PayPal Q4-19 Buyside Call Hosted by AllianceBernstein

January 30, 2020

2:50 pm ET

Harshita Rawat: Hello, everyone. Welcome to PayPal's Fourth Quarter Post Earnings call back. This is Harshita Rawat and I cover payments at Bernstein. We are very excited to have John Rainey and the PayPal investor relations team here with us today. John, thank you for taking out the time to chat with us.

John Rainey: Thank you, Harshita. It's a pleasure to have this opportunity and I'm also joined by a couple of individuals here from the management team at PayPal, but notably John Kunze who heads up our consumer and product and technology.

Harshita Rawat: Great. John, just to kick things off, can you compare and contrast the 2020 guidance that you gave yesterday with 2019, some of the puts and takes going into this year's forecasted number versus what you had in mind last year and some of the upside and downside risk to this year's numbers.

John Rainey: Sure. So I'd like to start with where the macro-economy is in contrast to a year ago. And I mentioned this on the call yesterday, but not to suggest that everything is perfect from an economic perspective, but I think there was certainly more trepidation in the market last year for some of the macro uncertainty whether it was related to China, and Europe at that time. And the holiday season was not as strong for us in 2018.

As we reflect back on the last quarter that we just reported on, we certainly saw some improvement as we went through the quarter. December was a really good month for us and that's carried on into January. And so I think in any discussion about the outlook for the remainder of the year, it's good to ground ourselves in the fact that we're starting from a much better place this year than we were last year.

Second, some of the key items that we're depending upon for growth next year have already been launched. And so specifically what I'm referring to is we have more growth coming internationally next year from our partnership with Uber. We've talked about the Paymentus relationship which went live in December and we continue to migrate merchants over.

And then we also have a few other deals that have been signed with large merchants which will drive more volume that we have certainty on at this point. And so I think there's still a number of items like in any year that we are dependent upon a successful execution on, but there are many things in place already this year that will drive growth based upon the fact that they were implemented at the tail-end of last year.

Harshita Rawat: And is the best way to think about 2020 revenue growth drivers, is that in addition to some strong base business growth rates as you highlighted, you have benefits from partnerships such as Paymentus, Uber, pricing changes, merchant wins, Honey and Venmo. But then some of this is offset by eBay and FX. And is there any item on this list which has a bigger impact versus others as we think about 2020?

John Rainey: Well we've called out that eBay will contribute about a point of headwind to our growth. And I think everyone recognizes that we enjoy a higher take rate almost 4 percent from eBay today, with that declining volume, that will put pressure on revenue. And also some of the larger merchant deals that we've signed by virtue of the volume that they contribute to our platform, they're going to come at a lower take rate, and so there won't be a commensurate increase in revenue as there is with volume.

So that's where I think some of the pressure is on some of the things that are contributing to that. Pay with Venmo is something that as we get into the second half of the year I think will be a bigger driver than what you've seen historically.

And then honestly, we're very excited about Honey. This is very new, I mean we're just a couple of weeks into closing the acquisition. We have to make certain estimates about what that synergistic benefit is and that's reflected in our guidance. We noted that we get about a point and a half of revenue growth (at the midpoint) from Honey that we're expecting in 2020. But obviously we'd love to outperform that and we're extremely excited about what the opportunity is here long term and we'd love to be able to execute on that even more quickly.

Harshita Rawat: And John, one of the bigger topics of discussion that came up last night is the international TPV deceleration which sort of brought the whole TPV down because the US seems very strong. Now, you highlighted that almost all of iZettle lapping is international, but appears to be a modest like-for-like deceleration.

Can you provide some color on the drivers of international TPV deceleration and more importantly, just give a little bit more context on the specific drivers of TPV acceleration? You've already called out some in terms of partnerships, new merchant wins, et cetera.

John Rainey: Sure. So international TPV decelerated about 4 points and the amount attributable to iZettle was actually 4.2 points of decel. So that really contributed to the entirety of it. If I step back and qualitatively describe some of the things that are happening there, certainly eBay does have an impact on that as well. They have a sizable presence in some of our core markets and as our volume is declining off of eBay, we see the impact of that.

I noted on the call, I believe yesterday that if you just look at transactions, there was a 6 percent decline in eBay transactions [on a year-over-year basis] on our platform in the quarter. And so we're managing through the impact of that and everyone is well aware that this year and next, those are the years that we will begin to transition away from eBay.

And I think the fact that we're doing that, while maintaining the margin profile and the growth profile that we are, speaks to some of the opportunities that we have in our business.

There has been also, currency movements that have affected some of what we see with cross-border and international and I think it's important to know that currency movements can affect the translation of those revenues, but there is also a consumer behavior element to that.

So if the Australian dollar is 6 or 7 percent less valuable versus the US dollar, than it was a year ago, we have the lapping effect of that, but the fact that you lap it doesn't all of a sudden make goods less expensive than they were to Australian consumers.

And so there's kind of a prolonged effect there that impacts our numbers too. But I think that's one of the great things about our business is that we are so diversified not only from a product perspective, but geographically.  And so we have those natural offsets when we do see currency movements in directions that may be less favorable for us for a period of time.

Harshita Rawat: And in terms of looking into TPV for 2020 you reiterated the mid-20s guidance.  So how much of that is new partnerships like Paymentus, Uber, the new wins are coming in and also some base business accelerations from 4Q because you did highlight some of the good trends coming out of December and January.

John Rainey: Sure.  I think -- I certainly appreciate the desire for the investor community to understand that bridge between 4Q to 2020, but it's really not just one thing. It's a multitude of items in our business that spans the entire company.

So they are new deals like the ones I mentioned.  We've got Paymentus going live.  We've also signed a big deal with Live Nation, that's going to contribute a lot of volume as well.  And so that's also live and we're moving forward with that.  And then Uber is something that we're pretty excited about expanding our footprint with them.

But I think there's something I want to be very clear about because of the recent purchase of ours - the TPV is unrelated to Honey.  We don't have any contribution to TPV from Honey in the forecast that we've given.  Honey is a slightly different business and we are still determining how we account for that.

And so we may elect to account for that as TPV, but that's something that we need to work through internally. Even the very -- how we reconcile their monthly active users with what we refer to as a net new active, we are working through that reconciliation process and we'll certainly inform this community when we reach a decision.

But we may find that there is a direct contribution from Honey to TPV that would add to that number. Certainly there is an indirect contribution that is in our numbers, but we're still working through the reconciliation of that.

Harshita Rawat: On the earnings guidance for 2020, can you expand upon your comments on EPS, the guidance implies somewhat of a deceleration from 2019 adjusted for some of the Honey dilution. Now, you do have a number of headwinds in 2020, Honey, CECL, eBay, accelerated investments.

So, can you talk about what EPS growth and margin expansion would have been in the absence of these items this year?

John Rainey: So let me give a little bit of characterization of this EPS guidance. So we said that eBay was about a point of headwind related to revenue [growth]. It's fair to assume that it's more than that related to earnings. Just given the profit profile of that business, higher take rate.

Now, back in the third quarter call, we said we expected earnings to grow 17 to 18 percent, EPS to grow 17 to 18 percent. Since that point in time, we've finalized the impact of the new accounting standard CECL for credit losses, that's about a point of impact. We also have the acquisitions of GoPay and Honey which is another 3 points of impact, so take 4 points for that total. Offsetting that is business strength of about 2.5 points that reflects some of what I described in what we've seen through the fourth quarter and into January.

And so that gives us, if you were to look at it on an apples-to-apples basis, we actually have an EPS, a sizeable EPS improvement versus our third quarter call. It's not a surprise I think though, that given this is the transition year away from eBay that we might be slightly less than the medium-term guidance that we gave which was ~20 percent EPS growth each year. But as you can see through the numbers that we've provided, it's above that if we adjusted for these one-time items.

So I guess to sum up that, we feel really good about the core earnings strength of the business. We've seen improvement in transaction margin trends both in terms of what you saw in the take rate in the fourth quarter as well as three continual quarters of improvement in transaction losses. And we continue to demonstrate that we can operate this company at a very low marginal cost as our other operating expenses have been in that mid to high-single digit range.

Harshita Rawat: That's very helpful, John. And let's talk about international for a bit. International is clearly a big opportunity for you. Over the last one or two years, you've had a number of strategic partnerships and investments including what you talked about China last night.

So, can you talk about your international strategy holistically, what are the countries you're currently very strong in and also over the next few years what is the more tangible opportunity in terms of international expansion and how you're going about that?

John Rainey: Sure. So historically, we have been strongest in the international markets where eBay had a significant presence. And those markets for us would be, in no particular order, the UK, Canada, Australia, Germany and France I would throw in there as well. We have a much more established presence in those markets. We've got a pretty significant penetration into the digital users there and see high levels of engagement.

But when you look across the globe at where we have more white space, these happened to be some of the fastest growing areas where you have the most digital users. And so examples will be countries like China and India. We've launched domestic India, that is going about as expected. We're going to have a more concerted effort there this year and next though to expand our presence in India.

And then certainly you see the investments we're making in China which also come with the GoPay acquisition. We think that that's a very promising opportunity given that we have an open platform where we can partner with the financial institutions, the financial ecosystem in China.

And just as a reference point, we're about 1 percent penetrated into their half a billion digital users, and when you allow that number of digital users to now use their payment instrument in the PayPal wallet to shop at our network of 24 million merchants across the world, that's a significant, a significant cross-border opportunity and one that we think we can play in and win in given our value proposition of what PayPal does.

Harshita Rawat: And on China, what's the timeline that we should think about in terms of the financial impact? Is it two to three years or is it more like a longer-term impact?

John Rainey: Well, we'll certainly see a financial impact in terms of the cost in 2020. We're making a pretty big investment there, but I understand your question is when are we going to start seeing the benefit? You won't see anything outsized in our numbers in 2020.

Let me be very clear, this is a long-term play for us. The investment that we're making in China is one that allows us to replicate our infrastructure there and have data localization and I think this is an important point, Harshita, because this is a trend that we see in a lot of countries whether it be like a Brazil, or in India or other countries like that and the investments that we're making in China are scalable ones that we can apply to these other countries and give us the opportunity to have the same type of presence that we aspire to in China in these other large developing countries.

Harshita Rawat: Yesterday, Dan reiterated the importance of offline. Historically, it's been harder to address by PayPal, now, you have initiatives such as the Venmo debit card and iZettle. Can we now, over the next couple of years see a more meaningful offline presence for PayPal? And how important is offline to your growth and your engagement over the next few years?

John Rainey: I think it is extremely important and I'm glad you asked the question. One could argue that we have been late to the party here and when we look at our aspirations both in terms of the number of consumers but also the level of engagement that we want those consumers to be at using PayPal offline, point of sale is a big opportunity for us.

And so that's why we call that out as one of the key initiatives that we have for 2020. And that can come through QR code, it can come through NFC, a number of different ways. But if you look at what some competitors are doing in terms of the amount of transactions that they're having on their platform, a lot of those are coming in the offline world. And everyday use case type items like transportation or food and we can play in that space we think very effectively.

And it's not just what our intentions are, we're hearing that from our customers. They want the opportunity to use a Venmo or a PayPal in an offline setting. And so that helps us move towards that goal of being an everyday part of their financial lives.

John Kunze: Hey John. Just to add to that, that our card strategy is a big part of our offline strategy as well. And we will have the ability to issue cards in many markets this year, upwards of 40 by the end of the year. And we have issued cards in the US for both the Venmo and the PayPal brands. We're seeing very good engagement with customers who are using these cards including daily use case spending where they're swiping at grocery, fuel, quick serve restaurants, and so forth.

And I think we're not going to be dogmatic about this approach and choose one mode over another, because the modes that are the majority use cases vary by country. And what we need to do is to be the best in breed in either mobile point of sale, card, NFC and QR and that's what we intend to do.

Harshita Rawat: Thank you. And then on the mobile point of sale and the offline point more broadly, can you talk a little bit more about iZettle? I know the regulatory approval delayed a lot of things for you in terms of what you can do and even talk about, so can you talk about how iZettle is performing, versus expectations, what does that look like in a couple of years?

John Kunze: Yes, thanks. Just to remind everyone, iZettle is serving small and medium size businesses primarily in the UK, throughout Europe and in Latin America and it's very complementary to our PayPal Here product that serves the same segment but primarily in the US, so very complementary markets.

We did, as you noted, start off slowly because of the regulatory issues, but now that we're past that, we're really focused on integration of iZettle into the PayPal stack and of rationalizing the two different stacks between PayPal Here and iZettle. And we already have iZettle integrated with PayPal in four markets in Europe. We're seeing some really good cross-sell benefits as a consequence of that and there's going to be more to come.

Harshita Rawat: Thank you, very helpful. Switching gears to Honey, I know it's only been three weeks since you closed the acquisition and you gave very good color on the pace of integration last night. What do you think has been some of the aspects of this deal that have been under appreciated by investors?

John Rainey: Sure, this reports up to John Kunze, I want to allow him the opportunity to speak to this, but I think there's a tendency for I think some of the investors to look at this as something like an affiliate marketing company and we believe it's much, much more than that. This is a company that has relationships with both consumers and merchants.

And what I think is maybe underappreciated is the opportunity that we have around data. Harshita, you've heard us talk before about how we see our share of checkout increase. The more that we can move PayPal up into the shopping experience and to present experiences to our consumers where PayPal is present earlier in the shopping journey gives us a much better opportunity to be the payment option when that is completed.

And so you can imagine shopping experiences where maybe you’ve got a saved item and we can present that to you when it's at the price point at which you want it and then we take you to that merchant seamlessly through the browser to complete that shopping experience.

And it's tailored to you and your preferences and your shopping patterns. And we think that that's a really promising opportunity that considerably expands our addressable market from where it is today.

And so this is something that we get pretty excited about. Now, to be clear, there's a lot of work to get to that point. There's some very obvious synergistic benefits in terms of cross sell that by themselves get us excited. But I think the data piece and what we can do there is what's maybe not as appreciated with investors, but John, I'd love any thoughts you have.

John Kunze: Yes, thanks. Just to enumerate some of the features for everyone's benefit, it's much more than just a couponing system. Obviously, we feel that this deal could be transformative for us. Just looking at their performance of [Honey's] 17 million monthly active customers, they have ~30,000 merchants they work with. Those customers found about $1 billion worth of savings opportunity in the last year.

So, there's excellent traction on the platform already because it's really a shopping companion more than anything else, and is an offers platform, rewards platform, a price-tracking system and allows customers to get deals on items that they want when they want it and in the context that they want it.

There are four major themes to the integration that we're working on right now.

The first is let Honey be and let the Honey team build out the best Honey platform possible. That's something that PayPal actually is quite good at, at acquiring companies and letting them run to be the best that they can be. And so, that's one of the major priorities.

The second priority is to integrate Honey experiences into PayPal for the purpose of cross-selling PayPal customers to increase downloads of the Honey extension. I'll note that on the day we announced the deal closure, we had end-to-end cross-selling on the site and log in with PayPal functionality available to our customers. And in just a few weeks, we've seen 100,000 downloads of the extension.

Most of those downloads, by the way, were logged in with their PayPal credentials which I think shows some evidence that we have really good ability to cross-sell their functionality into our base. And when you think about how big our base is with 24 million merchants and 300 million customers worldwide on the platform, we have lots of opportunity here to expand their business.

And then the third thing we're going to be doing is embedding Honey functionality into PayPal experiences. You'll be hearing more about that in the months to come.

And the fourth thing which is also very exciting is to think about how we can build tools for our merchants across that 24 million merchant base to allow merchants to self-serve their way into the platform and make relevant offers to our mutual customers.

Harshita Rawat: Thank you. Now, it's very helpful to hear benefits to both sides, both consumers and merchants. Let's switch gears and talk about some of your recent partnerships.

You've had a number of partnerships rolling in over the next few years – Paymentus, Uber, MELI, Facebook, the banks with pay with rewards, Union Pay, et cetera. Can you remind us how should investors think about the timing and relative magnitude of financial impact? Which of these partnerships are more relevant for 2020? Which are more longer term focus and which of these are you the most excited about?

John Rainey: Yes. So, for 2020, the partnerships that will have more of an impact on our financials are Paymentus and Uber. And I mentioned Live Nation, that's another one that stands out that is a larger deal. We also have a couple what we call mega deals that are larger merchants but nothing that we would really characterize as a partnership per se, just a typical large merchant deal that will help drive volume.

The investments though that we're making in 2020 around things like GoPay in China and what we're doing with MercadoLibre, those are benefits that we will – that will manifest on our P&L in 2021 and beyond. So, those are more longer term.

And I think that's what's great about the diversification of our business, is here we are, a company that has continually achieved mid-20 percent TPV growth, we're now over $700 billion in annual TPV and growing at that rate. And because of our profitability profile, we have the ability or the latitude to continue to make investments to continue that TPV growth in the future.

And so, these investments we're making are quite material in 2020. But they're also the vehicle by which we'll have that TPV growth in 2021 and beyond. And it goes back to kind of reconciling with our medium-term guidance, it's why we continue to have the conviction that medium-term guidance is achievable for us.

Harshita Rawat: And more broadly on partnerships – what are some of the milestones or events investors should be watching out for in terms of just looking at how you execute on these really large-scale, multifaceted partnerships.

John Rainey: The best way, I guess, to answer that is really most of our investors are also customers. And you will see that through new experiences. As large as some of these partnerships are, given that we will – we're over $700 billion TPV today, it's not as if all of a sudden you're going to see like a huge step function uptick in that.

We tend to roll out these experiences not necessarily in a big bang where all of a sudden we have a complete suite of new experiences for our consumers. We tend to roll some of them out as they're developed and then add to that. And so, I would encourage the investor community to see them for themselves as we do things like goods and services with Venmo and do more point of sale things and add cross-border opportunities with MercadoLibre and MercadoPago, those types of things.

Harshita Rawat: And then in the U.S. – pay with rewards has been an important partnership and also the company's focus area. Can you give some color on the changes you're seeing in user engagement as a result of some of these rolling out?

John Rainey: Yes. So, we do see with – let me step back. We have partnerships with Amex, Discover, Chase and Citibank. And with those experiences, if you’ve not used pay with rewards, I would encourage people to, because it's a very clean, seamless experience where it's simply another funding instrument in your wallet.

And that basically increases the utility of those points for users, where in the past maybe there were a limited number of opportunities or merchants with which you could redeem those points. This makes it a more fungible currency, if you will.

And so, where we have seen users engage in that, we see both one more engagement but also importantly a higher average transaction size because this is often sort of free money to people. And so, we tend to see larger average purchases when people engage with the pay with points. But to be fair, this is also something that we've got a multiyear plan around.

We think that points is something that is an opportunity for us given the reach that we have with our merchant base. And to be able to use your points to shop at 24 million merchants around the world is both great for consumers but it's also great for us because this comes at the same take rate but a much lower funding cost than the average transaction.

So, we want to build out a pretty robust experience around this that also emphasizes or better educate our consumers on how they earn points as well. There's still a not immaterial amount of our consumer base that experiences confusion about their ability to earn those points.

But I can't help but also talk about the opportunity we have with Honey on this because we've been asked in the past oftentimes like would we ever do our own loyalty program. And the answer to that has been no, because loyalty programs tend to be very expensive and for our user base they already have that opportunity to earn points.

But what Honey does for us is give us – it gives us another monetization avenue on that transaction. So, instead of paying or receiving a commission, we might elect to take some of that and provide loyalty points for that consumer base that then sort of increases their attachment, increases their engagement with us and instead of us simply taking all of that to the bottom line.

So, it's something that Honey is already doing but we're really excited about what we can do when we append that to our platform and look to drive more engagement and more loyalty among our over 280 million consumers.

Harshita Rawat: Thank you. And you gave a lot of good metrics on Venmo last night including more than 50 million users, $450 million revenue run rate annualized. Can you talk about how has your thinking changed on the relative importance of different monetization levers over the last few years. So, I'm thinking of pay with Venmo, the debit card, instant deposit and the new credit card that you plan to launch.

John Rainey: Well, I want to emphasize that the important thing for us internally right now with Venmo is growth. And the vehicle for that growth is to allow our customers, our Venmo customers to be able to use Venmo whenever and wherever they want.

And so, that could be through pay with Venmo. It could be through a physical card in an offline store. It could be through the scanning of a QR code and these are all things that we're doing.

I have been exceedingly pleased with the monetization avenues that we've had particularly around the instant withdrawal product, that has exceeded our expectations. But as we've also consistently said though, the real long-term play here is pay with Venmo.

And in the second half of this year, we'll have a better experience to roll out that over time will change the composition of that monetization to where pay with Venmo will contribute more to the overall revenue and profitability than what we're seeing like with instant withdrawal and the debit card today.

Harshita Rawat: If you think about the next few years, is Venmo a meaningful driver for 2020 or is it more of a 2021 and beyond impact as you roll out a lot of these new experiences.

John Rainey: It's one of the drivers for 2020, certainly. I think I would characterize it as meaningful. We continue to see good progress. Look, I think you've seen that in the numbers that we shared yesterday, just the fact that it has a $450 million annual run rate is something that we're very pleased about.

We can clearly see the demand from our consumers. They want to use this. But even the physical card has a certain cache with that user base where they want to put that down and then people are asked about it, how did you get the Venmo card.

And so, we're hearing loud and clear from our customers that they want to be able to use this. And we're excited to roll out and more of our experiences, even experiences like bill pay. Venmo will be one of the options when we integrate some of these large merchants with Paymentus.

Harshita Rawat: And on that point and all the experiences that you're rolling out – can you address some investor concerns that you may not be monetizing Venmo as aggressively as some of your smaller peers?

John Rainey: Well, sometimes there are tradeoffs, right? And tradeoffs can be trying to drive towards profitability or trying to go after a larger addressable market. And our history has been even if you look at our decision around choice three or four years ago is that we think that there's more shareholder value creation by going after the larger addressable market and being one of the premium players in the digital payment space.

And that belief holds true with Venmo as well. And so, we don't sit around internally and ask ourselves can Venmo be profitable. That question has been answered and it is absolutely yes.

But we don't want to sacrifice the growth opportunity by simply focusing on becoming profitable and fortunately for us, we have the financial profile where we have the ability to continue to make these investments in Venmo to try to grow it as quickly as we can without needing to rely on that to expand our operating margins in a particular quarter.

Harshita Rawat: That makes sense. Thank you. Let's talk about some of the business and profitability drivers coming out of last night. Now take rate – the performance was very impressive. You have historically hinted that some of the pressures and take rate that PayPal had seen historically are now moderating. So, can you talk about the puts and takes on take rate going forward and also in 2020 in terms of pricing, mix shift into larger merchants, P2P, international, et cetera.

John Rainey: Sure. I think, Harshita, that context is important in the answer to this question because we've seen pretty significant decline in the rate of decline in our take rate versus a couple of years ago. And so, I think it helps to understand what was driving that a couple of years ago. And this was when Braintree was in a hyper-growth phase and they were expanding from a lot of the small and medium-size merchants to the LE, the Large Enterprise space.

And so, that mix change actually created a bit of pressure on our take rate. And then from one period to the next, there might be hedge gains or losses that can influence that but that's where we were a couple of years ago.

In more recent periods, the single biggest contributor to the decline in take rate has simply been free P2P. And as we talk about the profitability profile, of the lifetime value of P2P customers, that's a consequence that we will happily take because we believe that's the right decision for our company.

But as you move into 2020, while we don't give specific guidance on take rate. The way to think about that is the rate of decline should be pretty similar to what we saw in 2019. And there are a few puts and takes that are driving that.

So, on the pressure side, certainly eBay is worth calling out. As I noted earlier, they have about a four percent take rate, a little less than that today. And as our volume comes off with that, we'll see that – we'll see pressure there.

The other area may be worth noting is Paymentus. So, the take rate model and bill pay is slightly different than what it is with our merchants. And so, that'll be a lower take rate that will put some pressure on that number as well.

Now, helping buoy that number or offsetting some of that pressure are two maybe three things. One is pricing. And those are largely the changes that we implemented in the back half of 2019. But also, in every year there are pricing changes that we make. And so, we've got other opportunities in 2020.

The second area as previously noted is pay with Venmo. That will continue to help improve what we see in the overall take rate. And the third area is Honey. And, again, Honey today as we're thinking about it is basically revenue contribution but not a contribution in terms of volume or TPV.

Now, as I noted earlier in the call, as we further research that, we may elect to change that but as it is today, that would be simply a revenue contribution than volume which will help buoy the take rate as well.

Harshita Rawat: That's very helpful, John. And then just following up on the pricing changes that you called out, I know you've always said that pricing is not a one year and done phenomena but more of a multiyear journey for you.

But for the fourth quarter specifically, was there – this is a question that we've gotten a lot – did you have some one-time TPV impact from some of the pricing changes that you've implemented?

John Rainey: No. We've not seen any elasticity effect from the pricing changes that we made. Now, to be fair, sometimes those may take a quarter or two to manifest. But with any price change that we do, we always do a test of the market.

And so, we have a pretty high degree of confidence around what the impacts will be if there is any offset in volume when we raise prices. And that's why we always try to price to areas where we think there's a very clear value-add component to that for customers be they consumers or merchants.

Harshita Rawat: Thank you. And then, looking at the other value added services – it's been growing faster than transactions revenue especially when you adjust this for one-off items. Can you talk about some of the long-term opportunities there? You kind of hinted that it should grow at least in line or faster than the transaction revenue. What would be the drivers of that?

John Rainey: Sure. So, let me – that increased 14 percent year-over-year in the last quarter and I want to explain a little bit of that. So, when we announced the agreement with Synchrony, we agreed that we would service that portfolio, PayPal would service that portfolio for a period of time as it transitioned.

In return for that, Synchrony compensated us about $55 million each quarter. And so, when we look at to compare to last year, we had $55 million related to that servicing element. It's not in our numbers now. And that [lapping] will persist for two more quarters, through the first half of 2020. And so, that creates pressure when we look at it from a year-over-year perspective.

And so to answer your question, Harshita, like once we get past that, you actually should probably see that grow faster than our transaction revenue as an example. And there's a couple of drivers there.

One is credit tends to be a fast-growing part of our portfolio both international consumer as well as the merchant piece. But that's also where the revenue for Honey will reside in our P&L. And so, that will contribute to outsize growth on an apples to apples basis as we get past the first half of the year.

Harshita Rawat: Just zooming in on the credit piece, it has been a faster growing area of your OVAS revenue. You've already divested your U.S. consumer credit book. At what point would you consider pursuing a similar asset-light strategy for your merchants and international consumers credit businesses?

John Rainey: Sure. Well, there's not a bright line test per se to where we say once we reach this point we will begin to look at asset-light transactions. There are a number of factors that influence that.

One is just the allocation of cash. We don't want to have credit be too much of a draw on our capital that it takes away from other things that we're doing. And there's a range of numbers there but certainly we don't want to get anywhere like we're spending more than 50 percent of our free cash flow to fund credit.

Another item that we look at is just the composition of our overall business in terms of credit composition to our overall business. When we did the – when we sold the U.S. consumer credit receivables portfolio, credit was approaching 10 percent of our overall revenue.

And I don't want to – I'm very focused on the durability of our revenue and earnings stream. And I don't want investors to ever be concerned about PayPal's ability to consistently have that durable stream of earnings through a credit cycle. And so, again, that's not a bright line number but as credit gets to be a larger part of our overall revenue composition, that's something else that we look at as well.

And then just the size of the receivables balance. When we sold the U.S. portfolio, the receivables balance was $6 billion. As you'll see in our 10-K that will come out or in our investor update, that total receivables balance is about $4 billion today. About two and a half of that is merchant, about one and a half is consumer.

And so, those are all indicators that would suggest that we're not at the point yet to where we think that we need to pursue a more asset-light transaction because credit does have a good earnings stream, right, there's a trade-off there. But I think it's reasonable to assume that in the foreseeable future meaning the next couple of years that those metrics are going to point in a direction where we feel compelled to do another transaction like that.

And I'll also suggest that we have already had issuers that have come out and talked to us about wanting to be a partner when we do that something like what Synchrony did with us. And so, there is demand there and I think we've demonstrated in the past that we can do this without damaging the earnings profile of our business and free up a lot of cash to allocate towards other higher-return alternatives.

Harshita Rawat: One more follow-up on the credit business. A new theme that's just come up over the last year or so is the growth of some of your smaller peers focused on the buy now pay later payment options. How do you think about that vis-a-vis PayPal credit?

John Rainey: So, we're very cognizant of that and we see a demand for that from our consumers. We launched that in the fourth quarter of 2019 in Germany and the U.S. And we're keenly watching that to see how that fits into our overall portfolio going forward.

Harshita Rawat: Lets talk about Braintree for a second which has received a little bit less air time but obviously a phenomenal asset for you. Can you give a little bit more color on Braintree – how the recent growth trends have been, the competitive landscape and also some of the partnerships that are coming like Uber, et cetera, which are more Braintree focused at least in the beginning?

John Rainey: Sure. So, Braintree has historically really focused on that small and middle market opportunity. And we continue to see great demand there. Dan noted on the call yesterday that we actually expect acceleration in Braintree's growth next year because of some of the extensive opportunities that we have there.

One of the things that we're focusing on is building out that suite of opportunities for that platform that merchants want – be they things like payouts or risk as a service which we've acquired through some of the acquisitions in Hyperwallet and Simility.

And then we're going to continue to focus on things that we think are in demand like alternative payment methods, local acquiring and international countries – things like that that continue to help us be have a strong competitive position in this space.

Harshita Rawat: And do partnerships like Uber which I think you called out sort of the opportunity in Europe, India, Brazil, does it sort of expand the international footprint for Braintree which has been more U.S. in nature?

John Rainey: Yes. You're absolutely correct. So, that gives us more international reach with that platform as we expand with our customers internationally.

Harshita Rawat: A question on expenses and just looking into the margin dynamics in the next couple of years. So you've demonstrated a very impressive leverage out of your non-transaction-based Opex, at what point do you run the risk of not investing in your business enough?

John Rainey: Well, we always take a multiyear perspective when we look at the investments that we're making. And we don't manage the company to have margin expansion in any particular quarter or constrain our cost to an arbitrary X percent growth each period. We're always looking at what can we do to continue the growth opportunities that we have.

And I think we're demonstrating that I think quite well in 2020 as we're not going to be a prisoner to margin expansion when we've got such significant opportunities like China in front of us that we know requires investment. And so, there's a bit of a threading of a needle aspect to that in balancing investment with profitability but we're not turning away good investments because we're trying to keep our cost at a certain level.

It just so happens that the nature of our business is such that we have a platform that can scale at a very low marginal cost. That wasn't necessarily the case in the past be it on the technical infrastructure side or what we were doing around customer service and these are all improvements that we made but we will continue to make so that we can keep continuing to grow at a very low marginal cost.

As I noted on the call yesterday, our incremental operating margin in the quarter was 35 percent. And we were able to do that while still growing cost in the mid to high single digit range, seven percent in the quarter. And so, we think that this is just a business that will continue to be able to scale at a low marginal cost while investing for the opportunities that we have in the future.

Harshita Rawat: On eBay – you gave a lot of color on the impact for 2020 which was kind of in line with what eBay had said on their call. But as you look out for eBay into 2021, what are some of the things that could result in a higher headwind versus what you kind of expect or on the flipside a lower impact.

I'm not asking for guidance on 2021 which I know you're not ready to give yet but just thoughts on the puts and takes into next year's impact for eBay.

John Rainey: Yes. We highlight in the investor update that we sent out yesterday a few of the items that can influence this. Now, we encourage the investor community to look at that. We feel like we have a pretty good bounds around what our expectations are in terms of our branded share check out.

And so, really the things that would influence to answer your question sort of where something could be outside of our control more is the pace of integration or the pace of roll out of eBay's managed payments, that's outside of our control. Merchants have to adopt that, right? They have to elect into that.

And so, there are a number of factors, pricing being one that can help influence that. But that's somewhat outside of our control. But even with that, we feel like there is enough certainty around what we – around the future based on what we've seen already that we've got a pretty high degree of confidence around what the financial impact would be.

Harshita Rawat: John, I want to be respectful of your time, so my last question for you is more around the competitive environment for the core PayPal button. Your core button still drives a sizable portion of your revenue and profit, how do you see the competitive environment for the button evolving and not necessarily right now where many of your competitors are a fraction of where you are, but in two to three years from now.

John Rainey: You see a lot of companies that are wanting to enter digital payments and some companies because of the trove of data that exists with that. And so, we recognize that we operate in a fiercely competitive landscape but we also have a growing user base that is using us more and more each day.

What we are focused on is continuing to provide reasons for our users who want to use us more in sort of everyday type occurrences. And in the face of all this competition, you continue to see us not only grow at a rate that's much faster than overall ecommerce, but do it while expanding our margins and that allows us to make these investments which you mentioned earlier so that we can continue that growth profile into the future.

And so, we're not looking to the next quarter or even the next year; we're really thinking about what does the landscape look like two, three, four, five years from now. And that's precisely why we made an acquisition like Honey because we think that that will be determinant of the success in the digital payments multiple years down the road much more so than the number of app downloads that someone has in the next quarter.

Harshita Rawat: Fantastic. Thank you very much, John, for your time today, really appreciate it. And thank you, everyone, for joining the call this afternoon.

John Rainey: Thank you, Harshita, appreciate the opportunity.