

Q2 2021 Earnings Call

Company Participants

- Dan Schulman, President and Chief Executive Officer
- Gabrielle Rabinovitch, Vice President, Corporate Finance and Investor Relations
- John Rainey, Chief Financial Officer and EVP, Global Customer Operations

Other Participants

- Ashwin Shirvaikar, Analyst
- Colin Sebastian, Analyst
- Darrin Peller, Analyst
- David Togut, Analyst
- James Faucette, Analyst
- Jason Kupferberg, Analyst
- Ramsey El Assal, Analyst
- Tien-Tsin Huang, Analyst

Presentation

Operator

Good afternoon. My name is Brana, and I will be your conference operator today. At this time, I would like to welcome everyone to PayPal Holdings Earnings Conference Call for the Second Quarter 2021.

All lines have been placed on mute to prevent any background noise. After the speakers' remarks there will be a question-and-answer session (Operator Instructions). Thank you.

I would now like to introduce your host for today's call, Ms. Gabrielle Rabinovitch, Vice President, Corporate Finance and Investor Relations. Please go ahead.

Gabrielle Rabinovitch {BIO 19771464 <GO>}

Thank you, Brana. Good afternoon, and thank you for joining us. Welcome to PayPal's earnings conference call for the second quarter of 2021.

Joining me today on the call are Dan Schulman, our President and CEO; and John Rainey, our Chief Financial Officer and EVP, Global Customer Operations. We're providing a slide presentation to accompany our commentary. This conference call is also being webcast, and both the presentation and call are available on our Investor Relations website.

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In discussing our company's performance we will refer to some non-GAAP measures. You can find a reconciliation of these non-GAAP measures to the most directly comparable GAAP measures in the presentation accompanying this conference call. Management will make forward-looking statements that are based on our current expectations, forecasts and assumptions and involve risks and uncertainties. These statements include our guidance for the third quarter and full year 2021.

Our actual results may differ materially from these statements. You can find more information about risks, uncertainties and other factors that could affect our results in our most recent Annual Report on Form 10-K and quarterly reports on Form 10-Q filed with the SEC and available on our Investor Relations website. You should not place undue reliance on any forward-looking statements. All information in this presentation is as of today's date, July 28, 2021. We expressly disclaim any obligation to update this information.

With that let me turn the call over to Dan.

Dan Schulman {BIO 1895545 <GO>}

Thanks, Gabrielle, and thanks everyone for joining us today. I'm pleased to say that on the heels of a record year our Q2 results once again reflect some of the best performance in our history, on both an absolute and a relative basis. It is now clear that customers around the world have embraced all forms of digital payments, even in regions where in-person activities are returning towards pre-pandemic levels. In this new normal PayPal serves as an essential and trusted platform for both consumers and merchants across all forms of commerce, payments, basic financial services

As a result, we hit a new milestone in Q2, surpassing \$300 billion of TPV for the first time in our history, growing 40% on a spot basis to \$311 billion with an annualized run rate of approximately \$1.25 trillion. This is even more notable given that eBay's TPV on our platform, declined by 37%. eBay exited the quarter at under 4% of our volume and we expect their TPV will approach 2.5% of our total volumes by year-end. Excluding eBay, our volumes grew by a remarkable 48% on a spot basis.

Our active accounts now exceed \$400 million, up 16% to \$403 million. We added \$11.4 million net new active accounts in the quarter, including an additional \$1.5 million merchant accounts. That brings our total merchant count to \$32 million. We still expect to end the year at the higher end of our previous guidance of \$52 million to \$55 million net new active accounts.

Transactions in the quarter grew by 27% to \$4.74 billion. And even as our net new actives continue to show strong growth, our transactions per active account accelerated 11% in the quarter to 43.5 times as our consumers engage more frequently across our growing suite of services. We grew our revenues by 19% to \$6.24 billion. This growth comes even as we lap strong results from last year and absorbed 811 basis points of revenue pressure from eBay, as their revenues on our platform declined 51% in Q2.

Excluding eBay, our revenues grew at approximately 32%. We now expect that eBay will be essentially 100% complete with their migration to managed payments by the end of the third quarter. We are maintaining our full year guidance despite the fact that this accelerated ramp puts an additional 100 basis points of revenue pressure in 2021. The good news is that this pressure begins to ease in Q4, and obviously positions us for accelerated revenue growth in 2022.

Finally, we delivered non-GAAP EPS of \$1.15 even as we continue to invest heavily in our growth initiatives. Venmo continued its strong performance in Q2 with \$58 billion in TPV, up 58% year-over-year, with over \$76 million active accounts. Revenue growth accelerated almost 70% in Q2, our highest growth rate in the past year, fueled by Venmo's product diversification strategy. More than 500,000 customers have established new business profiles on Venmo, with more than 300,000 created in Q2 alone.

Pay with Venmo revenues grew by 183% year-over-year. We're also seeing strong adoption in trading of crypto on Venmo, and this quarter we expanded the Venmo value proposition to allow merchants and consumers to pay for goods and services and receive buyer and seller protections for commerce transactions. This has been a very successful future on PayPal's P2P services and we expect it will be widely adopted on Venmo.

I'm pleased to report that the initial version of our new consumer wallet, Super App is code complete and we are now beginning to slowly ramp. In the next several months, we plan to be fully ramped in the US with a host of products and services across payments, basic consumer financial services and commerce and shopping tools launching every quarter.

New features will include high yield savings, early access to direct deposit funds, new and improved Bill Pay functionality, messaging capabilities outside of P2P to enable family and friend communications, as well as additional crypto capabilities and customized deals and offers. Each wallet will be unique, driven by our advanced AI and machine learning capabilities in order to enhance each customer's experiences and opportunities.

As I previously mentioned, 32 million merchants now rely on PayPal. They trust that our scale, security tools and resources will help them to grow their businesses in today's rapidly emerging digital economy. PayPal is the only payments company to offer features like global seller protection and fraud prevention services at no additional cost.

We are one of the few payments companies to allow consumers to use cryptocurrency as a funding source to check out on our platform. Our Buy Now, Pay Later offering comes at no additional cost to merchants, while boosting their conversion rates and increasing cart sizes by 39%. And we continue to expand our product differentiation through recent acquisitions like Chargehound and Happy Returns, that will drive additional value to both consumers and merchants post a sales transaction.

Our announced pricing adjustments in the US align our pricing with the value we deliver while giving us flexibility to aggressively compete in full stack processing and at point of sale checkout. We continue to see strong demand for our in-store services with

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approximately 1.3 million merchants now accepting our QR codes and continued momentum and excitement across our large enterprise merchants.

In fact every 20 seconds a new merchant signs up to use our QR codes. It's also very encouraging to see that consumers who use our QR codes spend more TPV. In fact 19% more TPV on the PayPal platform. Our in-store efforts will no doubt be a multi-year journey, but these trends reinforce our conviction to be a seamless omnichannel wallet. In Q2, our overall in-store efforts across QR and parts equaled \$6.3 billion in TPV, up 39% year-over-year.

Our in-store suite of services continues to expand with the launch of PayPal's iZettle in the US as in Europe PayPal Now offer small businesses in the US an integrated commerce solution that not only helps them to accept payments in store with the Zettle card reader but also helps them to manage sales and inventory across their various channels, all in one place. Our Buy Now, Pay Later product continues its strong growth and is proving to be extremely popular for consumers and merchants alike.

Since launch, we have processed over \$3.5 billion in TPV, with more than \$1.5 billion of that TPV in Q2 alone. Approximately 650,000 merchants have customers who use our Buy Now, Pay Later capabilities and 40,000 have positioned Buy Now, Pay Later upstream on their product pages. Over 7 million consumers have transacted more than 20 million times with our Buy Now, Pay Later product. Australia is now fully deployed and off to a strong start with additional countries in Europe, slated to rollout later this year.

Our employees, customers and government officials expect PayPal to be a role model and a responsible corporate citizen. I'm proud to say that we are delivering on our commitments to advance social justice and racial equity. Over the past year, we have committed all of the \$535 million we pledged towards advancing racial economic equality. And we recently launched a new \$100 million commitment focused on women's economic empowerment.

These efforts are a direct reflection of our values and our belief that PayPal must be part of a solution that drives a better future for all of us. I'd like to thank our employees for their passion and their never ending commitment for shaping a new and inclusive financial services system. We are entering a new era and we couldn't be more excited to help drive an emerging digital future where all small businesses and consumers can participate and thrive in a post-pandemic world.

And with that let me turn the call over to John.

John Rainey {BIO 17599063 <GO>}

Thanks, Dan. I'd like to start by thanking the entire PayPal team for their continued commitment to serve our customers and execute on our priorities. We are reporting another very strong quarter. Our results are indicative of the strength, diversification and breadth of our two-sided Global Payments Platform. PayPal sits at the intersection of digital transformation and e-commerce penetration.

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As the largest open platform for digital payments globally, we're uniquely positioned to address the opportunity that these secular tailwinds present. Over the past six quarters, our team's focus collaboration and resilience have allowed us to innovate at scale and deliver our best performance in company history. Globally the pace and shape of the recovery varies. As the environment continues to evolve we are evolving with it to serve the changing needs of our consumers and merchants.

During the second quarter restrictions started to relax across our core markets, and we saw the beginning of a return to normalcy in consumer behavior, Consumers are spending again in verticals that had been severely affected and have become more comfortable shopping in person and dining out

Merchants are repositioning for the post-pandemic world. Relative to our expectations, which were for reopening spend to closely track vaccination rates we've seen travel and events volumes return more rapidly. At the same time in markets that have reopened elevated e-commerce spending above pre-pandemic levels is ongoing and indicative of permanent shifts in consumer behavior

On a two-year basis our business performance is remarkably consistent and very strong. Our second quarter results last year were exceptional. We grew revenue 22%, delivered a 28.2% operating margin and grew non-GAAP EPS 49%. Both the operating margin and earnings growth, were the best performance we've ever delivered it's remarkable that in the second quarter of this year when we're lapping this explosive growth, our business is continuing to perform at a very high level.

Our results are even more impressive given the transitory headwinds we're facing from eBay this year. As part of eBay's managed payments transition we're absorbing a rapid migration of marketplaces volumes off of our platform. Further compounding this effect is the eBay benefited meaningfully from COVID last year, which makes the comparison this year even more difficult. For context from 2016 to 2019 the three-year compound annual growth rate for eBay Marketplaces revenue on our platform was approximately 2% and in 2020 this revenue grew 11% approximately 5 times faster

Also worth highlighting is that through this period as eBay's contribution to our revenue declined from 22% to 13% we've expanded our operating margin 500 basis points given the accelerated pace of migration in 2021. There is a more pronounced effect on our operating margin and earnings growth profile this year. At the same time, this is truly a transitory effect on our results, which we now expect to be very largely contain to 2021 with much less of a tail into next year.

And as we've discussed over the past several quarters, near-term forecasting continues to be complex given the global macroeconomic backdrop various stages of pandemic recovery and differing tasks of reopening. It's with this orientation in mindset that we head into the back half of 2021. Before discussing our outlook for the remainder of the year, I'd like to highlight for second quarter performance.

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Total payment volume grew 40% at spot and 36% on a currency neutral basis to \$311 billion. Our Q2 TPV grew at a two-year compound annual growth rate of 34% accelerating from 33% in Q1 and indicative of the strong momentum in our business. Versus the second quarter last year Merchant Services volume grew 43% currency-neutral, a resurgence in travel and advance as well as core payment volumes contributed to this performance.

This quarter, eBay had a much greater effect on our TPV than in the first quarter. In Q2, eBay marketplaces volumes declined 41% currency-neutral from last year. This is in comparison to a 3% decline last quarter. eBay represented 4% of our volume in Q2, down 512 basis points from last year.

In addition to lapping elevated growth during the pandemic, we saw a faster ramp of the payments transition than what we had expected earlier this year, which resulted in a larger decline in Q2 volume. Given the speed at which we're seeing intermediation progress our plans now contemplate nearly 100% completion of the merchant migration by the end of the third quarter. This accelerated timeframe means that while we expect a similar drag to our volume revenue and earnings growth in the third quarter this impact lessens in Q4 and begins to tail off from there. As a result, we will have a much cleaner exit to 2021.

Revenue increased 19% on a spot basis and 17% currency-neutral to \$6.24 billion. Transaction revenue grew 17% to \$5.8 billion and on a two-year basis transaction revenue grew 22.3% in Q2 versus 22.7% in Q1 of this year. In addition to the consistency of our results, this performance is even more remarkable excluding eBay. In the second quarter, eBay Marketplaces revenue declined 51% in comparison to Q2, '20 and 27% sequentially. Our revenue, excluding eBay, grew 32%, an 11 point acceleration from last year's already strong second quarter.

Other value-added services revenue grew 40% on a spot basis and 36% currency-neutral to \$441 million. These results were driven by strengthening credit performance and portfolio growth partially offset by lower interest income on customer balances. In the second quarter transaction take rate was 1.86% and total take rate was 2.01%. The mix effect of eBay contributed to more than a third of the 37 basis point reduction in take rate. The blended take rate on eBay volumes this quarter was 3.22% in comparison to 4.1% in Q2 last year.

The remainder of the decline was primarily driven by reduced currency volatility in the quarter, which resulted in lower growth rate in foreign exchange fees, a decline of \$122 million from foreign currency hedges recorded as international transaction revenue and growth in bill payment volumes. Bill payment is a vertical, characterized by both a lower take rate and an overall lower cost of funding than our e-commerce volumes, Q2 was another great quarter of volume based expense performance.

Transaction expense came in at 81 basis points as a rate of TPV this year relative to 83 basis points last year. Transaction loss as a rate of TPV was a record low 9 basis points versus 12 basis points in Q2 last year. The net effect credit provisioning on credit losses in the quarter, inclusive of originations and reserve reversals resulted in a benefit of \$104

million. In the quarter, we had an increase in loan origination activity and ended Q2 with \$3.9 billion in gross receivables, reflecting sequential growth of 11%.

Strong performance of our loan portfolio, improving macroeconomic trends and the mix of shorter duration originations from our instalment products resulted in our reserve coverage ratio declining to 14.9% from 21.4% at the end of the first quarter. As a result, transaction margin dollars grew 19% in the second quarter and transaction margin reached 56.8%.

I'd now like to cover our non-transaction related operating expenses. Overall, these expenses increased 27% and represented 30% of revenue. These are higher growth rates than what we've incurred historically, but as I suggested before, we believe that there has never been a more important time to invest in our business and the secular tailwinds in our business has perhaps never been stronger.

In Q2, we again invested aggressively in product innovation and our go-to-market initiatives. Sales and marketing increased 68% in the quarter and technology and development spend grew 23%. On a non-GAAP basis, operating income grew 11% to \$1.65 billion and our operating margin was 26.5%. This includes an approximately 12% or \$360 million decline in transaction margin dollars from eBay Marketplaces.

Normalizing for the reserve build last year and subsequent release this year, non-GAAP operating income declined 7% and operating margin was 23.9%. And on a two-year basis, the compound annual growth rate for operating income is 29%. For the second quarter non-GAAP EPS grew 8% to \$1.15. This includes an approximate \$0.27 per share headwind from the decline in eBay Marketplaces transaction margin dollars.

Adjusting for our increased credit provisions last year and this year's release of reserves, EPS declined 9%. And on a two-year basis, this represents 27% earnings growth annually. We ended the quarter with cash, cash equivalents and investments of \$19.4 billion and in addition, we generated \$1.1 billion in free cash flow.

I'd now like to discuss our outlook for the rest of 2021. Our business is performing exceedingly well, and overall, consistent with the outlook we provided on our last call. Given our strong year-to-date performance and our expectations for the back half, we're raising our TPV outlook and reiterating full year revenue and earnings. We now expect TPV growth to be in the range of 33% to 35% given the strong volume trends in our business. We continue to expect revenue for the year to be approximately \$25.75 billion representing 20% growth on a spot basis.

In addition, we continue to expect non-GAAP earnings per share to be approximately \$4.70 or growth of approximately 21%. We raised our 2021 revenue outlook by \$250 million or approximately one point of growth when we reported our first quarter results in May. We're now absorbing more pressure from eBay than we had previously expected.

Our current outlook contemplates an approximately seven point negative impact to revenue growth for the year. This corresponds to an approximately \$0.85 negative impact

to non-GAAP EPS from reduced transaction margin dollars. We're pleased that the strength of our platform, and the diversification of our business is allowing us to maintain this elevated outlook. In addition, we expect to generate more than \$5 billion in free cash flow or approximately \$0.20 of free cash flow for every dollar of revenue.

Now turning to guidance for the third quarter. This quarter we're up against our toughest revenue comparisons versus last year. In Q3 20, we reported 25% revenue growth, our strongest performance for the year. As a result of this dynamic as well as eBay's managed payments transition our plans had always assumed that in Q3 we would report our lowest level of quarterly revenue growth for the year.

However, now planning for eBay's drag on our revenue growth to be greater than previously expected resulting from both the accelerated pace of merchant migration in international markets as well as some additional core pressure, which magnifies this result. For the third quarter, we expect revenue to be in the range of \$6.15 billion to \$6.25 billion. At the midpoint this represents growth of approximately 14% of spot and includes about 8.5 points drag from eBay or approximately \$465 million negative impact.

On a two-year basis, inclusive of this drag, our guidance represents 19% growth. We also expect non-GAAP diluted EPS to be flat to last year or approximately \$1.07 reflecting increased investments to support our growth initiatives and the pressure, we're facing from eBay.

Our financial performance over the first half of 2021 has been very strong and consistent with the guidance we've outlined at the outset of each quarter. At the same time the environment in which we're operating while more stable than a year ago continues to be very dynamic and more challenging to predict than normal. Adding to the complexity is this exercise a predicting eBay's transition for which we have less than perfect visibility. Each quarter we try to provide our best estimate of the level of performance that we believe we can deliver.

Overall, our growth remains strong, and importantly we continue to see the categories that benefited from quarantine measures and shelter in place activities last year maintain higher levels of e-commerce volumes in comparison to pre-COVID levels. Our conviction in our ability to drive sustainably strong performance, and in the strength of our franchise has never been greater. This year we expect to process approximately \$1.25 trillion of payments volume.

We expect to grow revenue by 20% more than offsetting pressure to revenue growth of approximately 7 points from eBay and lapping our strongest year with 22% revenue growth. And given the momentum we have in development and innovation and the pace of scale of the new experiences, we're bringing to our customers we are investing in our business at record levels.

Further, last year we grew earnings 31%. On top of that performance this year, we plan to grow our earnings by 21%. Importantly, our team has never been more focused or aligned around the shared goal of being the leading digital payments company in the world. Last

year was a pivotal moment in our history and this year we're building on that foundation and continuing to realize our ambition for greater relevance, ubiquity and impact as a global payments leader. We look forward to sharing more of our progress with you.

With that, I'll turn it over to the operator for questions.

Questions And Answers

Operator

(Operator Instructions) Your first question is from Tien-Tsin Huang with JPMorgan. Your line is now open.

Q - Tien-Tsin Huang {BIO 6065319 <GO>}

Thank you. Thanks so much and thanks for all the details in the slides here. It's good. Just with the third quarter guidance being a little bit lighter than trend, but you're also reaffirming the year even with eBay expected to be one point worse. Can you just reconcile that thinking between the third quarter and holding the year and then also if you could just help us bridge third quarter to fourth quarter growth for us, given all the other moving pieces here? That will be great. Thanks.

A - John Rainey {BIO 17599063 <GO>}

Sure. I'll start there. Look third quarter has always been -- was going to be our toughest quarter from a year-over-year growth rate perspective for a lot of the reasons I outlined. There are a number of reasons that are contributing to the growth in the fourth quarter, but I think before I get into them. It's important to understand that if you look on a year-over-two year basis, the revenue growth actually is very consistent in each quarter of this year. And for the full year we will be growing in the neighborhood of 20%.

But of the items that are contributing to the growth in the fourth quarter there is a few that I think are notable to call out. One is, there's certainly less pressure from eBay. That abates somewhat in the fourth quarter. We also have some benefit from the pricing changes that we announced that go into effect next month. And then we have a number of different initiatives that we're rolling out in the second half of the year in which we get most of the benefit or the full quarter's worth of benefit in the fourth quarter.

And so all of those things tend to drive. I think some acceleration in what we're seeing in revenue from the third quarter to fourth quarter. And then as usual we always have some seasonality around the holiday shopping season which we again expect this year.

A - Dan Schulman {BIO 1895545 <GO>}

Now if there's one thing I can add to John's comments is Q3 is the height of eBay pressure. And then, as John mentioned, as we go into Q2 those headwinds that have been growing against us on eBay turnaround and become tailwinds. So we have

something like 850 basis points of pressure in Q3 as John mentioned that drops to 600 basis points of pressure as we go into Q4.

So that's a natural lift of about 2.5 points of revenue growth, and as we go into 2022 that continues to help our results and I think if you look beyond the eBay impact and looked at our adjusted results, you can see that the core business and the strength of our franchise has really never been performing better.

I think John mentioned one thing that I think is worth highlighting that the elevated spend around online is continuing even as we see economies reopen. I mean you can see that in our growth rates of our volumes, up 40%, 48% without eBay, but if you even look at things like our daily active users. Our daily active users versus pre-pandemic levels are up 43%. They were up substantially last year and they continue to grow as we go into this year. And so I think we have lot of strength in the core. Some of that's being matched by eBay, but eBay is all about timing.

We always knew these revenues were moving away, it's just a matter of timing and now we've got kind of what we think is the right case, a 100% in third quarter and then from there on in, those pressures abate.

Q - Tien-Tsin Huang {BIO 6065319 <GO>}

Agreed, thing just better. (inaudible).

A - Dan Schulman {BIO 1895545 <GO>}

Absolutely.

Q - Tien-Tsin Huang {BIO 6065319 <GO>}

Thank you both. (multiple speakers). Thanks.

A - Dan Schulman {BIO 1895545 <GO>}

Thanks Tien-Tsin.

Operator

Your next question is from Ashwin Shirvaikar of Citi. Your line is now open.

Q - Ashwin Shirvaikar {BIO 5027189 <GO>}

Thank you. Hi Dan. Hi John. I know you all -- you both provided a lot of information on eBay throughout your prepared remarks, but I did want to drill down further into sort of the overall effect of eBay on your results. If you can kind of speak to the ongoing impacts to the back half of the year and into next year, and then the flip side, obviously you've mentioned the ex-eBay performance, the 32% growth and so on. Should one expect that to be coming out of that sort of growth rate to be sort of a more normal appearance of what you can do?

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A - John Rainey {BIO 17599063 <GO>}

Sure I'll start Ashwin. I'm sure Dan will want to jump in. Look, I think there's a couple of metrics that really highlights the true performance of our business. But to start with we've always known that 2021 was going to be the year where we have the most significant impact from eBay. And the fact that we're lapping what was tremendous growth last year, and still performing at the level that we are this year in the face of that impact on eBay is really just quite phenomenal.

But I'll give you an example, I think really tells the picture here. So last year in the second quarter, we grew revenue 22%, and in that number there was a benefit of 5 percentage points of growth from eBay. So 22% revenue growth for 5 percentage points of benefit from eBay. This year in the second quarter, we grew revenue 19% and that number included 800 or 8 percentage points of headwind related to eBay's business. And so that really underscores the strength of the franchise and how well we're performing right now.

And quite frankly it's something that we're very excited about, because this sets us up for, I think much cleaner performance going forward and an acceleration in some of our growth rates when eBay is a much slower growing and smaller part of our business going forward.

A - Dan Schulman {BIO 1895545 <GO>}

And if I can maybe complement some of John's comments there, first of all, I do want to say this for eBay, obviously they remain a very close strategic partner for us. We still have about 60% share of checkout on eBay and obviously eBay merchants and consumers want and desire to use PayPal if you think about, just to give perspective -- historic perspective, if you think about when we split from eBay, six years ago, eBay's revenues as a percent of our total were 26% of our total revenues. And we believe that they're going to end this year around 3% or so. And that their TPV is going to be under 3% as a percent of our overall volumes. And so this is, as I mentioned before, it's a timing issue. And frankly, the sooner eBay transitions, the better it is for our future revenue growth.

I'd also say, just one other thing we are making a lot of progress with a lot of other marketplaces coming out of the eBay restrictions and we continue to see Ali Baba continue to ramp. Really pleased to watch the growth rates there and we are making a lot of progress with a lot of other marketplaces that we'll talk about as we get along further in the year. So eBay transition is behind us. At the end of this quarter, the headwinds dissipate and we're glad to start to move forward, as John said, we'll really be able to see the strength of the franchise start to shine as a result of that.

Q - Ashwin Shirvaikar {BIO 5027189 <GO>}

Thank you. Thank you for those comments.

A - Dan Schulman {BIO 1895545 <GO>}

Yeah, you bet.

Operator

Your next question is from James Faucette of Morgan Stanley. Your line is now open.

Q - James Faucette {BIO 3580933 <GO>}

Good afternoon, and thanks for all the commentary, Dan and John. I'm sure, there'll be additional questions on the quarterly cadence and eBay, but I wanted to touch on or for you to touch on something you mentioned earlier, and that is growing in store acceptance and QR codes. We've heard some positive things from industry sources recently on growing usage there. I'm wondering if you can give a little color on what you're seeing from PayPal's perspective, and how your acceptance works with the partnership with Clover from Fiserv and what you've done to enable that for merchants and consumers.

A - Dan Schulman {BIO 1895545 <GO>}

Yeah, I think I'll start on this one. And then maybe John can kick in. So first of all, clearly, pretty much every merchant, whether it's small, mid-size or large is envisioning a seamless omnichannel feature. And that's where physical and online kind of blur together that they now start to use that to digitally interact with their customers to basically tie in their loyalty programs, customize deals and offers to individual consumers. And that is moving well beyond just checkout.

Before we were thinking QR codes and other forms of contactless payments were great because was both fast and maybe more healthy in a pandemic environment. But all of our conversations now go beyond checkout. People are looking to drive loyalty and looking to drive rewards and coupons, more flexibility how consumers like, order, track pay for their services, customize incentives. And so that's really the conversations that we're having and that's where we're getting a ton of traction.

By the way, I do think that this seamless omnichannel effort by us is key to us doing everyday usage. And if I look at not just multiple millions of consumers that are using our QR codes, but what's happening is they also are spending 19% more TPV on the PayPal platform and that halo effect is a big deal as we look forward, especially as we look towards the Super App which maybe somebody will talk about later, but the more and more services we put together the more and more of that halo impact that occurs.

And so we obviously are up to now 1.3 million merchants, every 20 second, a merchant's signing up for more QR codes with us. We have a lot of momentum with large enterprises right now. But the conversations have moved to how do we fully integrate their loyalty programs into our app. How do we drive customize deals for them. And so those are taking a little longer to go live to site. But they are much more integrated than we've ever seen before. And we're seeing with customers like CVS, once you start to integrate that together, once you start to get a deterioration, we saw CVS transactions go up a 151% month-over-month.

And so we're really beginning to see some traction in the marketplace around all of these things. We're very excited about it. It's going to be a multi-year journey for us, but we

know that both merchants and customers expect us to be fully omni.

Q - James Faucette {BIO 3580933 <GO>}

Thanks a lot.

A - Dan Schulman {BIO 1895545 <GO>}

You bet, James. Oh, yeah, by the way, James. One other thing. You talked about Fiserv and Clover, forgot about that. So that is rolling out this quarter. We are a default funding instrument on Clover, the very close partnership that we have with Fiserv and looking forward to reporting more on that as quarters go on.

Q - James Faucette {BIO 3580933 <GO>}

Thanks for clarifying that, Dan.

A - Dan Schulman {BIO 1895545 <GO>}

Yeah, sorry about that. Yeah.

Operator

Your next question is from Darrin Peller of Wolfe Research. Your line is open.

Q - Darrin Peller {BIO 16385359 <GO>}

All right. Hey, thanks guys. Look, it's great to hear that the Super App refresh is going well. If you could just give us a little more specifics on the timing of the rollout. And then what you're looking forward to meet in terms of engagement or impact on NNA levels? And I guess just quickly on NNA. Dan you mentioned earlier, you're still confident in the high end of the \$52 million to \$55 million range which -- that would require a bit of a step up from second quarter levels. So just any more color on the condition there.

A - Dan Schulman {BIO 1895545 <GO>}

Yes, sure. I'll start right with that quickly. We always knew the second quarter was going to be the low point of the year because we did \$21.3 million, or \$23.4 million NNAs a year ago. And even though they are performing better than cohorts that we previously had historically, the churn is lower. It's still a ton of incremental churn versus traditional cohorts of on the second quarter. And we're clearly beginning to see that dissipate already this year as I look at NNAs coming in. And so I feel really good about that guidance right now.

Q4 is always a high point of the year. And so you'll see it start to build from second quarter, up in to third quarter and then up again in to fourth quarter. Then maybe if I can just -- if that answers your question on NNA, I'll go quickly into the Super App. We made a really substantial milestone by being code complete on this first iteration of the Super App. We're slowly ramping. It's the first change we've done to the app, first change since I've been here that we've done to the app.

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And so we want to kind of measure what the engagement levels are and the uptake of it, but this is going to be something where this isn't a big bang theory that this app in and of itself, this version is the be-all and end all. It obviously is going to look across payments, basic financial services and shopping tools. You're going to see releases and enhanced functionality come out pretty much every single quarter.

But early on, that's going to include things like high yield savings, enhanced Bill Pay which will do improve search and better UX, more billers, aggregators. We're going to do two day early access to direct deposit budgeting tools, something we haven't talked about, QA messaging. So if P2P you \$10 for whatever you're doing and you want to message me right back without sending me a P2P you can go do that. And we think that's going to drive a lot of engagement on the platform. You don't have to leave the platform to message back and forth.

Obviously, the UX is being redesigned with that rewards and shopping. We've got a whole giving hub around crowdsourcing, giving to charities and then obviously Buy Now, Pay Later will be fully integrated into it. And by the way, as we go in to next year we're going to -- like last time I counted was like 25 new capabilities that we going to put into the Super App. And so I don't want to dismiss at all. What we've done right now, but it just continues to improve going forward.

And the way that I'm looking at success with the Super App is, what kind of engagement levels do we get, fully expect engagement to move up. What's happening to our average revenue per active account? By the way, even with the new services we've recently launched our average revenue per active account at eBay went up 13% this past quarter and that's a really good sign along with the 11% improvement in TPA which was really a record in the last four years or so.

And so we've got a lot going on. I think our engagement, average revenue per active user and then we'll look clearly at all the halo effect as well. But we're excited to be on the journey right now and be underway. And again, you just see it continue to improve quarter-over-quarter.

Q - Darrin Peller {BIO 16385359 <GO>}

Yeah, you bet.

Operator

Your next question is from Colin Sebastian of Baird. Your line is now open.

Q - Colin Sebastian {BIO 6373379 <GO>}

Great, thanks, good afternoon. I want to follow up on the Pay Later initiatives. There's clearly you're gaining nice traction with the users. I wonder how much of that activity is incremental to volume if that's just a function of the higher conversion rate. And secondarily, we've heard from some merchants that return rates are little bit higher with Pay Later. So I'm just curious if that impacts merchant adoption at all. Thank you.

A - Dan Schulman {BIO 1895545 <GO>}

Yeah, sure. So look it was another terrific quarter, I mean just in every way for Buy Now, Pay Later. As I mentioned, we give 1.5 billion of TPV in the quarter alone, aside of [ph] \$3.5 billion. But this is amazing piece of a -- stat on that \$1.5 billion. That's up 50% from Q1, sequentially. So you can really see that even we had so much momentum in Q1, that momentum really accelerated in Q2. You've got a bunch more merchants using it now. 650,000 merchants, more and more of them are presenting it upstream on their product pages.

That obviously gives us a disproportionate share of checkout when that occurs, and here you can tell by the 7 million customers, doing 20 million plus transactions and obviously our repeat rates are extremely high.

There is a lot of satisfaction with the product. It's still something like 70% are repeating within six months and our halo effect is the same as it was last quarter. So 15% halo effect in TPV, still a substantial reduction in our TE cost, about a 16% reduction. We're still seeing 80% plus release funded through debit. And yeah, Australia we put in place just a couple of weeks ago and bam it's off to a really strong start right away. So -- and part of the reason Colin, that we're getting such strong results is because we have 400 million customers. And when we put something in, it happens at scale and we know those customers.

So the approval rates are much higher, returns are lower because we know the customer. And so a lot of the other Buy Now, Pay Later players don't necessarily know the consumer, the way that we know the consumer in this. And so, we're pretty pleased. We've got a ton on our roadmap ahead in terms of expanding internationally, more and more functionality that we want to put on the product itself.

A - John Rainey {BIO 17599063 <GO>}

Colin, I just had a couple of points there, I think are really encouraging as we look at the early progress there. One is that where we have upstream presentment, we see a double-digit click-through rate from consumers, which is quite encouraging. And particularly when you think about what Dan mentioned and scaling that across all of our customer base. But the other, and it's a very important one. And it actually ties back into Darren's previous question around revenue per user and engagement. But we see a 15% lift in overall TPV among those customers that are using Buy Now, Pay Later.

So we're early stages here, but as we've repeatedly said, we think that we've got a value proposition that is frankly second to none, and quite encouraged by some of the early results that we're seeing.

Q - Colin Sebastian {BIO 6373379 <GO>}

Great, thanks guys.

A - Dan Schulman {BIO 1895545 <GO>}

Yeah.

Operator

Your next question is from David Togut of Evercore ISI. Your line is now open.

Q - David Togut {BIO 1496355 <GO>}

Thanks so much, Dan and John. Given the new PayPal pricing model on branded and unbranded products effective August 2, can you gauge for us the expected annualized impact on revenue and non-GAAP EPS from these changes. And then as part of that, could you just elaborate on your physical point of sale payment strategy given the size of the price cut on physical credit and debit card transactions is quite substantial??

A - John Rainey {BIO 17599063 <GO>}

Sure, I'll take the first part of the question, David. Look our pricing change included both price increases and price decreases. And it remains to be seen and sort of the volume changes that come from each of those. And so in the context of our \$25 plus billion revenue base, I would say that for the year these are relatively immaterial on our results.

But I think very importantly, this provides a lot more transparency and clarity to our customer base around how -- pricing and really trying to price to the value that we provide for these customers, and we've demonstrated time and again where that value comes from and just survey data on customers' willingness to buy when PayPal is presented at checkout that is exponentially greater than when it's not. So this is probably overdue. It's been the first time in 20 years that we've made a change to our base pricing like this. But certainly think it puts us more in line with the market and really prices to the value that we're creating for our customer base.

A - Dan Schulman {BIO 1895545 <GO>}

Yeah, I think that is a pretty comprehensive response from John. I mean we obviously carefully review everyone of our pricing changes, up or down. We do extensive market research before we do any change. And as John said, we look at where we have value and we price in accordance with that. Clearly on the branded side, we think we had a tremendous amount of value, things that John talked about, buyer and seller protection, Buy Now, Pay Later at no incremental cost for our protection, highest checkout conversion, et cetera.

But we took down rates for basic full stack processing that also was reduced somewhat substantially from \$2.9 plus \$0.30 to \$2.59 plus \$0.49 and that is going to enable us to aggressively compete for all of the payment processing of the merchants that do business with us. And you've heard us say time and time again David, that we are going to move into the in-store space and we are going to move, so aggressively in there.

We rolled out Settle [ph] in the US, is a really beautiful full package. It doesn't just include card reader but inventory management, sales reach out and allows a merchant to seamlessly load inventory in both their online and in store locations, then across multiple

channels as well. So we're obviously going to be very aggressive on moving into in-store and it's always been part of our strategy. And by the way, if a small merchant does all of their business with us, they can actually see the overall cost come down.

And we want to encourage them to do all of their business with us because we are trusted platform they do turn to us. And we price, we think the right way. We finally unbundled some of this branded and unbranded because that's how the market is playing and we know where we want to be aggressive, and we're going after that

Q - David Togut {BIO 1496355 <GO>}

Thanks so much, Dan and John

A - Dan Schulman {BIO 1895545 <GO>}

Yeah, you bet, David. Thank you.

Operator

Your next question is from Ramsey El Assal of Barclays. Your line is now open.

Q - Ramsey El Assal

Hi, Dan, John, thanks for taking my question this evening. Dan, I wanted to get your updated view on Crypto and Blockchain and see how you guys are planning and engaging with the ecosystem from a consumer product perspective, and I know you just mentioned new crypto capabilities in the new app, but also from like a balance sheet perspective and internal technology perspective, how will you kind of engage with the ecosystem in the quarters ahead.

A - Dan Schulman {BIO 1895545 <GO>}

Well, we continue to be really pleased with the momentum we're seeing on crypto. And we're obviously adding incremental functionality into that whether we probably saw increased limits to 100,000 a week. We're right in the middle of some open banking integration, which will increase the ability to fully integrate into ACH and do faster payments.

We're going to launch, hopefully, maybe even next month in the UK, open up trading there, we're working right now on transfers to third party wallets and we really want to make sure that we create a very seamless process for taxes and tax reporting and so, we're really looking at how do we integrate that into both the trading and the buy with crypto on our platform.

But I will say this, all of that is interesting, but it is in the main course, in terms of what we are trying to do with our blockchain and digital currency business unit. We are clearly thinking about what the next generation of the financial system looks like how we can help shape that. We are working with regulatory agencies, central banks across the world. The number of countries that are looking at CBDC, Central Bank issued digital currencies

is increasing rapidly. And you're like in 40 countries like six months a year ago, you almost up to 100 countries looking at it right now.

And clearly there is an opportunity to think about a new infrastructure that can more efficiently, I believe that could be a lower cost to do transactions and also get money to people much faster than happens today. I mean, the other day I sent an EFT from one bank to another bank and that Bank told me we're taking three days to access that money in the EFT I sent. That's crazy. It needs to be instantaneous and there is a large desire by governments to really think how can you create a more efficient system using new technology to bring in more citizens more underbanked, underserved citizens into the financial system

Because they disproportionately pay a higher take rate in those who are fully bank to our higher income levels. And there's a lot of connections between digital wallets and Central Bank issued digital currencies. Imagine not having to send out stimulus checks but sending those directly into digital wallet. We instantaneous receive it and you don't have to go in to check cashing location and exchange that and get charged for that exchange there's just so many benefits to that as well as just plain utility to payments.

How can we use smart contracts more efficiently? How can we digitize assets and open those up to consumers that may not have had access to that before. There are some interesting defi [ph] applications as well. And so we are working really hard, and by the way, as you probably have seen we are trying to pick off the very best talent in the ecosystem to come work here at PayPal. We have a list of names and phone numbers and we are slowly but surely building a team that I think it's going to really shape the thought process around this and I'm really pleased with at least the early returns on that. Hopefully that helps you.

Q - Ramsey El Assal

It does, and very interesting. Thanks so much.

Operator

And we have time for one last question from Jason Kupferberg of Bank of America. Your line is now open.

Q - Jason Kupferberg {BIO 6867809 <GO>}

Hey, thanks guys. Just wanted to ask a couple here on margin. And for starters, can you just reconcile for us the unchanged revenue and EPS guidance for the year with the lowered operating margin guidance and talk about how much of the guidance change on margin is from eBay versus perhaps elevated OpEx growth expectations?

And then just as a quick follow on, give us a sense of how we should think about the margin potential of your business beyond this year as eBay conversion moves into the rear-view mirror. Thanks.

A - John Rainey {BIO 17599063 <GO>}

Sure, Jason, I'll take this and it's great to speak with you. So starting with the first part on the change this year really two things to note, one that we talked about is eBay. eBay, we expect to have an \$0.85 impact to our EPS this year. And the fact that we are performing and expect to perform for the back half of the year at this level and being able to whether that impact is I think really speaks to the strength of the overall business, but the second area and this sort of gets into the second part of your question as well, but we're also investing aggressively in our business.

I would argue that there's never been a more important time in our business to invest right now, to invest for a future where we believe in the primacy of digital wallets, we believe in the permanent pull forward of e-commerce we believe in the ubiquity of digital payments and too, we want to help shape that outcome. We want to be a leader in that space.

Now it happens that the structural nature of our business, our margins once they go up, and by the way they will, to be very clear about that. But at the same time, we don't want to be a prisoner to expanding operating margin one quarter to the next, because we want to be able to appropriately invest in our business to create the most shareholder value that we can over the long term, and become the company that we all believe that we can be. And so close out our margins will go up.

We said this year that we expect to have flat, maybe some marginal improvement in our margins. But as we noted at our Investor Day earlier this year, our margins will go up over time, but we want to invest for growth and invest to be that leading digital company, payments company that we know we can be.

Q - Jason Kupferberg {BIO 6867809 <GO>}

Okay, thanks for the comment

A - John Rainey {BIO 17599063 <GO>}

All right, thanks, Jason.

Operator

I would now like to turn the call back to Dan Schulman for closing remarks.

A - Dan Schulman {BIO 1895545 <GO>}

Thanks so much. Well, thanks everybody for those great questions. I want to thank everybody for your time. We hope that all of you and your families are staying healthy and I hope that you have a great summer as well, and we look forward to speaking to you soon. Take care and thanks again for your time.

Operator

This concludes today's conference call. You may now disconnect.

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