EVERCORE ISI SPONSORED MANAGEMENT CONFERENCE CALL WITH PAYPAL HOLDING INC. (PYPL)

Moderator: John Rainey
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Operator: Ladies and gentlemen, thank you for standing by. And welcome to the Evercore ISI Sponsored Management Conference Call with PayPal Holding Inc.

At this time, all participant lines have been placed in a listen-only mode, and later we will conduct the question-and-answer session. To ask a question at that time, simply press star, then the number one on your telephone keypad.

Thank you. I will now turn the call over to David Togut of Evercore ISI to begin. Please go ahead, sir.

David Togut: Thanks so much, and thanks so much to all of you for joining us for the quarterly buy side call with PayPal management. I'm David Togut; I research the Payments, Processing and I.T. Services industry for Evercore ISI.

Please see the Safe Harbor disclosures on PayPal's second quarter 2019 earnings call relating to any forward-looking statement.

It's now my pleasure to introduce PayPal management. Delighted to welcome CFO, John Rainey; Head of IR, Gabrielle Rabinovitch; and IR, Akila Moorthy. Thanks so much for carving out the time to be with us today.

John Rainey: Thanks, David. We're happy to join you and address any questions from investors. I'll also point out that joining us from PayPal is our Senior Vice President of Finance and Analytics, Erica Gessert. She's going to join us on the call as well.

David Togut: Terrific. Welcome, Erica. John, would you like to start off by making any opening remarks? And then, we'll head straight into Q&A?

John Rainey: Sure, David, thank you. So, obviously, I think there's some amount of disappointment among the investor community that is shared, along with the PayPal management team of having to lower our guidance. And I'm sure we'll address some of the specifics of that later. But I don't want that to take away from what was, otherwise, a good quarter. We saw 19 percent revenue growth, when we adjust for the sale of the credit receivables. We had a record number of net new actives over the last 12 months, record operating margin, record operating margin expansion, and so on.

So really pleased about how the business is doing. I think the important thing that I would want the investor community to know is that the decline in our revenue guidance is entirely related to timing. And we expect to realize the entirety of the benefits, related to both pricing, as well as the partnership integrations. Certainly part of the decline was related to foreign currency and FX, that will kind of move one way or another from one year to the next.

So – but when you look at the product and pricing-related items, we expect to realize the full benefit of that. This is simply a push out in timing. And maybe just one more comment on that is we often have to make estimates about the level of effort and the complexity of effort, even the amount of scope involved in these projects.

Sometimes they go better than what we think. In this case, it has taken longer. We wish that weren't the case. But we felt the prudent thing was to adjust our expectations on what revenue would be for the year – reset, and then move forward. So I'll stop there, David, and happy to field the questions that you have.

David Togut: Very clear. Thank you, John. So we received a large number of incoming investor questions. I'll jump right in. Many of these questions were focused on the change in guidance. You talked about three factors on the earnings call last night, which drove the reduction in FX neutral revenue growth for this year to 14 percent to 15 percent, from 16 percent to 17 percent.

The first one was timing issues related to product integrations. So if we start there, are there specific products where you saw delays and with specific partners?

John Rainey: Sure, I will start with this is not an across-the-board problem related to all of our product integrations. This happens to be specific to a few larger partners. One of which we called out on the call, which is Paymentus.

As we look at integrating with them and launching bill pay services, we realized – and they have as well – that we have additional capabilities that we can offer that will actually improve their platform. These were beyond what we initially contemplated when we announced and we signed this partnership. But they're the right thing to do. They expand the scope, they provide for a better customer experience. And we absolutely want to – want to do these things but they're going to take longer than what we initially imagined.

David Togut: Just as a follow up on that, any guidance, with respect to when some of these integrations would go live?

John Rainey: Sure. And so let me – let me explain what else is going on, in cases where it's not necessarily just expanded scope. Oftentimes, we are reliant upon the timing of the party that we're working with as well and when they want things to go live, when they want to roll out experiences. That's part of what we're dealing with here, not necessarily in the case of Paymentus, but with some of the other partners that we haven't named. And so it's a little bit outside of our control.

But that said, there's nothing about what we've announced that is an indication of a change in the relationship or the type of partnership that we intend to have with these companies. And so, it's not as if this is a big shift in timing. This is simply pushing this out a little bit.

Our general expectation around all of these is launch at year end. And that may be prior to Thanksgiving, it could slip into January. No one has an expectation that this slips into the back half of 2020. These are all around the year-end time frame.

David Togut: Understood. The second call out you had in your 2019 revenue guidance change related to pricing. Taken together, do the pricing changes and new product implementations with your partners hitting in late 4Q 2019 early 1Q 2020 imply acceleration next year, not only from the 3Q, 4Q 2019 run rate, which was a step down from Q1, Q2 of this year, but from what would have been the run rate without the guide down for the second half of this year?

In other words, could the growth rate in the first half of 2020 actually be considerably higher than what people might have been looking for before the second quarter earnings call?

John Rainey: Well, I guess, it's all relative to what one's expectations were. But all of these things take time to ramp. It's not as if when we launch an initiative that we receive 100 percent of the benefit on day one. So there is a ramp with that. And those require some estimation around how quickly they will do that.

The other thing to keep in mind is next year is the year that we transition off of eBay. So as you think about our medium-term guidance of 17 percent to 18 percent revenue growth, that's compounded annual growth over a three- to five-year period.

It's going to be higher in some periods; it's going to be lower in other periods. But, I think, it'd be reasonable to assume in a year, where we're transitioning off of our largest partner, eBay, that is going to be more towards the lower end of that range. So that number already has some pressure on it from that. And then, we have to see what the rollout is of these new product launches and the pricing changes.

But we'll give an indication when we get to the third quarter call about how we're thinking about 2020. It's a little bit early right now. But the main thing I would want to impress is that we have every bit of confidence in our business that we've had prior to this announcement.

Our business is still performing extremely well, as I talked about some of our stats in the second quarter. But even as we look at things that I tend to focus on, that I described as leading indicators in our business. So the number of net new actives, how engaged those actives are. Those are performing at exceptional levels. And as we look at the new cohorts that we're bringing on, they are more engaged than their prior cohorts.

So there are a lot of really positive indications about our business. And that's before you get to any of the opportunities that we've called out, like with Instagram and Facebook and what we're doing around Venmo and reward points and things like that. So we've got a lot of conviction in our medium-term plan.

David Togut: Understood. A lot of key points that I definitely want to expand upon. The first, is there anything you've learned about the possible trajectory of eBay volume, based on what we've seen in the first half of this year that might inform your view of next year? Specifically, what percentage of PYPL branded volume with eBay do you expect to retain and what the growth of the eBay volume itself might be?

John Rainey: David, there's nothing that I – I've seen, thus far, that's caused us to appreciably change our expectations on eBay. But we, obviously, pay close attention to what they're doing and particularly around managed payments.

And one thing that, I think, is noteworthy is that they've had the opportunity to launch in two markets this year. Thus far, they've only launched in one – the U.S. And, I believe, the indication they gave on their call was that they expected to launch Germany, either sometime later this year, maybe early next year.

And so, I think, that points to some of the challenges with going and getting licensing in markets, making sure that you can comply with all the regulatory rules and do what's required there.

So this is difficult, and we knew that going in, so we're closely watching it. But, look, I expect eBay will get better at this, as they have more experience with managed payments too. But these are all things that could influence the rate at which eBay moves their volume to managed payments.

And the other thing to think about too, which is something we're focused on as – when we get to the midpoint next year, and eBay has the ability to move more volume onto their platform, you then get into the shopping season – the holiday shopping season towards the tail end of the year.

And, typically, merchants want to have their experiences tested, locked down, ready to go as they get into that that period and not be experimenting with new product features, and so forth, so that could impact the timing somewhat as well.

But, again, that – though it's a little bit outside of our control what they do there. I will say that we still feel very confident about the amount of business that we expect to retain on this, on our branded button.

eBay noted on their call that in their U.S.-managed payments, that PayPal had 35 percent share of checkout, which was appreciably lower in their unmanaged payments business. I want to speak to that for a second because that's really sort of an apples and oranges number. I think it's not representative of what we expect in the future.

So eBay launched their U.S.-managed payments something like nine months ago. And they've been ramping that experience with that – those select users over that period of time. We were just launched in that experience last month. And so the 35 percent number includes a ramp-in period. We also need to take into consideration that in those prior eight months to us being launched, people were vaulting instruments of their own because PayPal wasn’t an option.

And one of the things that we have in our contract is presentment parity. So that's very important to us. So that 35 percent, I think, is – it doesn't represent what we expect when this is fully rolled out, and they are adhering to all of the requirements that we have in the contract.

David Togut: Very clear. Just returning for a minute, John, to pricing changes, which was a factor you called out last night: which products in particular, are you changing pricing on? Are these all going to be upward or downward adjustments? And then as a related question, does a pricing change relate to your new policy on refunds, and how might merchants be reacting to that?

John Rainey: Sure. So there are a number of different pricing changes that we've – that we've considered and some that we will roll out later this year. And the pricing goes both directions.

Some cases, we realized that to be more competitive with the market, we need to lower prices. In other cases, we recognize that we're doing a disservice to ourselves in terms of the value that we provide our customers, and how we price that relative to our customers that are charging more.

And so, specifically, with respect to the delay in the rollout, we took a step back and we realized two things. In the case of one of our pricing experiences, the experience that we put our consumers through was inferior to what some of our competitors were doing.

And, certainly, if we're going to raise prices, we don't want to do it on an inferior product. We took a step back and we said, "Look, let's approach this the right way, and improve what the experience is here." And that requires – that's a little more complex than what we imagined. And so, there's a delay related to that.

The second thing is that when you start dealing with things like you mentioned, refunds – refund pricing as an example. There are other pricing elements that, in some ways, tie into that.

And so, for example, like if a customer is returning an item, and –we're deciding whether we should retain the fixed piece or the variable piece, or both pieces of that, there's also an – a pricing element where who bears the risk of a changing currency if it's a cross border item that involves a different currency? And we need to be better aligned around all of those things to make sure that we're providing the right pricing that aligns with the value that we're giving those merchants.

So this was, for us, taking a step back, being a little more measured in our approach and making sure that we're being thoughtful, holistically, across the entire experience around how we're monetizing them.

David Togut: Understood. And then on the customer service side, investors are asking about the pace of rollout of new customer experiences, probably tied to pay with Venmo monetization, which is an important topic in and of itself. Are there any gating factors behind the rollout of new consumer experiences, for example, new money movement experiences? And should we expect to see some new consumer products in the next, say, six to nine months?

John Rainey: So there are no gating issues or problems that we're having, in general, with the rest of our product development product launches. And, yes, there are a number of new experiences that we're intending to roll out.

One that we're pretty excited around is pay with points. As we've announced partnerships with many banks, and we're moving towards an experience with that customer base, where, when they go to checkout with PayPal, their points are a funding mechanism in the checkout channel. And they can use all of that or a portion of that, just like you could move between a debit or credit card or different financial instruments.

We think that will be particularly compelling, particularly as we do a better job of promoting the ability to earn points as you use PayPal. There's still some lack of awareness around our customer base about the ability to do that. So, I think, holistically, we can provide a better overall experience there.

That may be the premise of your question, David, I want to allay any concerns that this is some type of insidious issue that is across all of PayPal, that the delay that we're talking about is really specific to a couple large integrations that we're doing. We're not experiencing any other type of issues with the rest of our products.

David Togut: That's very clear. What impact has Bill Ready's departure had on the rollout of new products? And what's the plan to redistribute his responsibilities as he transitions out of PayPal?

John Rainey: Sure. Fortunately for us, Bill had a very deep and talented bench. And many of you have had exposure to some of his key lieutenants. But his responsibilities were divided among three or four people. We've separated merchant and consumer. That was combined before. Merchant is now led by

Arnold Goldberg, whom many of you met at dinners we've had. Consumer is led by John Kunze, which is a known name for many of you. And there's a talented team around them as well.

And so I want to be very, very clear on this. We don't expect to miss a beat in product development, and what we're doing with consumer experiences, because of Bill's departure. Bill was an asset to the organization, and his fingerprints are all over PayPal, and Braintree.

But this was something that had been contemplated for some period of time. Dan and Bill decided that this was the right time for Bill to move on to the next chapter in his career. And this did not catch us off guard in any way. This is a planned transition. And we have the right team to execute on it.

David Togut: Understood. As a segue into some of the financial metrics. operating leverage certainly has been a big focus of yours and, definitely, a focus of ours on PayPal.

In Q2/19, PYPL expanded operating margin by 190 basis points. Normalizing for the credit receivables sale to Synchrony, held for sale accounting impacts and acquisitions, operating margin expanded 280 basis points. Is this level of margin expansion in Q2 sustainable for the rest of this year and into 2020?

John Rainey: So let me address that at a high level and get a little more specific with some of the numbers.

The operating margin expansion that we see in our business is absolutely sustainable. When you think about the list of things that keeps a senior executive up at night at PayPal, operating margin expansion is not one. We have clear line of sight how to continue to do that. That said, I think it would be premature to assume that we can have the type of operating margin expansion that we experienced this quarter, every quarter going forward. And let me tell you why.

I put expenses into three buckets. We have transaction expense, which had a four-basis-point improvement, year over year; transaction loss, which had a similar improvement year over year; and then all the other non-volume expenses.

The progress we have made on the non-volume expenses, we absolutely expect to continue. And from one period to the next, look, we may invest more in a certain period, to build up for seasonal peaks because of certain unique opportunities.

So we're not going to be a prisoner to having that same type of expansion each quarter when we know that maybe we can invest more, and that will be better for us longer term. But the business on an average annual basis, absolutely should show good strong leverage.

The other two areas, transaction expense and transaction loss, are part of the reason for outsized operating margin expansion this quarter. And let me take transaction expense first. The transaction expense we've seen quarter after quarter, the effect of changes in mix in our business to consumer behavior, and that's kept our transaction expense around that 95 to 98, 99 basis points.

We had a little better performance this quarter. But that improvement, relative to the range that I just described, was specifically due to the fact that we realized some of the volume incentives from the networks this quarter.

Last year, we recognized that in the third quarter. So that's going to create, as we move into the third quarter, as we think of financial results there, a little bit of pressure, in terms of the year-over-year comps, the fact that we had that in the third quarter last year, recognizing the second quarter this year.

On transaction loss, that's one that I'm actually more excited about. Because losses sometimes a result of kind of what happens to us, in terms of incoming fraud pressure, our ability to manage that.

The improvement this quarter though was not because of what happened to us, it's because of what we did. Very clearly, we've had some improved risk management capabilities through enhanced machine learning models. And that is primarily the single, biggest driver of that four or five-basis-point improvement. Now with all of these risk models and machine learning, if they take time to calibrate and to get to a point where you can trust on that performance quarter after quarter.

So, I think, again, it's probably premature to assume that we can have this level of transaction losses, each quarter going forward, this is going to – progress will be in fits and starts. We'll tweak this too much in one direction. And we might take a step backwards and then there's two steps forward. But, I think, longer term, this bodes very well for what our expectations are in transaction loss. I think it's going to come through fits and starts over the next few quarters.

David Togut: Understood, very clear. As a related question, regarding the second half of this year, your guidance seems to imply about 3 percent organic expense growth. First of all, is that correct? And if so, how much is due to cost takeout, related to the Synchrony and eBay transitions versus other factors?

John Rainey: So there is very little, if anything, that's due to eBay, just to address that. We still support their business today, from a customer service perspective. They still have a very small amount of volume that they've moved to their managed payments. So eBay is not necessarily a factor in that number.

We will benefit beginning – actually the end of June – first full month is July from the Synchrony transition, as we no longer have the employees that are servicing that portfolio. And that's – that is built into our guidance.

David Togut: Understood. On the take rate decline, which seemed to be a little bit larger than average at 13 basis points in 2Q/19, can you elaborate on how much of the take rate decline was, let's say, structural mix shift, i.e. P2P and eBay, versus how much might be transitory, for example, somewhat slower growth from cross border? And then how should we think about take rate going forward?

John Rainey: Sure. So take rate is always one of those things that there are a lot of inputs into, and it can distort what's happening to the underlying core trends in the business.

Similar to previous quarters, the biggest driver of the take rate decline is the expansion and growth of P2P, both for PayPal and Venmo. So the 13-basis-point decline, seven basis points of that was related to free P2P.

Now, we also benefited in the quarter by five basis points related to hedging. And that's a decline from the previous quarter of a couple basis points. So if you look at what's caused it to decline sequentially, we have a smaller hedge benefit in that number this period than we did in previous periods.

You strip all that out and it's pretty much the same story that we've seen in our business. There is some pressure from eBay, there is some pressure from mix to our business, but not necessarily in a bad way. So I'll give you an example.

Hyperwallet is one of the acquisitions that we've had over the last year. Hyperwallet has a take rate of less than 1 percent. However, an extremely low transaction expense as well. So it's a good transaction margin, good unit economics there. But if you solely focus on our unit revenue or take rate, just given the mix of our business, you see pressure on it like that.

And so, I use that as a – as an example. Hyperwallet was about a basis point, maybe two basis points of impact there, depending upon if you're looking at transaction take rate or total take rate, but it does show sort of the effect of changes in mix in our business.

David Togut: I see. And before we leave …

John Rainey: And maybe, David, just …

David Togut: Yes.

John Rainey: … to answer that a little bit differently, I always think a good analog for this is, how are we doing on the same-store sales basis? And on a same-store sales basis, we're still holding up very strong, as we have in previous quarters.

David Togut: Very good to hear. Before we leave second quarter financial metrics, just a quick return to transaction cost trends that we've seen recently, and maybe some thoughts about what the appropriate level for transaction losses are going forward.

John Rainey: I think for, right now, I would model it, as you've seen in quarters prior to the second quarter. I don't want to get ahead of ourselves here. Again, I'm excited about the new opportunities and capabilities that we have.

But that high teens, 18 basis points-ish range is, I think, a good way to think about it, until we demonstrate that we can repeatedly perform at the level of 14 basis points that we did or 15 basis points in the quarter.

We've had experience here with calibrating risk models and the progress here occurs in fits and spurts. And so, one quarter does not make a trend, despite our excitement about the improvements here. But once we demonstrate that we can do that repeatedly for a few quarters in a row, then I think it will be time to rethink what that number is on an annual run rate basis.

David Togut: Got it. You touched on customer metrics a little bit earlier. They were very strong in the quarter, especially the acceleration in net new active count growth to 17% plus compared with 15% in Q1/19. Could you elaborate on what some of the biggest drivers were, let's say, behind the Q2 acceleration in net new actives growth?

John Rainey: Yes, I'll start, and then I'll ask Erica to jump in with a little bit of input here. The trend, though, has been pretty similar to what we've seen in the past, where the single largest contributor to net new active growth has just been PayPal core. And specifically, P2P is still a very good acquisition channel there. You know, one of the improvements that we've seen, though, also is a reduction in churn, which Erica will speak to.

The second biggest channel would be Venmo. Venmo continues to perform very well. We did not give a new customer number in the quarter. But we talked about the overall TPV growth that's 70 percent. So we are very pleased with what we're seeing there. And again, high levels of engagement.

Beyond that, there's nothing in particular to call out, other than the fact that India continues to have a larger contribution to this than it has in past years. And that's simply because of the growth in that market, organically.

And, look, to be clear, India is a huge addressable market. But it's also pretty fragmented, and a lot of competition there. I think that if you look at why digital payments have probably struggled in India – and I've actually – would go further than that, just the fact – cash is the predominant form of transacting there, even for e-commerce sales. A large percentage of those are cash on delivery.

If you look at the reasons behind that – actually, this is where PayPal's value proposition really, really addresses some of the pain points for Indian consumers - we're excited about that long term.

I think the CLV or customer lifetime value that's ascribed to those net new actives is lower in India than it is for the rest of our business, because of a higher likelihood to churn given their higher competition, all of the factors that I mentioned. But we're excited about that long term. We believe that in a market that's got over half a billion digital users, that it's definitely a market that we need to have a strong position in.

Erica, do you want to add anything else on the net new actives?

Erica Gessert: Sure. I think Dan actually mentioned on the call some of the improvements that we've been having on the churn front. I would just say there's – as much as the acquisition pipeline is extremely strong for us, and actually has a lot more new opportunities that we're continuing to look at with partnerships globally, in Brazil, and Mexico and other places that we're kind of looking at now that we're also really starting to plumb the depths of the – of the opportunity with our engagement pipeline.

With any business that acquires as many – as many customers as we do every single quarter, you have a certain cohort of customers that is in event – or we call them "one and done." They come on and they transact once, and then they churn off. Some of these reactivate after 13 or 14 months. But any business has this layer.

We've been quite successful in the last year or two in starting to really start to engage those customers more actively. And it's actually that cohort – that newly activated cohort that's causing us to have a much better year-over-year churn percentage than we have seen in the past.

It's really great with Allison Johnson coming on six months ago, and as our CMO and really focusing in on how we drive engagement, how we message to our customers every single day that the places where they can get value out of PayPal, and I think it's really starting to bear fruit.

John Rainey: Thanks, Erica.

David Togut: Thanks for that. That's a good segue to pay with Venmo monetization. At the end of the first quarter of this year, you had a $300 million annualized revenue run rate on pay with Venmo. Can you give us some insight into what that rate might be as of the end of the second quarter?

John Rainey: So we're not disclosing what that rate is right now. It's progressing ahead of our expectations. In fact, I would call out Venmo when we look across our suite of product initiatives, Venmo is one that stands out as outperforming our initial expectations, and that continued into the second quarter. We're extremely pleased about that.

I've been asked other questions, David, like, "What is the cadence of reporting information on the Venmo?" We provided a lot more in the previous quarters because of the rollout of pay with Venmo and the monetization efforts that were beginning.

I think it's probably fair to assume and we'll refine our thinking on this as we go forward. But probably every three to four quarters, we'll be updating with Venmo numbers, be it customers or annualized revenue, or if there is material information to share in the interim that we think is relevant to consumers and to investors rather, and can help inform their thesis on this.

David Togut: Appreciate that. As a related question, what percentage of Venmo users in Q2 engaged in a monetizable transaction?

John Rainey: Yes. We didn't give that number on the call. But I can kind of give you sort of a rough approximation. We did say that 15 million of our customers have engaged in a monetizable transaction in the quarter. And while we didn't give a new number of customers, we said last quarter was 40 million, so assume some marginal growth and you get to around 35 percent or so.

David Togut: Got it. Thanks for that. It's very helpful. What's the timeline to profitability for Pay with Venmo? And if you could elaborate on your thought process around how you think about investing for growth in that – in that business versus showing margin?

John Rainey: Sure. So the timeline to profitability – and I want to be a little nuanced with my wording here, for just Venmo, in general, not necessarily pay with Venmo. But if you take the entire suite of products that we have there is still very similar to what it was.

And we haven't been specific on that. But the way that I would characterize it is there are a few stages of getting there in a hyper growth product like that. So we started with extreme growth with Venmo and it was kind of like every incremental transaction that you have, your losses deepen. And then you get to a point where we are now, where we've stopped the rate of losses and we're moving towards breakeven.

And then, thirdly, we get to breakeven. Then last to where it's a big profit contributor for us. We have very clear line of sight on how to get to each of those. But we're not to breakeven yet, and this is something that I said previously, it's not going to happen in the next quarter or two. And that was – someone inferred that is, "Well, then it's going to happen in three quarters." That's not what I meant. I mean, this is something that is further down the road. But we have very clear line of sight and convictions that can happen.

In terms of the investment, David, we feel like we are investing appropriately into Venmo. We need to get that experience right. And like I know we've said that and sometimes investors will be like, "Well, what does that mean? What do you mean have the experience right?"

Well, when you go to check out at a merchant with Venmo, we want to make sure that is flawless. If the button is supposed to morph depending upon your likelihood to use PayPal versus Venmo as a customer, that needs to happen all the time. And that's not the way it is right now.

You know, this is a pretty significant undertaking on our part, and one that, we think, is too precious to not get right. We want to nail this. And we have full confidence that when we do that, the P&L will take care of itself.

David Togut: Understood. PYPL's top 20 marketplaces TPV growth, ex-eBay was very strong, 30 percent-ish in the second quarter. Can you talk about your plan with restricted marketplaces that become unrestricted at the end of the operating agreement with eBay? And how might you message that as we approach July 2020?

John Rainey: So we're in discussions all the time with all the industry players and people that we can partner with that are – we're restricted from today. It's not as if on the very next day after eBay, we're going to come out with a swath of announcements, like, "Here's all these new partnerships."

All of these agreements take time. And they're specific to what the needs are of those marketplaces. But there are ample opportunities and a lot of interest being expressed on the parts of those other large marketplaces.

You know, some more than others, obviously. But the way I would describe it is, if you go back to January of '18 when eBay made the announcement of moving to managed payments with a different payment provider, there was some concern, – certainly warranted, about, "Would we be able to backfill that volume from eBay?" At PayPal, right now we know that will happen. We want to do many times, in excess of that. And the types of opportunities that we're in discussions with and exploring are sizable enough that when we get past the operating agreement, I think, this will be a very tired discussion, because people will see that if we execute on these opportunities – it could even dwarf eBay.

David Togut: Understood. Shifting to capital allocation, can you update us on your thoughts, with respect to buyback versus acquisition, especially looking at where your stock is trading in the market today versus valuation of acquisitions that you might make at current prices?

John Rainey: Sure. So the guidance that we gave around capital allocation over the long term hasn't changed. And that's, specifically, on average, returning 40 percent to 50 percent of free cash flow to investors each year, and using about $1 billion to $3 billion of capital for acquisitions.

Now that's, on average, over that period. And we are being opportunistic. When our stock prices very attractive, and maybe there are not other opportunities that are as attractive, you've seen us go out and buy back more stock.

As a side point, in the quarter, we didn't buy back any stock. But that was more result of being subject to blackouts because of certain things that we had going on. I don't want anyone to read through that as something else. But there are also very attractive acquisition opportunities out there as well. We've happened to spend a little bit more this year on some more strategic investments.

And let me address that because these were, I would say, more anomalous to what we've done, historically, and what we probably will do going forward. These are not just investments for investments sake, these were tied to or intend to be tied to commercial partnerships with each of these companies – MELI and Uber, because of the unique opportunity that they are.

And I think they're both very intuitive. I probably don't need to get into great detail. But just with MELI alone, you can understand given that we're not as strong in Latin America that this holds a lot of promise for us.

So I put those into a slightly different bucket. It's not just portfolio diversification for us. I know investors can do that on their own. They don't need PayPal to diversify their portfolio. So that is, to be very clear, not the purpose.

I think, going forward, the acquisitions that we make would be more similar to what we've done in the past, where these companies are complementary to our platform, or allow us to expand in certain regions of the world where we are not as strong today.

David Togut: For example, iZettle?

John Rainey: I'm sorry?

David Togut: For example, more iZettle-type acquisition, giving you …

John Rainey: Yes, exactly.

David Togut: …omnichannel capability and building out European presence?

John Rainey: Like that. Yes.

David Togut: Got it. OK. And on that topic, how are iZettle and Hyperwallet are performing versus your expectations? And what are the key milestones we can track on these acquisitions?

John Rainey: Yes. So they're both performing very well. Simility is also performing well. Hyperwallet gives us a capability that was mainly sort of a weakness in our platform with payouts. And we made that part of the PayPal commerce platform that we've launched out to have a holistic suite of services for our merchants. And so very, very important to what we're offering to merchants today, and it's performing very well.

iZettle is also performing very well – good, strong growth. Where we struggled there is that we've been delayed in implementing that. But that hasn't caused iZettle to miss a beat. They have continued to move forward with growth and expansion and they're doing very well.

In terms of measuring us, one of the things that you should see going forward is our ability to cross sell into iZettle and PayPal. There's a very complementary customer base there. And then regions of the world that, candidly, I think, have more growth opportunities than maybe of the U.S., which tends to be a little more saturated. So, first phase will be executing on that cross sell. And you'll hear us talk more about that as we progress next year.

David Togut: Understood. Just being respectful of your time, John, I'd like to, if we could, perhaps, just close with two questions.

The first is just one on regulation with PSD2 starting in September. We're going to see consumer ACH payments for e-commerce transactions, as well as open banking. You know, how do you see the – or assess the opportunity and risks to PayPal, especially given your strong European payments franchise?

John Rainey: So with PSD2 and, specifically, strong customer authentication, SCA, these are things that, I believe, were announced back around 2013, 2014. We've anticipated this, we are well prepared for this transition. I've heard some indication that maybe in certain exceptions the date could get pushed past September. We're not relying on that. We'll be ready for that.

I do understand that with some merchants in some experiences, there have been some challenges. But actually I think that's where PayPal can help those merchants to deal with those challenges. So we are well prepared for this transition.

David Togut: Understood. Just for a closing question, how will you work with Facebook on its Libra project? How do you envision Libra progressing and in what time frame? And why won't Libra disrupt PayPal’s business model?

John Rainey: Sure. Well, very, very early on to have a lot to say on that. I'll point out that we have a non-binding letter of intent, along with over 25 other companies for Libra. Libra doesn't exist today. So it's very premature to talk about what could be here.

I will say that our interest is aligned with the fact that this is democratizing financial services for an underserved population that is very significant around the globe. And so, we're very aligned with Facebook on that.

But there are real concerns that we've all heard expressed, particularly around the compliance and regulatory impact of this. Those are areas though, that I would argue, we are best-in-class. We work in a strong and collaborative partnership with global regulators and policymakers. It's absolutely foundational to what we do and, I think, very additive, in what we bring to the table with Facebook.

We always try to ensure confidence and credibility with regulators and communicate in an open, transparent, proactive way. So our position is that we think that we can – we can help along this. We don't think it will disrupt us. We can actually participate in some of these areas where we have clear strengths and areas that don't need to be replicated by others that are participating. It's very much part of the partnership strategy that we have.

David Togut: Understood. John, thanks so much for being so generous with your time and insights--greatly appreciated. Thanks as well, Gabrielle, Akila, Erica. And thanks to everyone for joining us today on the call, and especially to those who sent in their questions.

John Rainey: Great. Well, thank you, David. Appreciate the opportunity to discuss many of these things with this group. Appreciate it.

David Togut: Thank you. Have a great day, everybody.

John Rainey: All right. Bye-bye.

Operator: Thank you, everyone. This does conclude today's conference call. You may now disconnect.

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