MercadoLibre, Inc. Earnings Conference Call Script First Quarter 2019

Date: May 2nd, 2019

Part I: Introduction and Disclaimer – Investor Relations

Hello everyone, and welcome to the Mercado Libre earnings conference call for the quarter ended March 31th, 2019. I am Federico Sandler, Investor Relations Officer for Mercado Libre. 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.

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 2019 earnings press release available on our investor relations website.

Now, let me turn the call over to Pedro.

Part II - Overview & Financial Results – Pedro Arnt

Thanks, Fede.

Let me kickoff this earnings call by stating that we are encouraged by entering this new year with continued momentum in our business and are seeing our strategy delivering on multiple fronts in a sustainable manner.

Case in point, some of the key metrics for the quarter:

- Net revenues that accelerated for the 4th consecutive quarter on an FX neutral basis to 93% growth YoY as our payments business continues to grow rapidly while we also have become more efficient in marketplace shipping spend.
- Operating income that was positive once again at $10.1 million dollars.
- Positive Net Income, after 5 quarters of loss, giving us confidence in our ability to dial up, or down the profit levels of our P&L as we see fit.

We continue to execute against a focused and strategic roadmap intended to capitalize on the secular trends of ecommerce and fintech in the region that will allow us to extend our market leadership. We are transforming from a pure third party marketplace business, to building the leading ecommerce ecosystem and digital financial services platform in Latin America. In the process, we are redefining our relationship with our customers, increasing our touch points with transactions through logistics and financial service offerings, strengthening our technology platforms and in doing all this, increasing our addressable market as we are able to serve our users in a more expansive manner than in the past.

So, let's begin our strategic progress report for the quarter with our fintech business this time, a growing area of focus for the organization. Mercado Pago has kicked off 2019 on a very strong note. During the first quarter of the year total total payment volume reached $5.6 billion dollars, a growth of 83% YoY on an FX neutral basis.

As we increasingly focus our efforts on expanding our online-to-offline ("O2O") payments solutions in the markets where we are currently in, and expanding the financial services we offer our merchants away from Mercado Libre's marketplaces, off marketplace total payment volume already explained 95% of the incremental payment volume during the quarter.

Off marketplace total payment volume reached $2.5 billion dollars, and continued to gain incremental share from total payment volume reaching 45% of total this quarter versus less than a third only a year ago. In line with that, in Argentina, where we have deployed the most complete payments ecosystem as of date, off marketplace total payment volume represented more than half of TPV for the first time ever. Also, during the first quarter of 2019, Total Payment Transactions, in number not in volume, of the off marketplace segment on a consolidated basis represented over 60% of all payments transactions, growing for the 6th consecutive quarter above 100% YoY and accelerating to 251% YoY. These aforementioned off marketplace data points that I have just called out, give us increasing confidence that we are making meaningful inroads in growing and scaling our payments business well beyond our ecommerce marketplace, and look to replicate that success we see in Argentina throughout other markets.

Within that off marketplace segment, we continue to be very encouraged with the results of our MPOS business, as it is increasingly becoming a key driver of incremental off marketplace payment volume, a strong top line generator, and perhaps most importantly a key distribution tool for our other fintech offerings.

The installed base of MPOS devices in our main countries keeps growing at a steady clip. A testament to this, is the fact that payment transactions from MPOS devices alone already account for almost half of the off platform payment transactions. In terms of MPOS payment volume, it surpassed the $1.0 billion dollar mark for the first time during the first quarter, growing on a consolidated basis a solid 260% YoY on an FX neutral basis, and 171% YoY in US dollars. This growth of our MPOS business delivered this quarter was driven, for the most part by solid performances in Brazil and Argentina.

The buildout of our mobile wallet two-sided network also continues to scale and grow in size and frequency of use. During the quarter, we reached an important milestone as we crossed the 3 million active payer mark in a single quarter on our wallet, while active collectors accelerated to 420% YoY to over half a million. Additionally, wallet total payment volume continues to grow triple digits both on an FXN and in USD, while it also continues to gain share from off platform total payment volume reaching almost 20% on a consolidated basis, a gain of 400 bps versus a year ago.

Continuing on our mobile wallet initiative, Argentina was also highlight as we begin to observe the powerful synergies present in our O2O payments ecosystem. During the quarter, Argentina QR in-store payments share grew 40 percentage points versus last year, coming to represent 43% of all wallet TPV. It is also important to highlight that QR in-store payments in Argentina are delivering meaningful customer satisfaction as when we measure Net Promoter Scores, we observe a significant gap versus other existing offerings. Additionally, we continue to see both a shift in funding from credit or debit cards to account money as we add usage cases and ubiquity of use, as well as growth in invested amounts in our Asset Management products, that already surpassed 50% of total available account money in Argentina. We look forward to launching this full stack of O2O solutions in Brazil and Mexico during the second half of the year.

Our merchant services business has also delivered encouraging results as this quarter was the second consecutive quarter of acceleration, growing 75% on an FX neutral basis across all sites.

We are also pleased with our results on the Credits front. In Brazil, optimizations to our collections and credit scoring capabilities have positively impacted merchant default rates, and consequently have accelerated the pace of originations in number and nominal amount during the quarter. In line with that, I am also pleased to report that in Mexico, merchant credits are tracking extremely well with positive adoption and the lowest default rate on any of the markets that we offer the product. Finally, we also began offering our credit solution to our MPOS users in Mexico, which we believe should strengthen our value proposition in that country given how underserved this merchant base is when it comes to access to credit. It is also important to highlight that our consumer credit business in Argentina and Brazil continues to fire on all cylinders as originations are up QoQ by a factor of almost 1.2 times.

Our vision is that access to innovative technology must be an engine of financial inclusion and opportunity through Latin America, and we remain deeply committed to advancing on that goal. The region is rapidly accelerating towards digital payments, and we know that we have a huge opportunity ahead of us to make a real difference to the constituencies we serve across the region.

Let’s move on to some of the highlights in our logistics unit, a key enabler of greater transactionality, engagement, and conversion on our marketplaces.

I am pleased to report that we continue to improve and have greater control over user experience as we shift more volume to Mercado Envios. Penetration of our shipping solution on a consolidated basis grew 10 percentage points YoY to 81% of all items sold. In line with that, we are also making progress in shifting volume to our managed network. On a consolidated basis, cross docking efforts reached 17% penetration (vs. 7% LY) while dropshipping decreased to 76% and the managed network reached almost ¼ of all items shipped.

During the quarter, Argentina was a highlight as Mercado Envios penetration grew by 19 percentage points YoY to 56% of items sold allowing for more widespread adoption of free shipping in that country that is driving strong marketplace growth there. We are also enthused by the results of our Flex solution, but first let me remind you what that is. Flex is a MELI proprietary technology that is ideally suited for local or intra city deliveries, where our technology overlay enables existing logistics partners that currently work with our merchants to scan, upload, and deliver packages through our Mercado Envios network. Through this solution, we are able to not only reduce our reliance on traditional carriers, but also drive penetration of Envios higher, while also taking care of the last mile in a much more efficient fashion, which is generally the more complicated part of getting goods from a merchant to a buyer's doorstep.

Since its Launch in late 2018, MELI flex shipping solution has already reached 5% of all items shipped and already represented over 50% of the shipments within the city of Buenos Aires. The shipments are not only meaningfully cheaper than dropshipping or cross docking, but they also have better lead times with over 90% of deliveries occurring same day or next day, which is resulting in more sales and better conversions for those merchants who adopt the product. We look forward to continuing to deploy Flex in several of the other large cities where we operate throughout the region during the remainder of this year.

On the fulfillment by Mercado Libre front, penetration continues to scale well in Mexico gaining 5 percentage points sequentially and reaching 20% of all items shipped, while in Brazil scaling up has lagged somewhat remaining flat QoQ as we continue to build out product and processes to scale it. However, in Brazil cross docking does continues to grow steadily as it is reached 15% of items (vs. only 5% LY).

The operational metrics on our managed network are also encouraging. On a consolidated basis, average lead times improved by 40% on a YoY basis, and median lead times improved by almost 25% versus last year. Also, shipments arriving in less than two days reached almost half of all Mercado Envios deliveries on a consolidated regional basis.

We've also made advances in growing the size of our managed network as the buildout of fulfillment capacity continues in full swing. During the quarter, we opened one fulfillment center in Buenos Aires with 200 thousand units storage capacity, a second fulfillment center in Sao Paulo with 350 thousand units storage capacity and a cross docking center also in the city of Sao Paulo with a processing capacity of 60 thousand orders per day.

Now, let's move on to some of the highlights in the marketplace business.

Despite increasingly tougher comps and continued optimizations in our shipping subsidies, the marketplace business continues to show great resiliency. Gross merchandise volume reached $3.1 billion dollars. On an FX neutral basis, consolidated GMV re accelerated to 27% YoY growth driven by solid execution in Argentina, and steady performance in Mexico. Argentina GMV on an FX neutral basis accelerated to 70% YoY and Mexico maintained momentum at 48% YoY growth despite the toughest comp of the year (where it grew 77% in Q1'18).

The solid performances in Argentina and Mexico were partially offset on a GMV basis by Brazil, which grew 18% on an FX neutral basis. However average two year local currency growth for the first quarter in Brazil, remained around 44%, indicating that part of the slowdown can be attributed to very tough comps from the prior year. Additionally, the deceleration in Brazil is also explained by the implementation of free listing caps, resulting in a reduction of free GMV from 11% during the first quarter of 2019 to only 5% of GMV this quarter.

It is also important to know that in Brazil we exited the quarter at a higher growth rate than we entered it.

We continue to focus on category expansion as a catalyst for growth of our marketplace businesses. During the quarter, we have expanded and improved our supermarket experience in Mexico with already more than 18.5k Consumer Packaged Goods SKU's available on our site. Although still on an early stage, we observe that basket size is also approximately 20% higher on orders that have supermarket items in Mexico, a clear indicator that this is a key vertical to increase purchase frequency on the site is trending in the right direction. In line with that, we have also improved the user experience in our apparel vertical by enhancing discovery engines, further facilitating returns, and strengthening our intellectual property program which has been instrumental in incorporating established brands that improve assortment and bring brand equity to our marketplaces. As a consequence, apparel is the fastest growing category growing at 79% YoY on an FX neutral basis consolidated.

Not only do we continue to expand categories, but we are also deepening product selection and assortment. Listings available on the platform, a measure of the depth of inventory surpassed the 200 million mark for the first time. This quarter also marks the 9th consecutive quarter of growth in this important KPI at a rate higher than 50% over the prior year.

We are continued to make strides on our shift to mobile first platform. During the first quarter of the year mobile app GMV represented almost 50% of GMV, a 10 percentage point improvement versus a year ago, while 81% of all new registered users were also coming from mobile devices. If we consider web mobile into this mix, GMV coming from mobile experiences is 63% of gross merchandise volume.

Finally, we made meaningful progress in offering more robust search and discovery experiences to our buyers through our catalogue initiative. During the quarter, catalogued GMV reached 29%, 38%, 25% of GMV in Brazil, Argentina, and Mexico respectively representing an improvement in the mid to low teens YoY for these markets. This is an important initiative for us, since cataloguing allows us to understand better the inventory we carry, enables us to better understand what products to show our buyers, and consequently allows us to highlight the second to none price and selection we offer to our users in the region. As we grow the percentage of GMV that is catalogued, our buyers will be able to find the products they are looking for more quickly and this should result in higher conversion rates.

Before I move on to financials, let me give you an update on a recent secondary offering we performed during the first quarter of 2019, where we finalized a successful capital raise of $2 billion dollars from both financial investors as well as a strategic investor, PayPal. This capital raise gives us greater balance sheet flexibility over the long run, and we expect to use this capital primarily to fund the growth of our payment initiatives, build out our logistics capacity and drive the adoption of these services, as well as for General Corporate Purposes.

As we move forward in the year we will outline in greater detail how our pace of investment will pick up, with specific call outs of areas where we are increasing spend levels. We maintain long term opportunities such as payments and logistics as priorities, with potential for margin contraction in the short term depending on the return windows of these investments that we carry out.

It is important to highlight that we very pleased that Paypal was a strategic investor in the transaction. The latter, we believe, not only validates the joint vision we share in terms of business and purpose to digitalize the economy and leverage technology to generate financial inclusion, but also to offer compelling financial solutions to those who are unserved or underserved by traditional financial institutions. The trust that has been built over the years with PayPal and the history we have of informally interacting, gives us the confidence that we will be able to find areas that will generate synergies with each other as we move forward into the future. In this regard, our teams are working on determining what commercial agreements can be put in place that complement PayPal’s global merchant base, data, products, and technology with our local know-how and distribution capabilities.

Let me now move on to financials. During the quarter we continued taking the necessary steps to re-calibrate our P&L and rebalance our financial model to deliver sustainable growth. From a top line perspective, Gross Billings ascended to $547.8 million dollars the 20th consecutive quarter of gross billings growth above 60% on an FX neutral basis driven by improved monetization on our marketplaces and continued successful execution on our payments business particularly on our financing business and off platform revenue streams through merchant services and MPOS.

On an FX neutral basis our main countries also delivered solid performance from a gross billings perspective on an FX neutral basis: Mexico maintained momentum growing 113.5% YoY, Argentina accelerated to 108.2% and Brazil sustained solid percentage growth of 50% reaching 50.9% YoY.

Consolidated Net revenues came in strong as well, reaching $473.8 million dollars, and accelerating to 93% YoY in FX neutral basis as we optimized shipping & loyalty program subsidies.

Gross profit ascended to $237 million dollars during the quarter, representing 50% of net revenues versus 50.7% last year. Shipping carrier and operating costs explain most part the gross margin compression over the prior year.

We’ve included a detailed breakdown of these, and also other OPEX margin evolution in the cover slides that accompany this presentation.

As reported operating expenses grew to $226.9 million dollars or 47.9% of revenues versus 59.9% during the first quarter of 2018.

Main drivers of OPEX leverage this quarter were attributed to scaling marketing given increases in efficiencies on buyer protection payouts, lower loan loss provisions from our credit portfolio, as well as leverage in salaries & wages.

As a result, Operating profit for the first quarter of 2019 ascended to $10.1 million dollars an increase of $11 million dollars versus last quarter.

Below operating income, we saw $15.6 million dollars in financial expenses attributed for the most part to financial interest related to the convertible notes due 2028.

Interest income increased by 166% year on year to $24.4 million dollars mainly attributable to a higher float in Argentina and Brazil, as well as the proceeds from the convertible note issued in August of last year.

Our forex line was negative $3.7 million mainly due to the U.S. Dollar revaluation over our Argentine Peso net asset position in Argentina.

As a result of all this, net income ascended to $11.9 million dollars an increase of $14.2 million dollars versus last quarter resulting in basic net income per share of $0.13 cents.

That wraps up our strategic report. We started the first quarter of 2019 on firm footing, and although we are very encouraged by the performance of our business and the opportunities that lie ahead of us, we still have plenty of work to do in order to deliver on our product roadmap and consolidate our leadership position. We have accelerated our revenue growth and earnings growth with positive cash flow, while we continued building superior experiences for our users. The sustained momentum we see in the business gives us the confidence to continue investing behind high potential areas, such as fintech and logistics. We are very pleased with our progress, and look forward to keeping you updated next quarter as we continue to democratize commerce and money in Latin America.

With that, let me turn it back over to the operator for questions. Thank you.