MELI Q3'12 Earnings Conference Script

Date: Nov 1st, 2012

MERCADOLIBRE 3Q12 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 September 30, 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, Executive 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 Alex, and good afternoon to all those joining us on today's call.

As you have just seen from our released results, during the third quarter of 2012, our business has continued to perform well, on the basis of strong fundamentals from our multiple business units: marketplaces, payments, classifieds, advertising, stores, and now also shipping. In fact, this overall strength of the ecosystem has compensated for the anticipated year-on-year slowdown in the growth of our core marketplace, as it began to comp against the successful launch of our new technology platform in the third quarter of last year. Consequently, third quarter revenues grew a solid 37% in local currencies, as businesses other than the core marketplace came to represent a record 31% of revenues. It's also worth noting that, in addition to a ramp up in revenue contribution, these newer service offerings increase the efficiency of our ecosystem as a whole, providing great long-term synergies for our marketplace and, more importantly, generating a better user experience on our platform. We have always identified innovation as the key to adding value in e-commerce, and we believe the results we are seeing across the board are proof of our sustained focus on delivering the innovative solutions and formats required by our fast growing and increasingly sophisticated user base.

So, before going into a detailed overview of our operational and financial performance in the quarter, let me first take a brief moment to update you on the progress of some of the key initiatives that we believe are driving growth across our platform that I have just mentioned, therefore representing key strategic drivers for the long-term success of our business:

- One of these is the on-platform piece of our payments solution, MercadoPago, which in the third quarter continued to grow its marketplace penetration, as we continue to make its use compulsory on select seller profiles and product categories. This process of integrating payment through MercadoPago into the buying flow will necessarily move forward in slow and careful manner, but we expect it to keep delivering gains in payments penetration and user experience, as we have seen in the third quarter of 2012, which grew its on-platform penetration by more than 250 bps versus the third quarter of last year. We believe this cautious roll-out is the correct approach for now, since the long term benefits of integrated payment have short term costs in lower conversion rates as we change the way we have allowed users to transact on our platforms over the past 12 years.

- Staying with payments, off-platform MercadoPago is a growing part of our total payment volume that requires its own approach, including a strong commercial push to keep spreading the MercadoPago brand beyond our marketplace. Leveraging on the brand and product recognition afforded by being the exclusive payments solution for our marketplace, we have grown our off-platform payments at consistent triple digit rates. The sum of payment volume transacted on and off our marketplace affords us a growing scale that makes us more competitive in terms of processing costs to our system, an efficiency that we pass on to our clients in the form of competitive pricing. We are growing our payments business on a firm foundation of quality and value, positioning us well for the future. In the third quarter, number of payment transactions off our platform continued their impressive streak, posting a growth well over 120% year on year.

- In the meantime, Mobile keeps picking up speed. This initiative is proving to be more than a novelty to our buyers, and it is quickly becoming a format where transactions occur. It accounted for more than 4% of our gross merchandise volume in the third quarter, with certain countries already having more than 10% of transactions coming through mobile devices. With approximately four and a half million accumulated downloads at the close of the quarter, we are confident that mobile volume, originating from our native app or through HTML5, is just getting started.

- As you may recall, mobile is one of many current efforts enabled by our new technology platform. Similarly, we expect a growing number of developers to link up to our APIs and begin building innovative integrations and applications for our users. Just yesterday we hosted the first MercadoLibre Developer Conference in Sao Paolo, and were extremely pleased not only with the turnout, but also with the intense networking it generated. We believe this is just the first step in a crucial initiative to open up our business, which will have important implications as we continue to open up our platform and make it publicly available to third parties so that customized solutions and functionalities can be built that will allow for more efficient trading on MercadoLibre.

- Moving on to our work with vertical product categories, this is another good example of developing a consistently richer supply and delivering new formats and features to meet the demands of our users. As I mentioned earlier, during the quarter we saw very strong results coming from our accelerating classifieds verticals. And, in addition to that, we have continued advancing with more verticalized apparel categories in Brazil and Argentina, and have also started to lay the groundwork for further verticalization across other relevant categories such as autoparts. [PAUSE]

- We are also looking ahead in terms of shipping efforts, rolling out our solution to a wider base of sellers than last quarter. As the number of sellers offering integrated shipping grows, we are also giving these listings more prominent placement throughout the site. This will ensure that this added value penetrates our marketplace at a faster pace, and an increasing number of purchases made on MercadoLibre offer sellers integrated payments and shipping, greatly improving the convenience of the purchase. There is still plenty to do, but we are positive about initial results, and see this as a truly transformative initiative, that we look forward to updating you on in the future.

- Finally, a brief mention of our Customer Experience efforts, another important area of focus for us, where our investment in new resources and a growing team is paying off. We continue to further integrate salesforce.com CRM tools with our existing platform and feel better equipped than ever to keep delivering improvements in customer satisfaction and retention rates.

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Having just covered some of the more relevant initiatives for the quarter, let me say that we are very pleased with our focus, and with the direction in which we are headed. These initiatives point at strengthening our already broad ecosystem, getting a better wrap around the user experience that we offer, and ensuring the excellence of service that our users deserve.

Advancing along these lines, we trust that we will keep building the most comprehensive e-commerce hub in all the markets where we operate.

In the meantime, let me give you a detailed overview of our key operational metrics in the quarter, those that best illustrate the underlying FX neutral growth of business. [PAUSE]

In the third quarter of 2012:

- 4 million new users registered on our site, growing our base of confirmed registered users 25% year on year.
- Successful items grew 22%, reaching 17.6 million.
- Number of payment transactions grew 65%, to 6.4 million.
- Gross Merchandise Volume was $1.44 billion, growing 20% in local currencies.
- And Total payment volume was $480 million, growing 55% in local currencies.

This translated to a solid financial performance. Specifically, in the third quarter of 2012:

- Net revenues were were $97.3 million, a 37% growth in local currencies.
- Gross profit margin was 73.6%.
- Income from operations was $33.7 million, with an operating income margin of 34.7%. In local currencies, operating income grew 27% year-on-year.
- Net Income before Income/Asset Tax Expense was $36.0 million, growing 16% in local currencies.
- Net income was $26.1 million, a 14% year-on-year growth in local currencies.

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Diving into further detail on our topline, our core marketplace revenues outpaced GMVe rate of growth. This growth was attributable mainly to:

Final value fees growing slightly above GMVe based on higher average pricing than one year ago.
And, growth in listings driving additional placement fee revenues versus last year, as our supply has broadened considerably, illustrated by a 29% year on year growth in live listings.

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As for payments, off-platform processing fees kept outpacing the rest of our ecosystem on the strength of triple digit growth in volume, while revenues from installment purchases accelerated versus the second quarter of this year, resulting in total payments revenue growth above 60% in local currencies, year on year in the third quarter.
Classifieds and Advertising also had a good quarter:

- classifieds new listings growth remained solid through the quarter
- monetization improved
- Dealers continued to gain share of listings year on year.

In the meantime, Advertising contributed to revenue growth through improved volume of inventory displayed and higher costs per clic than last year. As a result, Classifieds & Advertising accelerated their growth trajectories to a combined rate above 50% in local currencies.

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In summary, robust contributions from our business units, particularly our newer ones, led to solid topline growth despite the tough comparisons brought by the launch of our new platform in the third quarter of last year. Year on year, consolidated net revenues in local currencies grew 25% for Brazil, 69% for Argentina, 29% for Mexico, and 57% for Venezuela.

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And now for a detailed look at our entire P&L:

Gross profit grew 16% in the third quarter, to $71.6 million. Gross profit margin was 73.6% of revenues, versus 75.4% in the third quarter of 2011, and 73.1% in the second quarter of 2012. Year-on-year gross margin contraction is primarily attributable to our payments business growing faster than our marketplace. COGS associated with payments grew in line with total payment volume, representing approximately 280 bps in margin contraction, while incremental expenses primarily related to our investments in hosting and customer service represented 70 bps in margin contraction. This was partially offset by efficiencies in sales related taxes, generating 160 bps in margin improvement.

Operating expenses for the period totaled $37.9 million, a 20% increase versus the third quarter of 2011. Operating expenses as a percent of revenues were 38.9% in the third quarter, versus 38.7% in the same period last year, as the expected scalability of our business model was offset by investments in new development and customer service offices, costs associated with hiring and retaining talent in our newer offices, and the deceleration of our topline growth.

Let me now walk you through a brief breakout by line item:

Sales & marketing, our largest line item expense, increased 11% for the quarter to $18.6 million, dropping as a percentage of revenues to 19.1%, vs. 20.5% for the same period last year. We benefited primarily from continued efficiencies in marketing spend and a reduction in our Bad Debt ratio, contributing a combined 250 bps to margin. These efficiencies were enough to offset:

50 basis points in margin contraction brought by higher compensation costs than last year. And, 60 basis points worth of higher buyer protection program expense resulting from increased coverage brought about by higher usage of MercadoPago.

[PAUSE]

Product Development expenses grew 35% to $8.0 million compared with $5.9 million for the third quarter of 2011 reaching 8.2% of revenues versus 7.3% last year. 120 basis points of margin contraction came from higher compensation costs, as year on year we grew our investment in a programming team that is crucial to our focus on product innovation.

G&A grew 26% year-over-year to $11.3 million in the third quarter, representing 11.6% of revenues versus 11.0% last year. Approximately 100 bps of margin contraction came from compensation costs, and 45 bps from legal fees, partially offset by scale in other concepts.

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As a result, operating income for the second quarter of 2012 was $33.7 million. Operating income margin for the quarter was 34.7% vs. 36.7% in the third quarter of 2011.

Below Operating Income, we benefited from $2.9 million of interest income, practically even with the third quarter of last year, as lower yields, primarily in Brazil, offset the greater cash balances invested at present.

Forex expense was $194 thousand, but bear in mind that in the third quarter of 2011 our Forex line was aided by the appreciation of USD balances held by our subsidiaries, contributing roughly $3 million to this line. This generates a 420 bps margin contraction due to foreign exchange, when looking at the third quarter of 2012 versus that of 2011.

With this, we arrive at a pre-tax income of $36.0 million, 2% higher than in the same quarter of last year in USD and 16% higher in local currencies.

Income tax expense was $9.9 million in the third quarter of 2012, resulting in a blended tax rate of 27.5% versus 25.1% in the third quarter of 2011 and 27.7% in the second quarter of 2012. I remind you that last year's tax rate was unusually low due to a $2.0 million reversed tax valuation in Brazil.

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Net income for the three months ended September 30, 2012 was $26.1 million, decreasing 1% when compared with $26.3 million during the same period of 2011. Net income in local currencies grew 14% versus last year. Had there not been a one-time tax benefit last year, net income growth for the third quarter would have been 7% in USD, and 23% in local currencies.

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Net income margin was 26.8% in the third quarter, resulting in a basic net income per common share of 59 cents.

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Property & equipment and intangible asset purchases for the quarter totaled $3.3 million, and consequently, for the period ended September 30, 2012, net cash provided by operating activities less purchases of property, equipment and intangible assets, totaled $21.9 million, versus $19.2 million last year.

Cash, short-term investments and long-term investments at the end of the quarter totaled $237 million.

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Wrapping up this detailed look at our financial performance, I would like to reiterate that we are pleased to see the business deliver 37% revenue growth in local currency, and in particular with the performance of our adjacent business units which represent a growing share of our revenue. We feel the growth rate, despite decelerating versus Q2, is solid, since this quarter marks the first anniversary of the launch of our new technology platform, and the subsequent acceleration it has brought about in our business, making for tough year over year comparisons. Furthermore, looking beyond 2012, we believe that as a result of the successful launch of this new technology platform we are in a much better position to continue to carry out the plan and vision we have for the company.

With that, we will now take your questions.