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Stock Note

MercadoLibre Q3s

Quick Take – Strong beat; Credit getting more focus

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- **What's new:** MercadoLibre reported numbers which were 13% ahead of consensus at the revenue line, driven by both Commerce (stronger than expected GMV, better take) as well as Fintech (with TPV well ahead). This didn't quite flow through to gross profit but did filter down well to EBITDA and EBIT as post-Covid reinvestment initiatives - while up sequentially - were lower than we factored.
- **Details:** On the Commerce side, MELI looks to be gaining share in Brazil based on 74% y/y GMV growth and the 43% market growth reported for Q3 (Ebit-Nielsen). Management feels more comfortable (with execution, 1P, logistics) to push Black Friday/other promos in Q4 having previously sat on the side lines. As we had suggested, take-rates are also pushing up. Fintech meanwhile continues to show very rapid adoption of Wallet use, while as management is getting more comfortable pushing Credit (loan book up significantly, delinquencies falling to a more sustainable level). On the traditional payment side, MPOS has recovered to pre-Covid levels and management looks to be attempting to target higher value (SMB) customers.
- **Estimates and Valuation:** We flagged consensus revs/profitability looked low in our recent initiation (see Wallet Wars) and see significant room to move up. Not only at the revenue level, but profitability also has upside.

Buy

Ticker:	MELI:US
Price Target:	USD1,450
Potential change:	+15%

Summary highlights

- **GMV growth increased again, post Covid-dominated Q2, despite a return of foot fall to bricks and mortar**
  - Brazil GMV growth of 74% y/y suggests it is winning back share in Brazil (market growth of +43% y/y in Q3 for Brazil)
    - More success in key focus verticals such as electronics and CPG
  - Management feels better placed to be more aggressive around promo efforts in Q4 such as Black Friday
  - The Andean region (Colombia, Chile) is beginning to get more attention (from the company, and from investors)
- **Take rates stepped up by 80bps in Q3 vs Q2 supporting a <u>Group revenue beat of 13% vs the street</u>**
- **Focus on logistics remains strong**
  - Managed Network penetration is up to 64% on a consolidated basis, and finished the quarter at 74%
    - This is ramping very quickly (at 43% in Q2). With that said, fulfillment in Brazil is rather lower at 22% suggesting the gains are largely coming from cross-docking with fulfillment being the route to achieving <2 day deliveries; Mexico fulfillment is 55% share of shipments
  - The issue of *Correos* is ever diminishing. Despite a 6 week strike having still some near-term issues, long-term it has spurred the move into managed networks. <u>We won't be discussing this issue very soon</u>.
- **Fintech - Wallet and Credit in focus**
  - MPOS devices adds (1.3m) were strong, as footfall returns; TPV is now back to pre-Covid levels
  - There are signs MELI is trying to move up the value chain, targeting SMBs with *Point Smart* launch (being +40% higher TPV)
  - Mobile Wallet users are up strongly, to 14m (last reported at 8m in Q1)
    - Much of this came from Covid-related cash support in Brazil (booking government payments into wallets)
    - P2P is driving usage, although is free for account money and debit usage (and so zero direct monetisation)
  - Management seems more confident pushing Mercado Credito
    - The loan book bounced back and previous (2019) uncertainties look to be in the past
    - Delinquencies have eased over the quarter
- **Profitability came in ahead this quarter**
  - Although priority remains on pushing top line growth, we sensed nearer term margins may hold up a little better
  - For the time being, top line growth is being achieved with a lower level of spend than management had previously envisaged

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Q3 results – good top line and EBITDA beat versus NSR and Consensus

- **We summarise the key results below**
  - Revenue came in 13% ahead of consensus
  - Gross profit was more in-line, beating by 2%
  - Direct profit and EBITDA beat more convincingly on the back of a lower than expected post-Covid sales and marketing push

Results summary

Group	Q3 20	NSR Q3 20e	% diff	Cons Q3 20e	% diff
GMV	5.90	5.76	2%	5.29	12%
TPV	14.51	12.94	12%	13.12	11%
Revenue	1,116	1,004	11%	983	13%
- of which					
Brazil	611	521	17%	510	20%
Argentina	285	273	4%	285	0%
Mexico	150	152	-1%	136	11%
Other	70	59	18%	53	32%
Gross profit	480	484	-1%	470	2%
margin	43.0%	48.2%		47.8%	
Direct profit	223	133	68%		
% margin	20.0%	13.2%			
EBITDA	111	7	1390%	43	156%
% margin	10.0%	0.7%		2.7%	
EPS	0.30	-0.55	-154%	0.32	-6%

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Q3 revenue growth – acceleration across the board

- **We summarise the growth rates below**

Y/Y growth rates

Revenue, local FX	Q1 19	Q2 19	Q3 19	Q4 19	Q1 20	Q2 20	Q3 20
Group					71%	123%	148%
- Brazil	91%	89%	78%	74%	56%	87%	112%
- Argentina	82%	112%	119%	104%	123%	223%	257%
- Mexico	229%	260%	153%	-2%	81%	139%	139%
Fintech					83%	86%	105%
- Brazil					65%	47%	
- Argentina					130%	185%	
- Mexico					150%	168%	
Commerce					62%	149%	181%
- Brazil					48%	120%	
- Argentina					117%	258%	
- Mexico					71%	134%	

Revenue, USD	Q1 19	Q2 19	Q3 19	Q4 19	Q1 20	Q2 20	Q3 20
Group	48%	63%	70%	43%	38%	61%	85%
- Brazil	64%	74%	77%	61%	31%	36%	57%
- Argentina	-8%	14%	39%	27%	42%	110%	145%
- Mexico	221%	265%	146%	1%	74%	96%	111%
Fintech					45%	34%	52%
- Brazil					40%	7%	
- Argentina					46%	85%	
- Mexico					140%	119%	
Commerce					33%	80%	109%
- Brazil					25%	60%	
- Argentina					38%	133%	
- Mexico					64%	92%	

Group revenue in local FX terms increased to 148%, moving up in Brazil and Argentina, and staying at strong levels in Mexico

Both main products saw an improvement:

- Fintech saw a step up to 105% y/y
- Commerce saw a step up to 181% y/y

This growth translated well into USD growth also: at the group level accelerating to 85% y/y, with Fintech up 52% and Commerce up over 100%

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Q3 profitability coming in ahead

- **We summarise margin performance below:**
  - At the time of the Q2s, management had suggested the Covid induced easing of spend would return in Q3 and beyond
  - While it did, it wasn't at the same sort of level we had been expecting
    - The market was also positively surprised, although we were on the more cautious side
  - While it is clear that the priority lies with growth, there seemed to be a slight shift of emphasis in terms of near-term better margins
    - Some of the markets and geographies are reaching maturity which then benefit from scale
  - Offsetting this remains the ongoing nature of the competitive markets in Brazil and Mexico in particular
    - With MELI looking to be more involved in the Q4 promotional period in Q4
  - While investment efforts are increasing in Colombia and Chile, two positive margin businesses today

Profitability summary

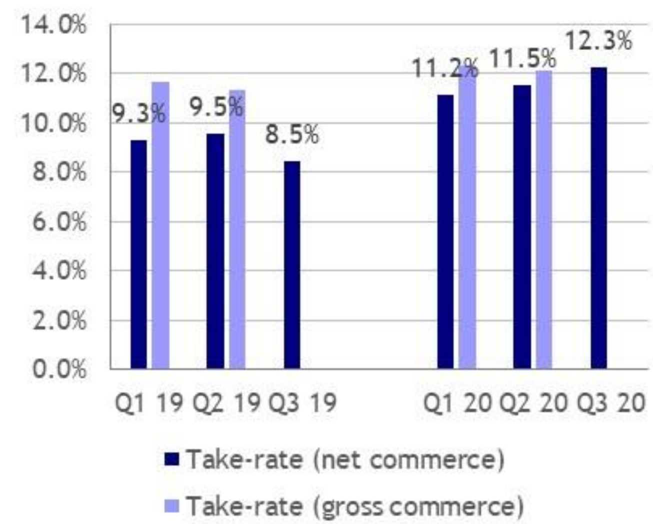
	Q1 18	Q2 18	Q3 18	Q4 18	Q1 19	Q2 19	Q3 19	Q4 19	Q1 20	Q2 20	Q3 20	Q3 20e
Gross profit margin	50.7%	47.6%	47.7%	47.2%	50.0%	50.0%	47.1%	45.7%	48.0%	48.6%	43.0%	48.2%
Direct margin	**Q1 18**	**Q2 18**	**Q3 18**	**Q4 18**	**Q1 19**	**Q2 19**	**Q3 19**	**Q4 19**	**Q1 20**	**Q2 20**	**Q3 20**	**Q3 20e**
Brazil	3.9%	9.7%	13.9%	17.7%	25.5%	19.0%	4.9%	12.8%	18.8%	30.2%	18.0%	17.0%
Argentina	43.8%	32.0%	27.8%	21.1%	27.7%	26.3%	23.8%	18.8%	24.0%	28.3%	32.1%	18.0%
Mexico	-54.7%	-125.0%	-21.4%	-21.5%	-20.1%	-32.3%	-45.0%	-60.2%	-21.1%	12.2%	3.7%	-5.0%
Group	13.4%	8.9%	14.3%	11.6%	20.0%	13.9%	2.4%	3.4%	13.2%	26.9%	20.0%	13.2%
EBITDA margin	-5.7%	-5.0%	0.1%	2.3%	5.4%	0.9%	-10.3%	-7.1%	-1.2%	13.9%	10.0%	0.7%
EBIT margin	-9.2%	-8.4%	-3.1%	-0.2%	2.1%	-2.3%	-13.6%	-10.2%	-4.6%	11.3%	7.4%	-1.5%

GMV trends – gaining share in Brazil; Take rates up

- **MELI saw GMV up 117% y/y (at the group level) y/y**
  - Brazil was up 74% y/y, and improvement from 58% the prior Q
    - This compares to the Brazilian market up 43% in Q3 20 (Ebit-Nielsen) and suggests MELI is gaining share again in Brazil
    - And compares to B2W up 56% y/y (MGLU, VVAR yet to report)
- **New verticals in focus and showing success**
  - Consumer Electronics saw acceleration to ~100% YoY growth
  - CPG was up 181% y/y, with focus on supermarkets within Brazil
- **Take rates were up again**
  - Continuing recent positive momentum – on a net basis (shipping subsidies not split out this Q*), up 80 bps on Q2 20

GMV - absolute and y/y

Take rate*

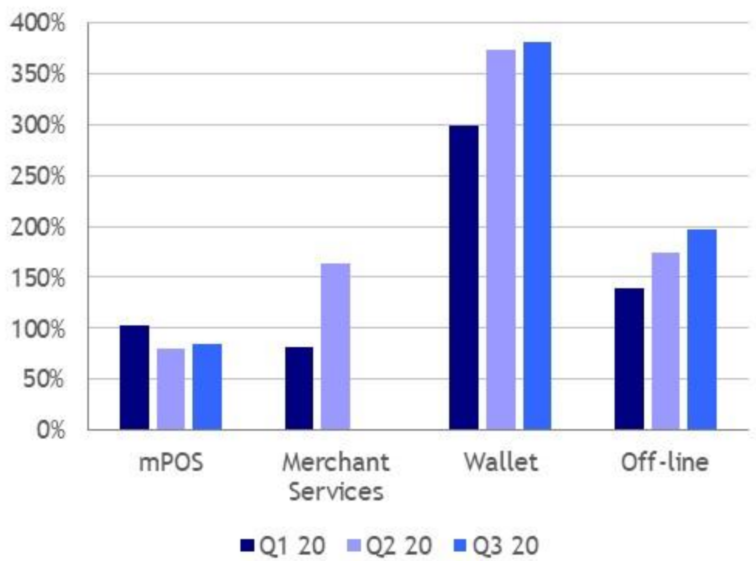


** Take rate defined as Gross Commerce (including subsidies over GMV)*

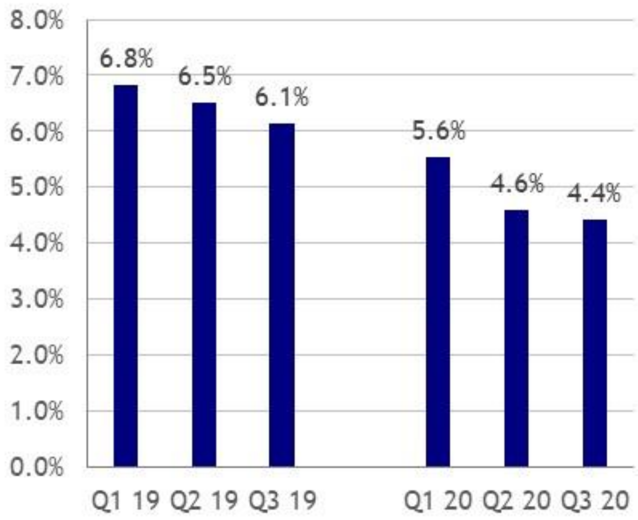
Payment trends – accelerating TPV, take rates down (as expected)

- **MELI saw TPV up 162 y/y vs 140% the prior Q**
  - Off-platform was up 197% y/y
  - Growth was driven by wallet but MPOS nudged up also (Merchant Services not disclosed yet this Q)
- **Take rates were down from 4.6% in Q2 to 4.4% in Q3 and given the higher flow through the wallet**

TPV - by segment, y/y



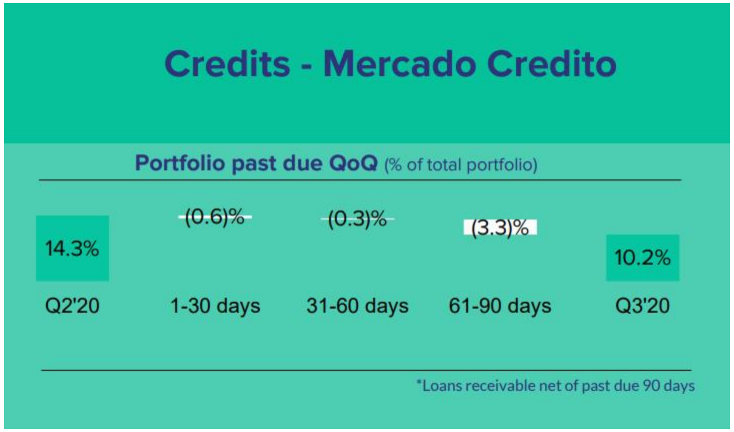
Take rates



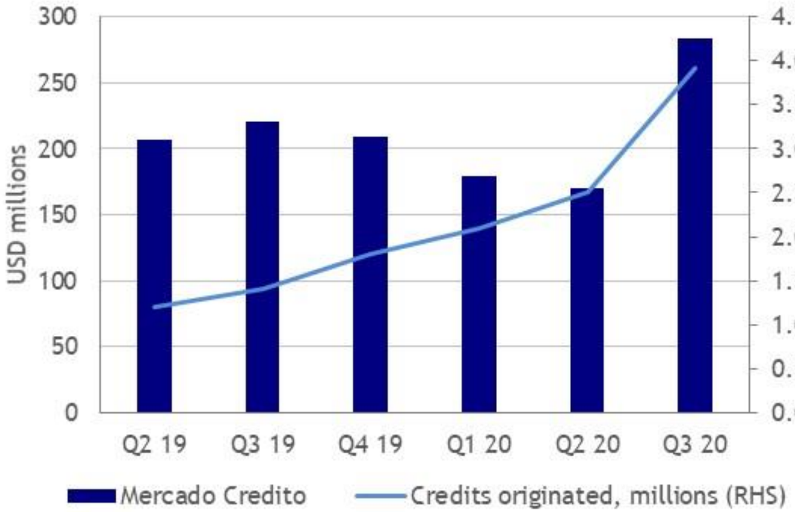
Wallet driving TPV, Credit confidence returning

- **Mobile Wallet users (payers) stepped up to 14m users**
  - The last time this was reported was Q2 (8m)
  - 4m of the additional users came though from Brazil, in part due to the utility of "cashing in" on Coronavouchers
  - Wallet TPV continues to increase almost x5 on a y/y basis
    - The driver is increasingly P2P where account use and debit use is now free on this segment
    - Utility bill payments and cell phone top ups are the other key drivers
- **Mercado Credito also saw a pick up in momentum**
  - Having been more tentative in Q2, given Covid, the loan book stepped up to $280m. This process had started at the end of Q2
  - Initially management increased APRs in anticipation of higher delinquencies. However, this ultimately didn't come through
    - Delinquencies improved over Q3
  - Consumer engagement was enhanced through lowering caps on consumer credit

Credito delinquencies*



Credito developments



** From Q3 MercadoLibre presentation material*

Disclosures

12 month historical recommendation changes are available on request

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