it, but the metrics you're showing are really encouraging. Where do we go from here? Can you drive it faster? I know you keep preaching patience, but what should we be looking at from QR codes and point of sale acceptance?

John Rainey

Let me give you a data point here, among those that are using QR code with PayPal, we're seeing a [19%] lift in TPV. So again, like precisely driving the outcome that we're really trying to achieve and I'm quite excited about that. Now, all that said, QR use is still a very small part of our overall volume right now. And it will probably be that way for a period of time. We're having to go out and organically develop the other side of this network on the merchant acceptance. And this is why it's so difficult for people to

compete in payments because you've got to have both sides of that network at scale. And it's tough to do organically. Now, fortunately for us, we're a household name with these merchants and many of them, we have the online acceptance already. So I think it's an easier path, but it's not one that's going to be done in the next quarter or two. I would ask for patience from the investor community, because this is something to be successful, it's going to take a period of time that measures into years to where we have the saturation and ubiquity and importantly, changing consumer behavior around this. This is something that requires a lot of investment, lot of work on our part and learning from some of the experiences that we're rolling out. We've already learned, like, as an example, the importance of employee education at these merchants because very often they are what's in between a consumer wanting to pay and that POS device in store. So [employees have] got to help [consumers]. We've learned some things there already, and that's changed the way that we're thinking about go-to market, but something that we're quite excited about. And again, I think most of us would agree, this is not going to be a matter of if it's successful, it's going to be when, because this is something that I think is just fundamentally easier and a better way to pay going forward.

James Faucette

Great. Well, John, like I said, I promise it was the last question. We've run a little bit over. I really appreciate your frankness as well on all these topics. Any last things you want to make sure that we hit on or take away that maybe we didn't sufficiently during the hour or 45 minutes?

John Rainey

No, I would want to thank you first, James, it's always fun to do this with you. I think we hit on a lot of the relevant questions, certainly that we're hearing from analysts and the investor community. Look, we're excited about what the future holds for us. 2021, it's going to have some challenges in it, not

unlike 2020, but fundamentally we find ourselves in a place where there's been a step change in e-commerce and digital payment activity. And that's why we're investing so heavily into this. This is a point in time that is not going to pass us by, and we don't want to regret having not done something that can help shape the outcome here of the future that we believe in.

James Faucette

That's great. Thank you very much, John, Gabrielle. Thanks for your time today and all the work you put into keeping us investors and the investment community updated. And have a good day, everybody.

John Rainey

Thank you all. Bye.

James Faucette

Thanks, bye.

Operator

This concludes today's conference call. Thank you for participating. You may now disconnect.