Wolfe Research Conference Call with PayPal Post 1Q20 Results Transcript

Held On: May 7, 2020 – 1pm EST

PayPal Participants:

John Rainey – *CFO*

Erica Gessert – *SVP, Financial Planning and Analytics*

Gabrielle Rabinovitch – *VP of Investor Relations*

Wolfe Research Participants:

Darrin Peller – *Managing Director – Payments, Processors, and IT Services*

Operator Introduction:

Good afternoon and welcome to the Wolfe Research fireside chat with PayPal, CFO webcast, hosted by Wolfe senior analysts covering payments, processors, and IT services, Darrin Peller. All attendees will remain on listen only mode throughout the call. If you'd like to ask a question, please find the questions icon in the menu on your screen and now I hand the call over to Darrin.

Darrin Peller:

All right, thanks Analynn, and thank you everybody for joining us this afternoon Eastern and morning for those on the West Coast. First of all, I just want to reiterate, we hope everybody is healthy and doing well and managing through this as well as possible. But most of all, I really want to thank everybody for being with us and really want to thank PayPal's management team here. So we have John Rainey the CFO of PayPal, on with us. We have Erica Gessert, who's the SVP of Financial Planning and Analytics, who can give us some really good insights into some of the trends, consumer behaviors and analytics they're seeing. And of course we have Gabrielle from Investor Relations as well. And so with that, John, thank you for joining. Why don't we start with you and I really do appreciate the time this afternoon.

John Rainey:

Well thank you Darrin. I appreciate you hosting this call. Look forward to our conversation today.

Darrin Peller:

Thanks. Look guys, anybody else that's on the call that wants to ask a question at the end, we're going to try to keep this to about 35, 40 minutes of Q&A between us and the PayPal team. But feel free to email either the fintech@wolfresearch.com inbox or you can just type it into your text box if you're logged in on the link.

So with that John, if you could just tell us more, I mean it was pretty clear and substantial, the trends we were seeing and really to some degree even the dramatic shift in trends you're seeing in the business. Maybe just start off with a reminder, what did you see in terms of the shelter and place orders, the spread of the pandemic, how did that affect you in March? And then obviously as we just alluded to, it really does look like you had a massive 180 in April. If you could just talk more about that first.

John Rainey:

Sure.

Darrin Peller:

And then maybe we'll get into a little more in the weeds after that.

John Rainey:

Okay, sure. So you're right, Darrin, and it's been exceedingly difficult to really forecast during this period because of these massive cross-currents that we've seen. They follow what has happened in society. Right? So if you think about the beginning of March and maybe have more of a U.S. centric focus, like the first thing that people did was they stopped international travel, then domestic travel, and then shelter-in-place measures took hold. And so we saw the travel and event vertical come down sharply. That caused a lot of concern because that was happening actually before we saw some of the uptick in e-commerce spend. Then as we got into the back half of March and into April, we started to see more consistent trends in our business at very elevated rates.

And there were some hypotheses that as we got through April, some of this was due to stimulus checks. Quite frankly, it's been difficult to parse out the impact of that. Even as we look around the world where the level of stimulus has differed by country, there has not been any notable change in trends. It's very consistent in terms of high levels of e-commerce.

Obviously, initially there was a big focus on groceries and personal protective equipment and things like that, but this has taken hold in other areas like fashion for example. If you're working five days a week and you usually went to the dress shop on Saturday and the dress shop is no longer open, we're seeing people shopping on Saturday more. Even the day of week trends have changed dramatically to where historically Monday has been our largest day of the week in terms of volume. Now we're seeing huge shopping days on Saturdays.

I think the multimillion dollar question for us is how much of this is ephemeral and will go back to normal when these shelter-in-place measures are relaxed versus how much of it are truly changes in consumer behavior. And on that point, we've been doing a lot of customer surveying and anywhere between a third to almost 75% of our customers, depending upon the nature of how the question is asked, have suggested that they're going to continue doing things like shopping online for groceries and things like that, that they weren't doing before.

Darrin Peller:

That makes a lot of sense. I mean, so when you think about what we saw in April where, obviously it almost looked like it accelerated as the month progressed. I mean, look a common question we've gotten is obviously how much of it related to stimulus checks. I mean, it's probably hard for you to exactly tell, but what you're saying it sounds like is that there's been indications that at least a third or more are indicating they're going to keep going with this in terms of using the actual new initiative, new capabilities they didn't really use before.

John Rainey:

Yeah, you're exactly correct. So with stimulus checks, again we're certain there is some impact, but it's very hard to see any appreciable effect from that when we look at comparisons of regions around the world. But I used kind of a cheeky example yesterday on the earnings call, but like buying groceries. If you want to be able to hold the avocados to make sure that they are ripe, maybe you wanted to go to the grocery store, but when you go through that experience and then you realize like, wow, that was really effortless and I got exactly what I wanted, you have a tendency to continue to do that. And so, we do expect some of these trends to have some staying power.

I'm not suggesting in any way that you're going to see these e-commerce levels that are two to three times the growth rate of what they were pre-coronavirus. But we do think this is kind of a seminal moment where there's a big shift to e-commerce, but I think just as importantly, even when the compulsory shelter-in-place measures are relaxed, the health concerns are still there. People are still going to be concerned about touching a keypad on the point-of-sale device or handling cash in the store. So that's why we've shifted some of our strategies to focus on those things that matter to customers.

Erica Gessert:

John and Darrin, this is Erica. I just thought I'd add a little bit of additional color and nuance to some of the survey data that John referenced. We are doing surveys week by week, by week as customers are coming on. And one of the interesting things that we've seen is not only are customers kind of saying, "Hey, we're going to persist in some of these activities." But we're also hearing from customers saying, "Hey, this is the first time I've done this." So 20 to 30% of people are saying this is the first time I've actually bought groceries online or ordered from a restaurant online, actually up to 40% are saying it's the first time I've done a big box retailer purchase online.

Then there are also people, who as the weeks mount saying, "I'm intending to do this after shelter in place abates." So it's quite interesting to see what the customers are telling us on that.

John Rainey:

Yeah, Darrin, one more thing to add to that, which was kind of interesting as we think about the evolution through March and April. Initially there was, I think as people were working from home, you saw a lot of things like office supplies or people buying a chair that's ergonomic that they can sit in, or home and garden was kind of a curious one where we saw a big uptick. And that made sense because this was a new environment and people needed new things. But as we've progressed all the way into May now we're seeing a more balanced shift across many of the verticals. This is more representative of just a normal day of business for us.

Darrin Peller:

Yeah, I think that makes a lot of sense. The data's really helpful. On that note, when we think of the material net new active growth you saw in the month of April, specifically, I think you said 7.4 million. We think about that relative to a normal month for you guys, which has been somewhere in the two to three million, maybe a little over three and a good quarter range. I mean it's just remarkable. And talking about, I think, you said 10 to 20 million for the quarter over and parsing that out a little bit. I mean if you can give us a little more of a sense of who these net new actives are by a combination of brands, PayPal checkout specifically versus Venmo versus maybe Xoom. Where are they coming from? Are they again I guess just more P2P or commerce or any other details, I think would be really helpful.

John Rainey:

You bet. Erica you want to take that?

Erica Gessert:

Sure, I'll take it. So I think as we talked about on the call, the increase in NNAs is quite broad based. PayPal and Venmo both have very significant growth, compared to pre-COVID levels. Xoom is at 400%

compared to pre-COVID levels. It's obviously still a smaller share of NNA's and actually Honey in April had about the same number of NNA's that they had in all of Q1. So all of these across, kind of across the business, we're seeing a lot of growth.

Between, P2P and commerce - I mean it's actually very, very evenly spread. And the other thing that we're seeing is it doesn't really matter whether it comes from P2P or commerce because the next transaction is mixed as well. Right? So if somebody comes in through commerce, the next transaction is quite often P2P and vice versa. So people are kind of coming in, they're adopting it at 30% higher rate than they did kind of a year ago, similar cohorts. And so they're coming in, they're actually getting to their third transaction much, much faster. And we're seeing a variety of transactions as they do come in.

John Rainey:

A little bit, a point of clarity on that. So one of the things that Erica's team looks at is what we call our 10 day adoption rates. And for us that’s when a new customer has completed their third transaction. And those 10 day adoption rates for these new cohorts that are coming in, are 30% higher than prior cohorts. And more over when we look at just engagement around like daily active users, that's up 20% in the month of May.

Darrin Peller:

Wow. That's incredible. I mean with regard to regional details, is there any more comment you can give us just in terms of where they're coming from?

John Rainey:

We've been asked that question a few times, Darrin, and there's not something meaningful to call out. It is really broad based. We see this around the globe. Certainly I think China stands out as one that as you contrast to the first part of the first quarter, we were at much more depressed levels and that has rebounded appreciably. Although, I'm cautious to say that that is, the example that the rest of the world will follow. I think China's different and for a lot of reasons you might expect different behavior there. But we're just, whether it's Germany, Australia, and New Zealand, just around the world, we're seeing these elevated levels across the board.

Darrin Peller:

Yeah, all right. I mean, from the sound of your answers, it seems like a lot of these users that are new or not necessarily just pulled forward from future years, but frankly a lot of them wouldn't have potentially used it before. I think you alluded to certain types of demographics on the call. So that's certainly nice to see from an additive standpoint.

When we think about engagement levels relative to other cohorts of new users, I mean I think you started to suggest on the call yesterday it was strong, but any more details would be really helpful on some of the trends you're seeing.

John Rainey:

Sure. Erica?

Erica Gessert:

Well, yeah, I mean I think on engagement, like I said, that the things that are kind of signals to us are this 10-day adoption rate, which is 30% higher. I mean that's extremely positive. The other kind of a signal for us in terms of long-term retention and engagement is the diversity of transactions or the number of products and merchants that people use when they come on. And all of these are at elevated levels versus what we normally see. So I think we, I always want to be cautious, six weeks doesn't make a trend, but we are seeing these metrics consistently improve with each new weekly cohort. So we're feeling very good about it.

Darrin Peller:

Great.

John Rainey:

The other thing, Darrin, I'd point out, is that, while surely some of this is perhaps pull forward from net new actives we might have expected to get in the future. We're seeing a big shift in demographics as well though. So we think a lot of these are customers, as noted earlier, that the silver tech category that are actually purchasing something online for the first time and we might not have otherwise got them as a customer.

Darrin Peller:

When we think about engagement level just a little more broadly now, longer term, I mean that's an area that we've been focusing on, you guys have clearly talked a lot about. This is helping to some degree in terms of near term, but longer term, what do you think is the potential for overall levels of engagement in the business and have any of your plans around the initiatives you had previously had to improve engagement been changed or put on hold or even accelerated?

John Rainey:

We've had this aspirational goal of PayPal and Venmo being an everyday part of our customer's financial lives. I think, that's a long way from where we are today. You might call that aspirational, but the plans that we have internally are directed to try to achieve that. One of the things that we recognize is to achieve that, we need to have a presence in more than just online shopping. Offline is a space that we need to occupy. And previously we thought that that would be longer to play out, particularly in the U.S. and some of our core markets that we're in. But we also think that, again, I don't want to sound callous about this, but we can capitalize on some of the anxiety and fear that exists about going into a store, and touching a keypad or handling cash. And so that's why we've shifted some priorities to go all in on this right now.

Look, this is not just us sitting in a conference room and saying, "This would be nice to have." We're hearing the demand from merchants. Some of the top merchants in the country are talking to us about what we can do to have contactless payments in store. This is kind of a sweet spot right now where there's, I think, a strong demand from consumers and merchants who want it as well.

Darrin Peller:

Yeah. I think some of the greatest level of excitement from investors after yesterday was just the pure math of a slightly higher engagement level lasting beyond just this pandemic. Times the net new actives numbers, obviously it could be very, very powerful. I guess we'll have to wait and see what's truly sticky about what we're seeing now in terms of behavior, but, correct me if I'm wrong, it sounds like you expect at least some of those behaviors to be sticky, although you can't tell for sure about how much of it yet. Right?

John Rainey:

That's true. Look, we don't want to get ahead of ourselves here. As Erica noted, six weeks does not necessarily make a trend that we can extrapolate out into perpetuity, but... Certainly when people have mobility and social distancing measures are relaxed, we're going to expect some type of return to... we'll call it normalcy. But we do see that some of these behaviors are going to stick. Xoom is an interesting example, so our remittance platform. If previously you were going into a physical location to transfer money to a loved one internationally, and now you can't do that so you sign up for Xoom and you use that platform, you're never going back. It is too easy, too convenient. It's less expensive. Some of these things we really do expect will be sticky and have some permanence.

Darrin Peller:

Okay. Real quickly before we go into the next topic, just the merchant new actives and the merchant demand, I think that's a key topic we're hearing from across the industry right now, is anyone that can help with onboarding around e-com, digital, omnichannel, what kind of trends are you seeing there in terms of incremental merchants that maybe you would have liked to have had before but were tough for some reason or another competitively?

John Rainey:

Yeah. The trend that we've seen that is most pronounced on the merchant side are from merchants that previously really didn't have an online presence, were reliant on a physical storefront. With businesses closed, that's their lifeline, to actually begin selling things online. They're coming to us for the first time to have PayPal process their payments. That's been, I think, a much larger portion of the new merchant signup than what we typically see.

Erica Gessert:

I would just add one more point here. One of the other things that we are seeing and our quickest way of measuring share of checkout is by looking at our full stack merchants, and we're seeing an appreciable lift also in share of checkout. This is with our existing merchants. It's not onboarding, but it's a really interesting phenomenon because we're now getting merchants who are existing merchants coming back to us and talking to us about additional products and services, PayPal Credit if it wasn't there before, because they're seeing this appreciable lift. They're seeing the lift in our own business and the increase in consumers, and they want to do more with us as well.

Darrin Peller:

All right. Thanks, Erica. Just to shift gears a little bit at least, but still on the topic of what you're seeing recently, you're working with the U.S. government on several different stimulus programs. If you could just tell us a little more about how you're partnering and what you're doing and maybe if this can change some of the ways you work with the government over the long-term would be helpful.

John Rainey:

Yeah, I think it certainly can, Darrin. We've even seen a shift in how the government thinks about this FinTech segment going through this. When the first discussions around mailing out stimulus checks were taking place, we reached out and said, "Look, we can help here. We uniquely can help here." Who knows if there will be additional stimulus checks that go out, but we've been working closely with the U.S. government and other governments as well. We've been really pleased to be able to distribute the amount of loans that we have to our merchants, and they're not just our merchants. Probably 80% of the loans that we've distributed are to existing PayPal merchants. About 20% are to entirely new merchants that have not had a relationship with PayPal but hopefully will going forward. Again, with our technology, we solve a need here that exists.

Darrin Peller:

Okay. Guys, when we shift gears a little bit and talk more about some of the concerns in the economy that we're seeing, how are you thinking about the recession we've now entered? Do you have any views on the potential duration or how it could impact PayPal from all the data that you see? Are there any indicators from what you're watching that can give us a read-through for anything in the near term or even the medium-term impacts?

John Rainey:

I'm probably no better equipped than your audience to opine upon what we see, but we're certainly being very measured and conservative as we look at the potential impact. None of us in our lifetime have seen unemployment at this level, but at the same point in time, we haven't seen the Fed step in and provide stimulus like they have and take the measures that they have. It's very hard to predict, and what the shape of the recovery is, how deep we go. PayPal is certainly tied to consumer spending, no doubt about that. But at the same point in time, I don't think that you can look at a moment in history when e-commerce has not increased, even through prior recessions. I hesitate to call it recession-proof, but it certainly is more immune to it than maybe other trends that we see so that the shift to online is happening whether people's spending levels are going down or not.

I think importantly as we think about parts of our platform, Honey is a really interesting example in that it caters to the very need that people have when their pocketbooks are getting tighter by looking at deals on certain items and trying to find price points at which customers are willing to buy them. We think that we're somewhat insulated. I don't want to suggest that there would be no impact, but given the breadth and diversity of our platform, we certainly think that there are aspects of it that are more immune to a recession or spending levels than others.

Darrin Peller:

Right. Going back to the results on the first quarter for a minute, and we got this question from a couple of investors, more even leading into earnings, but you updated revenue guidance of the quarter in late February and then came in meaningfully below that 1% headwind to growth that you called out. If you could just talk to us more about the revenue that was impacted in the quarter, and how big are the travel and event verticals for you? If you want to just give a little color on why you didn't actually pre-announce in late March or early April, I suppose it was just because some of the trends you were seeing inflecting, but any more color would be helpful.

John Rainey:

Sure. When we updated our guidance, I think it was February 27th. At that point in time, COVID-19 was really contained to China and some of the adjacent countries. The impact was a point of revenue growth for us. Within the guidance range that we provided, and we affirmed our EPS guidance, as we got into March... I wish I had a better reason to give you in terms of why we didn't update, but honestly, Darrin, it was impossible to predict. When we looked at the trends, literally if we would have gone out and said something on March 14th, on March 16th, what we would have told you would have been... It would have been different. We wanted to provide an update, but we didn't think that we could be reliable because the trends were changing so quickly. Importantly, it's back to this notion of cross-currents. We had one part of our business, the travel and event vertical, which, to your question, is about 9% of our normal volume. We had that. That was plummeting.

Not only did we see the growth decrease in that vertical, it went negative because the number of refunds that were going out vastly exceeded new bookings. It was negative TPV for us for a period of time. You had that going, and then following that was the beginning of the e-commerce strength that we saw. It was just exceedingly difficult to go out and provide any type of guidance that we thought could be relied upon. Then as we got into April and we closed the books, we thought about pre-announcing and updating the previous guidance that we had given, but we also thought that we needed to provide context to our numbers. I think you probably saw a little bit of that yesterday just in the stock price reaction. On the print, we were down 5% or 6% and that rebounded after people understood the underlying story. We elected to just wait until earnings. Also, that's why we pushed back earnings a week, so that we could have the full month of April to provide those trends.

Darrin Peller:

All right. Just sticking with the recent trends then, if we touch on P2P, Venmo, Xoom versus PayPal, can you just talk to us what you're seeing on the P2P side again? I know you said Venmo grew 48%. Obviously, that's impressive, given the nature of it. I guess just talk a little more about the use case changes you're seeing. Then maybe on the remittance side also, we've seen forecasts that are a really tough environment for global remittances, the World Bank calling for, I think, a 20% drop, given recessionary concerns, just remind us again how you're seeing things differently in Xoom.

John Rainey:

Sure. With P2P in general, it's the same composition that we've seen historically in terms of where that usage is. Some of the use cases have changed, which segues sort of to the Venmo part of the question where we were going into March with levels of growth on Venmo well north of 50%. As things like March Madness... That's something that drives a lot of P2P volume. People want to go exchange bets on basketball games. With that cancellation, that caused a drop-off to where Venmo growth was only around 30% for a period of time. But then we noticed the use cases starting to change and the desire for people to have increased spending limits.

Actually, we reacted pretty quickly to respond to our customers and increased spending limits for a significant portion of that population as those use cases were changing. Even as we look today, the overall level of Venmo transactions is down from what we expected, but TPV is back to what we expected because of the higher spending limit size. On Xoom, certainly I think across the board you've seen international remittances decline. But as we've noted there, we've picked up some share shift, and some of the year-over-year increases in our customers or even going back to just pre-COVID comparisons are in the multi-hundred percent range.

Darrin Peller:

Got it. All right. Then on eBay, we've gotten a handful of questions. It looks like eBay obviously had a strong Q1 and that April was off to a good start. How much of the upside are you seeing coming from eBay? If you could just update us on your expectations for their managed payments initiatives, is it still on track versus your expectations?

John Rainey:

Sure. eBay, really, as you look at the month of April and even into May, , the benefit is proportional to the size that they are of our business, which was 8% of our volume in the first quarter. But certainly very early on, they accounted for more than that. What we saw is there was a lot of PPE that was being sold on eBay and the transactions in some days was 60% to 70% growth year-over-year. What happened though, there was actually quite a bit of a fraud that was taking place.

People were selling counterfeit items or not what they were purported to be, and eBay clamped down on that. I think the last number I saw was they shut down like 5 million different products that were being sold around that. We've seen their growth levels normalize and come back in line with the rest of our business. On managed payments, I would say that that's generally tracking as we had expected. As they begin to more fully transitioned in the back half of this year, we built that into our guidance. Again, we do expect that we will retain a considerable amount of that business, particularly on the branded side, which is the more profitable element for us.

Darrin Peller:

All right. All right. That's helpful.

John Rainey:

Maybe one thing to add to that, Darrin, and Gabrielle or Erica, you can correct me with the number, but on Germany, where they've already had the ability transition 10%. They're only at...

... 6%, which gives them some indication too, Darrin, of the merchant desire to shift. That plays into our thinking on this as well. Again, just because they offer something doesn't mean that merchants want to move to that.

Gabrielle Rabinovitch:

Overall, on their most recent call, they called out about 32,000 merchants having moved over to their managed payments program. Clearly, that's a very small segment of the overall merchants that we serve that are eBay merchants.

Erica Gessert:

Yeah. I would just add, I mean, we were actually expecting, in our own planning, we were expecting the transition to be faster given the parameters of their way. Yeah. There's nothing to add to John's point on branded share of checkout. I mean, we see very, very high and increasing share of checkout actually as even as merchants are transitioning over to managed payments. We feel pretty good about it.

Darrin Peller:

Okay. Thanks. All right, let's shift down the P&L lines a little bit. I mean, there's definitely been questions on the strength of your volume-based expenses. Transaction loss and transaction expense were strong. How should we think about the sustainability of that performance we just saw?

John Rainey:

The transaction loss results that we've reported now for four quarters, I think it's where we are more comfortable, assuming that's the new run rate . It may vacillate a little bit in one direction or the other, but you know we are at levels that are 20% to 30% down on a unit basis from where they have been historically and that's been driven by improvements in our own capabilities there. I think it's safe to assume that we can be more confident in counting on this going forward.

Transaction expense is less something that we're doing and more just a result of mix. If you think about verticals like travel and event where we do a lot of unbranded card processing, those obviously carry a higher transaction expense. The dip down to 91 basis points is more reflective of the mix change in our business that we're seeing, which arguably, some portion of that is more temporary.

Darrin Peller:

Okay. All right. Thanks. John, in just thinking about other expenses and really operating margin, you obviously showed really strong margin trends in calendar or in the first quarter before we started to see some of these impacts. How should we think about operating margin expansion in this environment? Still think about expansion over time and then in the near term, are you targeting a certain level of operating margin performance? I bet if you could even add on to that, what type of expense levers you have to manage OpEx in this environment. That'd be helpful too.

John Rainey:

Sure. Our thoughts around operating margin are consistent with what they have been over the last couple of years where we want to continue to invest in the business appropriately but still show margin expansion. Some of what we're seeing right now is actually more related to strength on the transaction margin side as the revenue flow through to earnings is higher on branded experiences and so that has less to do with what we're doing on the operating expense side. We haven't actually taken any concerted initiatives or efforts related to Coronavirus to manage operating expenses. We've said we want to continue to invest. In fact, the range that we provided on our second quarter earnings was intended to reflect that there are a number of different outcomes depending upon the pace at which we're willing to invest in the quarter. We're certainly prioritizing organic investment, but we believe we can still do that and show the operating margin expansion.

On the non-volume related expenses. If you just look at it on an organic basis, we're flat in the first quarter and we think that we'll continue to perform at the level that we have historically because of the scalability of our platform. There are a number of different options if we need to pull those levers. Some of them too, Darrin, are actually happening naturally. I'll give you an example. Customer service, we've got 5,000 internal employees and an equal number of external employees that manage our contacts. We receive about 60 million contacts a year. In 10 days time, we moved the entirety of that workforce to a work-from-home experience and what we're seeing is actually lower contact rates and the highest productivity levels that we've ever experienced, measured in terms of the number of contacts that a teammate can handle in one hour.

This is a very efficient way for us, but also in a call center environment, the challenge is always matching the staffing level to peak demand. You've got these demand curves that come in during the day and it's difficult to do that when you're actually asking someone to come into the office to field that contact because to match that demand curve perfectly, you might need to schedule someone for one or two hours. We don't want to ask an employee to do that when you've got a 30 minute commute each way.

If you're sitting at home and we know that our peak contact is between eight and nine in the morning, we can actually ask somebody to work for an hour and then take a couple hours off and then resume after lunch. It actually enables us to be a lot more efficient. These are just some byproducts of the environment that we're in.

I don't expect that we're going to go back to exactly the way we were before. Certainly with customer operations, even our risk management, we see that we can effectively handle this from a work-from-home type program.

Darrin Peller:

Okay. Right. There are definitely some of these that are permanent changes, but clearly you're also trying to manage. I guess, one other question on the P & L side is just on the credit impacts. I think a lot of investors expected some of this, but there was some surprise though on maybe the CECL changes. If you just touch on if you feel your coverage is now adequate on from a reserving standpoint or should we expect to see an additional impact in Q2? Any of your thoughts changed about moving credit off balance sheet further and then maybe just touch on your Synchrony RSA income stream, that risk or not. Those are some of the common questions we're getting on credit right now.

John Rainey:

Sure. We've always been very mindful of the potential risks that could exist by being too heavily focused or levered to the credit business. Fortunately we sold the U.S. consumer credit receivables book because certainly during this crisis that we're going through, that would have had a larger impact than we would have wanted. When we look at the coverage or the reserve that we have for that, there are a number of factors that go into that impact, the coverage there or the reserve there. Unemployment probably being one of the larger ones. When we took all that information into account and admittedly, there's some bit of subjectivity to it as well. We believe that we were fully reserved for the environment that we saw at the end of the first quarter.

If that got worse, could that result in additional charge? It could. As I sit here today, it doesn't feel very different to me than it did at that point in time. I have to point out, we are, our coverage ratio is 17% so that's, I think well north of what the industry average is. We feel pretty good about that. We'll continue to monitor credit and assess the riskiness of that, but it's got to, it certainly has a place in our platform. We would not have been able to do a lot of the things that we did for our customers, if not for that credit business.

Then lastly, I would just say when we look at the overall increase, the $237 million increase that we made related to CECL, that's relatively small against a backdrop of one-and-a-half billion dollars of operating cash flow, $1.3 billion of free cash flow. We think that it's well contained within our business.

Darrin Peller:

Okay. Look, when we put it all together, thinking about modeling OVAS revenue growth over the course of the next couple of quarters, can you just give us any insights on how investors should really think through that?

John Rainey:

Sure. There's a couple of puts and takes there. Specific to the second quarter, we will be lapping last year, excuse me, where we had a $58 million benefit related to Synchrony paying us to service during the transition time period. We're lapping that and then as we look at just the back half of the year as well, we've got a lower interest rate environment and that's where we recognize interest income on our customer balances. Those are a couple of negatives.

Specific to the second quarter, obviously given that we've relaxed some of the given payment holidays and things like that to our credit customers, we're going to see the credit part of that be down appreciably and then offsetting all of that to a certain extent is the addition of Honey year over year. The net of all of those things I just talked about in the second quarter is going to result with other value added services being in the range of what it was in the first quarter. Probably slightly worse than that. I would expect it to be flat to slightly negative in that range given what we see right now. Certainly it will improve upon there as we go into the back half of the year as we no longer were lapping the Synchrony transitioning to agreement.

Darrin Peller:

Okay. Honey is what contribution right now and how has it been going? I know you guys touched on the call, it was obviously sounding pretty strong, but any quick update there?

Gabrielle Rabinovitch:

Yeah, so from our revenue, Honey represented about $45 million of revenue in the quarter and that was basically what our plan was. I believe for Q1, Honey added approximately 680,000 users. Those were users on top of the initial addition that we added that 10.2 upon closing of the transaction in the month of January, and then for April, I think Honey added about 640,000 users. We don't segment report, so we don't give profitability of Honey on its own. That said, we did call out that non transaction related expenses would have grown. They would have been essentially flat, less than 1% growth, but for acquisitions, you can think about the vast majority of that coming from Honey expense base.

Darrin Peller:

Okay, thanks Gabrielle. John, when you think about your guidance now, obviously you know there's some questions we're getting over the 20% growth rate in revenue in April versus the 15% on the quarter. I think you touched on it on the call yesterday, but any more color you can give us on the assumptions and the scenarios that got you to 15% growth? I guess just if you come in lower than that, what would have happened differently and if you feel that 15% is appropriately conservative given the backdrop of the environment?

John Rainey:

I think there's a lot of unknowns right now and I think as noted yesterday, probably the thing at the top of the list is how long does shelter in place last and what are the reversion of behaviors once that's relaxed? Gosh, we just don't know. You're seeing, I think 60% of the country is still subject to shelter in place. We're keenly watching some of these regions that are relaxing these in advance and we've got a couple data points in Austria and Germany where they've done that in advance of others and we're seeing some more elevated levels of eCommerce spend but we just don't know. We do have some assumption about the level of eCommerce spend coming down from where it is today as those measures take place. It's tough to say.

We think that 15% - it could be on the conservative side. If it got less than that, then we've probably seen something that's been pretty dramatic relative to what our expectations are today. At the same point in time, I want people to appreciate that whenever we exit this, whatever that looks like, there is the reverse of what happened going into this is going to happen. Meaning that if shelter in place relaxed and people no longer are shopping online and they can go shop in physical stores, we'll see that eCommerce trends come down some, but the longer lead time items like travel and events, you're not going to book a trip to Hawaii and fly there on Saturday. It's going to be weeks out. When that revenue comes back, it may actually take some time. There's a pace at which this recovery happens and that impacts our business in a similar or reverse way of what happened in March.

All those things factor into the consideration that we've given to our forecast. Then I guess lastly, I would say, credit is still, that impacts us quite severely in the second quarter as we've relaxed a lot of measures for our customers, giving them payment holidays.

Darrin Peller:

Right. On that note with credit, I mean look, in general terms, is there any other variables that we should keep in mind? Not on the revenue side for guidance, which sounds like you're trying to really factor anything you can that you know about in the environment. On EPS, I mean there's transaction losses, there's credit, there's obviously your own expense management. Any other key factors we should keep in mind that if you actualize that 15% growth would get you to the higher low end of your range?

John Rainey:

Well, a lot of the flow through on earnings are revenue from these higher transaction margin branded transactions. If that's more than what we saw in April, that has some opportunity for EPS, appreciation relative to the guidance that we've given. We are somewhat, we're investing quite a bit in the second quarter, but there's a pace to which we can do that responsibly as well. We don't just want to throw money at things. We want to be thoughtful about how we're going about some of these initiatives and the extent or the pace at which we can do that could impact our performance in the second quarter as well.

Darrin Peller:

So you pulled the full year guidance, which I understand given the uncertainty in the back half, but your medium-term guidance I think is still intact?

John Rainey:

We've not changed our medium-term guidance. That's correct. And look, there's just a tremendous amount of uncertainty and who knows what the economy looks like 18 months from now, and who knows how much these e-commerce trends continue, the extent to which they continue. We think that there's some puts and takes there. Very clearly there will be some impact on personal consumption if we have prolonged levels of unemployment at this level. But there's also some secular changes taking place in front of our eyes around e-commerce spend and how people are behaving, and so that endures to our benefit in that case.

Darrin Peller:

Yeah. Yeah, that makes sense. Look, just to wrap it up before we take questions from anyone in the audience, but 1.3 billion of free cash in the quarter I think is 60% growth over last year. We've got some questions on whether you benefited from any one-time items on that, or at the same time you also drew down from the revolver in the quarter. Are there any differences in your free cash generation profile that we should just keep in mind?

John Rainey:

The free cash generation profile will generally follow the earnings profile. So as we've got a higher flow through on some of the revenue that we're bringing in, that's going to benefit free cash flow, but generally I would say we're still expecting to be in that 20% free cash flow margin range. Within the first quarter specifically, there were some working capital adjustments, a couple of $100 million, that are not representative of the true earnings in the business. And you can parse that out by looking at our cash flow statement on the 10Q

Gabrielle Rabinovitch:

In addition, cash taxes were a little lower, which is normal for us in Q1. CapEx is slightly lower typically than our trend as well. But nothing new to call out.

Darrin Peller:

You did 800 million in buybacks in the quarter. Are there any changes in how you're thinking about share repurchases? While you're on that, just any priorities as it relates to capital allocation at all?

John Rainey:

No change to our capital allocation strategy. But I'll add some color to that statement because I think capital allocation in general is something that has been heavily scrutinized by companies as we've gone through this, you've seen people stop share buybacks, stop dividends, things of that nature.

We have a durable earning stream, and so we want to continue to do all the things that we were doing in a balanced way. I think about our share buyback, probably a good way to think about that is just offsetting dilution from share-based compensation this year.

Certainly, given some of the priorities that we have around some of the investments that we want to make. And look, we're also canvasing the landscape to see, are there companies that are attractive to us that are complementary to our platform, that can help us accelerate some of the initiatives that we're working on that are maybe priced more attractively than they were going into this crisis.

So we're trying to be responsible and good stewards of the resources that we have to allocate that capital in a way that maximizes shareholder value.

Darrin Peller:

Okay. All right, guys, last question for me before we take, there's a whole bunch of questions from the audience on, but first with, just broadly speaking, your initiatives that you were working on strategically, even before this started, you had so many different partnerships in the pipeline and in process.

Any quick thoughts on any changes in those priorities, or the investments, or time horizon on whether it's MELI, or it's Facebook, or Uber, or all the other big partnerships you guys were working through, Paymentus? If you could just give us maybe a one liner on each, or something like that, would be great.

John Rainey:

Yeah, so I would say there's no substantive change in anything that we've talked about thus far, and I think Paymentus is one that people have been appropriately focused on and that is on track. We're pleased with how that's going and you'll see a more pronounced impact to our volume and our P&L related to that in the second half of the year.

At the same time, Darrin, like everyone recognizes that during the peak of coronavirus, everyone is focused internally and focused on liquidity , and things like that. So there's a natural sluggishness that exists when you've got a crisis like that and you're trying to work across companies but nothing that is, I think, materially impacting our plans or substantively different than what we talked about before.

Darrin Peller:

Okay. All right. Why don't we jump to questions just in the interest of time. I'm just taking them in order they came that we have listed here. And if anyone doesn't get to their question, guys, in the interest of time, I don't think we'll get to all of them. Just email us after and we'll try to follow up. But what are the most important overall TPV yields for both Q1, and how should we think about it for Q2?

John Rainey:

The TPV yields?

John Rainey:

Oh so-

Darrin Peller:

The revenue yields, yeah.

John Rainey:

Yeah, yeah. So generally there's going to be a higher flow through in 2Q, meaning that a greater proportion of revenue for the TPV that we're bringing in because of some of these branded experiences and cross-quarter has rebounded as well. And that tends to, because of the nature of that, carry a higher take rate in most cases as well.

Darrin Peller:

Okay. I guess so what you're saying is basically the type of mix that we saw in Q1 might actually reverse to some degree, whether it's some of the Braintree versus some of the higher yielding cross-border and other metrics?

John Rainey:

Well, if you look at some of the merchants and the travel and event vertical, like Uber or an Airbnb, we tend to process quite a bit of their volume and there's always a relationship, an inverse relationship, between the amount of volume that you process and the take rates that you're able to enjoy from that. So as we see less volume on our platform from customers like those, that affects that relationship.

Darrin Peller:

Okay. All right. Another question, John, is, how do we bridge from the 35% branded revenue growth to the 20% overall revenue growth seen in April? What are the pieces that are significantly under-performing versus strengths of the core PayPal brand?

John Rainey:

Well, Uber and Airbnb would be two that stand out there. Just some of the same merchants in the verticals that I've mentioned, it's probably exactly the same phenomenon as the prior question.

Darrin Peller:

Okay. All right. Now, this next question we've gotten from a few different investors, but can you discuss what form the in store checkout takes hold? Is it more? Is it more than with a physical POS, or is it partnering to offer PayPal via exiting in-phone wallets for NFC purposes, like Apple pay?

John Rainey:

Yeah, so there's a couple of different approaches there. One is the use of QR codes with the SMB segment where that is the point of sale opportunity for them. The other is to look at potentially partnering with existing POS providers to use PayPal as a form of payment there so it differs based upon the size of the merchant and their breadth and ubiquity.

Darrin Peller:

Okay. And when you think about where you guys are on that process, in terms of trying to build further along physical point of sale presence, can you just give us a little update there as well?

John Rainey:

So Darrin, we're, I think it's fair to say early on, but this is an initiative that we're focused on and have resourced this appropriately. We do recognize this is a moment in time where, fair to say. Maybe the stars are aligned to make this opportunity successful.

And so, it's something that we won't be talking about launch of this in 2021. This is something that is a priority for us right now and is an immediate thing that we're addressing.

Darrin Peller:

Okay. All right. And then, there's just one more bigger picture that we're getting from a couple of investors, and this is around the value proposition of PayPal on the conversion in this environment and really, it's the competitive dynamics. Implications on the competitive environment versus some of the others. If you can just comment on how you see yourselves versus other e-com gateways, online companies.

John Rainey:

Sure. Well I think there's nothing better than good hard data to speak to our performance versus others. And we consistently see higher levels of conversion with PayPal than other forms of payment online.

And that's one of the best and most compelling things when we go to merchants and try to sell the PayPal propositions, excuse me. And when you're converting at two times the industry average that's precisely what a merchant wants. And it underscores even more important in this type of environment. So just a continuation of some of the strengths that we've had historically.

Darrin Peller:

Yeah. All right, guys. Well, I think we're just bumping up on time now anyway, so why don't we leave it there. Really appreciate it. Again, for anyone that that did ask a question that we weren't able to ask right now, just feel free to shoot us an email. We'll try to get that answer for you as well.

Guys, be safe. Thank you very much for all your help with this. And again, great quarter and good luck with everything.

John Rainey:

All right. Thank you, Darrin and thank everyone for attending, and everyone be safe. Okay?

Darrin Peller:

Thanks, guys. Take care.