Oct 19th, 2020
Americas
Equity Research
TMT

Stock Note

MercadoLibre

Wallet Wars

Soomit Datta
+44 20 7375 9128
soomit@newstreetresearch.com
(Analyst)

Sales

Ethan Lacy
212 921 4925
ethan.lacy@newstreetresearch.com

Zach Monsma
212 921 7729
zach.monsma@newstreetresearch.com

Daniel Gilroy
646 647 8361
daniel.gilroy@newstreetresearch.com

Charlie Gaynor
+44 20 7375 9121
charlie@newstreetresearch.com

Steven Perez
+44 20 7375 9112
steven.perez@newstreetresearch

Michael Chambers
+65 6809 0503
michael@newstreetresearch.com

- **What's new:** While E-commerce remains the fuel for the engine, in this re-initiation we focus on Fintech, payments and the prospect of MELI developing *Mercado Pago* into a broader financial services platform. Nirvana would be a m-wallet or *Super App* across Latin America, akin to ANT Financial in China.
- **Fintech - From payments to credit:** A long tail of micro merchants and E-commerce growth should provide tailwinds for payments growth. However, we've seen at ANT the reduced significance of payments and the opportunities in credit, asset management and insurance. Credit will be MELI investors' next focus and the battleground will be its *Pago* wallet, competing against other E-commerce providers, digital banks and even the wireless industry. As with ANT, we see *Pago* as well placed to translate marketplace behaviour into better credit scoring for a region which is heavily unbanked. We provisionally include *Credito* at USD100/share in our target.
- **E-commerce - Brazilian recovery:** In the near-term, the market will stay focused on the recovery in Brazilian GMV. Q3 GMV should be up on Q2 (Covid establishing a new benchmark) and we expect take-rates to even improve on more efficient shipping and new and more intelligent pricing structures.
- **Valuation:** The >10x 2021e EV/sales multiple is justified by the 22% revenue CAGR forecast through to 2030.

MercadoLibre (Buy)

Ticker:	MELI US
Price Target:	USD1,450
Potential change:	+20%

Summary and Valuation

Wallet Wars

- **Fintech is now over one third of group revenue and growing fast: +175% in nominal and +90% y/y in USD terms.**

- **The driver has been the Payments business, driven by off-line mPOS (in-store, point of sale) and on-line Merchant Services (E-commerce) Acquirer businesses. Tailwinds (low E-commerce share of retail, a long tail of micro-merchants) will continue to support growth here.**

- **Going forward, however, the driver of payment volumes (TPV) will be the mobile wallet (m-wallet). As opposed to the Acquirer business, the m-wallet is a consumer focused product. Usage today is focused on utility bill payments, P2P transfers, in-store QR code payments and cell phone top ups.**

- **m-wallets won't be monetised through payments. Rather, as a tool of engagement, as a route to selling other financial services. ANT Financial represents the Nirvana of such aspirations - a Chinese *Super App*.**

- **The market is yet to price Fintech success for Mercado Libre beyond payments; consumer and SMB credit is the next frontier. Sure, there will be competition - from E-commerce providers, digital banks and even the wireless industry (***we had calls with the Head of Financial services at Vivo (Rodrigo Gruner) and TIM Brasil (Renato Ciuchini) to help form our understanding of this business model***) - however close to half of LatAm is unbanked and credit is scarce. MELI can draw on knowledge of its 52m active users and hope to translate this into more accurate credit scoring than can be achieved by the banks today.**

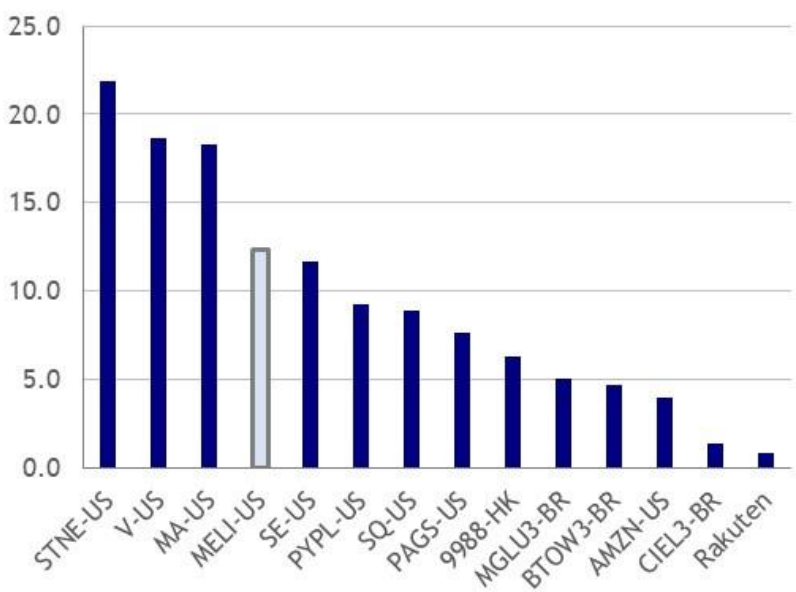
- **Meanwhile, concerns on core E-commerce GMV in Brazil look to have been put to one side. A combination of structural support from Covid/lockdowns, combined with investments in logistics have seen GMV accelerate from the low's. Q3 is expected to be strong also. We also see the opportunity for take-rates to tick up over time, as shipping subsidies unwind and efforts to push Advertising are accelerated.**

- **The stock has rallied, deservedly so. However, on a growth adjusted basis (Q2 revs +61% in USD), valuation isn't overly stretched. Credit is provisionally included at USD100/share and should be the next source of upside.**

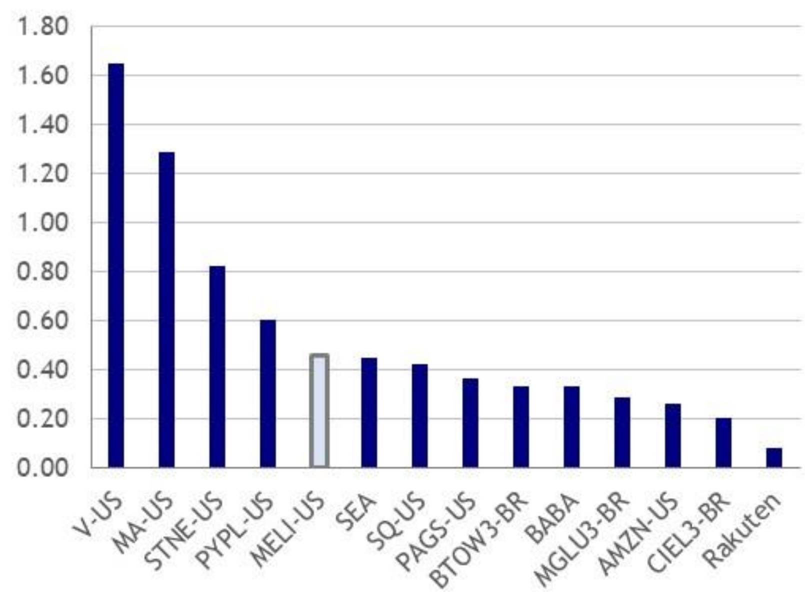
Valuation – in-line with peers on a growth adjusted basis

- **We benchmark MELI against Payment and E-commerce peers**
  - The payment peers tend to trade on higher multiples given higher growth expectations
  - Versus local peers:
    - Payment plays trade on EV/revenue of 10x (PAGS) to over 20x (STNE)
    - E-commerce plays are nearer 5x EV/revenue (MGLU and B2W) although have either a large bricks and mortar component (MGLU) or are a lower quality business (B2W)
  - Versus international peers:
    - The payment companies trade over 10x whilst Amazon trades on <5x, although the latter isn't a great comp given the value which is derived from AWS (60% of operating income in 2019)
- **On a growth-adjusted basis (EV/Sales 2020e vs 20-22e Sales CAGR), MELI trades nearer to the sector average**
  - In fact, it sits in the middle of the payment providers and the E-commerce plays

2020 EV/Sales across Payment and E-commerce



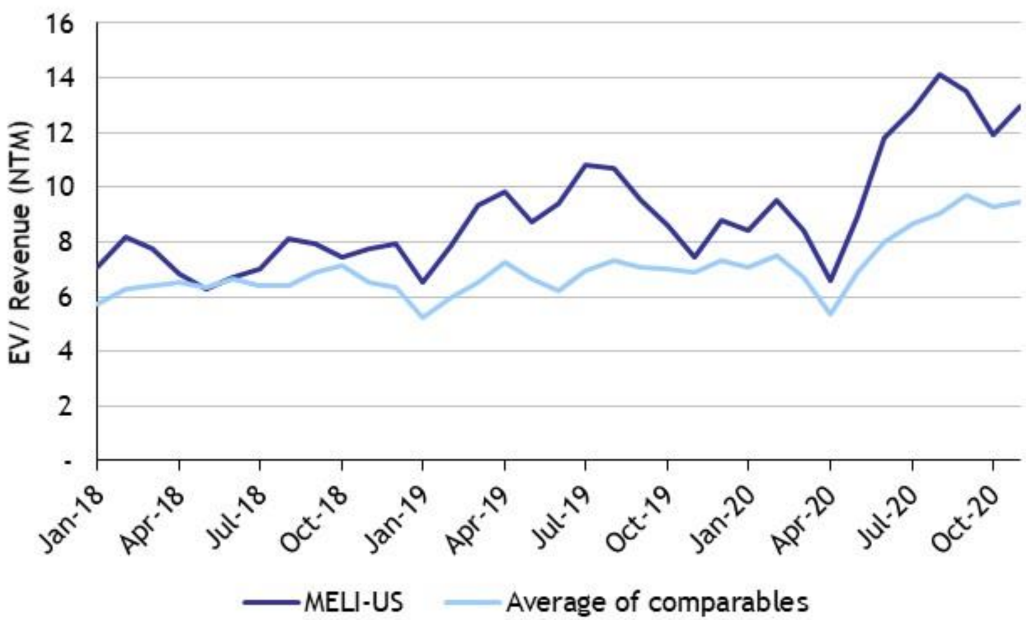
Revenue "PEG" (2020 EV/Sales vs 20-22 CAGR)



Mercado Libre EV/revenue vs peers over time

- **We show how the multiple for Mercado Libre has trended over time vs peers (see previous slide for list of peers)**
- **We would highlight two aspects to the multiple vs peers:**
  1. The gap all but closed earlier this year, largely on the back of concerns on Brazilian GMV. This concern has alleviated now and we are comfortable growth is back on track (as we discuss later in this note)
  2. Over the last 12-18 months, there has been a growing understanding and appreciation of the payments business which has helped build in a premium
- **We expect to see revenue and earnings upgrades continue at MELI based on where are estimates are versus consensus**

12m forecast EV/revenue*



NSR vs consensus

USD m	2020	2021	2022
NSR revenue	3,699	5,561	7,702
Consensus revenue	3,538	4,821	6,605
NSR vs cons	4.6%	15.4%	16.6%
NSR Gross profit	1,766	2,591	3,512
Consensus Gross profit	1,691	2,309	3,217
NSR vs Cons	4.4%	12.2%	9.2%
NSR Gross margin	47.7%	46.6%	45.6%
Consensus Gross margin	47.8%	47.9%	48.7%
NSR EBITDA	175	283	509
Consensus EBITDA	185	229	501
NSR vs cons	-5.3%	23.7%	1.5%
NSR EBITDA margin	4.7%	5.1%	6.6%
Cons EBITDA margin	5.2%	4.8%	7.6%

* Factset data

Summary financials

- **Our target of USD1,450/share is Sum of the Parts based**

USD m	2019	2020e	2021e	2022e	20-22e CAGR
Price, USD	1,200				
SHOUT, millions	49.7	49.7	49.7	49.7	
Market Cap	59,652	59,652	59,652	59,652	
Net debt	-2,165	-2,069	-2,003	-2,070	
Cumulative dividend	0	0	0	0	
EV	57,487	57,583	57,649	57,582	
EFCF					
EBITDA	-80	175	283	509	
less capex	-141	-259	-334	-385	
less interest	48	18	32	29	
less tax	-65	-30	-47	-86	
Total	-239	-96	-66	67	
Financial metrics					
Gross revenue	2,558	3,839	5,761	7,965	44.0%
Net revenue	2,296	3,699	5,561	7,702	44.3%
Gross profit	1,102	1,766	2,591	3,512	41.0%
% margin	48.0%	47.7%	46.6%	45.6%	
EBITDA	-80	175	283	509	70.4%
% margin	-3.5%	4.7%	5.1%	6.6%	
Operating income	-153	83	117	239	70.1%
Net income	-172	70	101	182	61.1%
EPS	-3.5	1.4	2.0	3.7	61.1%
DPS	0.0	0.0	0.0	0.0	
Net debt/EBITDA	nm	nm	nm	nm	

USD m	2019	2020e	2021e	2022e	20-22e CAGR
EV/Revenue	25.0	15.6	10.4	7.5	
EV/EBITDA	-719	329	203	113	
EFCF yield	-0.4%	-0.2%	-0.1%	0.1%	
PE	-350	848	591	327	
Dividend yield	0%	0%	0%	0%	
Returns					
ROIC	-20%	4%	5%	10%	
Financial/Operational					
GMV	13,997	20,732	30,276	41,161	40.9%
TPV	28,390	47,148	78,532	119,128	59.0%
of which on-platform	13,052	19,539	28,836	39,615	42.4%
of which of-platform	15,338	27,609	49,696	79,513	69.7%
Gross revenue	2,558	3,839	5,761	7,965	44.0%
Subsidies	-261	-140	-200	-263	37.1%
Net revenue	2,296	3,699	5,561	7,702	44.3%
of which Commerce	1,205	2,384	3,603	4,981	44.5%
of which Fintech	1,091	1,315	1,958	2,722	43.9%

What are the risks?

- **MercadoLibre is priced for growth and any structural factors which jeopardise this won't be well received**
- **E-Commerce: Historically the concern has been Amazon**
  - Amazon is investing in Brazil but its share of GMV is estimated to be low single digits
  - It is likely to become more relevant over time but will struggle to out-invest MercadoLibre, or players such as Magazine Luiza, both of whom have large strong balance sheets and are rolling out logistics networks at a pace
    - Pay Pal's equity support in 2019 (taking a 3.5% stake) implies potentially further backing from the $240bn market cap payment giants
  - Amazon is relevant in Mexico, but has shown little appetite to invest in Argentina

  Conclusion: We don't think Amazon is the concern it was 5 years ago
- Elsewhere, we see continued competitive efforts from E-commerce Brazilian players but MELI's new pricing plan should see it at least maintain take rates while improving its competitive position in key vertical like electronics
- **Fintech: take rate declines, financial services may take longer to deploy, a Fintech bubble?**
  - Payments is a competitive space and m-wallets are proliferating. Take-rates are declining and the pace of this could surprise on the downside (although we factor this into estimates)
  - *Mercado Credito* is being cautiously deployed, with focus still on merchants and less so on consumers. The ability to scale this up quickly, as we have seen at ANT Group is hard to predict
  - Money has flowed into Fintech which is providing opportunities for Mercado Libre and peers. However, a number of these businesses won't survive and liquidity could dry up
- **LatAm-exposure: Despite a USD reporting entity and being listed in the US, MELI's two key markets are Brazil and Argentina. This leads to both:**
  - FX risk, although a net cash position limits the balance sheet risk
  - Economic weakness as Covid continues. In the near-term, Covid is driving structural changes which support E-commerce in the region. The second derivative is, however, the economic consequences which will depress spending on some level
- **We expect the market to price the stock off top-line growth but persistent lack of profitability could raise concerns**
  - Having eased back on investments over Covid, the near-term guide is for elevated expenditure to push top-line growth. We would expect this to come from higher spend on product & technology as well as sales and marketing.

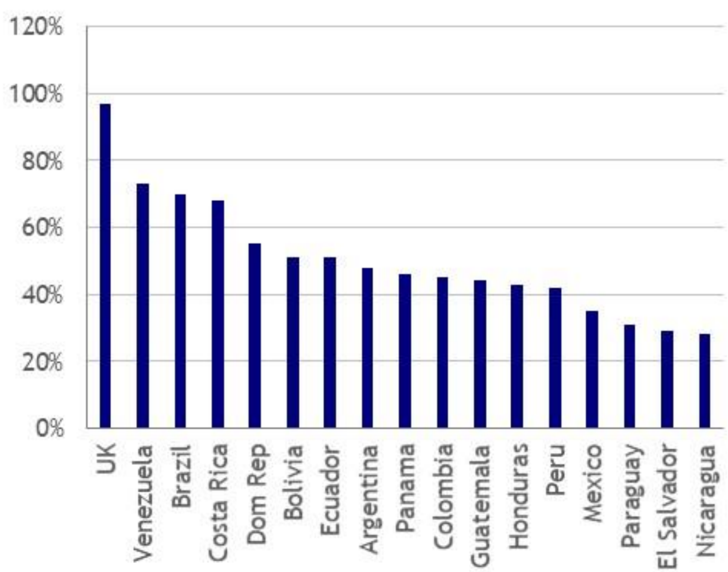
Fintech and Payments

Ongoing migration to E-commerce and long tail of micro merchants provide tailwinds for payments growth

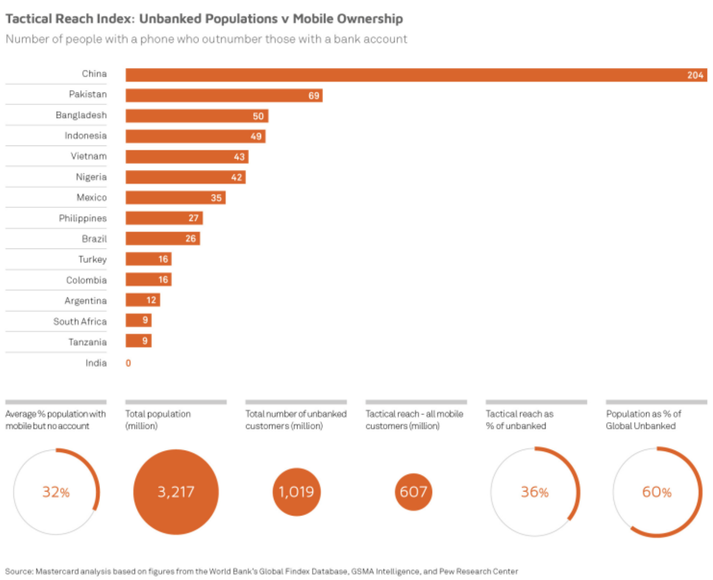
Briefly setting the scene: Digital adoption shifting dependence from cash

- **Latin America historically has a large unbanked population**
  - In Brazil 30% of adults don’t have a bank account. This equates to 45-50m “unbanked” people
  - Mexico stands out with very low banking adoption
- **Meanwhile, 4G is becoming ubiquitous**
  - In Brazil, 26m people are estimated to have a mobile phone (and can access financial services) but don’t have a bank a/c
- **Wireless is an enabler: 69% of all Mercado Libre GMV is originated on a wireless device**
- **Brazil has become a Fintech hub**
  - Neo-banks across LatAm are providing wireless-focused digital accounts (and m-wallets) and services at a clip
- **Digital adoption thriving: E-commerce is growing rapidly**
  - Cash payments are still relevant: *boletos* in Brazil and OXXO/other in Mexico. The latter represent 24% of e-commerce
  - Payment volumes are up strongly

Adult population with a bank account*



Phone ownership vs unbanked



Source: * Statista

Mercado Pago/ “Fintech” today

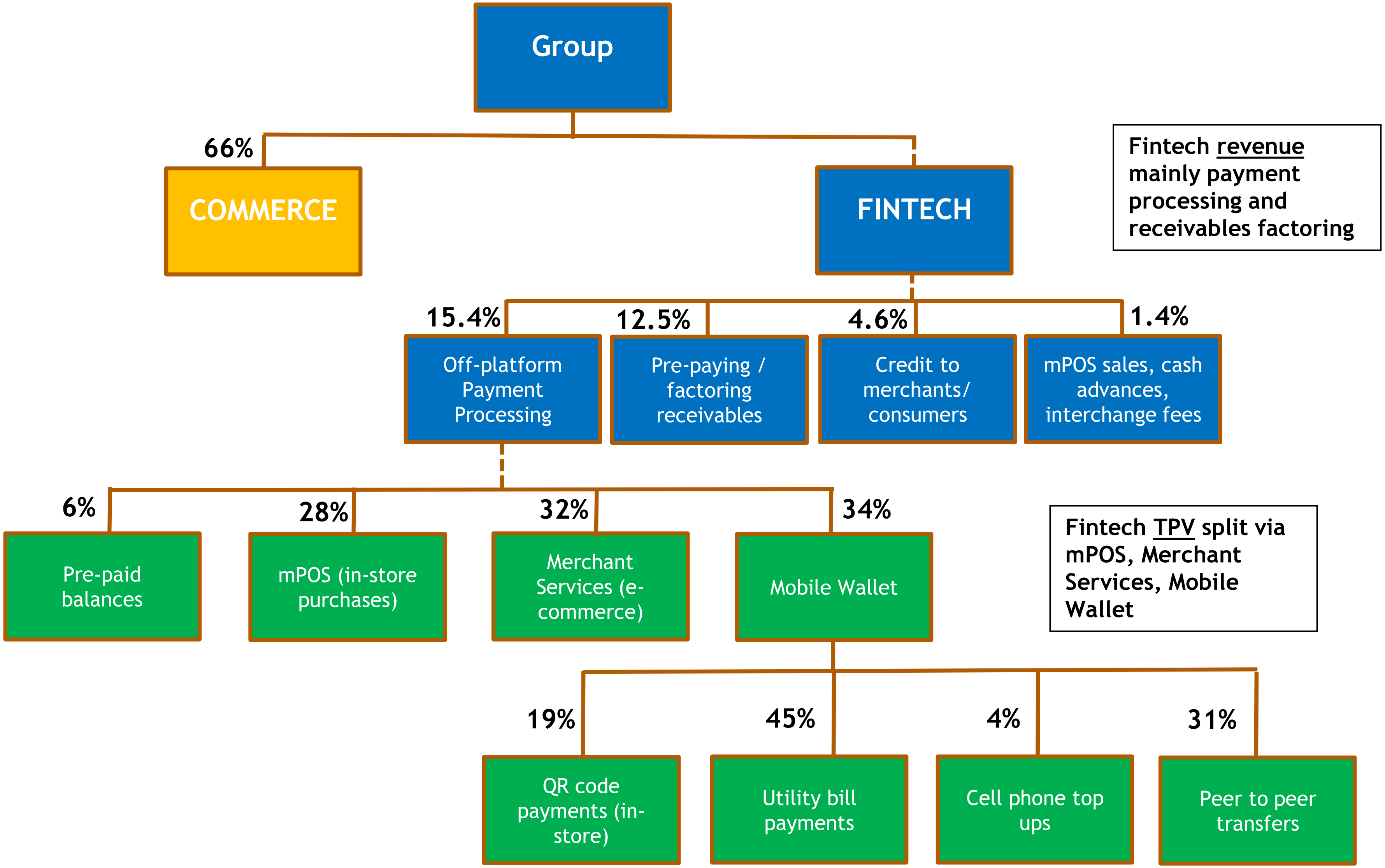
- **Mercado Pago or “Fintech” makes up ~40% of Group revenue for Mercado Libre (slightly less in Q2 given Covid)**
  - Service is available in Argentina, Brazil, Chile, Colombia, Mexico, Peru, Uruguay, and Venezuela
- **Pago was initially launched to support on-platform sales**
  - Similar to Paypal/eBay and Alibaba/Alipay (re-branded now within Ant Group)
  - Today 94% of all on-platform Mercadolibre purchases are paid for using Mercado Pago
  - Fees for this service are bundled into the commission Mercado Libre charges the merchant for selling
- **Adoption of Pago has quickly moved <u>off</u>-platform. Off-platform TPV now representing close to 60% of all TPV**
- **Off-platform payment volumes can be split into three main payment types:**
  1. <u>Mercado Pago Point - Point of Sale (POS)</u>: launched in 2015, providing a device for merchants to take in-store purchases.
  2. <u>Merchant Services</u> facilitating payments on-line for e-commerce transactions
  3. <u>Mobile Wallet</u>: allowing store payment by wireless handset (QR/NFC), or paying utility bills, topping up pre-paid recharges. Linked to debit/credit cards or through cash balances in customer Pago accounts
- **In 1/ and 2/, Pago acts as a payment processor, charging merchants a commission (MDR) on the total payment volume (TPV)**
- **In the case of 3/, the m-wallet is a consumer product, direct monetisation**
- **More recently Pago has started to move into credit and asset management. Insurance services are expected to follow**

<u>mPOS device (in-store)</u>

<u>Merchant Services (on-line)</u>

<u>Mobile wallet</u>

Payment Processing drives Fintech revenue; Mobile Wallet driving TPV



new|street RESEARCH

Soomit Datta | 44 20 375 9128 | soomit@newstreetresearch.com

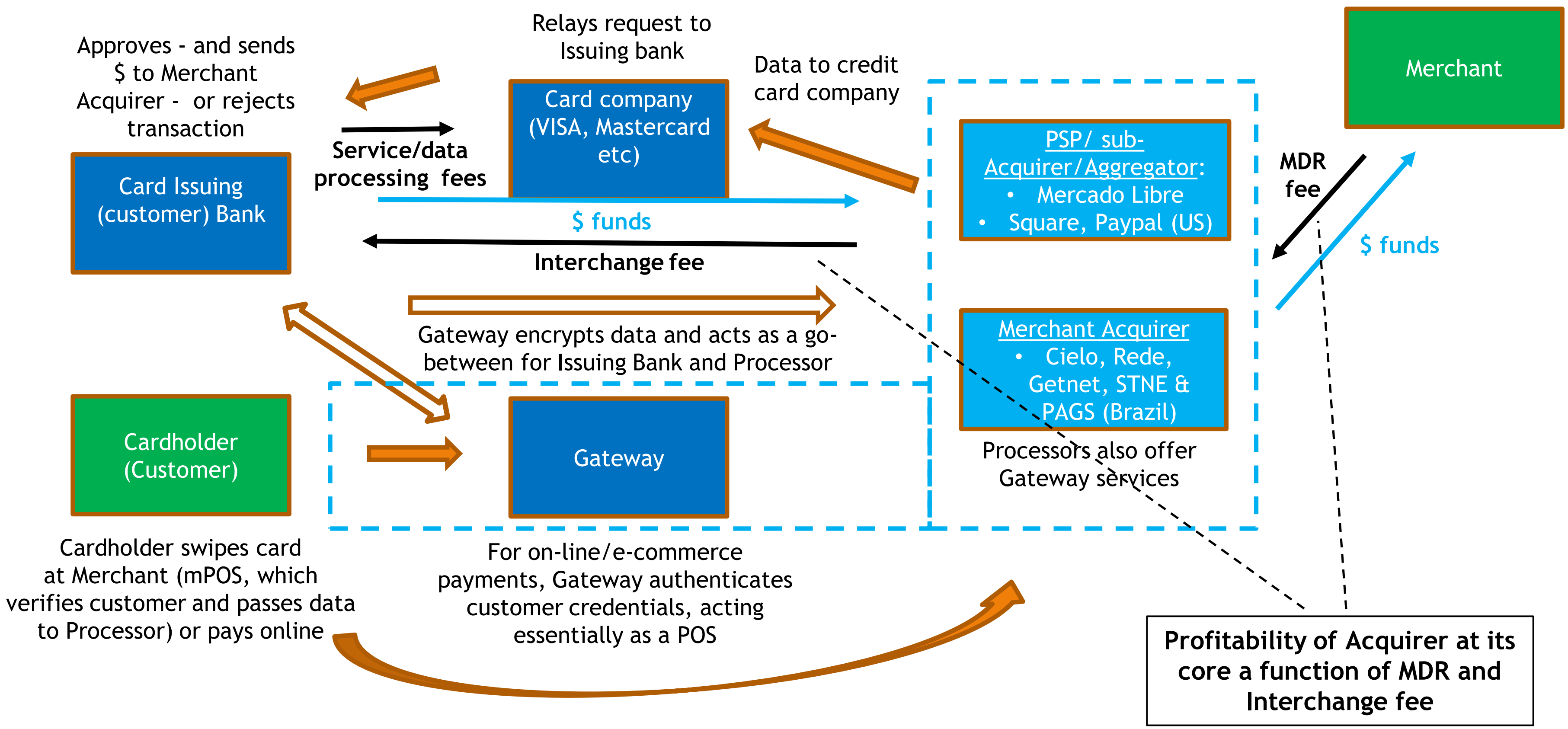
How does Mercado Pago fit into the Payment Cycle

- **MercadoPago principally acts a Payment Processor, mediating between Merchant, Credit Card Network and Issuing Bank, and facilitating the transfer of funds in a transaction**
  - Traditionally this role would be fulfilled by a "Merchant Acquirer" (in turn a service traditionally provided by the banks), providing a Merchant Account and clearing and settling functions
    - The main Acquirers in Brazil include
      - Cielo, Rede and Getnet owned by the traditional banks, focused more on larger merchants
      - Stone, focused on SMEs
      - Pagseguro, focused on smaller merchants
  - Increasingly, payment processors deviate from the formal Acquirer model:
    - Payment service providers (PSP) provide customer-facing solutions, sitting in between Merchant and Acquirer
      - <u>Mercado Pago today acts as such as a "Sub Acquirer"</u>, with TPV routed via an Acquirer
    - An "Aggregator", such as Paypal and Square in the US, pools a number of merchants under a single Merchant Account
- **Mercadolibre also owns a Gateway, which facilitate the encryption of the customers' details**
  - Gateway functions will often fall under the remit of the Processor
- **Whatever the exact nature of Payment Processor model, the business model is broadly the same and at its heart an arbitrage**
  1. Processor charges an MDR (Merchant Discount Rate) to the Merchant for the service
  2. At the same time, the Processor then has certain costs to pay, including the Interchange fee paid to the Card issuing bank
- **Specifically as a <u>sub-Acquirer</u>, Pago acts as merchant of record and pays the Acquirer the MDR, charging the Merchant on top**
  - High volumes for Pago lowers the MDR payment to Acquirer. In Brazil, the economics is not meaningfully changed for Pago being a sub-Acquirer vs a full Acquirer. In Argentina and Mexico, however, there is upside if Pago becomes a full acquirer
  - The Acquirers benefit from a factoring relationship with Pago
- **Outside of this basic model, Acquirers in Brazil today also monetise in one key way: pre-paying (factoring) receivables and earning a rate for this service:**
  - This is particularly a LatAm phenomenon, where retail payments are very often made in installments. The Acquirer will pre-pay the receivable on behalf of its Merchant, as a form of working capital support
  - Prepayment for the Acquirer can be funded through selling on receivables rights (to banks, or to investment funds set up to hold receivables – FIDCs in Brazil), as well as own capital and existing borrowings

Soomit Datta | 44 20 375 9128 | soomit@newstreetresearch.com

The Payment Cycle

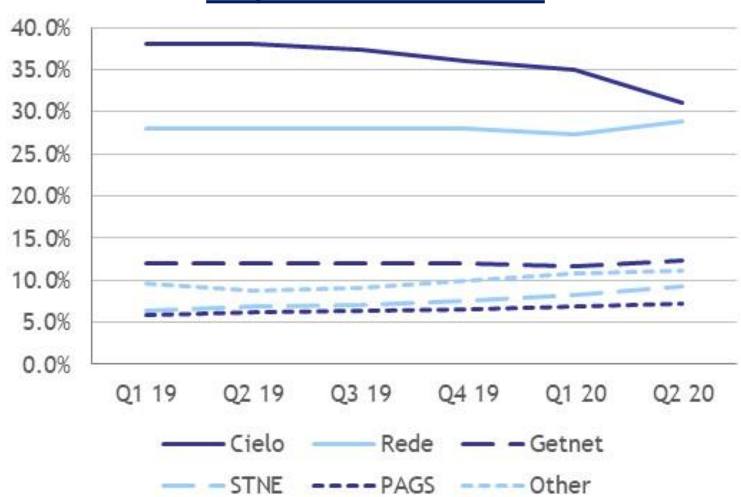
- **We summarise the Payment Cycle for a traditional (VISA, Mastercard) credit card payment below**
- **Pago acts a sub-Acquirer (although it has a licence to act as an Acquirer in Brazil)**



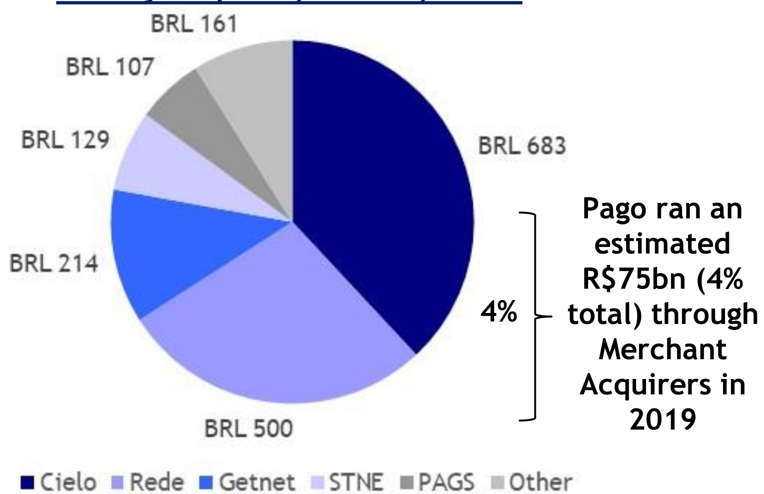
Brazil – a closer look at the Acquirers competing in this space

- **We show the split of market share by Acquirer in Brazil below**
  - TPV shown below includes on-line/e-commerce payment value originated by the Acquirer
  - Pago is a sub-acquirer so its TPV passes through one of the main acquirers below. Our estimate for Mercado Pago TPV in Brazil suggests it had 4% of total TPV in Brazil. Share was nearer 2-3% in 2018
- **The incumbent acquirers in Brazil are owned by the banks:**
  - Cielo (Bradesco and Banco do Brasil), Rede (Itau) and Getnet (Santander). Focus has traditionally been on larger merchants
- **The "new kids on the block" are Stone and Pagseguro**
  - PAGS focus is on mPOS for micro merchants although is diversifying through "Pagbank"
    - This is Pago's most direct competitor and where its share gains have come from
  - Stone is more focused on SMEs and gaining share from Cielo and Rede. It focuses on mPOS although is extending its business model to banking, credit and software, the latter through the recent bid for Linx
- **Pago expects its share to grow but its micro merchant focus, and more limited offering, will naturally limit further gains**
  - Low share today points to further easy wins. However, we don't anticipate *significant* efforts to target higher value merchants and move up the value chain

Acquirer market share



TPV by Acquirer, BRL bn, 2019



Who else competes in the Payments space?

- **Argentina**
  - Prisma was the dominant acquirer until broken up by the Macri government in 2017 in order to foster competition

- **Mexico**
  - More fragmented with >10 acquirers. The largest are the bigger banks (BBVA Bancomer being no1)

- **What about the global players?**
  - **Pay Pal has started to offer a service in Brazil and Mexico and is working *in concert* with Mercado Pago**
    - Paypal users (300 million world wide) will be able to pay at local merchants which integrate Pago
      - Delivery is for within the market in question only
    - Likewise, Pago payment will be accepted at merchants accepting Paypal
    - Paypal will also become a payment option on the Mercado Libre marketplace
    - Paypal took a 3.4% stake in Mercado Libre as part of a broader $2bn fundraising round in 2019
  - **Stripe launched in Mexico in late 2019, operates in Brazil and has growing ambitions for LatAm**
    - Focus is on-line processing, white-labelling value added services (financial reporting, billing, marketplace services). As such, it competes directly with Pago.
  - **Square has largely stayed away**
    - The business model of Stone in Brazil largely follows Square, focusing on mPOS
  - **Apple Pay, Google Pay compete as a mobile wallet, rather than as a payment provider**
    - Apple Pay was launched in Brazil in 2018 and typically charges 0.15% per transaction
      - This is now forecast to be a US$1 bn revenue stream for Apple in 2020 on a global basis (although much smaller in LatAm)
      - NFC is much less common in the region
    - Google Pay launched in Brazil (late 2019) and at the time said it wouldn’t charge issuers, processors or retailers for using the system

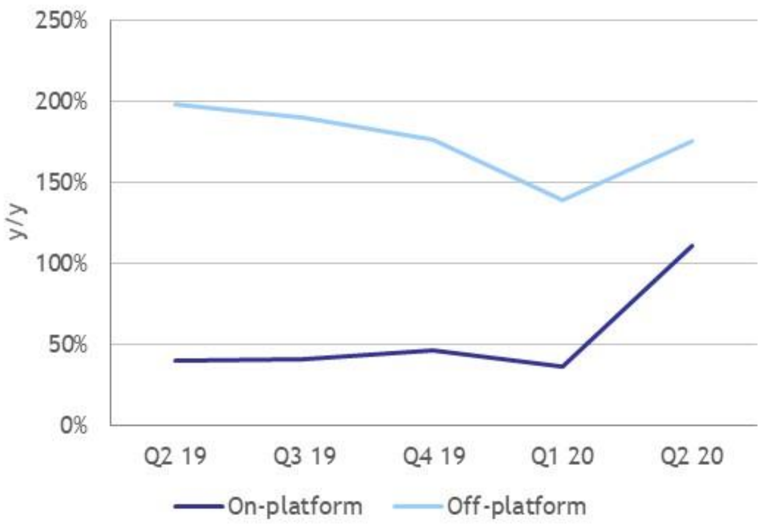
Soomit Datta | 44 20 375 9128 | soomit@newstreetresearch.com

TPV has seen rapid structural growth at Mercado Pago

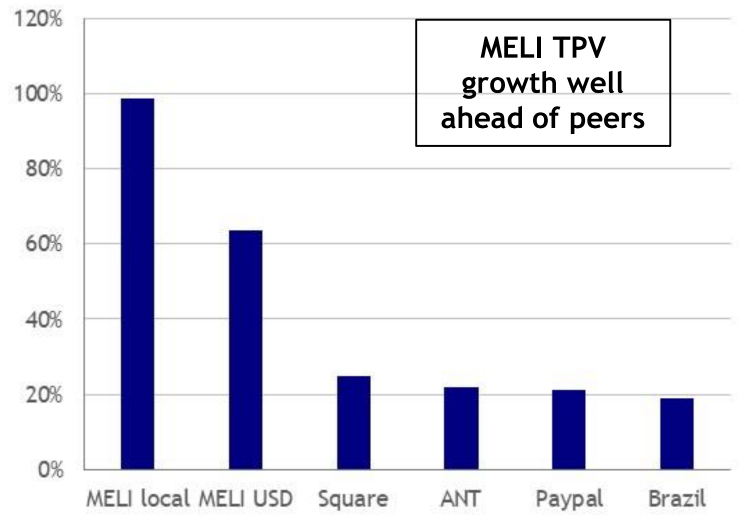
- **TPV growth for Mercado Pago is very strong both on-platform (mirroring platform growth) and off-platform**
  - Brazil makes up 55% of total Mercado Pago revenue (Argentina is 35%)

- **We show Mercadolibre TPV growth versus the Brazilian market and with the bigger payment processors globally**
  - TPV growth is over 100% y/y on-platform and ~175% off-platform
  - This growth is well in excess of the Brazilian market (~20%) and the global powerhouses, even when looking in USD terms (and/or backing out ~40-50% inflation in Argentina which runs through the reported local FX growth rates)

TPV growth rates



TPV growth versus International peers

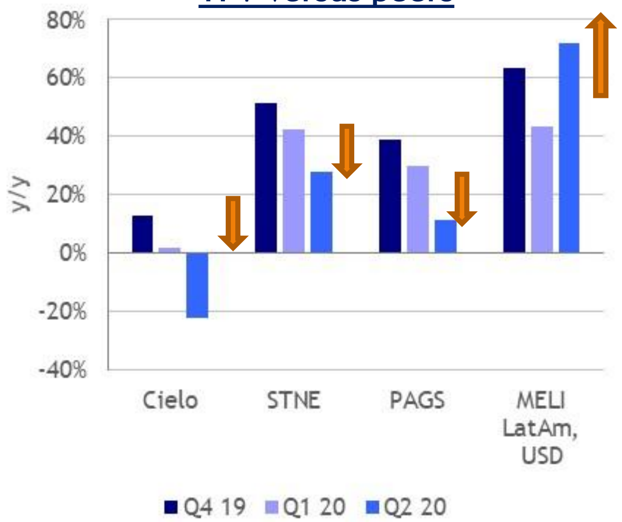


Soomit Datta | 44 20 375 9128 | soomit@newstreetresearch.com

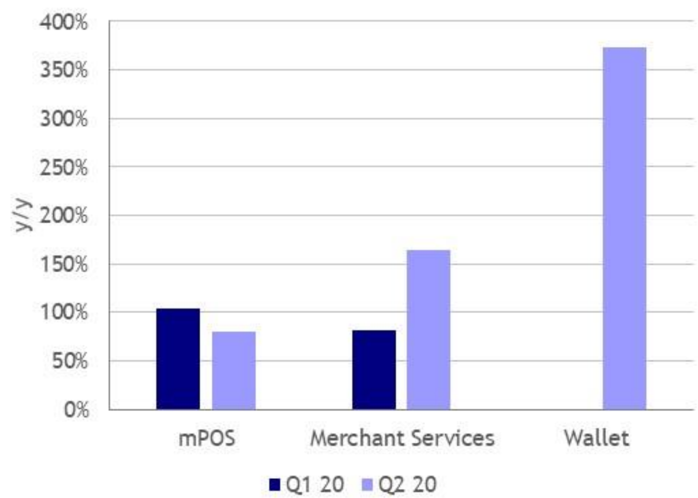
Covid – driving merchant services and contactless

- **Buying trends following Covid have been more mixed across the industry**
  - Off-line, in-store payment growth (mPOS) has typically slowed, impacting acquirers like Pagseguro and Stone which are more dependent on off-line sales in Brazil
    - Higher ticket items typically sold in installments (apparel, white goods, electronics) declined leading to lower credit card payments and lower financial income (through pre-paying receivables)
    - There was a swing to Contactless payments (mainly QR codes through mobile wallets)
  - **On-line payments rallied through Covid**
    - Mercado Libre's Merchant Services saw a significant step up in growth
    - This more than offset MercadoLibre's slow down in mPOS
- **Mobile wallet is the bigger driver of TPV today**
    - This is a mix of off-line (QR codes, preferred as a "contactless" payment in a Covid world) and on-line (utility bills, P2P transfers)
    - However, this is "non-Acquirer" TPV - unless being also processed by Pago - and monetised generally at lower rates

TPV versus peers



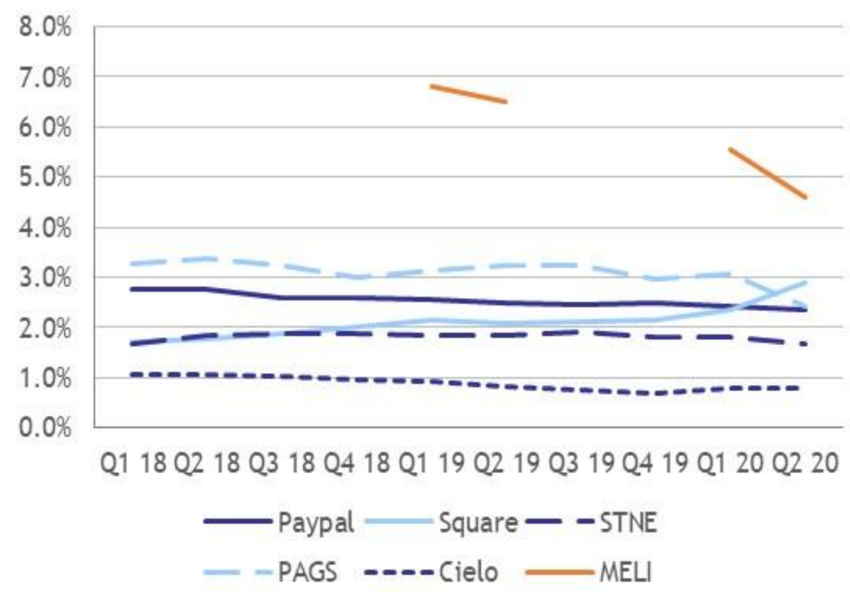
TPV at Pago by segment



Take rates – competition and wallet use drive down take-rates

- **The Acquirers' take rate is typically the net Merchant Discount Rate (MDR less Interchange fee/other transaction costs), plus other revenue streams such as pre-payment revenue and POS sales/subscriptions, versus TPV**
  - Not all definitions are completely aligned and arguably one should take out the funding costs for pre-payment as well as depreciating POS equipment
- **For MercadoLibre the take-rate tracked by the market is "Fintech" revenue versus total off-platform TPV**
  - This is a new definition as of Q1 2020 and hence the lack of complete data set (Fintech revenue was previously mixed with Marketplace Advertising and Classifieds revenue)
  - Note that on-platform payment fees are bundled into selling commissions and not part of Fintech revenue
- **The higher take-rate for MELI than peers is due to:**
  - Pago typically targeting smaller merchants, which tend to have higher MDRs. As the market leader in Brazil, Cielo (with the lowest take-rate) typically targets larger merchants, for instance
- **For MELI this still offsets the structural downward pressure coming from "non-acquirer" wallet TPV gains**
  - These typically earn lower fees
- **Take-rates downward momentum expected to continue**
  - Mercadolibre expect monetisation rates to fall due to ongoing competition in payment processing, and wallet adoption
  - *(Although the Q2 dip is explained by Coronavoucher schemes introduced by the government)*
- **Acquirers are diversifying to support take-rates**
  - Stone bid for Linx (software) being a case in point

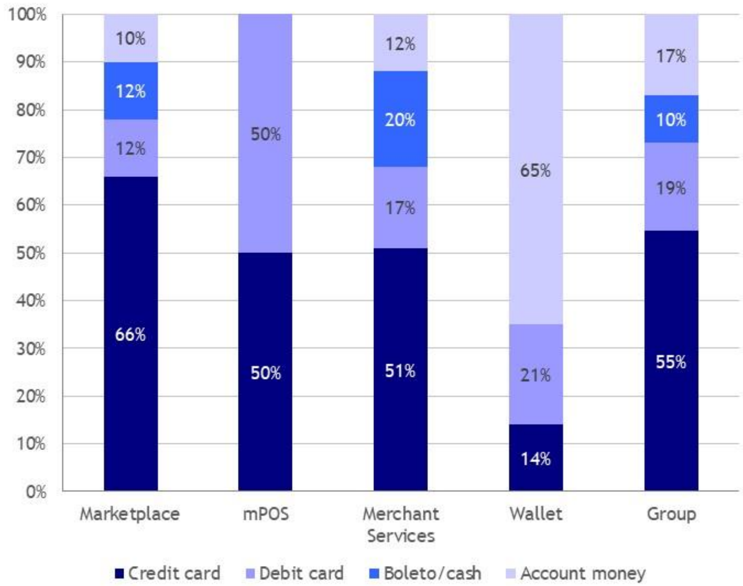
Take rates in versus peers



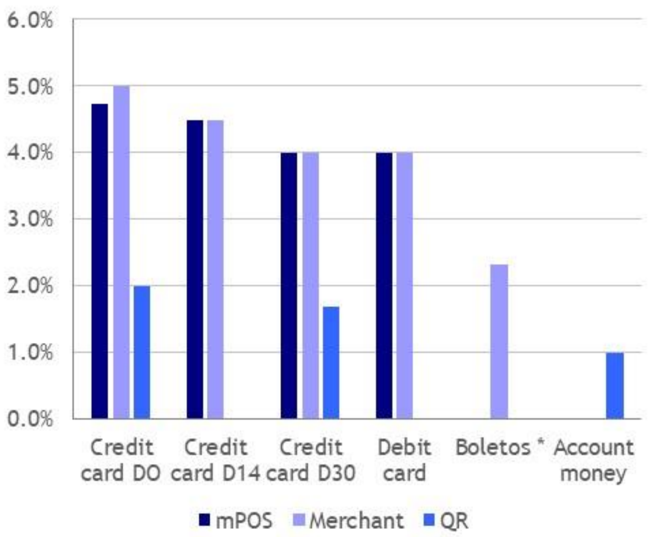
Money mix impacts the rate

- **The mix of the different payment modes (marketplace, mPOS, merchant services and wallet) will impact the take-rate given the different mix of underlying payment mechanism:**
  - Credit cards have the highest commission and are the most popular E-commerce payment type
  - Debit cards are lower. The law limits interchange fees (charged by the card issuer) to 50bp (average)
  - With the exception of linked cards, Wallet TPV is typically lower
    - QR code payments are booked at 99bp in Brazil and 60bp in Argentina
    - Utility bill and phone top ups are low (digital phone top ups in Brazil are in the 1-1.5% range)
    - P2P transfers from account money are zero rated
- **Take-rates are enhanced through factoring receivables**

TPV mix by payment type



Price list by payment type in Brazil



Source: Mercado Pago price list * *Boletos* are charged at R$3.49/transaction; the % rate is based off an average ticket price of R$150. DO/14/30 relates to the number of days cash is received after payment by credit card

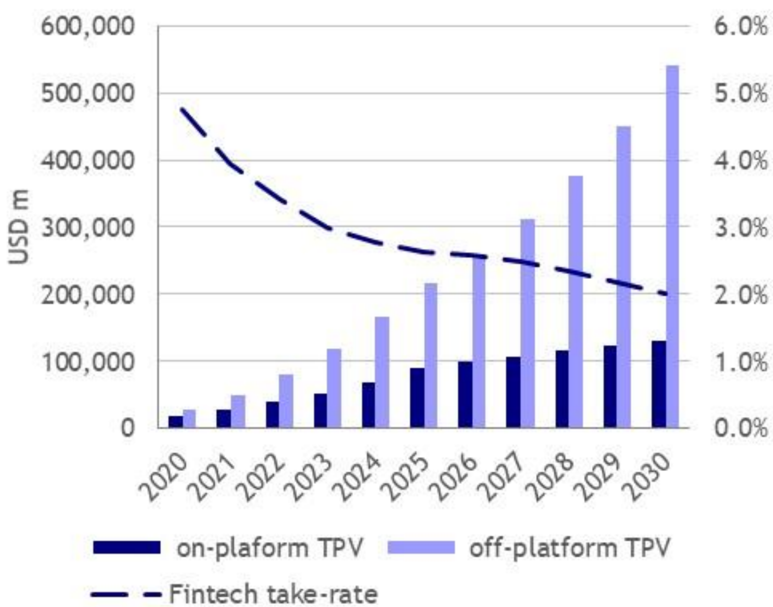
PIX – GMV upside, a drag on take-rates but supporting QR expansion

- **PIX is a system being deployed by the Brazilian CB to accelerate instant payments throughout Brazil. The goal is:**
  1. To reduce consumer dependence on cash, and
  2. Reduce concentration of payments through a handful of banks
- **Money flows will circumvent the traditional payment system in Brazil, avoiding the need for Acquirers, Card Schemes (VISA, Mastercard etc) and Issuers**
- **The system will be operable 24/7 and allow transactions to happen in real time (<10 seconds)**
- **Launch is mid-November**
- **Customers will assign one of three forms of ID type (email, phone number or social security number) and be able to:**
  - <u>Use for in-store payments through QR codes – this is where management is perhaps most enthused</u>
  - Transfer monies to and from other mobile wallets
  - Use on-line for e-commerce and bill payments
  - Transfer monies to/from bank accounts (and wallets) although consumers do not need a bank account to be on the system
- **E-commerce should further thrive. Cash usage should fall as should dependence on traditional payment means in Brazil:**
  - *Boletos* – the ubiquitous "ticket" which operates under a bar code system in Brazil, used for payments of utility bills, rents and increasingly e-commerce for those without a bank account. The boleto acts as an invoice which can then be paid in cash at post offices, banks, lottery agents and even supermarkets
  - Electronic transfers such as TEDS and DOCs
  - Debit cards
- **While banks charge fees of up to R$20 for DOC or TED transfers, PIX will be free for the sender.**
  - The recipient, if not an individual, will be charged 0.10 reais (less than 2 US cents) for every 10 transactions.
- **There is no credit within the system, however, and credit cards usage should be broadly unaffected**
  - >50% of Mercado Pago TPV is linked to credit cards
  - Exposure to debit cards will likely come under pressure
- **For Mercado Libre, this should be a structural positive**
  - <u>GMV gains should offset payment losses</u>

Fintech assumptions

- **We assume strong growth of TPV going forward**
  - This is offset by a declining take rate
- **Nevertheless, Fintech revenue growth is set to remain strong for the foreseeable future**

TPV and take-rate



Fintech revenue

The Super App

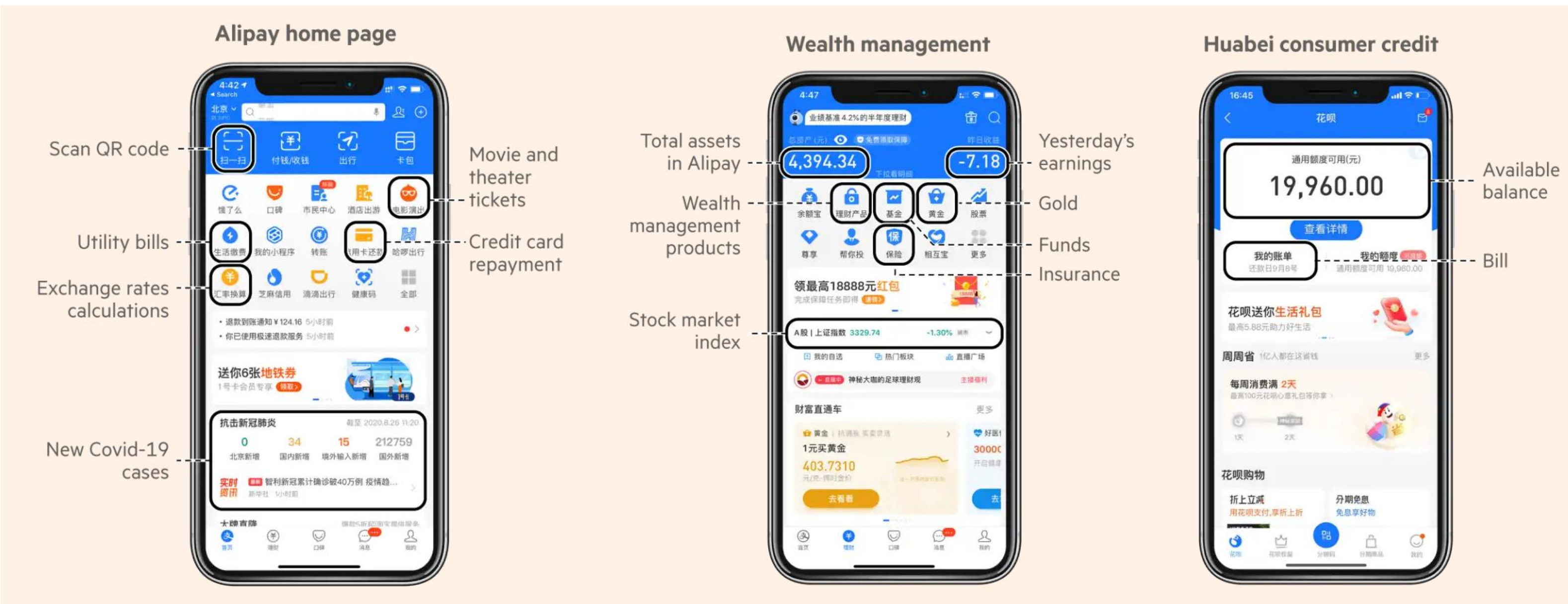
ANT Group provides a possible glimpse of the future

Super App Nirvana: ANT/Alipay Mobile Wallet

- **Having launched in 2004 as Alipay and spun out of Alibaba in 2014, the re-branded ANT Group is set to IPO later this year**
  - Latest rumoured hoped for valuation is USD280bn for 100% (raising $35bn), which implies 13x annualised H1 20 revenue, or 43x annualised H1 PE (assuming no debt)
- **ANT has moved beyond the underlying Alipay business to become an all-embracing digital platform - a "Super App"**
  - WeChat is similar in concept, springing from its origins in messenging and social media
- **The size of the ANT IPO is already focusing investor attention on such Super Apps**

"I came back from China with this ambition ... I want to do what Tencent and Alibaba are doing there ... no more barrier between digital and physical," Chief Executive Frederico Trajano (Magazine Luiza) told in a meeting with investors and analysts in Sao Paulo (Dec-19).

Alipay



Chinese Super Apps will be hard to replicate in LatAm (or anywhere)

- **There are two key differences between Brazil (and LatAm) and China in terms of the ability to pursue a Super App:**
  1. **Regulation is likely to be different:**
     - The Brazilian Central Bank is building to the launch of PIX. The premise of this is moving away from reliance on the small number of banks who still dominate payments. Key for this is interoperability for all agents, operating in an open loop environment.
     - The Chinese anti-trust laws have shown themselves to be generally more relaxed about new industry market share: 1-2 dominant providers have emerged in on-line travel, mobile payments, food delivery and ride hailing. It's unclear that the anti-trust body in Brazil, CADE, would share this view (we suspect not).
  2. **Technology:**
     - There is a crucial difference in the way that the WeChat and AliPay platforms are now constructed, versus existing wallets outside of China
     - These platforms use mini-programs (or "Applets"), which are akin to traditional Apps created exclusively for the WeChat (or Alipay) platform. This confers a few advantages:
       1. They take up a low amount of memory (limited to 4 Mb)
       2. They are very quick to load and update automatically
          - For instance, scanning a bar code in-store to pay for a good would instantly launch a mini program
       3. They can be shared easily (via WeChat)
       4. They are integrated into the WeChat eco-system and so, for instance, can take payment from
     - A WeChat user therefore never needs to leave the WeChat application

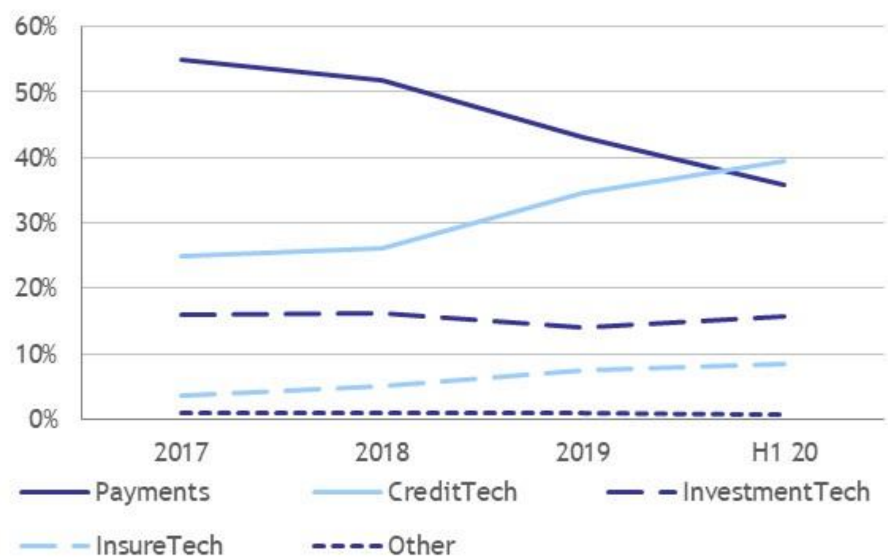
According to Rodrigo Gruner, the Head of Financial Services at Vivo, recreating the WeChat App in Brazil (or the US, evidently) simply wouldn't work on existing smartphones based on existing storage capabilities

The Chinese Tech advantage

Alipay – from Payment to Super App

- **Whilst almost all of Mercado Pago comes from payments, in the case of ANT Group payments represented just 35.9% of revenue in H1 2020**
  - Take rates are low (0.5-0.6%) despite payments being dominated by just three players: Alipay, WeChat and China Union
- **Rather, Online consumer and SMB lending (CreditTech) now makes up almost 40% of total revenue**
  - ANT originates loans but the underwriting is done by financial partners ANT has 100 partner banks. Only 2% of loans sit on ANT's balance sheet (for SMBs)
- **ANT also runs an investment platform, including its own Yu'E Bao fund and partnering with over 170 asset managers**
  - It currently has close to USD600bn invested through the platform
- **A smaller shares of revenue comes form its insurance platform, where it partners with 90 insurance companies**
- **In addition to these billed revenue services, the App serves to aggregate lifestyle services:**
  - News
  - Cinema/theatre bookings

ANT Group revenue contribution



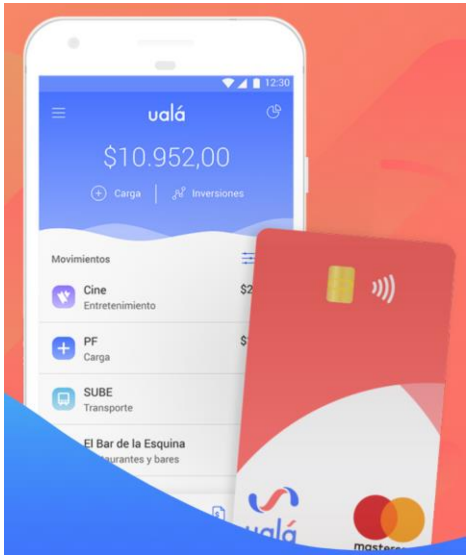
RMB 2.1 trillion (USD320bn) of loans have been originated by ANT Group

Today's m-wallet model: Drive engagement, originate credit (and other services)

- **A lot of companies in Brazil are chasing Super App nirvana: Brazil is the fourth largest market globally for mobile wallets today (according to *Buyshares*)**
- **The Wallet model is typically:**
  1. Provide free on-line/digital bank account; include other features (pre-paid cards)
     - There are over 600 m-wallets today in Brazil, including *Mercado Pago*
     - Uala (Softbank/Tencent backed) is one of the largest in Argentina and recently launch in Mexico
  2. And/or: Support an underlying business model. This could be:
     - Enabling cheaper pre-paid recharges for the telcos
     - Cash-back offers from the likes of e-commerce providers B2W (through *Ame)* and Magazine Luiza (through *Magalu Pay*)
     - Note, the Mercado Pago wallet today doesn't really see any synergy with the marketplace platform, rather it operates as a standalone entity
  3. Or: Be globally recognised, like Apple Pay or Google Pay
  4. Enable payments (QR codes), cell phone top ups, P2P transactions either through card or from account balances
  5. Try and upsell credit and/or other lucrative services
- **Crucially, "free" banking and payments is not generally the end-game**
  – Acquirers & card systems will continue make a turn on the payment processing (albeit diminishing in Brazil given PIX). Apple Pay will also take a clip as it assumes some payment liability and books interchange fees
  – However, as a pure wallet, the upside here is limited. As a PSP, Pago has a shoe in both camps
- **Where the real money is: Credit**
  – Mercado Pago is offering SMB and consumer loans
  – AME has started to offer loans of up to R$500 for the unbanked, and up to R$50,000 for those starting a business; in partnership with a number of Fintechs
  – Vivo (wireless)* recently launched Vivo Money

B2W Digital (Brazil)

Uala - Argentina/Mexico



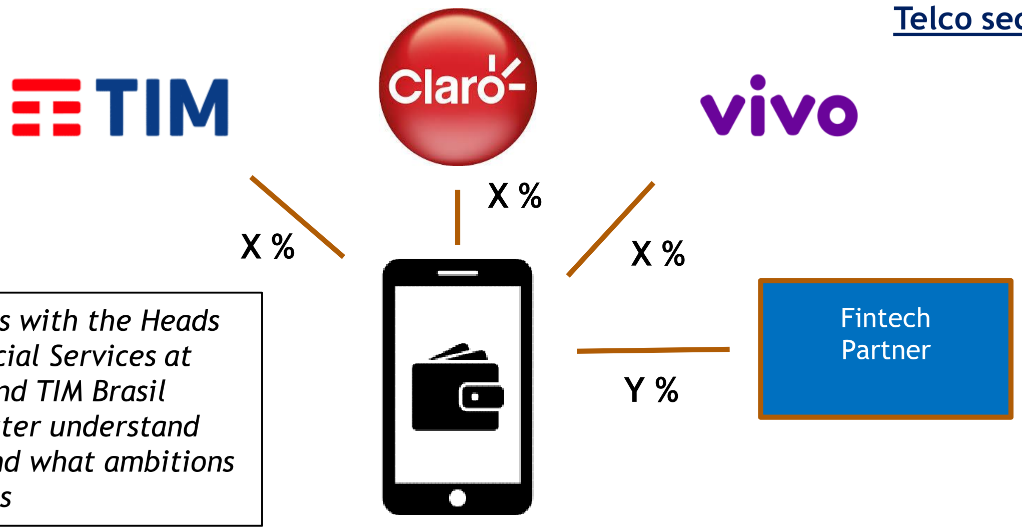
Initiatives from the Wireless Industry

Vivo Money launch brings Credit into focus

Mobile wallet competition: Telcos in Brazil looking at the space

- **The telcos all have payment and m-wallet initiatives. As Vivo and TIM have indicated, this has been triggered by:**
  - The emergence of a long list of potential Fintech partners (C6, for example, which has already partnered with TIM)
  - The introduction of PIX, which is set to drive accelerating payment volumes
  - A desire to drive down the cost of pre-pay recharge
- **This cost potential alone makes exploring wallet opportunities worth while**
  - In-store costs distributors (newspaper stands, lottery stores) charge 5-6%
  - Digital top ups are 1-2%: this could be through existing wallets (Pago), bank websites (Itau/Bradesco) or through CC cards
  - Some of the digital banks are even cheaper than this
- **The industry may look to act in unison to enjoy scale: drive down recharge costs**
  - The use of PIX and ongoing digitlisation efforts will average down the recharge cots
  - However, the industry acting together would be in a better position to negotiate with the small number of large nationwide distributors responsible for in-store
- **A Fintech partner would likely be brought into manage the structure**

Telco sector wallet possibility



We held conference calls with the Heads of Innovation and Financial Services at Vivo (Rodrigo Gruner) and TIM Brasil (Renato Ciuchini) to better understand the m-wallet concept and what ambitions the wireless industry has

What we have seen so far - TIM partnership with C6

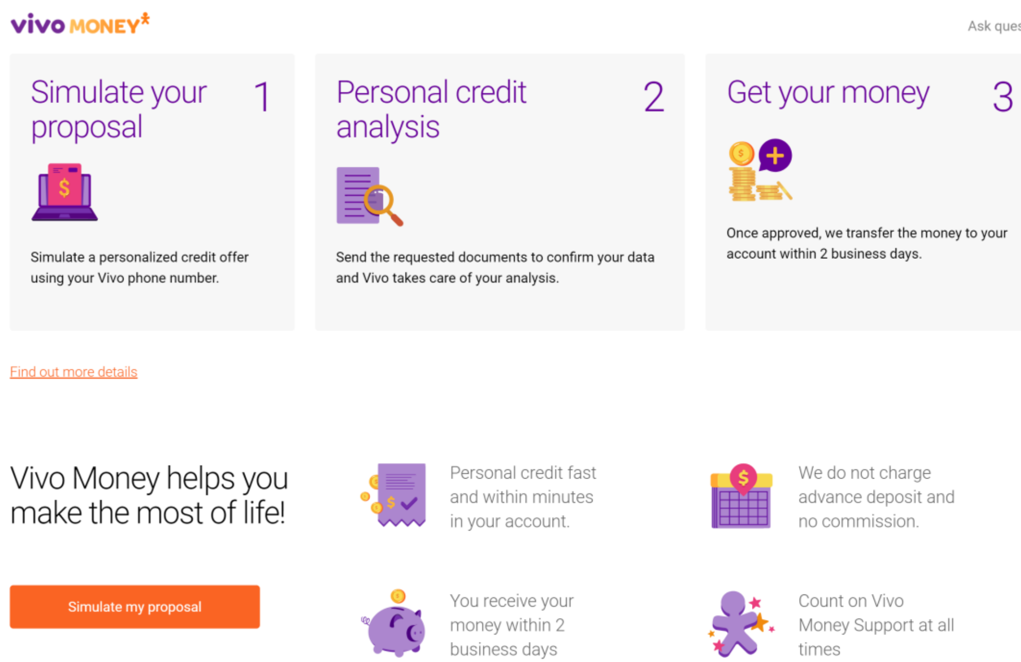
- **TIM Brasil launched a new range of tariffs in early July last week in association with digital bank, C6**
  - Offers are today available to the 11-12m Controle customers in Brazil, as well as to the 32m pre-paid base
  - TIM's higher-end post-paid customers (~8m customers, which include TIM Black) will need to wait a short while for the launch
- **Focus at this stage is not on the "unbanked"**
- **However, July's tariff launch is more aimed at customers who already operate in the financial system but want to share in the additional benefits offered by C6.**
  - C6 is one of a number of neobanks which have sprung up in Brazil recently to challenge the dominance of the 5 major banks in Brazil (Itau, Banco do Brasil, Bradesco, Caixa, Santander) which dominate the market for credit (85%) and deposits (84%) in Brazil today
- **TIM customers registering with C6 will be automatically recognised as a TIM customer and start to receive these benefits**
  - TIM will share some customer details with C6 to facilitate the credit approval process. Here in lies the appeal of the banks aligning with the wireless sector, where operators have a very strong profile of the individual customers
- **As well as receiving C6 banking services, TIM customers will also receive benefits in terms of incremental GB**
- **Each customer signed up through TIM will entitle TIM to a fee**
  - If an undisclosed customer target is achieved, TIM will take payment in the form of equity in the bank
  - This is set to be a "relevant" amount
- **We understand the relationship with C6 to be exclusive**

TIM Brasil / C6 offers

Launch of Vivo Money

- **Telefonica Brasil launches Vivo Money on October 19th, a personal credit service for Post-paid (and Hybrid customers) offering borrowing of up to R$30,000**
  - Borrowing takes place through the website (www.vivomoney.com.br) through a simple process where the Vivo customer enters their phone number, the amount of credit needed and the number of installments needed.
- **The credit offer is being carried out in partnership with *QI Sociedade de Crédito Direto*, which first got its lending licence in late 2018 (this is not a full banking licence but a secondary tier).**
  - As such, Vivo will not be acting as the lender but rather taking a spread between the bank lending rate and the rate offered to customers. Rates start at 1.99% per month which is in the mix of lending rates in Brazil.
- **At this stage Vivo Money offer is targeting post-paid customers and - it appears - those with a bank account.**
- **We would anticipate moves to target pre-pay customers in the coming months**

Vivo Money launch



Can telcos be more than a dumb pipe?

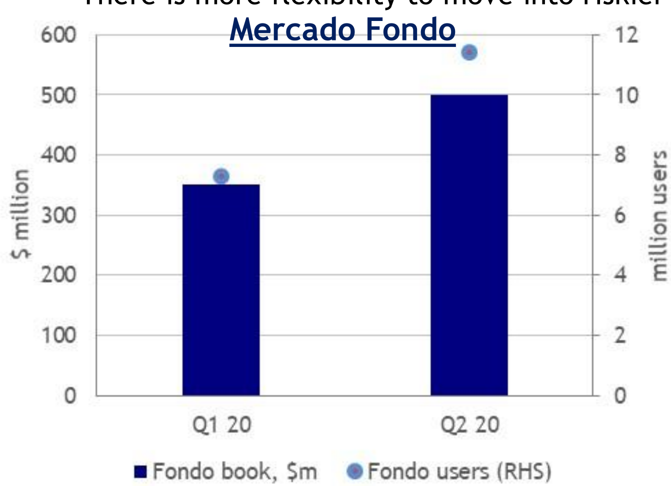
- **Can telcos mine their customer base more effectively than others?**
  - Recent regulatory changes mean payment data for post-paid (and hybrid) customers is made available to the Credit Bureau in Brazil. As such the telcos lose exclusivity on this data set
  - In reality, for credit scoring it's not clear how useful this is for assessing loan worthiness
  - Rather it is customer behaviour which is perhaps equally or even more useful for assessing lending
  - Wireless operators know:
    - Where you go, who you talk to, which Apps you use and when
  - For pre-pay customers, with no credit profile, the digital footprint is pretty much ALL the information out there:
  - The use of big data and AI allows the aggregation of all of this with targeted outcomes. One such outcome could be consumer credit lending to the unbanked, a historically perilous occupation for Brazilian lenders
- **What are the issues?**
  - There is a grey area in the extent to which consumer behaviour can be used
  - On an individual basis, there are limitations unless consent can be given
    - Although tell this to Big Tech!
- **Vivo pilot feedback**
  - Vivo trialled Vivo Money through from August 2019 through to April 2020 before launching
  - Using purely payment analysis – and not yet tapping AI and behavioural data – it believes it has reached the same level of precision as the big banks
  - Again, engagement is expected in the form of payments, giving the opportunity to then target lending
  - Theoretically this payment knowledge could also inform targeted lending

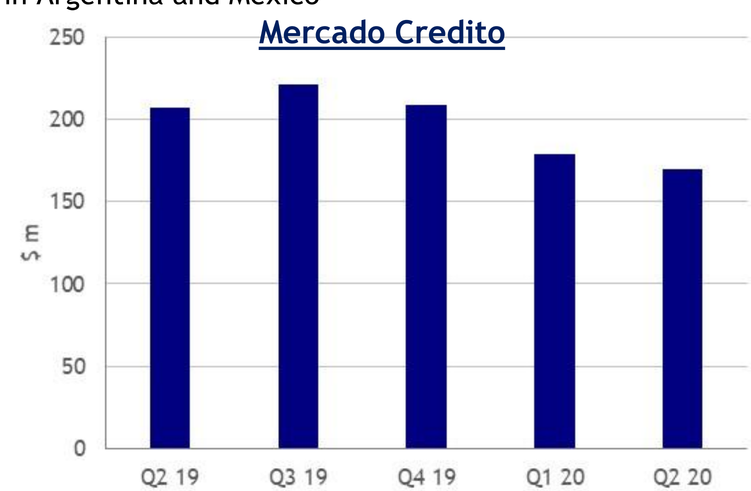
Soomit Datta | 44 20 375 9128 | soomit@newstreetresearch.com

Provisionally, we think Credit could be worth >USD100/share

Initial moves from Pago into Credit and Asset Management

- **Mercado Credito is available in Argentina, Brazil and Mexico**
  - Initially launched in Argentina offering credit to on-platform merchants, this was extended to Brazil and Mexico
    - This is relatively low risk given merchant flows pass though Pago enabling easier collection of interest and principal
  - Loan facilities were then extended to mPOS merchants (off-line, off-platform) in 2018
- **Lending has also been provided to on-platform Buyers**
  - This was extended to Mercadolibre users buying off-platform in 2019
- **Initial moves into *Credito* have been cautious so far but is targeted as a future growth pillar**
  - In the past, MELI has not been able to lend directly in Brazil, partnering instead with financial institutions
  - This is changing with an application to become a SCFI (a "secondary" bank) which should come through very soon. Funding sources are being diversified, having secured last month a USS$75m loan from Goldman Sachs to target merchant lending
  - MELI is also about to launch a credit card (in which it will act as the Issuer)
- **Mercado Fondo, an Asset Management arm was launched in 2018**
  - This allows for cash funded mobile wallets to be invested providing a return above and beyond standard bank accounts
    - In Brazil at this stage cash has to be deposited at the central bank and invested in government securities
    - There is more flexibility to move into riskier products in Argentina and Mexico





What is Pago's right to win? The same as ANT/BABA: Mine the customer base

- **ANT's expertise in credit origination stems from its knowledge of the customer from BABA's E-commerce platform**

- **This is the USP of ANT Financials Services, which achieves this without any cross-ownership**
  - The joint ownership of Marketplace and Fintech at Mercadolibre means this is a redundant issue today

- **From the ANT IPO Prospectus (25 August 2020):**
  - *"We have unparalleled customer insights and proprietary algorithms used in decision making. The extensive range of services that we and the Alibaba ecosystem provide - payment, commerce, logistics, local services, merchant services, digital entertainment, offline store visits, map navigation, among others — collectively generate a wealth of high-quality, differentiated and commercially relevant insights into consumers and businesses that use our platform. Our intelligent decisioning systems take into account the constant streams of insights to give a real-time assessment of a customer's credit quality, investment preferences or insurance needs. We also use our dynamic risk management system and technology to develop fraud detection approaches that have led to one of the lowest payment fraud loss rates.*

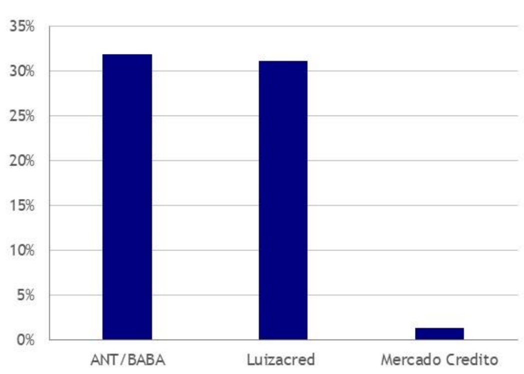
- **In addition, ANT also partners with the local underwriting banks**
  - This means the credit models can develop dynamically and be adjusted accordingly over time

- **AI and Big Data**
  - In addition, ANT invests significant sums in big data and AI to ensure that behaviour patterns from the marketplace can be applied to ANT's lending
  - Likewise, is developing its own *credit risk models with "unique data that differentiate our scoring from traditional financial institutions, as we are able to leverage machine learning and artificial intelligence algorithms that we historically used for fraud prevention"*

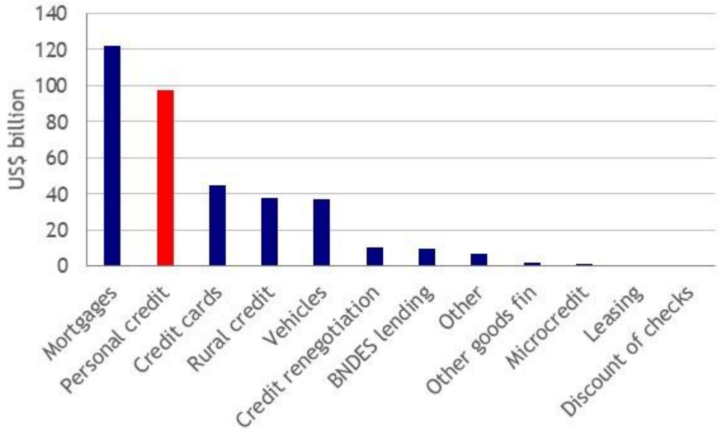
What’s the target credit market in Brazil

- **There are a couple of different ways to look at this:**
  - **What have peers achieved?**
    - ANT’s loan book (consumer and SMB) is worth one third of BABA GMV (China only)
    - Magazin Luiza in Brazil has a loan book of close to one third of total sales through its JV with Itau, Luizacred, which lends up to one third of total sales (physical/E-commerce) predominantly through credit cards
  - **Personal credit across the region is underserved, in part due to the large unbanked population. In Brazil:**
    - Household lending in Brazil is today mainly composed of mortgages (Caixa alone has >70% of the market)
    - Total household lending in Brazil is US$373bn (Aug-20) of which US100bn is <u>personal credit</u>. This $100bn market is the one which:
      1. MELI (and other banks, telcos) are looking to target and,
      2. Which is growing rapidly
         - Growth slowed early in the Covid cycle but evidence suggests that demand for recently has picked up (Central Bank data below through to August)

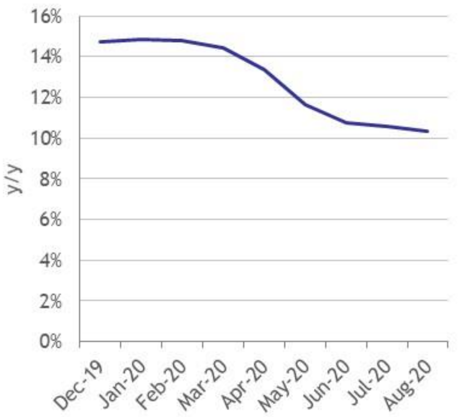
<u>Loan value to sales</u>



<u>Household debt across Brazil</u>



<u>Personal Credit growth</u>



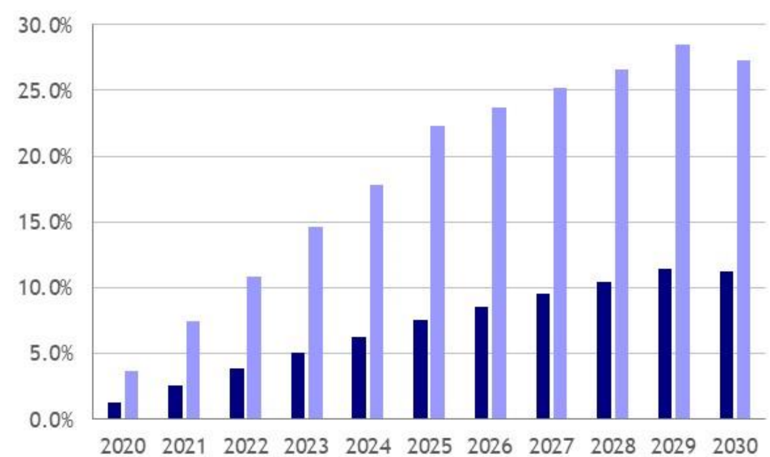
What could this be worth for MELI in Brazil. Provisionally included at USD100/share

- **We provisionally included a valuation of USD5bn, or USD100/share for Mercado Credito. We assume:**
  - Mercado Credito can scale the business up to lending 10% of GMV over time
    - This implies a loan book of USD12bn by 2030
  - A blended lending rate of 24%; Vivo Money is lending at rates from 1.99% per month
  - Funding cost in line with the “high single digit” Goldman Sachs loan rate (funding its merchant loans specifically at this stage)
  - A delinquency rate of 10%
- **This is a DCF based analysis, although the market is likely to focus on revenue contribution**
  - By 2030 we provisionally see this business contributing 10% of Group revenue and 27% of Fintech revenue
- **Given the broad range of assumptions, we show a sensitivity analysis below based on % of GMV loaned and delinquency**
  - Crucial is the assumption that the Marketplace behaviour algorithms can prevent delinquency creeping into the high-teens
  - We keep the current funding costs, although as the business scales – and expertise is proved - this is almost certainly likely to come down from today’s current rates

Credit valuation for Mercado Libre, USD/share

Delinquency	% of GMV loaned: 2%	4%	6%	8%	10%	12%	14%	16%	18%
2%	48	97	145	194	242	291	339	388	436
4%	41	83	124	166	207	249	290	332	373
6%	34	69	104	138	173	207	242	276	311
8%	27	55	83	110	138	165	193	221	248
10%	21	41	62	82	103	124	144	165	186
12%	14	27	41	55	68	82	96	109	123
14%	7	13	20	27	33	40	47	54	60
16%	0	-1	-1	-1	-1	-2	-2	-2	-2
18%	-7	-15	-22	-29	-36	-43	-51	-58	-65

Revenue share of Credito



E-commerce – Brazil GMV growth recovering, upside to take rates

E-commerce: Market was concerned about wavering Brazilian GMV

- **One of the market's bigger concerns has been MELI's GMV growth in Brazil**

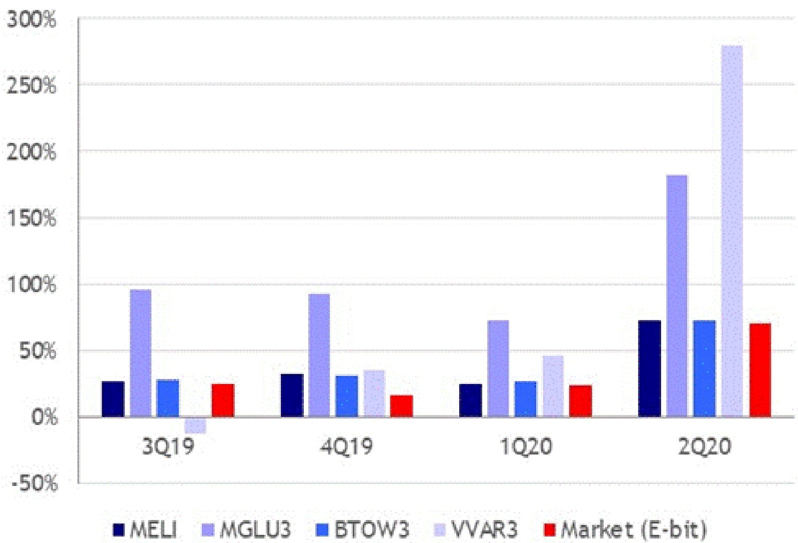
- **The other E-commerce providers had started to show higher (and accelerating) y/y GMV, whilst MELI was slowing**

- **We can isolate a number of drivers of the softer performance, which have and continue to be addressed:**
  1. **Unwinding heavy shipping subsidies in 2018 and early-2019 took the edge off GMV growth**
     - The subsidies proved hugely expensive - notably for lower priced goods given flat pricing. This wasn't sustainable
     - Instead MELI has focused investments in logistics and shipping driving down delivery times and improving user experience
  2. **Competing against 1P players has been harder in certain categories**
     - Magazin Luiza has re-focused efforts on E-commerce in recent quarters
       - 1P doesn't have to manage the "first mile" while "Ship from Store" (now with 700 participating stores) helps as a last mile alternative
     - Investments in logistics have managed to offset some of this natural advantage
  3. **Moving into 1P for verticals such as electronics and FMCG**
     - Competing against providers with their own inventory has proved difficult. If MELI carries its own stock it has more flexibility around pricing and promotions
     - Likewise, on CPG – which has seen huge growth under Covid – delivery times are even more crucial
     - MELI is now targeting high single digit GMV exposure to 1P (up from low today) as it pushes this initiative
  4. **Flat rate pricing across verticals has proved uncompetitive**
     - MELI is now pricing different verticals at different rates
       - Higher margin businesses such as apparel now carry a higher fee
       - Allowing categories such as electronics to price more favourably
     - This was trialled in Colombia in Q1, in Mexico and Argentina in Q2, and was rolled out to Brazil in Q3

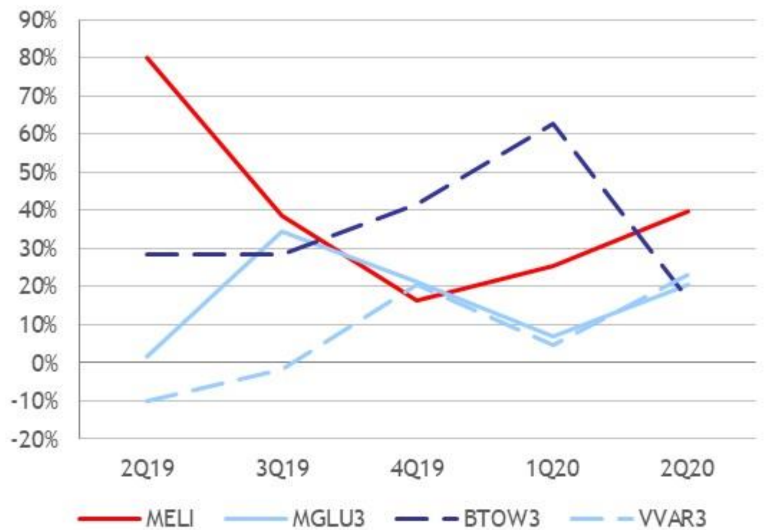
Growth has since recovered in Brazil; Q3 looks good also

- **MELI has seen its GMV recover in Q2, which should continue through Q3**
  - Although Covid has supported E-commerce more broadly, MELI's result was viewed seen as evidence of better execution
  - y/y growth for MELI Brazil was up strongly; it's not split by country, but group GMV – driven by Brazil – was up 102% vs 34% in Q1 (in nominal terms)
  - We expect that GMV will have continued expand in Q3 (up mid-teens q/q and accelerating y/y in USD terms)
- **Growth rates at peers continue to be higher y/y as we show below (with an estimate for Brazil based on revenue split) BUT:**
  - This is partly due to the larger size of MELI. In fact, MELI's estimated share of GMV in Q2 2020 increased to 40% versus the other Big 3 operators, having dropped to below 20% in Q4 2019
  - It is also explained by the higher demand since Covid for FMCG goods, which 1P players have been better positioned to support

Brazil y/y GMV trends through Q2



GMV share of additional GMV



Managed Network investments to cope with rising demand

- **The improvement in Brazil has been supported by more investments into logistics and managed networks.**
- **More broadly, this is anyway a key focus area for the group**
  - As a 3P provider there is a fundamental challenge when competing with the 1P providers such as B2W and Magazin Luiza who distribute their own goods straight to the customer
- **Mercado Envios is Mercado Libre's shipping solution**
  - This is a solution for merchants which lets Mercado Libre arrange delivery of the good to the customer
- **The shipping solution can be split further into three broader types, the first 2 being part of MELI's "Managed Network"**
  1. Fulfillment: The merchant keeps goods in MELI fulfillment centres. Once ordered, they can be shipped straight to the customer. This leads to the quickest delivery times
  2. Cross-docking: MELI sends a vehicle to pick up the merchant's goods and bring them to a MELI distribution centre. The goods pass through the centre quickly ("cross-dock") before being sent for delivery
  3. Drop-shipping: The traditional mode of shipping and the slowest. The merchant sends the good with MELI reduced to providing customer address details. In Brazil this mode is almost entirely reliant on the postal service (Correos) which has a reputation for strikes and sudden price increases

Shipping solution

Shipping Solution	Group Penetration	Brazil	Delivery times, days Brazil	Mexico	Argentina
Fulfillment	20%		<2	1.6	2.3
Cross-docking	23%		3.4		3.8
Managed Network	43%	>50%			
Drop shipping	57%	<50%	6.0	2.9	5.9

MELI's Managed Network push will drive down delivery times

- Management thinks Brazil should get to 80-85% pretty quickly
- Adjusting for the 6 day average delivery times through *Correos*, MELI believes it competes on a par with 1P delivery times

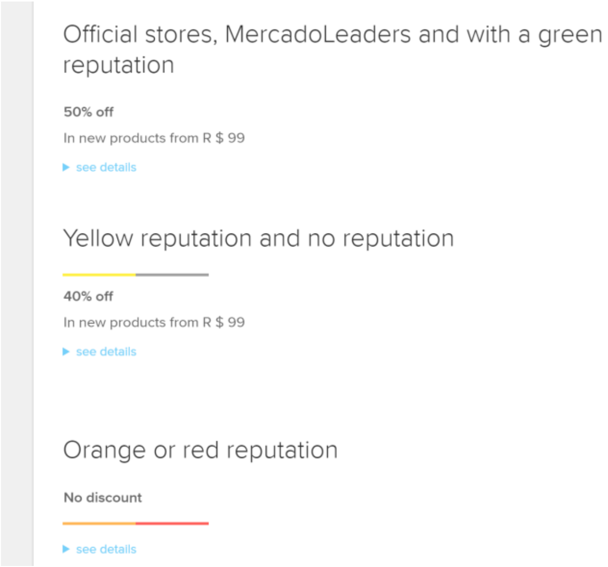
1. **MELI logistics is a last mile solution being pushed by the company to support deliveries**
   1. Employment of contractors working exclusively for MELI in smaller branded (yellow) vans

Getting shipping right is a key challenge

- **Improved service and delivery times all comes at a cost. Despite "free shipping" initiatives, somebody pays for it:**
  - Below a certain price (R$99 in Brazil) the buyer pays for the shipping (unless the seller wants to offer it for free)
  - Above that price, shipping costs are split between MELI and the merchant
    - We show below the chart for MELI's shipping subsidies as % of GMV over time (costs are netted off gross revenue)
    - Shipping subsidies principally ballooned due to the instance of lower priced goods being sold which, back in 2018, were costed as % of value of the good i.e. sell a low priced good, pay a low shipping fee
    - This has been unwound and there is now a flat cost for shipping lower priced goods
  - The split is determined by the status of the seller i.e. the higher the value of the seller, the lower their cost
- **Much of Mercado Libre's investment is in fulfillment centres and cross-docking warehouses**

Shipping subsidies as % Gross revenue

Shipping by customer



Logistics by market

- **We summarise the state of the Managed Network below, by market**
- **There is no real guidance on expansion other than the company suggests that there will be incremental investments across the region and that Mercado Libre is probably 50-55% from where management envisions the topology of the logistics network to eventually be**

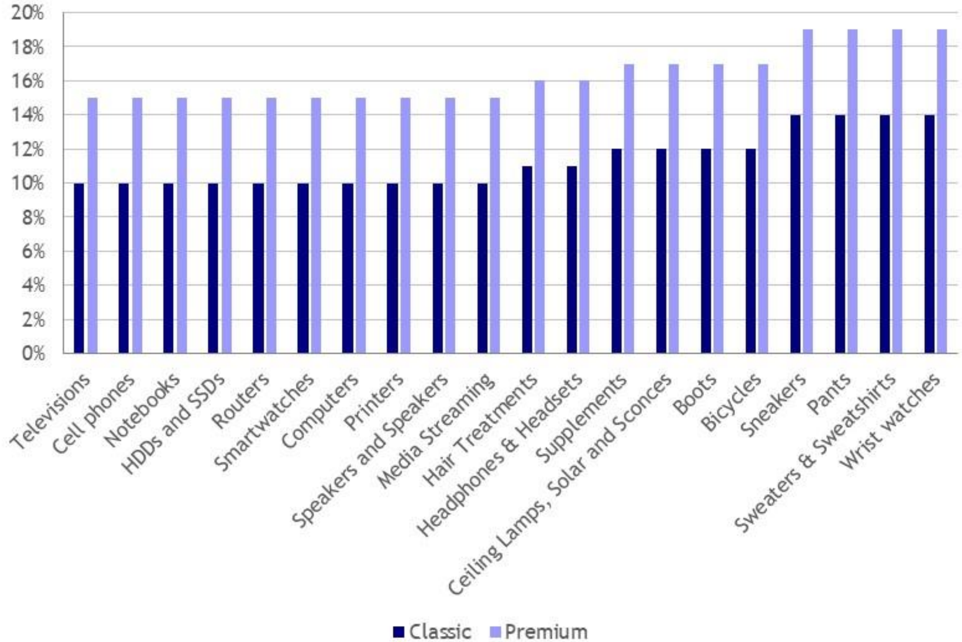
- **Mexico:**
  - Three fulfillment centres which go from 30k m2 too 100k m2. Two in DF and one in Guadalajara. We will likely open an additional in the north of Mexico.
  - Added to that, the company expects to have between 35-40 service centres across the country for last mile consolidation and delivery by years end. These can vary from 500m2 to 6k m2 of storage capacity
- **Brazil:**
  - Three distribution centres (DC's) in operation (two in the state of Sao Paulo) and one in the north in Bahia and capacity varies from 45k m2 to 150k m2. A fourth one is opening in the south and there is a debate as to whether to open more in Brazil.
  - Additionally, there are seven Cross-Docking centres that vary in capacity 8k m2 and 16km2. More will open but there is no formal guidance
  - There are also expected to be almost 70 service centres across the country for last mile consolidation and delivery. Capacity varies from 1.5k - 6k m2
- **Argentina**
  - There is a hybrid Cross Docking/Fulfillment centre of approximately 40km2 in the Province of Buenos Aires. This plus Flex and airfreight is the current target for Argentina
- **Chile**
  - One fulfillment with potential capacity of up to 35k m2 in Santiago.
- **Colombia**
  - One fulfillment with potential capacity of up to 50k m2 in Bogota

New pricing model to improve competitive positioning

- **MELI offers free, classic and premium listings**
  - Efforts are underway to reduce the exposure to free, which we think is now <10% of total listings
  - Classic and Premium listings are differentiated by placement, while Premium allow for selling through installments
- **Flat rate pricing across verticals has proved uncompetitive**
  - This was trialled in Colombia in Q1, in Mexico and Argentina in Q2, and was rolled out to Brazil in Q3
  - Classic and premium listings are now differentiated by vertical. The ambition is to keep blended take-rates the same but be more competitive (and sell more) in the verticals that count
    - Higher margin businesses such as apparel now carry a higher fee
    - Allowing categories such as electronics to price more favourably

Pricing differentials by vertical in Brazil

Reducing charges on more competitive segments

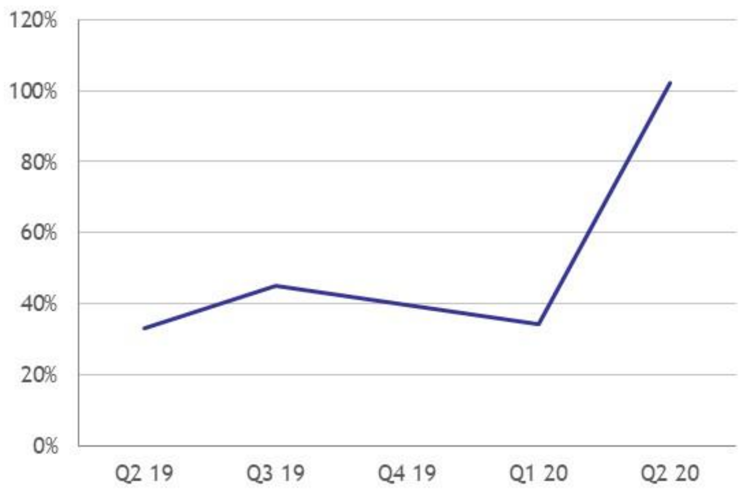


Higher margin apparel take rates being pushed up

Lockdowns across LatAm - supporting regional E-commerce

- **The Covid environment across the region has ultimately driven strong E-commerce demand, notably in certain categories**
  - Suffice to say, with lower footfall customers are switching to on-line
  - Having suffered initially in March/April, momentum recovered on exiting the quarter and through July
- **GMV of goods sold on the Marketplace grew at >100% YoY in 2Q20 on a local currency basis (vs. +34% in 1Q20)**
  - As well as a strong performance in Brazil, in Argentina GMV growth increased to +230% YoY in 2Q20 (vs. +81% in 1Q20)
  - In Q3 we expect continued GMV expansion across the group
- **CPG demand (food, beverages, healthcare) is particularly high under lockdown**
  - MELI rolled out its *Supermercado* concept in April in Brazil and Mexico (previously in Mexico)
  - CPG GMV of low single digit share of GMV is expected to grow to nearer 10% in 2020
- **Electronics (<40% of GMV) initially struggled but has bounced back**

MELI Group GMV y/y growth (local FX)

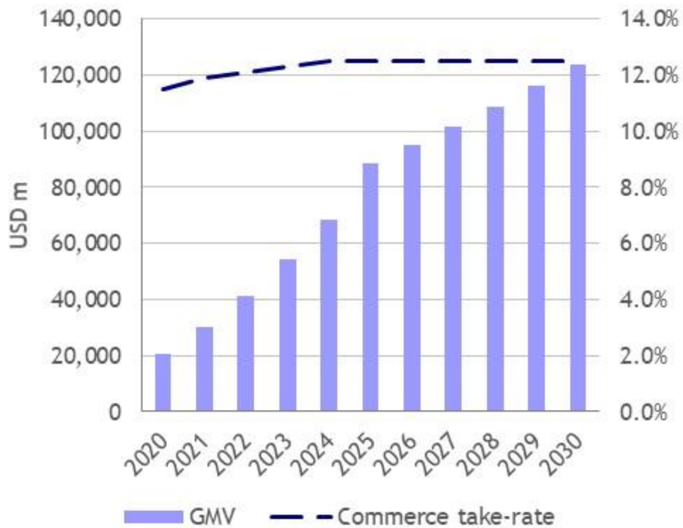


Items sold and average ticket price

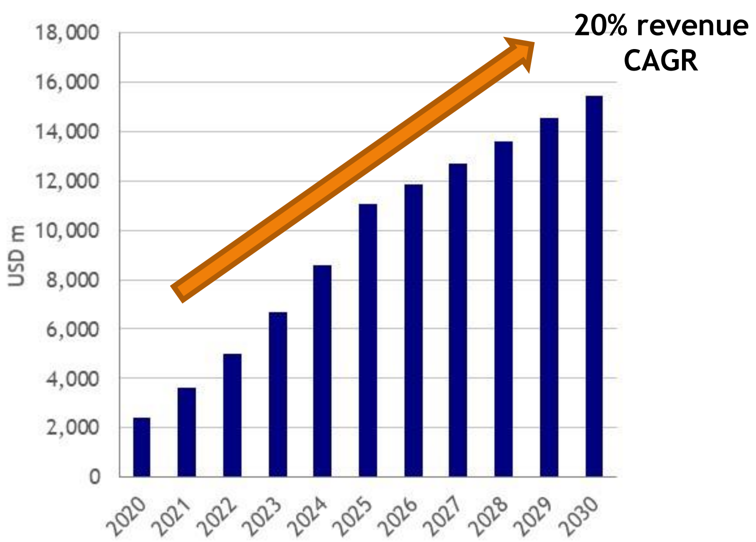
Take-rate and Commerce revenue developments

- **The better commercial positioning (and higher GMV) should alleviate downside pressure on take-rates from competitive risks. In addition, there are other reasons why take rates can increase**
  - Shipping subsidies should continue to decline, albeit from now lower levels. The subsidies are netted off gross revenue meaning net revenue is reported after shipping cost. We show this momentum below for Q2 2020 vs Q2 2019. It's possible that shipping revenue could even be increased over time.
  - Management is refocusing efforts on Advertising, having recently relaunched its Ad platform, re-branding from "Mercado Libre Publicidad" to the snappier, "Mercado Ads". From Fernando Rubio, Vice President of Mercado Ads: " *We want to accompany brands, agencies and sellers to reinvent themselves and accelerate their growth in the digital world. The prominence of e-commerce in the advertising market is accelerating and both large brands and media agencies and SMEs have a great opportunity to exploit and enhance their growth.* Ad revenue is not disclosed but is part of the ~13% contribution to Commerce revenue coming from Classifieds, Ads and "Other", suggesting room for upside.
- **We would also flag that the optics of switching to 1P will also positively impact take-rates, given revenue includes the full (GMV) value of the good rather than the ~12% take-rate. However, there is also a COG.**

Take-rates and GMV forecasts



MELI Commerce revenue

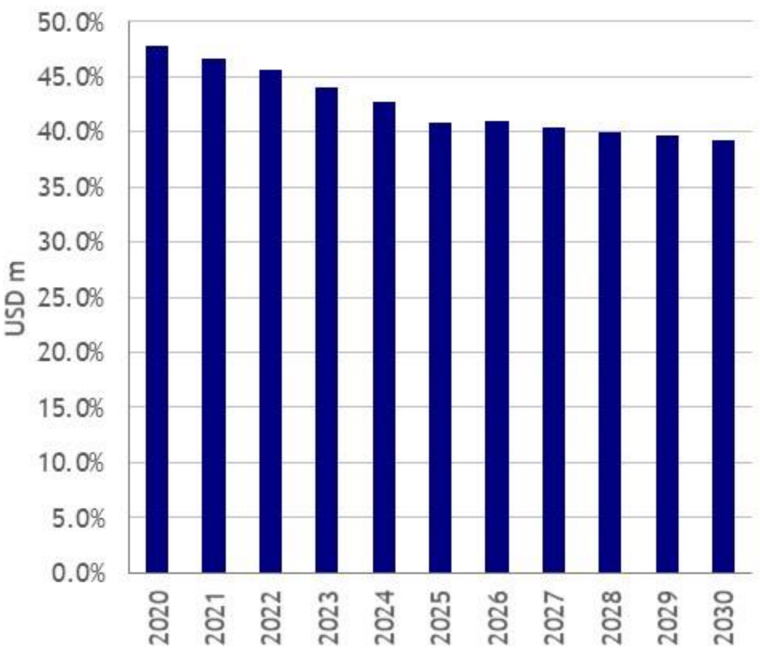


Payment, take rates and gross margin

- **The chart below shows the development of gross margin over time at the group level**
  - Commerce is, in the main, a higher gross margin business than payments given the interchange fees paid away*. As such, the growing preponderance of payments on-platform and Fintech revenue (largely off-platform) on the business structurally shrinks the gross margin. In addition, a move to 1P will also shrink the margin over time (although we don't explicitly forecast this)
  - Falling shipping subsidies also support the gross margin

Gross margin by quarter

Gross margin expectations



* Gross costs include: bank and credit card processing charges for transactions and fees paid with credit cards and other payment methods, fraud prevention fees, sales taxes, shipping operation costs (including warehousing costs), carrier and other operating costs, certain taxes on bank transactions, cost of products sold, hosting and site operation fees, compensation for customer support personnel, ISP connectivity charges and depreciation and amortization.

Summary of Mercado Libre estimates

- **We show how gross profit feeds through to profitability below**
  - We expect EBITDA margins to expand from low-single digit levels in 2020 given the operational leverage in the business model
  - In the outer years of the DCF we see EBITDA margins of 20% and net income margins of 11%

Summary of estimates

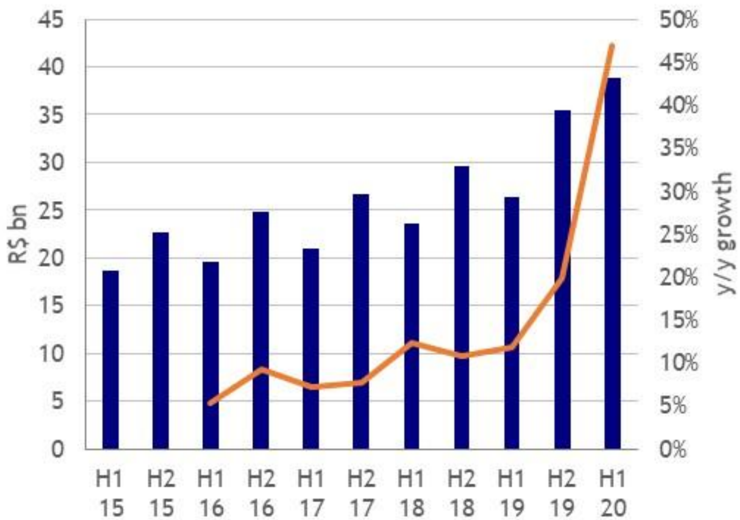
USD m	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	CAGR 20-30e
GMV	20,732	30,276	41,161	54,236	68,644	88,562	94,816	101,660	108,664	116,295	123,725	20%
% growth	48.1%	46.0%	36.0%	31.8%	26.6%	29.0%	7.1%	7.2%	6.9%	7.0%	6.4%	
TPV	47,148	78,532	119,128	171,739	233,730	303,635	353,636	412,457	481,854	564,371	661,694	30%
% growth	66%	67%	52%	44%	36%	30%	16%	17%	17%	17%	17%	
on-plaform TPV	19,539	28,836	39,615	52,470	66,752	86,564	93,151	99,875	106,755	114,252	121,552	20%
off-platform TPV	27,609	49,696	79,513	119,270	166,978	217,071	260,485	312,582	375,099	450,119	540,142	35%
off as %	59%	63%	67%	69%	71%	71%	74%	76%	78%	80%	82%	
Gross revenue	3,839	5,761	7,965	10,566	13,604	17,280	19,086	21,000	22,971	24,904	26,934	22%
Net revenue	3,699	5,561	7,702	10,234	13,197	16,788	18,569	20,459	22,408	24,324	26,337	22%
% growth	61%	50%	38%	33%	29%	27%	11%	10%	10%	9%	8%	
% local FX	110%	65%	49%	42%	37%	34%	17%	16%	16%	15%	15%	
Commerce take-rate	11.5%	11.9%	12.1%	12.3%	12.5%	12.5%	12.5%	12.5%	12.5%	12.5%	12.5%	
Commerce revenue	2,384	3,603	4,981	6,671	8,581	11,070	11,852	12,708	13,583	14,537	15,466	21%
Fintech take-rate	4.8%	3.9%	3.4%	3.0%	2.8%	2.6%	2.6%	2.5%	2.4%	2.2%	2.0%	
Fintech revenue	1,315	1,958	2,722	3,563	4,616	5,718	6,717	7,752	8,825	9,787	10,871	24%
% growth	60%	67%	53%	43%	40%	33%	25%	23%	21%	17%	17%	
Gross Profit	1,766	2,591	3,512	4,499	5,640	6,855	7,600	8,258	8,969	9,650	10,348	19%
% margin	47.7%	46.6%	45.6%	44.0%	42.7%	40.8%	40.9%	40.4%	40.0%	39.7%	39.3%	
EBITDA	175	283	509	917	1,417	1,986	2,494	2,939	3,591	4,299	5,080	40%
% margin	4.7%	5.1%	6.6%	9.0%	10.7%	11.8%	13.4%	14.4%	16.0%	17.7%	19.3%	
Net income	70	101	182	367	589	823	1,067	1,400	1,815	2,281	2,805	45%

Marketplace Annex

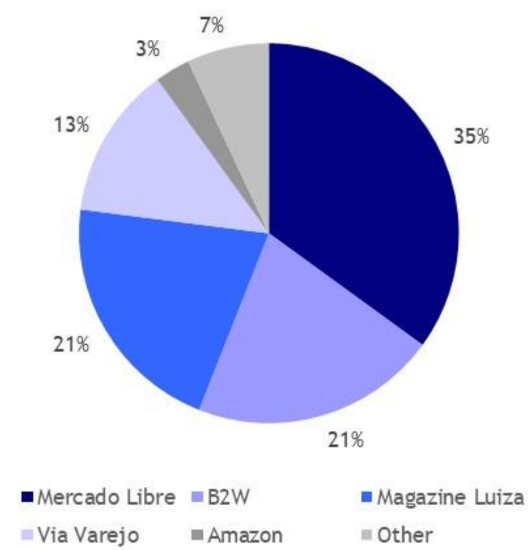
#1 player in key Brazilian E-commerce market

- **The key market for MercadoLibre's Marketplace platform is Brazil (61% of Marketplace revenue), where they are largest player in a rapidly expanding E-commerce market**
- **Revenue growth in E-commerce has been running at ~10% until the 12 months since when it has accelerated**
  - 2015-18 were impacted by the recession in Brazil, with much lower headwinds in 2019
  - Growth of ~50% y/y in H1 2020 was driven by elevated demand under Covid lockdowns
- **E-Bit and company estimates put Mercado Libre total market share at "mid 30%s", with B2W no.2 at 21% (including Netshoes), Magazine Luiza no.3 and Via Varejo in the mid-teens**
  - Analysis of these "Big 4" names' GMV suggests Mercado Libre market has been pretty steady (at 45-50%)
- **Amazon has been seen as the risk in the past, with low single digit share today**
  - 2017: Amazon opens its Brazilian website to third-party electronics retailers
  - 2019: Amazon starts offering its Prime delivery services in Brazil
  - 2020: Amazon constructing a second distribution centre in the northeast of Brazil

E-Commerce growth in Brazil



E-Commerce market share in Brazil

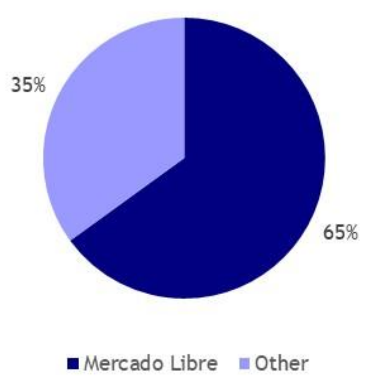


Source: E-Bit, Company estimates

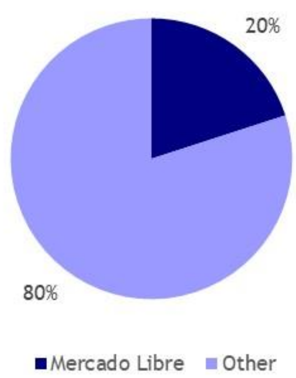
Dominant in Argentina, more competition elsewhere

- **Mercado Libre enjoys a very dominant position in Argentina, with 60-65% market share**
  - Market trending to one-player market
  - No international appetite for investment
  - Other local players include Fravega (home appliances) and Garbarino (home products)
- **Mexico is growing rapidly; it’s a more disaggregated market**
  - Mercado Libre share is in the low 20%’s
  - This is the one LatAm market where Amazon is relevant with 12-15% market share
  - A smaller number of players have <10% share, including Coppel, Walmart, Liverpool, Sam’s Club, Sears, HomeDepot
- **International interest in Colombia, though it’s early days**
  - Mercado Libre share is estimated at low 30%s
  - Rappi, backed by Softbank, does on-line delivery (including food) and is the market leader by volume (although is estimated to be smaller than Mercado Libre by GMV)
  - Ali Express (Alibaba international sales) have close to 10% share of items sold by volume
  - Falabella has <10% share

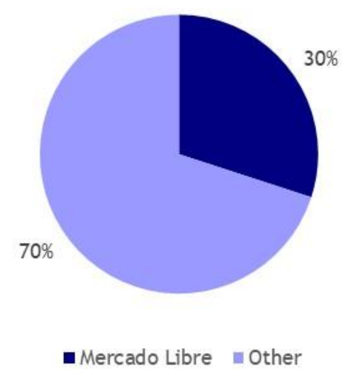
Argentina % market



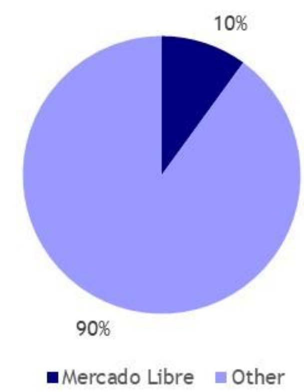
Mexico % market



Colombia % market

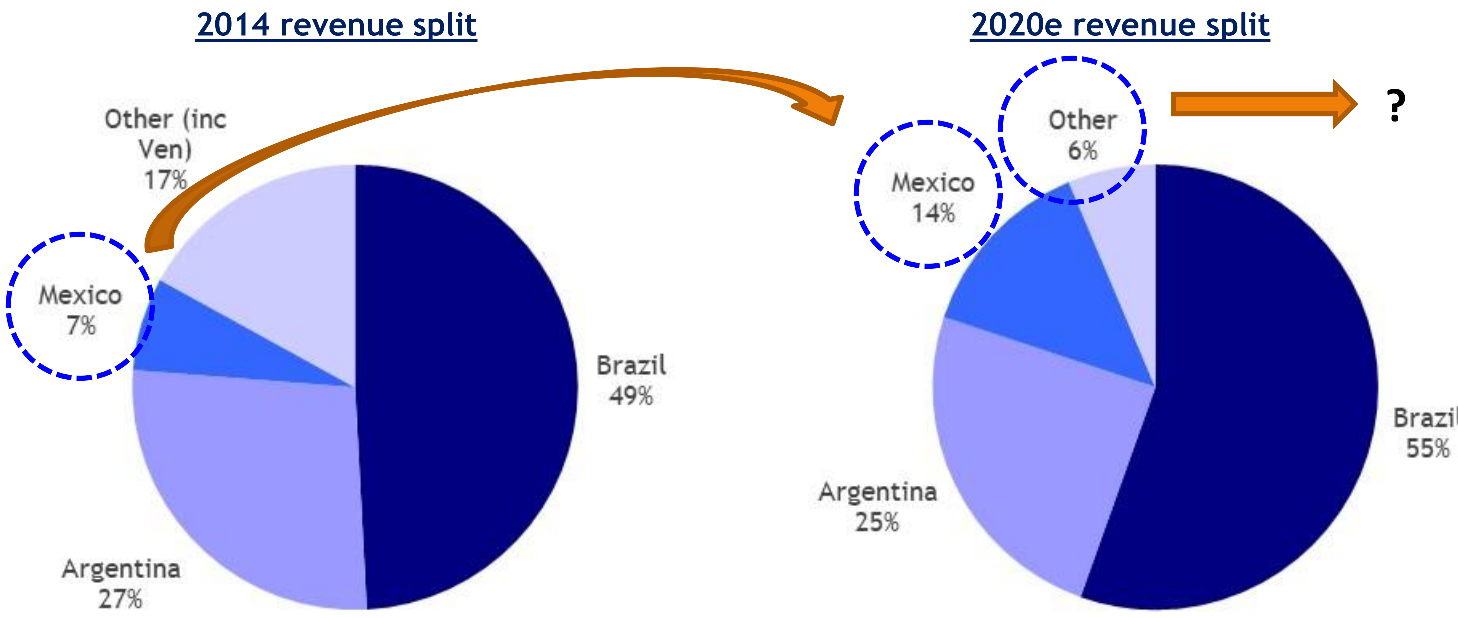


Chile % market



Colombia and Chile coming on board

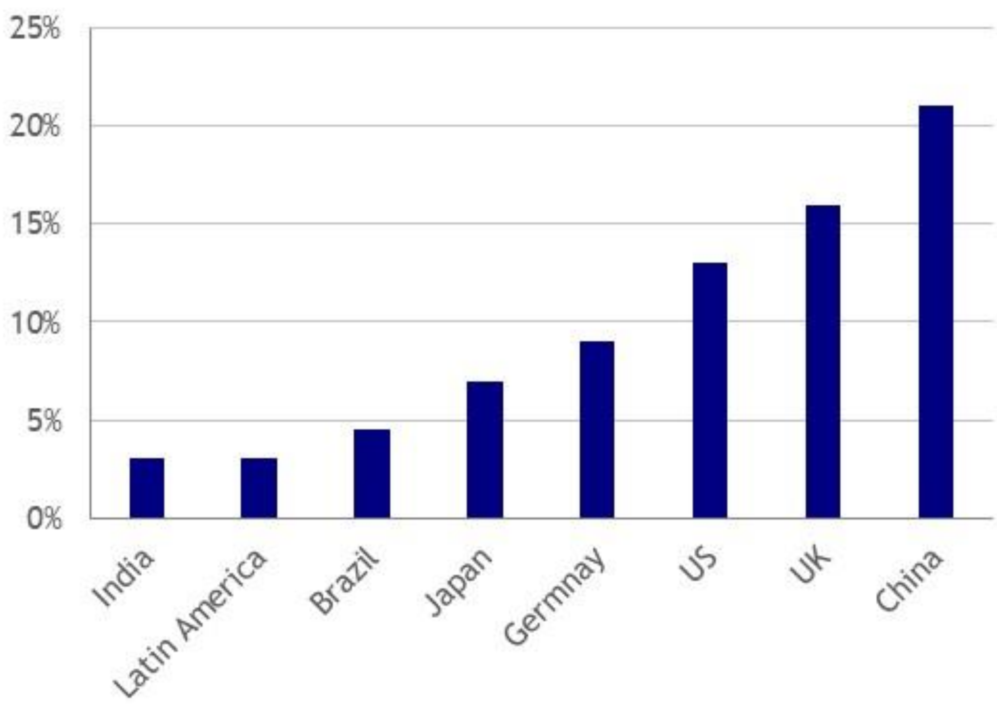
- **Of the 18 countries in the region the marketplace operates in Brazil tends to get most of the focus**
- **Chile and Colombia are now getting more management focus**
  - MELI is targeting $100m spend on logistics in Chile over the next 2 years having inaugurated its first distribution centre in early October. This should be on-line by YE
  - A new distribution centre is also planned for Colombia
- **This reminds us of Mexico, which for a long time was small enough to not focus on**
  - Investment in infrastructure here means this is now worth 14% of revenue (and bear in mind Mexico is a market in which Amazon competes aggressively)



Much for E-commerce to shoot for in the region

- **E-Commerce is still nascent in the region**
- **Brazil is ahead of the region but Online retail represents a small proportion of total retail sales in Brazil, with plenty of scope for growth**
  - Brazil has close to 5% penetration (as % retail sales)
- **China remains the target**

E-commerce penetration (as % retail sales)



Disclosures

12 month historical recommendation changes are available on request

This report was produced by New Street Research LLP. 11 Austin Friars, London, EC2N 2HG Tel: +44 20 7375 9111

Regulatory Disclosures: This research is directed only at persons classified as Professional Clients under the rules of the Financial Conduct Authority ('FCA'), and must not be re-distributed to Retail Clients as defined in the rules of the FCA.

This research is for our clients only. It is based on current public information which we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied on as such. We seek to update our research as appropriate, but various regulations may prevent us from doing so. Most of our reports are published at irregular intervals as appropriate in the analyst's judgment.

This research is not an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients.

All our research reports are disseminated and available to all clients simultaneously through electronic publication to our website.

New Street Research LLC is neither a registered investment advisor nor a broker/dealer. Subscribers and/or readers are advised that the information contained in this report is not to be construed or relied upon as investment, tax planning, accounting and/or legal advice, nor is it to be construed in any way as a recommendation to buy or sell any security or any other form of investment. All opinions, analyses and information contained herein is based upon sources believed to be reliable and is written in good faith, but no representation or warranty of any kind, express or implied, is made herein concerning any investment, tax, accounting and/or legal matter or the accuracy, completeness, correctness, timeliness and/or appropriateness of any of the information contained herein. Subscribers and/or readers are further advised that the Company does not necessarily update the information and/or opinions set forth in this and/or any subsequent version of this report. Readers are urged to consult with their own independent professional advisors with respect to any matter herein. All information contained herein and/or this website should be independently verified.

All research is issued under the regulatory oversight of New Street Research LLP.