

MercadoLibre

Stock Note

2021 - Focus switch to Credit/ Deep dive into Card Issuance

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- **What's new:** We are updating our target from \$1,600 to \$2,000 and see MercadoLibre as the expected top performer in our LatAm coverage. Whilst 2020 saw material GMV strength driven by Covid conditions (and fiscal support), a better economic outlook for 2021 (~+5% GDP, from -5% in 2020) should provide a firmer bedrock for Credit expansion. This is set to start with the Q1 launch of a credit card in Brazil.
- **Deep dive into credit cards:** We have been particularly focused on the optionality on the Fintech side of the business. In our [Oct initiation](#) we had carved out the Credit opportunity from broader Fintech and now further unpeel the onion: carving out credit card issuance separately, ahead of expected Q1 launch in Brazil. Take-up should be strong given on-platform cash back incentives, highlighting also the synergy of owning E-Commerce and Payments. This helps push up our Credit EV to US\$11bn (from \$5bn), with better FX (than when last set) also a support.
- **Consensus disconnect:** The trading update from earlier this week - while a little vague - pointed to ongoing strong revenue growth momentum in Q4. When we look at consensus, however, we find we are >20% ahead for 2021 and 2022.
- **Valuation:** 2020 saw the stock run and run on multiple expansion and revenue upgrades. While the former may have run its course (let's see) upgrades look set to continue.

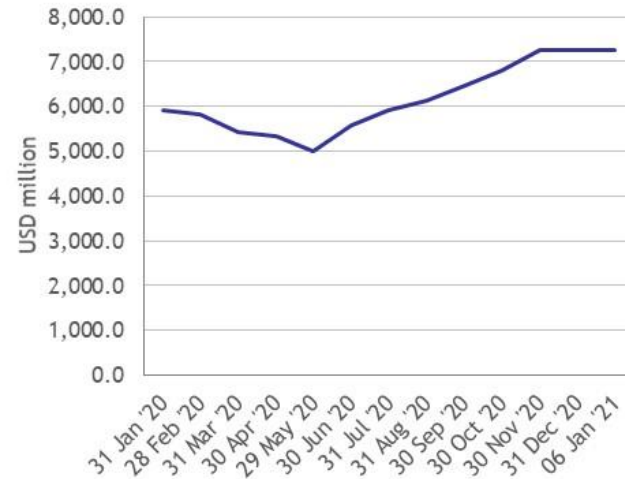
Buy

Ticker: MELI:US
Price Target: USD2,000
Potential change: +25%

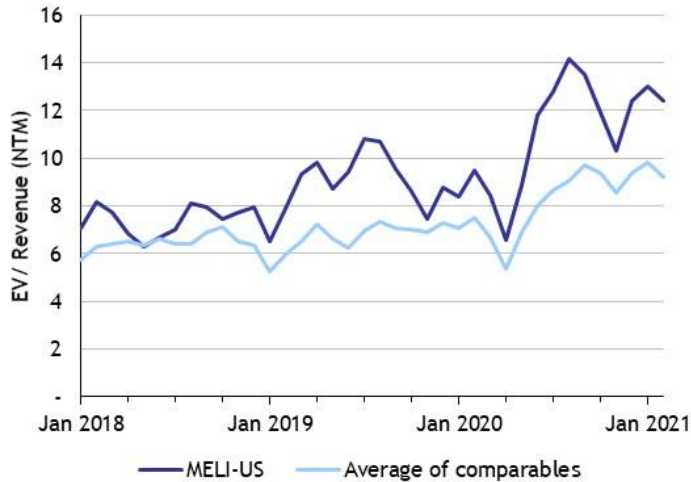
Revenue upgrades and multiple re-rating drove the stock in 2020

- 2020 saw the stock driven by both revenue and multiple revisions
 - EV/revenue (12m forward) is up from 8x to 12x
 - The premium vs the peer group is ~30% today
 - This widening is explained by the stronger revisions
 - Whilst BABA being in the regulatory headlights drags the group average
 - Revenue revisions have been very significant
 - We doubt whether recent USD weakness is reflected in numbers

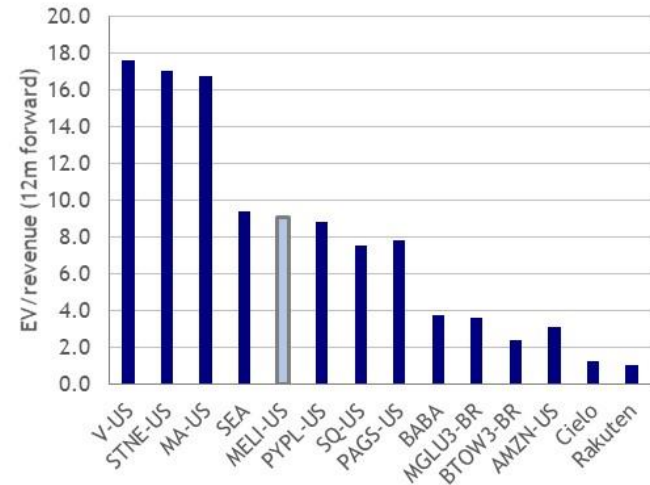
Revenue revisions



Multiple expansion through 2020



EV/revenue versus peers



Latest commentary and BBG consensus look disconnected

- As part of this week's announced debt offering (which it is confirmed will see the redemption of 50% of MELI's \$880m convertibles and shore up its ESG credentials), the company also announced a trading update
 - This suggested growth continues to be strong, although steered to a negative operating loss for Q4
 - Of the two, the former (positive) is the more likely driver of the stock

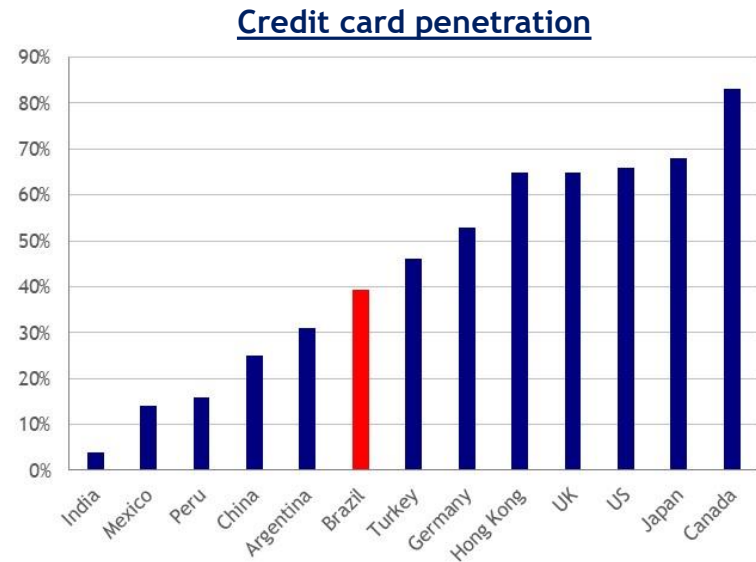
The guide is:

- ***For Q4 20 (y/y) and FY 20 both GMV and TPV “up significantly”. Supported by Covid behaviour which “may not continue into 2021”***
 - We have GMV USD growth of 79% in for Q4 vs 62% for Q3; for TPV we have 100% versus 92%
- ***Q4 20 y/y revs will be “generally in-line” with recent Q’s; we have markets cooling very slightly from the hyper strong Q3 run rates (on our call the CFO had commented that E-commerce had come off mildly since the Covid peak)***
 - Brazil at 104% y/y in Q4 vs 112% in Q3 in local FX
 - Argentina at 225% vs 257%
 - Mexico at 131% vs 139%
- ***Better income (loss) from operations, such that the Q4 20 loss will be lower than the Q4 19 loss. Versus Q3 20 (strong positive) the trend is weaker as per seasonal trends***
 - We're at (positive) USD59m of Q4 operating income, consensus is at USD22m
- **We are looking for \$6.4bn and \$8.7bn of revenue in 2021 and 2022 which is well ahead of consensus at \$5.3bn and \$7.2bn**

We are looking for \$6.4bn and \$8.7bn of revenue in 2021 and 2022, respectively, which is well ahead (almost 25%) of consensus at \$5.3bn and \$7.2bn

Tapping into strong Credit Card consumption; recycling cash into E-Commerce

- **Credit cards have seen rapid take-up in Brazil in recent years**
 - Offerings from *neobanks* are proliferating with demand continuing to be supported by Brazil's instalment model for payments (as well as more attractive fees)
- **With an estimated 132 million cards in Brazil, we think credit card penetration is probably close to 40% (% of POPs owning one or more credit cards)**
 - International peer comparisons suggest there is upside here
- **Covid led to a slight unwind of this trend in 2020 as the environment sees customers revert TPV exposure to debit**
 - Credit TPV across Brazil dropped to 56% of total (credit + debit + cash cards) in Q3 but this will be a temporary shift and we expect a return to the >60% historic levels from 2021
- **Cards typically have incentive schemes; Pago is set to offer 4% cash back we understand with on-platform purchases**
 - This is more than the typical ~1% cash being offered by Fintechs currently (in lieu of miles) and demonstrating the synergy value of exposure to both E-Commerce and Payments



* Definitional change at the start of 2018

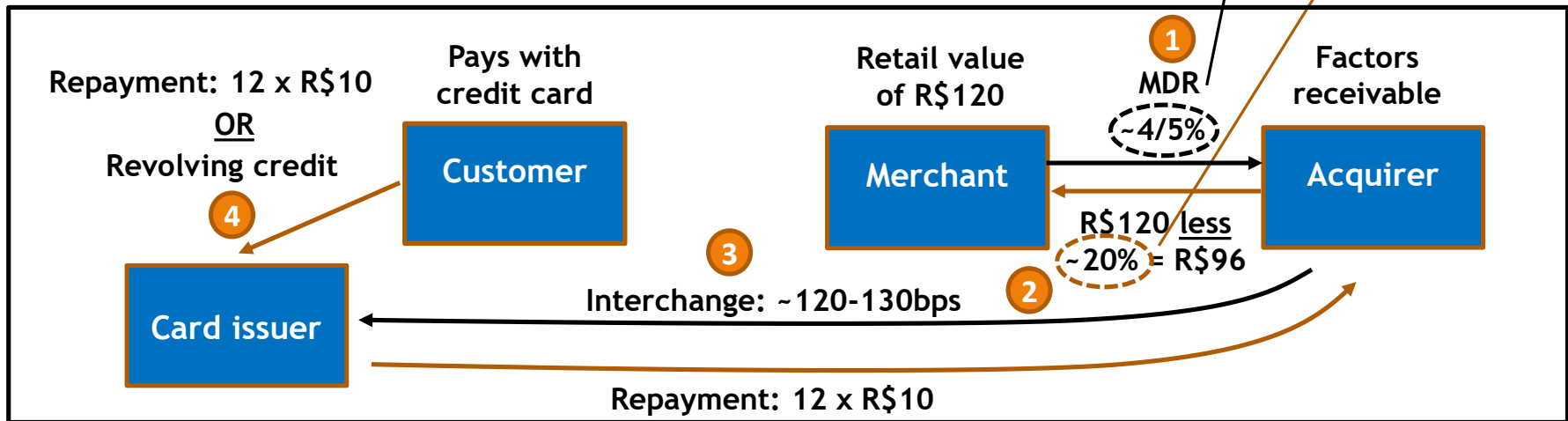
Credit cards: The Instalment model and Revenue upside to Pago

- As an Acquirer, Mercado Pago already takes a slice of value from the credit card value chain
 - Booking a discount rate (MDR) on credit card payments over Pago
 - Pre-paying receivables at rates of ~20% (12m instalments)
 - This creates credit exposure for Pago to the card issuers (and not the merchants) which is low risk
- Issuing their own credit card means Pago can add two further revenue streams
 - Booking interchange on transactions
 - Revolving credit fees
 - These can reach up to 300% per annum
 - This provides huge revenue upside, therefore, although in part matches the credit risk

MDR and pre-payment fees (example)

Transactions	D0	D+14	D+30
Debt Transactions	1.99%	1.99%	1.99%
Credit Transactions Single Instalment	4.99%	3.99%	3.19%
Credit Transactions Multiple Instalments	5.59%	4.59%	3.79%
Prepayment Fee	2.99%	2.99%	2.99%
Credit Transactions 02x Instalments	9.91%	8.91%	8.11%
Credit Transactions 03x Instalments	11.29%	10.29%	9.49%
Credit Transactions 04x Instalments	12.64%	11.64%	10.84%
Credit Transactions 05x Instalments	13.97%	12.97%	12.17%
Credit Transactions 06x Instalments	15.27%	14.27%	13.47%
Credit Transactions 07x Instalments	16.55%	15.55%	14.75%
Credit Transactions 08x Instalments	17.81%	16.81%	16.01%
Credit Transactions 09x Instalments	19.04%	18.04%	17.24%
Credit Transactions 10x Instalments	20.24%	19.24%	18.44%
Credit Transactions 11x Instalments	21.43%	20.43%	19.63%
Credit Transactions 12x Instalments	22.59%	21.59%	20.79%

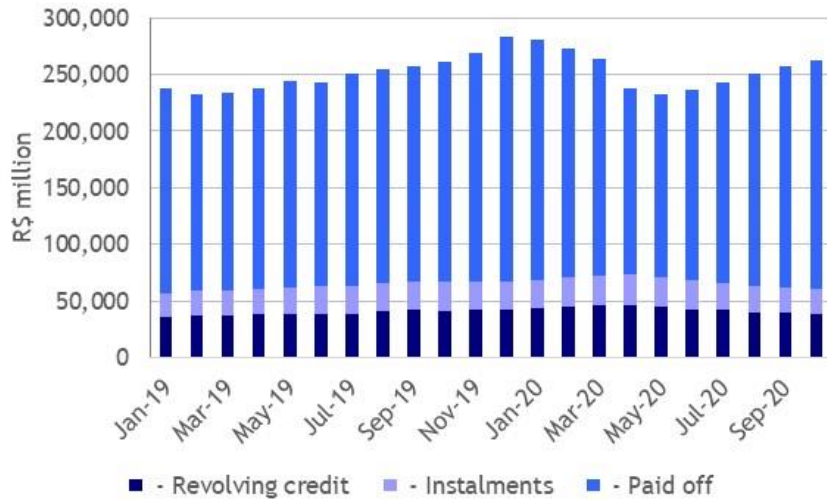
Credit card flows for a good sold at R\$120 retail



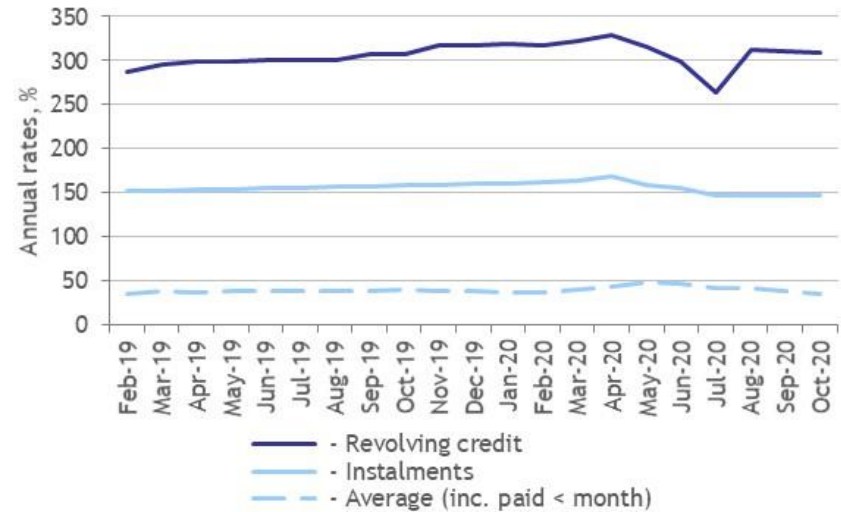
Rates particularly high on revolving credit in Brazil

- Revolving credit makes up just 15% of outstanding credit card debt
 - Though rates are high at over 300% per annum (i.e. 30,000 basis points!)
- On average, credit card receivables rate is ~35%
 - There is a strong incentive to pay off debt within the month

Split of credit card debt



Average rates on credit cards



Source: Brazil Central Bank

Assumptions for *Pago* Credit Card Issuance model

- We model in a launch in Brazil early in 2021; we make no assumptions on roll out in other markets. We assume:
 - Pago credit cards can reach 3% of active issued credit cards by 2030;
 - TPV per card in-line with the Brazilian market (R\$750/sub/month)
 - An interchange rate of 130 bps, broadly in-line with the market
 - An average coupon of 35%, NPL provision of 10% and funding costs of 6%
 - Network fees (paid to Visa or Mastercard) equivalent to 30 bps/transaction
- On this basis we see net interest income reaching almost USD600m by 2030, or 30% of *Credito* net interest income

Pago Credit Card Issuance Model

USDm	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
Total cards in issue (all Brazil), million	132	142	152	157	162	167	172	177	182	187	192
Brazil POPs, million	215	218	222	225	228	232	235	239	242	246	250
Pago cards issued, million	0.00	0.28	0.76	1.26	1.78	2.34	2.92	3.54	4.19	4.86	5.57
Pago share of market		0.2%	0.5%	0.8%	1.1%	1.4%	1.7%	2.0%	2.3%	2.6%	2.9%
Assumed payment volume / sub / month, USD	144	145	146	146	147	148	149	149	150	151	152
% change	0%	1%	1%	1%	1%	1%	1%	1%	1%	1%	1%
Total Pago credit card TPV		494	913	1771	2682	3655	4692	5793	6958	8189	9488
Interchange, bps	130	130	130	130	130	130	130	130	130	130	130
Revenue from interchange	0	6	12	23	35	48	61	75	90	106	123
Credit card receivable as % total Credito		49	137	354	671	914	1173	1448	1740	2047	2372
Other (working cap, payrolls)	200	737	1252	1930	2788	4258	5143	6154	7277	7589	7867
Average coupon	35%	35%	35%	35%	35%	35%	35%	35%	35%	35%	35%
Financial revenue	0	17	48	124	235	320	411	507	609	717	830
Total revenue	0	24	60	147	270	367	472	582	699	823	953
NPL on credit card receivables	0%	10%	10%	10%	10%	10%	10%	10%	10%	10%	10%
Provision for delinquency		5	14	35	67	91	117	145	174	205	237
Funding rate	0%	6%	6%	6%	6%	6%	6%	6%	6%	6%	6%
Funding cost	0	3	8	21	40	55	70	87	104	123	142
Net interest income	0	16	38	90	162	221	284	350	421	495	574
as % total Credito	0%	11%	14%	21%	25%	23%	24%	24%	25%	27%	30%
Network fees (per transaction), bps	30	30	30	30	30	30	30	30	30	30	30
Network fees	1	3	5	8	11	14	17	21	25	28	31
Net interest income less Network fees	14	35	85	154	210	270	333	400	471	546	596

Fintech revenue - updated assumptions

- We show below how Credit Card issuance can fit into the broader Fintech space
 - We see credit card issuance (Brazil only) contributing to 5% of Fintech revenue by 2025

Fintech revenue split (Group)

USD million	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
Revenue split for Fintech											
Acquirer revenue (incs factoring)	1,139	1,764	2,255	2,739	3,365	3,897	4,536	5,129	5,687	6,314	7,040
Wallet TPV revenue	123	230	413	572	740	913	1,084	1,283	1,516	1,789	2,105
Pre-paid balances	20	22	24	27	30	33	36	39	43	48	53
Credit card interchange	0	6	12	23	35	48	61	75	90	106	123
Credit card financial	0	17	48	124	235	320	411	507	609	717	830
Other lending (payroll, working cap etc) financial	119	258	438	675	976	1,490	1,800	2,154	2,547	2,656	2,753
Total Fintech	1,401	2,298	3,190	4,160	5,381	6,701	7,927	9,187	10,494	11,630	12,905
<i>Old</i>	<i>1,434</i>	<i>2,273</i>	<i>3,154</i>	<i>4,105</i>	<i>5,298</i>	<i>6,576</i>	<i>7,749</i>	<i>8,958</i>	<i>10,215</i>	<i>11,312</i>	<i>12,542</i>
<i>% change</i>	<i>-2.3%</i>	<i>1.1%</i>	<i>1.2%</i>	<i>1.3%</i>	<i>1.6%</i>	<i>1.9%</i>	<i>2.3%</i>	<i>2.6%</i>	<i>2.7%</i>	<i>2.8%</i>	<i>2.9%</i>
% split											
Acquirer revenue (incs factoring)	81%	77%	71%	66%	63%	58%	57%	56%	54%	54%	55%
Wallet TPV revenue	9%	10%	13%	14%	14%	14%	14%	14%	14%	15%	16%
Pre-paid balances	1%	1%	1%	1%	1%	0%	0%	0%	0%	0%	0%
Credit card interchange	0%	0%	0%	1%	1%	1%	1%	1%	1%	1%	1%
Credit card financial	0%	1%	2%	3%	4%	5%	5%	6%	6%	6%	6%
Other lending (payroll, working cap etc) financial	9%	11%	14%	16%	18%	22%	23%	23%	24%	23%	21%
Total Fintech	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%

Summary of estimates

USD m	2019	2020e	2021e	2022e	20-22e CAGR
Price, USD	1,580				
SHOUT, millions	51.7	51.7	50.7	50.7	
Market Cap	81,680	81,680	80,111	80,111	
Net debt	-2,734	-2,626	-937	-983	
Cumulative dividend	0	0	0	0	
EV	78,946	79,054	79,174	79,128	

Financial metrics

Gross revenue	2,558	4,098	6,606	8,982	48.0%
Net revenue	2,296	3,958	6,392	8,704	48.3%
Gross profit	1,102	1,765	2,668	3,580	42.4%
% margin	48.0%	44.6%	41.7%	41.1%	
EBITDA	-80	251	303	620	57.3%
% margin	-3.5%	6.3%	4.7%	7.1%	
Operating income	-153	142	127	359	59.1%
Net income	-172	100	108	220	48.0%
EPS	-3.5	2.0	2.2	4.4	48.0%
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	34.4	20.0	12.4	9.1	
EV/EBITDA	-988	315	261	128	
EFCF yield	-0.3%	-0.1%	-0.1%	0.1%	
PE	-479	1355	744	365	
Dividend yield	0%	0%	0%	0%	
<u>Returns</u>					
ROIC	-20%	4%	2%	8%	

Financial/Operational

GMV	13,997	21,307	32,747	43,415	42.7%
TPV	28,390	51,131	86,982	130,894	60.0%
of which on-platform	13,052	20,455	31,765	42,546	44.2%
of which of-platform	15,338	30,676	55,218	88,348	69.7%
Gross revenue	2,558	4,098	6,606	8,982	48.0%
Subsidies	-261	-140	-215	-278	40.9%
Net revenue	2,296	3,958	6,392	8,704	48.3%
of which Commerce	1,205	2,557	4,093	5,514	46.8%
of which Fintech	1,091	1,401	2,298	3,190	50.9%

Sum of the Parts

- We have incorporated the 50% pay down of the 2028 USD880m convertibles as announced in yesterday's filing which slightly reduces our fully diluted share count
 - We assumed this was paid down at \$1.6bn - based on Jan 6th close pricing and as guided to in the 8K - although as flagged final pricing may change slightly
- Our target now includes an additional ~USD6bn of EV, which in part comes from incorporating the Credit Card opportunity explicitly

Sum of the Parts, USD million

PRODUCT	Metric	Forecast	Multiple	100% EV	% of EV
E-Commerce	Marketplace GMV 21e	32,747	1.4	45,846	46%
Payments	Acquirer TPV 21e	86,201	0.5	43,100	43%
Credit	DCF			11,204	11%
Total value				100,150	100%
2021E net debt				-937	
Equity value				101,088	
YE 21 shares + converts				50.7	
Value per share				1,994	
Price				1,580	
Upside				26%	

Disclosures

12 month historical recommendation changes are available on request

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