MELI Q2'12 Earnings Conference Script

Date: Aug2nd, 2012

MERCADOLIBRE 2Q12 EARNINGS CONFERENCE CALL SCRIPT

Part I: Introduction and Disclaimer – Investor Relations

Hello everyone, and welcome to the MercadoLibre earnings conference call for the quarter ended June 30th, 2012. My name is Alex de Aboitiz and I am the head of Investor Relations for Mercadolibre. Our senior manager presenting today is Pedro Arnt, Chief Financial Officer. Additionally, Marcos Galperin, Chief Executive Officer, and Osvaldo Gimenez, Senior Vice President of MercadoPago, will be available during today's Q&A session. This conference call is also being broadcast over the Internet and is available through the investor relations section of our website. [PAUSE]

I remind you that management may make forward-looking statements relating to such matters as continued growth prospects for the company, industry trends and product and technology initiatives. These statements are based on currently available information and our current assumptions, expectations and projections about future events. While we believe that our assumptions, expectations and projections are reasonable, in view of the currently available information, you are cautioned not to place undue reliance on these forward-looking statements. Our actual results may differ materially from those discussed in this call, for a variety of reasons, including those described in the forward-looking statements and risk factor sections of our 10-K and other filings with the Securities and Exchange Commission, which are available on our investor relations website. [PAUSE]

Now, let me turn the call over to Pedro.

Part II: Overview & Financial Results – Pedro Arnt

Thank you. First of all, welcome and thanks for joining us on our recap of MercadoLibre's second quarter of 2012.

Having closed a strong first half of the year, I would like to start by reviewing some of the drivers behind the solid performance across all our business units both at the top and bottom lines, as revenues grew 47% in local currencies and 28% in USD, and net income grew 91% in local currencies, and 71% in USD during the quarter.

To start out, I would like to note, that having posted these solid financial results despite significant currency headwinds and signs of slowing economies throughout the region, confirms our understanding that sustained positive e-commerce trends and solid internal execution continue to be determinant drivers of our company's growth.
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Accordingly, capturing market growth through innovation on our platforms is where we remain focused, conscious of the great mid to long-term prospects of technology enterprises in rapidly developing regions. Internet penetration continues on the rise and better connections are allowing internet users to become increasingly engaged online. A growing middle class is therefore visibly adapting its shopping habits in the countries where we operate, and the search for convenience, competitive prices and unmatched variety leads them to us. As e-commerce gains share of retail, we continue to benefit from the strong top of mind presence that we've built, and from our commitment to deploying the best user facing products and technologies, offering the right solution for each of our user's needs, thus increasing the relevance and ubiquity of the services we offer.

To quantify the success we believe we are having, here is a quick overview of key operational metrics that illustrate the underlying, FX-neutral growth of our business. During the second quarter:

- 3.7 million new users were registered and confirmed on our site, 31% more than in the second quarter of 2011, bringing our total confirmed registered users to 73.2 million.
- Successful items were 15.8 million, a 36% year on year growth
- Total number of payments were 5.5 million, a 78% year on year growth
- GMVe was $1 billion, 299 million, a 37% year on year growth in local currencies
- TPV was $411.6 million, a 64% year on year growth in local currencies

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These strong operational metrics translated well into financial performance. Specifically, in the second quarter of 2012:

- Net revenues grew 28% in US dollars to $88.8 million, a 47% growth in local currencies.
- Gross profit margin was 73.1% vs. 75.6% in the second quarter of 2011, and 74.8% in the first quarter of 2012, driven principally by the growth of our lower margin payments business.
- Income from operations grew 48% to $31.9 million, with an operating income margin of 35.9% vs. 31.1% in the first quarter of 2011. In local currencies, operating income grew 66% year-on-year.
- Net Income before Income/Asset Tax Expense grew 56% year on year to $35.1 million. In local currencies Pre-tax income grew 77%.
- Net income was $25.4 million, growing 71% year-on-year. This represents a 28.6% net income margin versus 21.4% a year earlier. In local currencies, net income grew 91% year-on-year in the second quarter.

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Now I would like to dive into further detail on how we achieved these results.
Let me start with our core marketplace, which today represents approximately 70% of our revenues.

Our rate of GMVe growth for the quarter, excluding the impact of FX, continued to be, we believe, above market.

This 37% local currency growth drove a more than proportional increase in marketplace commission revenues, as a result of increased pricing versus last year charged to reflect higher MercadoPago penetration, which reached 32% of GMVe, versus 28% in the second quarter of 2011. In fact, it's an all-time high, resulting from a streamlined integration with our marketplace checkout, and the gradual implementation of a strategy that makes it obligatory for certain user segments to settle marketplace transactions through MercadoPago.

Marketplace revenues from placement fees were up mainly on growth in listings, as we've been able to widen our base of sellers considerably versus one year ago. Live listings on our site grew 31% year on year, while new tools for inventory management released in the quarter keep generating incentives to list and manage large volumes on our platform. Expansion in listings was also driven by continued work on our new vertical formats for products in a few apparel categories. After our initial tests with shoes in Brazil, we have now extended vertical features to more apparel categories in Brazil, thus spreading these new formats to a much wider base of listings. The initiative is now underway in Argentina as well.

In short, during the quarter, our expanding Marketplace supply was matched with growing Marketplace demand, as our focus on improving selling tools, greater payments adoption and streamlined checkout generated improved conversions.
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Our payments business performed very well all-throughout, not just marketplace processing, which I have just outlined. MercadoPago's stand-alone revenue sources, financing and off-platform payments, grew at a faster pace than marketplace, classifieds and advertising revenues.

Off-platform processing fees were an important driver of that growth, as our payments service keeps spreading beyond MercadoLibre and into the wider e-commerce arena, growing in the triple digits and still only a fraction of this expanding addressable market. With Mexico and Venezuela contributing a stream of new payments business which was practically non-existent at this time last year, we feel positive about the shape of our payments business.

In this context, financing revenues also had a very good quarter, growing on the basis of both the increase in payments penetration we've discussed for the quarter, as well as lower underlying interest rates that improved our spread on transactions.
To complete our picture of revenue growth, Classifieds and Ad Sales revenues grew at a combined rate above 50% in local currencies, a strong contribution to total top line growth.
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In summary, each component of our platform is helping to drive our growth, despite some deceleration in the back end of the quarter, as we began to cycle out the improvements to registration and buying flow which took place in the second and third quarter of last year.

The following growth rates on a country basis should help to round out the review of our top-line performance for the quarter:

In local currencies, year on year growth of consolidated net revenues for the second quarter was 36% for Brazil, 81% for Argentina, 30% for Mexico, and 72% for Venezuela.
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While the top-line results we have just called out confirm the sound performance of our existing business, we also feel good about some of the longer term and still less visible progress being made on a few other key fronts.

Such is the case of our mobile efforts, that already contribute more than 5% of our traffic, though still a small share of our total GMVe. We expect this new channel to keep expanding at a fast clip as smartphone penetration continues to rise. Traffic through our native applications, that have already been downloaded 3.4 million times, is increasingly complemented by traffic to our newly released HTML5 website version.

Add to this our SaaS storefront offering, MercadoShops, which reached 46 thousand active shops in the quarter, for an impressive 23% growth quarter on quarter.

Finally, as mentioned last quarter, one of our key objectives for the year is a renewed focus on improving Customer Experience on our platforms. Our investment in this area, led by the formal opening of a new customer support center in Uruguay, and continued implementation of world/class customer management tools, are showing strong results as we continued improving most service level metrics, and consequently have seen our net promoter scores increase consistently during the first half of the year.

Last but not least we are pleased to have launched during this quarter the initial stages of our shipping deployment. We are live with our integration with Correios in Brazil, whereby MercadoLibre determines pricing, collects fees and issues shipping orders and tracking numbers on behalf of sellers, so that all the seller has to do is drop ship his or her product. Although the number of sellers who have been on-boarded is still small, it is growing rapidly. We are convinced that this new service will be an important competitive factor for us going forward.
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Let me now go over the rest of our P&L with a detailed look at our cost structure during the second quarter:

Starting with Gross profit, it grew 24% to $65.0 million. Gross profit margin decreased to 73.1% of revenues, versus 75.6% in the second quarter of 2011, and 74.8% in the first quarter of 2012. Year-on-year gross margin contraction is primarily attributable to an increase in fees directly associated with additional payment volume, representing 278 bps in margin contraction, as well as incremental expenses primarily related to our investments in hosting and customer service, representing 90 bps in margin contraction, offset by efficiencies in sales related taxes, generating 122bps in margin improvement. [PAUSE]

Operating expenses for the period were 37.2% of revenues, versus 44.5% in the same period last year, as we saw impressive operating leverage in each of our line item expenses, amounting to 730 basis points of margin improvement. These positive margin expansions are a consequence of a scalable business model, close management of expenses, as well as benefitting from no significant incremental investments in the current business cycle. In absolute terms, Operating expenses totaled $33.1 million, a 7% increase versus the second quarter of 2011, and here is the breakout by line item:

- Sales & marketing, our largest line item expense, increased 7% for the quarter to $16.8 million, dropping as a percentage of revenues to 18.9%, vs. 22.5% for the same period last year. We benefitted primarily from improved marketing ROI, a 170 bps improvement, better bad debt ratios, a 120 bps improvement, natural leverage in our business model and an easy year on year comparative that included certain one off losses in the same quarter of last year. Had we incurred those losses this year, they would have had a negative impact of 180 bps on margins this quarter.

- This leverage was more than enough to offset credit card chargebacks, which grow at a faster rate than revenues as a result of increased payments volume. It's important to note that on a sequential basis we have taken steps to control chargebacks, producing an important quarter on quarter drop in the ratio of chargebacks to TPV.

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- Product Development expenses grew 11% to $6.1 million compared with $5.5 million for the second quarter of 2011 dropping to 6.9% of revenues versus 8.0% last year. The improvement in Product Development as a percentage of revenues is principally attributable to capitalization of software projects contributing 104 bps to margin improvement.

- G&A grew 4% year-over-year to $10.1 million in the second quarter, dropping to 11.4% of revenues versus 14.0% last year, as we continued to deliver economies of scale. G&A expenses also benefitted from a lowered accrual pertaining to our long-term retention plan that contributed 105 bps of margin.

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As a result, operating income for the second quarter of 2012 was $31.9 million. Operating income margin for the quarter was 35.9% vs. 31.1% in the second quarter of 2011. Below Operating Income, we benefited from $3.0 million of interest income, arriving at a pre-tax income of $35.1 million, 56% higher than in the same quarter of last year in USD and 77% higher in local currencies.

Income tax expense was $9.7 million in the second quarter of 2012, resulting in a blended tax rate of 27.7% versus 34.0% in the second quarter of 2011 and 27.0% in the first quarter of 2012. Year over year tax improvements were mainly driven by greater mix coming from Argentina, were we have our lowest tax rate. Also, our tax rate for the same prior year period was impacted by the non-deductible nature of last year´s one-time expense mentioned earlier under Sales & Marketing.

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Net income for the three months ended June 30, 2012 was $25.4 million, reflecting an increase of 71% when compared with $14.8 million during the same period of 2011. Net income in local currencies grew 91% versus last year. This represents a 28.6% net income margin, up from 21.4% for the same quarter of 2011, resulting in a basic net income per common share of 57 cents.
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Property & equipment and intangible asset purchases for the quarter totaled $6.0 million, and consequently, for the period ended June 30, 2012, net cash provided by operating activities less Property & equipment and intangible asset purchases, totaled $33.5 million, versus $8.2 million last year.

Cash, short-term investments and long-term investments at the end of the quarter totaled $220.2 million.
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Wrapping up, our second quarter was another strong quarter for us, with sustained above market rates of growth in our operational metrics, and improved profit margins as we benefit from investments made during previous cycles.

We look forward to continue executing on our vision of what the e-commerce landscape in Latin America can look like over the next 5 to 10 years, and the growing role we imagine for ourselves in this emerging context, while trying to manage as efficiently as possible the balance between immediate and long term profitability.

With that, we will now take your questions.