

MERCADOLIBRE (BUY, TP: \$1,600)

FINTECH AND WALLET OPPORTUNITIES - 3rd December 2020

Pedro Arnt, MercadoLibre CFO;

Federico Sander, MercadoLibre IR

Wallet

- Lots of wallets today, particularly in Brazil.
 - Expect a 2nd wave - market will consolidate down to a handful of names
- Engagement is key, adding incremental financial services is the focus for all
- There is, nevertheless, still a monetisation opportunity today for Payments; which is the main usage today (QR, P2P, cell top ups, utilities)
- Take-rate: plan is to ideally keep at current levels (~1%)
 - Nothing yet from intro of PIX which changes this (PIX being charged at 99 bps in Brazil, as per QR account money)
 - Hard to legislate for what others might do in the future though
 - Hoping won't be a loss leader (not an obvious risk but depends on competition). Wants to avoid the route of China
- Volume opportunity from migration to cash is enormous (two thirds of transactions are still in cash)
- Payments will ultimately largely be a wash, however, in terms of profitability
 - For the next 2-3 years payments will lose money at the EBIT level before turning positive
- Can accommodate some downward pressure on take from PIX as the cost structure is lower i.e. PIX not expected to be a risk to profitability

Credit

- Very positive on trajectory
- Think of the \$15bn of TPV transacted in Q3
 - Transactions that could have been done on credit
 - Potentially take 15% of this on credit. Like "hunting in the zoo"
- Key is to get the right balance on spread vs risk i.e. the right growth-to-risk ratio
 - Don't want to be too conservative and miss out on the opportunity
 - Credit helps drive TPV growth
- Start slow and steady start: initial cohorts tend to be less profitable
 - The best way to assess credit is ultimately to test the water
 - Lend in small sums to build a cohort of good borrowers
 - Weed out the weaker customers
- EBIT margins will reflect this mix in the growth phase

- Will be in the high single digit, low double-digit range before ramping more materially
- SCFI (new “Financial Institution” regulatory badge in Brazil) is not a “game changer” to lending but is significant in improving the economics of the lending
 - Improves the cost structure and means don’t have to pay a clip to a lending/partner bank
- Customers today are coming from the MELI platform, from both sides (consumer and merchant)
 - Savings products help underwrite the consumer better
 - Processing payments helps underwrite the merchant
- Not just the “unbanked” which is an issuer but the “under” banked
 - i.e. not enough credit being offered, or too expensive credit
- Credit card is being trialled with friends and family. Launch is expected in Q1 2021
 - This is more than the historically branded (only) cards
 - MELI will be the issuing bank
 - This will be a hybrid of debt and credit
 - Offering 4% cash back for those spending on the platform, vs 1% being offered (in lieu of miles/incentives) typically across new credit cards coming to market
 - Sounds like it will be mainly a digital card
 - Debit is the hardest card to make profitable
 - One of the bigger cost obstacles is getting the card physically to the customer

Receivables registry

- Regulatory change set to lead to competition for factoring of receivables – clearing house
- Pedro sees this as the first step in a series of open banking initiatives from the Brazilian central bank
 - With the CB pushing for financial institutions to share customers’ transaction details with third parties
 - Access to third party data should be a win for MELI
- There is an opportunity there – meaning MELI could chase receivables factoring from STNE, Cielo etc
- However, this is a mid-term target, and not in the pipeline for the next few quarters

Advertising

- Set to be the biggest positive driver of Commerce take rates going forward

Commerce/Covid

- After the ramp up in adoption and behaviour changes during Covid, there has only been a mild drop-in E-Commerce activity
- Stressed that while the outlook is better, normality in retail hasn’t returned
 - Will take another couple of quarters to work out how Covid has ultimately played out for the business
- Pedro convinced, however, NOT reverting to pre-Covid levels
- One example: 30% of new buyers in Q2 2019 returned in Q3 (2019) as a buyer. In 2020, this has been 40%

Paypal relationship

- Super smart management, great partner
- Supportive of cross border remittances which is a huge business in Latin America
- Relationship will take time to develop

Mexico

- Fintech opportunity theoretically very large, large unbanked population in Mexico (one of the biggest in the region, whereas Brazil one of the lowest); low banking and credit card usage
 - Very early stage though in Mexico, doesn't sound like it will be a significant driver for a few quarters
- On the other hand, Commerce business in Mexico much more significant and Pedro sees as a more meaningful driver in the near-term
 - Underpenetrated
 - Big room for growth through category expansion
 - Market share leader
 - Walmex doing a great job but not a threat to near-term business development