

# MERCADOLIBRE 1Q16 EARNINGS CONFERENCE CALL SCRIPT



Date: May 5th, 2016

## **Part I: Introduction and Disclaimer – Investor Relations**

Hello everyone, and welcome to the MercadoLibre earnings conference call for the quarter ended March 31st, 2016. I am Martín de los Santos, Senior VP of Finance and head of Investor Relations for MercadoLibre. Our senior manager presenting today is Pedro Arnt, Chief Financial Officer. Additionally, Marcos Galperin, Chief Executive Officer, and Osvaldo Giménez, Executive VP of Payments will be available during today's Q&A session. This conference call is also being broadcasted over the Internet and is available through the investor relations section of our website.

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I remind you that management may make forward-looking statements relating to such matters as continued growth prospects for the company, industry trends and product and technology initiatives. These statements are based on currently available information and our current assumptions, expectations and projections about future events. While we believe that our assumptions, expectations and projections are reasonable in view of the currently available information, you are cautioned not to place undue reliance on these forward-looking statements. Our actual results may differ materially from those discussed in this call, for a variety of reasons, including those described in the forward-looking statements and risk factors sections of our 10-K and other filings with the Securities and Exchange Commission, which are available on our investor relations website. Finally, I would like to remind you that during the course of this conference call we may discuss some non-GAAP measures. A reconciliation of those measures to the nearest comparable GAAP measures can be found in our first quarter 2016 earnings press release available on our investor relations website.

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Now let me turn the call over to Pedro.

## Part II: Overview & Financial Results – Pedro Arnt

Thanks Martin, welcome everyone to our first quarter conference call for 2016.

Let's get started by summing up our performance during this past quarter: the year has gotten off to a great start, with sustained momentum of key operational metrics, coming off an already strong ending of 2015. We are very pleased to see our business outperform market growth rates, while we continue to improve the quality and number of value added services we offer in the areas of marketplaces, payments, logistics, classifieds, credit, and advertising. We believe these results are clear indicators that MercadoLibre is driving value to its users, while scaling the business appropriately for the long term.

With that in mind, let's take a quick look at some key indicators that highlight our solid operational results.

For the first quarter:

- Successful items accelerated to 39% growth year over year, reaching 38.3 million units sold, and recording the highest growth of the last 4 years
- Gross merchandise reached \$1.8 billion dollars, and excluding our Venezuelan operations, grew 58% on an FX neutral basis.
- Total payment transactions grew 86% to 27.5 million
- Total payment volume grew 108% on an FX neutral basis, reaching \$1.4 billion dollars and representing over 75% of our GMV for the quarter
- And finally, registered users were up 19.6% year on year, reaching 151.5 million, after we added 6.9 million new users during the quarter

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As units sold and GMV point out, our Marketplace business had a great quarter, and we are encouraged to see this strength is evenly spread across multiple geographies. Our Brazilian and Argentine businesses performed extremely well, while Mexico and Colombia delivered promising results.

Let me give you some specifics. Brazilian units sold grew 46% up from 22% during the fourth quarter of 2015. When looking at Gross Merchandise Volume, the results were equally impressive, accelerating on an FX neutral basis to a robust 61% vs. 33% growth in the last quarter of 2015. Argentina is also off to a solid start for the year. Successful items grew 53%, the fourth consecutive quarter where that metric is growing north of 50%. GMV growth in local currency was 77%. Units sold grew 21% in Colombia during the first 3 months of 2016 and 17% in Mexico, accelerating from 10% and 15% last quarter. If we look at Revenue growth in both these countries, the results are also very reassuring. In the

case of Mexico Revenues grew in local currencies 42%, and in Colombia at 32%, as we begin to see the pick up of our enhanced marketplace and subsequent take rate improvements from shipping, credit and payment processing revenues that come along with it.

Product selection also expanded nicely as the number of live listings being offered on Mercado Libre's marketplace grew by almost 70% during the quarter, reaching 55 million listings. This growth in listings is attributed to the simplified pricing structure we launched last year, and to our freemium strategy, that has also been very successful at capturing incremental inventory, particularly for used goods.

Key user engagement metrics are also moving in the right direction. We have been able to successfully accelerate demand, providing vibrancy across our marketplaces. As a result, unique buyers displayed strong growth across all geographies, with the consolidated number of unique buyers growing 23% year over year.

So all in all, we are very satisfied with the performance and execution of our marketplace BU.

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MercadoPago continues to affirm itself as one of the key facilitators and drivers of e-commerce in Latin America. Total Payment Volume on our platform on an FX neutral basis grew 104% year over year. This growth is attributed to both on MercadoLibre penetration growth of our payments system, as well as our off MercadoLibre merchant service business.

With regards to on-platform, on a country by country basis, Brazil continues to lead the way with 94% penetration, while penetration gains across all other countries has driven overall adoption of MercadoPago to 65% of our GMV exiting the quarter.

Another highlight was our merchant service business. The strength of this business is the result of continuous enhancements in user experience and functionalities, great execution on the commercial front in signing new merchants and gaining share from existing ones, and executing well on key initiatives such as open platform integrations, cross border payments, and prepaid cards just to name a few. Off platform payments processing has consolidated itself into one of the fastest growing segments within Mercado Libre, reaffirming our thesis that the opportunity away from our marketplace could be multiple times larger than on our marketplace. Exiting the quarter, off platform payment revenues grew on a consolidated basis at 128% year on year on an FX neutral basis, the fourth consecutive quarter of triple digit growth in this segment.

On the mobile payments front, adoption of mobile POS systems by merchants in Brazil is gaining traction. Within just 10 months of launch, transactions done through these devices already represent double digit percentage of our platform Total Payment Volume in that country.

This opportunity is still in early seed stage, but shows the potential that exists in the Fintech space for MercadoPago across the region, and complements other efforts in peer to peer payments, consumer credit, and merchant credit that we are also seeding as part of our transactional ecosystem.

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Shipping continues do very well overall, as it gains adoption on our platform with items shipped growing at a solid 114% year on year to 17.2 million units. This is very good performance, as it underscores the growing adoption in markets beyond Brazil, where 70% of units are already using our shipping solution. Consequently, on a consolidated basis, 45% of all items sold on MercadoLibre were shipped through MercadoEnvios. We are very confident that the roll-out of this value added service will significantly contribute to an improved user experience to users in the countries where we are offering the service.

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Our advertising segment maintained the momentum from last year as performance advertising revenues keep gaining share of total advertising revenues over our display formats, propelled by the success of our new product ads on search results formats. In local currencies, advertising revenues grew by 136% year on year, while in USD revenues grew an equally healthy 49%.

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As our performance along key indicators continues to deliver strong results, as I have just outlined, we are increasingly confident in the way we have been managing our financial model and allocating capital. We believe that all our business lines present large opportunities, are highly synergistic among themselves, and will benefit from scale advantages over the long term. Consequently, the right time to invest behind these opportunities continues to be now, so as to seed future growth and continue to gain market share in our already scaled business lines.

Within that context, let me walk you through the financial highlights of the past quarter.

We saw strong marketplace revenue growth mainly driven by the pickup of our unit volume. On an FX neutral basis excluding Venezuela, marketplace revenues grew by a robust 48% year on year. In USD Marketplace revenues remained flat as a result of strong FX headwinds across all our geographies.

Non-marketplace revenues also experienced strong growth rates. In local currencies non-marketplace revenues grew 74% and in USD 19% year on year. The main contributors to this growth, in order of relevance, came from the following items:

- MercadoPago processing revenues accelerated to 128% year on year in local currencies, driven by the growth of payment volume on and off our platform.
- Financing Fees growing in local currencies 52% year on year were aided by the adoption of interest free listings in Brazil, Argentina, and also Mexico.
- Classifieds revenues accelerated to 49% on an FX neutral basis, driven by continued momentum in our Argentine business.
- Shipping revenues grew 69% on an FX neutral basis, and despite this being strong growth, is a deceleration due to contra-revenues of approximately 2 million dollars stemming from an increase in external fraud carried out with shipping labels that were not used for MercadoEnvios shipments but were billed to our accounts. We estimate that these contra-revenues had a negative impact on our margins of nearly 1.5% points. More importantly, we have worked with our shipping partners to stop the usage of these fraudulent shipping labels, and have seen shipping fraud rates return to normal levels as of April.
- And finally, advertising which continues to consolidate as fast growth segment, growing in local currencies 136% also contributed to the strong non-marketplace revenue performance.

Combining marketplace and non marketplace revenue effects resulted in net revenue of \$157.6 million dollars, a growth of 75% year over year on an FX neutral basis, and 57% excluding Venezuela. Total Revenue growths in local currencies for each country were as follows: 54% for Brazil, 71% for Argentina, 42% for Mexico, and 249% for Venezuela.

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Gross profit was \$102.2 million dollars. Gross profit margin was 64.8% of revenues, versus 69.8% in the first quarter of 2015 and 65.1% during the fourth quarter. 100 bps of margin contraction are attributable to investments centered in providing best-in-class customer service to our users and the remaining 400 bps of margin contraction are explained by the incremental impact of payment processing fees and sales taxes as MercadoPago and MercadoEnvíos continue to gain share of revenues.

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Operating Expenses totaled \$71.7 million dollars, down 8% from last year's first quarter, a 705 bps margin improvement on an as reported basis.

If I break down our OPEX lines:

- Sales & Marketing grew 25% year on year to \$32.7 million dollars, or 20.7% of revenues with the most significant expense items having been an increase in online marketing expenses and in our Buyer Protection Program.
- Product development expenses grew 27% to \$21.9 million dollars, representing 13.9% of revenues. This continues to be a key area of investment for us, and one where we do not plan to manage to leverage in the near future.
- General & Administrative expenses totaled 17.1 million dollars, a 6% decrease vs last year as the business continues to scale in these areas.

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Consequently, on an as reported basis, operating income for the quarter was \$30.5 million dollars, up 19% versus last year. Excluding the impact of Venezuelan write offs that occurred in the first quarter of 2015 year, operating income decreased 27%, representing 19.3% of revenues, versus 28.2% a year ago, and 18.6% during the fourth quarter of 2015.

One final comment on our margin structure. During the past few quarters these margins have negatively impacted by currency devaluations. For the first quarter of 2016, on an FX neutral basis, Gross profit margin would have been 67.4% and operating margin would have been 24.4%.

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Below operating income, we saw \$5.7 million dollars in financial expenses, mostly corresponding to interest accrual on the convertible bond issued in 2014.

Further down, interest income was \$7.3 million, up 68% year on year explained by an increase in interest rates in many of the countries where we operate that improved yields on our locally invested cash positions.

Our forex line was positive \$5.1 million during the quarter due to an appreciation of USD balances held by our subsidiaries, mainly in Argentina where there was a strong devaluation of the peso during the quarter.

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Income tax expense was \$7.0 million during the quarter. The blended tax rate for the period was 18.7%. The improved tax rate can be explained by a higher concentration of pretax

profit in Argentina (where we are beneficiaries of the software tax holiday), by lower pre-tax profit, and by tax loss carryforwards stemming from our Venezuelan operations.

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As a result of all this, net income came in at \$30.2 million dollars, or 19.2% of revenues. This resulted in a basic net income per common share of 68 cents.

Purchases of property and equipment, intangible assets, advances for fixed assets and payments for businesses acquired, net of cash acquired totaled \$17.3 million dollars during the quarter. For the period ended on March 31st, Free cash flow, was negative \$29.1 million dollars. The decrease in negative cash flow is primarily explained by working capital variations that occurred in the MercadoPago business during the quarter. Cash, short-term investments and long-term investments at the end of the quarter totaled \$528.3 million dollars.

Wrapping up, we declared our quarterly dividend of \$6.6 million dollars, or 15 cents per share, payable on July 15, 2016 to shareholders of record as of the close of business on June 30, 2016.

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Concluding our review of the business, I'd like to say that we are satisfied with the operational and financial results we have delivered during quarter. The strategic initiatives we've been pursuing have allowed us to continue growing our business, not only by complementing our vision of an enhanced marketplace, but also by allowing us to deliver world class technology solutions to our increasing user base. We look forward to continuing to report back to you on the advances we make throughout the remainder of the year during our next call.

And with that, we can take your questions now...