Report
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Mutate in Melius

In 1939, William Hewlett and David Packard, onetime classmates at Stanford, could be found tinkering around with electronic components in a modest garage in Palo Alto. These were the beginnings of the Hewlett-Packard Co. Fifty years later a plaque would be set outside the garage, dubbing it the "Birthplace of Silicon Valley." And along with the Valley, a tradition was born. The many similarities amongst the trajectories of Microsoft, Amazon, Apple, and Google, those icons of contemporary corporate success, include one rather prosaic detail: they, too, came out of garages.

The stories are well-known: young men, wealthy in ideas and poor of means, come together in makeshift workspaces generally ceded by some indulgent relative. Oases of introspection, incubators for creative talents, these make-do establishments came to stand for social mobility and the cultural transformation wrought by the tech world. More than a physical presence, they became a state of mind. A "garage mentality" is an essential attribute in this new environment of digital entrepreneurship.

The business we'll tackle in this and the next Report also started in a garage. Not in Silicon Valley, though. Closer to home: Buenos Aires, in the neighborhood of Saavedra. And just like the cellar in Jorge Luis Borges' "Aleph," it would see the unveiling of an enigmatic portal, a vision of revelatory mechanisms: not the staggering reality of the universe, in this case, but rather the dynamics of commerce in Latin America.[1]

The year was 1999, and Marcos Galperin, fresh out of Stanford (there it is again), had just gotten together a group of fellow MBAs to make good on a project first conceived at the university: Mercado Libre, an e-commerce company for Latin America. They were taking inspiration from eBay, which had just made it onto the Nasdaq the year before and was emerging as a remarkable success story during a heady time for internet start-ups. Over the nearly twenty years that followed, Mercado Libre (henceforth "the Company" or "Meli") went from an idea in a garage to the 7th-biggest e-commerce site on the planet, leading in the largest nations in Latin America (Brazil, Mexico, Argentina, Chile, and Colombia), where it has a foothold in 19 nations across the region. In 2017, 33.7 million unique buyers connected with 10.1 million unique vendors to make 270.1 million transactions, generating a gross merchandise volume[2] of $11.7 billion, growing almost 50% over the previous year. Now Argentina's largest company, valued at $15 billion, Meli defied the conventional wisdom among e-commerce companies in Latin America for many years, demonstrating it was possible to combine high growth with a healthy capital structure and profitability.

The numbers themselves are eloquent. They reflect the virtues of the business model we discussed in the last few Reports: platform-based configurations with central nuclei and articulated peripheries, characterized by network effects, increasing returns, exponential growth, and with rich-get-richer and winner-take-all results. In Meli's case, these attributes come alongside the traits found in good, time-tested companies: decisions focused on the long term and based on thorough analyses, "well-founded intuitions," extreme caution, discipline and perseverance during execution, a visionary entrepreneur with a rare talent for leadership, a cohesive, experienced, and resilient team able to work collectively, adapt, and take risks

1 The Aleph and Other Stories *is one of the most important books by the Argentine master, a genius of fantastic realism. In the story that gives its name to the book, a character with the same name as the author ventures into the basement of a house on Garay Street and comes across a small sphere, known as the Aleph, through which he can behold the entire universe simultaneously. Time becomes horizontal,* ***space infinitely condensed****. "The Aleph" is widely considered a miniature of visionary experience in general. The description of what the protagonist beholds in that single point is of a rare beauty. If you'll allow the literary license, we'd like to add that the cellar in "The Aleph" lays just about 30 km from the Galperin family's garage.*

2 *Henceforth GMV.*

when necessary, and a corporate culture that fosters both innovation and simplicity.

Meli's success can be traced to the rare combination of these two sets of ingredients. To put it succinctly: a winning idea that found the right time and place to take root and an entrepreneur and a team able to blaze a path into the unknown, turning an improbable project into solid reality. And if we look back, it's hardly obvious that Latin American consumers, known for being a more conservative bunch, would throw in their lot with online commerce and give up on the traditional experience of physical contact before purchase. To say nothing of the fragility of digital infrastructure – back then, internet access was a privilege reserved to just 2% of the population in the region – or of the geographic particularities and logistical complications that have concentrated the lion's share of purchasing power into chaotic urban spaces.

The winning recipe also included another element: a dash of luck. An angel investment in June of 1999 was followed by the first round of financing from investors ($7.6 million) five months later, with the second ($46.5 million) soon after, in May of 2000, just before the dot-com bubble burst and the taps dried up**.** Not only was the Company able to make it through the capital drought, but it also learned early on that resources can become scarce very quickly. A good reason for internal projects to observe a prudent hierarchy, so that they can be meticulously dosed over time.

The most critical stage of the fight for survival in Darwinian environments usually comes early on. That's exactly what happened here. The allure of the internet drew the best talents into entrepreneurship, and the best business schools in the United States were hubs for promising projects and enthusiastic investors. Serious competitors cropped up during this time, including Lokau in Brazil and DeRemate.com in Argentina. The latter was the product of a group out of Harvard, Yale, and Kellogg, whose members were perfectly aware that this town, so to speak, wasn't big enough for two projects of that size. DeRemate got a $45 million check from the Spanish giant Telefonica, through its website Terra, and began gaining ground in the market quickly thanks to an aggressive communications strategy. On the verge of a hefty IPO, the market buckled. DeRemate's founders and executives weren't able to reconfigure the company or adjust their expectations to the sudden lack of liquidity for tech companies. Since Mercado Libre had been forged with a frugal outlook, a taste for execution and a vocation for longevity, with decision-making firmly oriented towards the long term, it was able to adjust and evolve during a time of financial restrictions. In the absence of the easy option of throwing capital at problems, the limitations on funding that emerged shortly after these initial rounds forced the Company to develop internal solutions to grow the business, right from the very start. Meli didn't just survive, it took advantage of these straitened conditions – and the hesitation of its competitors – to consolidate the market. If DeRemate had made it to the IPO first, Mercado Libre would surely have faced a steeper uphill climb and its trajectory might have been different. Was this just the luck of the draw, once again? Or perhaps – to recall the words of Amundsen – what some call luck is simply having one's affairs in order[3].

2001 was an important year for Mercado Libre. eBay was moving into place as the world's biggest e-commerce site and had started looking to expand into Latin America. Fierce competition among would-be partners ensued and Mercado Libre emerged victorious, having displayed characteristics in line with eBay's ambitions: the most skillful team with the strongest positioning and most consistent strategy to capture the region's enormous potential for future growth. eBay became the Company's biggest shareholder, with a 19.5% stake. This marked the beginning of an important strategic partnership, and Meli incorporated iBazar, a wholly owned eBay subsidiary in Brazil. Beyond the triumph of bringing a coveted strategic partner on board and gaining access to both the cutting edge of knowledge in the field and greater capital availability, the deal lent Meli new heft, putting it a head above the competition. This was key; after all, we're talking about a segment known for its winner-takes-all attributes.

The partnership came at an important stage, just as the Company was facing the countless challenges that we mentioned in the last Report, hurdles inherent to the development of platform business models: how to gain scale, reach critical mass and establish network effects,

3 *DeRemate's operations were ultimately acquired by Meli – Chile and Argentina in 2005, and the rest in 2008. The latter, whether through an irony of fate or not, were paid for with the resources from the previous year's IPO. For those drawn to the fascinating dilemma of luck vs. skill, we recommend that you (re)read Dynamo Reports 75 and 76, where we followed the fortunes of the Fortunate (75) and the Skilled (76).*

deal with the problem of coordination by constructing a balanced value proposition for both buyers and sellers, monetize the product without undermining users' value perception, and continually improve the user experience on the platform. A few more specific obstacles were also brought into play. For example, the issue of credibility/reputation. From the start, Meli's stance had been to create an open forum where buyers and sellers could meet and establish the terms of their negotiations one-on-one. The priority at this stage was for the site to gain relevance and vault over the critical bar into the virtuous territory of increasing returns. Naturally, as in any open platform, unwanted participants could easily make their way in.

The practice of commerce rests essentially on trust. In the past, from street markets to bustling trading posts, markets had prospered on the strength of reputation – an institution constructed through word-of-mouth communication. Similarly, mechanisms that establish confidence and attract the participation of repeat buyers and sellers would have to be a cornerstone of the success of e-commerce. There is one important difference, however. In traditional networks, the quality of communication tended to degrade as the market expanded. The advantage of online networks is their unlimited capacity for storing information and tracking behavior at an extremely low cost, making social control more effective. Indeed, a number of feedback mechanisms – comments on participants' profiles, transaction evaluations, opinions about the purchase and sale experience – established a base of credible information with which participants could overcome their initial suspicions. In a result that speaks to the insights of game theory, frequent sellers (long-term players) benefit most from cooperative behavior and conduct designed to build a solid reputation, since this allows them to increase their payoffs in repeated games over time.

That's why, just six months into its existence, eBay launched the Feedback Forum, an evaluation tool that allowed buyers and sellers to rate their transactions as positive, negative, or neutral, as well as encouraging them to provide a brief comment about the experience. The mechanism was gradually refined to boost usage and improve the quality of the information it gathered, steering clear of bias during evaluations. Today, it's quite clear that the success of such marketplaces stemmed from the introduction of feedback. And Meli learned that lesson quickly, implementing ratings early on.

Faced with the potential threat of unqualified participants, the Company soon acted to institute meritocratic mechanisms for evaluation and classification that rewarded good behavior and punished bad actors. This was the start of *MercadoLíder*, where sellers would be rated in accordance with the quality of service that they provided. That information was translated into a "reputation thermometer" fed by a number of factors, including number of sales, positive ratings, and a limit for complaints and returns.

With the marketplace itself working, it was time to address some of the other snags that result from the virtual nature of these transactions – elements that cut down on the attractiveness of e-commerce, both in general and specifically in the region, known as "frictions." They fall into two main categories: payments and logistics. The former has to do with establishing a simple, safe method for accepting payments and settling financial transactions. The latter involves delivering intact merchandise in the quickest, most affordable way possible. Much of Meli's efforts over time have focused on offering ways around these obstacles. This meant that the Company not only promoted a better experience for users, but it was also able to exert internal control over variables that proved important for the platform.

The first hurdle was the issue of payment. In the early days of online marketplaces, buyers and sellers would get in touch directly to settle on a form of payment. Complaints abounded: buyers made payments without getting what they'd paid for, and sellers sent out products without getting what they'd settled on. In 2004, Meli launched *Mercado Pago*, a payment solution that made users' lives a lot easier. Now buyers could deposit the sum into an account held by the Company, and it would only be turned over to the seller once the buyer confirmed receipt of the item. This freed vendors from the obligation of dealing with multiple payment systems (different card networks, banks, and acquirers), as well as allowing them to receive advancements on sales. Buyers no longer had to go through the tiresome process of registering payment information or worry about scrutinizing the specifications or origins of the products they purchased, with the platform serving to control risk for them. Once the transaction experience was made easier, conversion rates went up significantly, making for a meaningful improvement in the economics of the business.[4]

Indeed, with an efficient, safe payment solution, the volume of transactions on the platform saw remarkable growth. *Mercado Pago* had been a part of the plan that Galperin developed back at Stanford. Prudent and strategically precise, the Company waited for the right moment to address the issue: it only launched its payments solution after it was clear that the tool would be relevant for the marketplace. *Pago* was led from the outset by the sure-handed Osvaldo Giménez, an early executive partner, and became a robust pillar on which other important fronts of Meli's expansion could rest, as we'll see a bit further along.

Year after year, the Company's results seemed to be validating its business plan. In 2006, with GMV of $1 billion, Meli had already broken even. Galperin and his team had reason to believe that they were on the right path, and they harbored even more expansive ambitions. Even with a strategic partner nearby that might be seen as a natural buyer, the Company headed in another direction. In a move that hardly seemed obvious for a "Latin American website," Meli listed its shares on the Nasdaq in August of 2007. Not only did this mean cutting the umbilical cord to eBay, the listing brought the classic advantages: institutional benefits, equity (around $49 million in primary resources, net of fees), increased visibility, professionalization, and a greater ability to retain talent.

It was in this context, around the IPO, that we began our interactions with Meli. It was a fruitful encounter and we were quite impressed by the young founding executives, who made us want to better understand the e-commerce and marketplace universe. Even with the traditionally brief pre-deal period, ballasted by our productive interaction with management and envisioning the opportunity this could represent, we decided to participate in the offering.

The IPO was a success. A few days after the listing, the Company's shares doubled in price. And at this point, our lack of experience in analyzing businesses with characteristics like these – with a dynamic of accelerated growth, where investments are calculated as expenses and leave no trace on the balance sheet – came into play. We couldn't see that the Company was laying the foundations for its future success in the form of the less visible intangible asset that was clients' engagement with the marketplace. Without this fundamental insight, the valuation rang hollow. As the stock price soared, we decided to sell our shares, which was a small part of our portfolio. We kept on monitoring the case, however, putting time and energy into the effort to better understand it even in the absence of a clear short-term opportunity. What kept us interested was the rare vision and talent of the management team.

The years since have brought consistent growth, and every year has brought fresh confirmation of their initial vision: that e-commerce in the region would offer countless opportunities to whoever was prepared to take advantage of them. We soon identified a virtuous aspect of this business model, which isn't completely subject to the winds from abroad that define the macroeconomic conditions and the way each country does business. On the contrary, marketplaces are resilient configurations with defensive characteristics; during times of crisis, individuals place even higher value on a deeper selection and more competitive prices, as well as looking to supplement their incomes.[5]

It also became clear how the Company stood out on the market – it offered not only a marketplace, credit and payment services, but also an integrated network of logistics solutions. The companies looking to capture the rising penetration of e-commerce in the area were either identified with specific vertical industries (electronics, basically), or they were traditional retail/consumer goods firms looking to develop an online sales channel for their own products (1P model). Meli was the only marketplace (3P model) actually able to offer a broad variety of merchandise at competitive prices across almost every market. Given the nature of the business, we knew that with this value proposition, the competitive advantage of gaining scale before all the other players was nothing to sniff at.

Operating in Latin America brings interesting advantages. With a blend of simplicity and realism, Meli observed winning trends across the world's major

4 *With the aid of technology, the Company has grown more sophisticated. Over time it has come to use artificial intelligence such as neural networks to identify fraud, evaluating around 4,000 variables in a matter of milliseconds.*

5 *Just by way of illustration: in 2015/16, as Brazil's GDP shrank 7.5%, Meli's net revenues in the country grew 140%.*

markets over time in order to incorporate them at the local level, making adaptations wherever necessary. As one of the founding partners recalled, Google didn't invent the search engine, and Facebook didn't invent social networks. The extraordinary thing about them was their execution. And so, throughout the Company's history, important decisions followed the paths blazed by peers abroad. From eBay, for example, they took the pioneering concept of the marketplace, as well as ratings and review mechanisms; from Amazon they took the core value of logistics management and the offering of services like fulfillment and free shipping; from Google came the concept of opening up some of their code to developers; from Paypal, payment solutions; from Alibaba, credit and the concept of a wallet.[6] Meli's greatest virtue over the years was its ability to identify relevant trends early on, adapt them to local conditions, and, above all, implement them at the right time with precision, agility, and skill.

In this field, with the breakneck transformation of technology, where information flows freely and major insights make it quickly into the public domain, an assertive execution is often more valuable than an original concept. Even so, major decisions were made when the Company still lacked obvious indications as to the best path to be taken, and/or under circumstances where targeted pilot testing wasn't feasible. These were critical moments, and it's worth recounting one of them.

Technology is the beating heart of the marketplace. It's what makes growth, scale, and security possible, underpinning the speed and quality of participants' experience. Early on, Meli's technology stack was based on the state of the art at the time: Oracle databases, SunMicrosystem servers, Unix operating systems, and Exodus servers. This proved a solid configuration, the foundation for trustworthy growth. But Galperin knew that eventually, developing proprietary tech could bring an important competitive advantage. He maintained an internal focus on this goal from the start, setting up multiple software development centers. In 2009 the definitive decision was taken and the Company dove headfirst into the task of completely redesigning its technology stack. By then, Meli had seen that the migration from desktops to cell phones was a lasting trend. The "New World" project sought to rebuild systems from the bottom up to provide robust infrastructure that could keep pace with the swift transformations demanded of it, integrate third parties, and embrace the nascent reality of mobile apps. The Company would need to be able to innovate quickly, be flexible, and customize. It was no foregone conclusion to abandon a safe model that had been working satisfactorily. But the understanding was that a continued exclusive dependence on major systems providers as they moved to implement necessary upgrades would ultimately prove fatal.

This meant a total overhaul of the Company's tech area – in place of a monolithic structure with a single database, an extensive code package and a large, hierarchical team, there came a decentralized framework with smaller teams arranged in cells, each able to work independently and functioning like businesses of their own, with their own source codes, data, processes, and infrastructures. The changes brought greater agility and flexibility – so coveted in the tech world – but they also came with additional advantages, reshaping the corporate culture, where a passive or defensive compliance mentality gave way to an environment that fosters initiative and execution.

The project, skillfully led by CTO Daniel Rabinovich, entailed a massive collective effort on the part of the Company. Absorbing capital and mobilizing a dedicated team, it became a primary focus for executives. There would be no looking back. In October of 2012, Meli announced at an event in São Paulo that it would be opening its platform up to the developer community – yet another important decision, and a pioneering move in

6 *We'll go into greater detail on each of these initiatives.*

Dynamo Cougar x IBX x Ibovespa Performance up to July 2018 (in R$)

Period	Dynamo Cougar	IBX	Ibovespa
60 months	95,6%	65,8%	65,8%
36 months	47,6%	50,4%	52,3%
24 months	21,3%	38,2%	38,9%
12 months	11,1%	19,8%	21,0%
Year to date	-0,2%	2,4%	2,8%

NAV/Share on July 20 = R$ 779,848325600

Latin American e-commerce. This initiative also took root. The Company encouraged adoption by sharing revenues with service providers; the rate of innovation picked up speed, and new apps made life easier for sellers and improved buyers' experience. The platform could now be accessed on mobile, WebTV and tablets, as well as HTML5 browsers – all developed by third parties. As a result, the Company saw an extremely virtuous dynamic in the growth of its transaction volume, the overall value of merchandise, and revenue.

Still addressing its frictions, Meli moved on to the second building block, the logistical challenges it was facing. In 2013, it launched *MercadoEnvios* in Brazil. This was a partnership with the Correios, the Brazilian postal services, through which the Company began controlling the flow of products – taking yet another key step away from being a site that offered items and toward being a business platform.

Until then, buyers and sellers had arranged deliveries directly, through a chat tool. Of course the Correios, given its reputation, established asset base, scale and capillarity, could offer a better logistical solution thanks to its network of nearly 12,000 branches. Especially when it came to the "first mile" in Brazil. Just a quick note here. In a few words, logistics for a marketplace can be divided into three stages: the first mile is the seller taking the merchandise to the logistics operator. The second stage includes the operations carried out by the logistics operator, such as inventory control, sorting, storage, handling, and, in some cases, packaging and labeling. The third, known as the last mile, is the delivery itself, when the carrier takes the merchandise to its final destination – for marketplaces, normally consumers' homes.

Through this agreement, Meli began issuing a Correios label in the seller's name right after the transaction, and he or she would then leave the labeled package at a branch of the postal service. This allowed the Company to overcome an important logistical obstacle of capturing the first mile. Meli passed the commercial benefits of the partnership on to its sellers, as well as developing systems that provided buyers with more accurate order tracking, which brought the advantages of more predictable delivery times. Partnering with the Correios cut down on logistical costs for sellers, increased efficiency in the delivery process via order tracking, and meant that less energy had to be put towards administrative issues, freeing up resources to focus on product sales.

As *MercadoPago* became an established part of the platform, and with *MercadoEnvios*' penetration increasing at a fast clip, the Company was able to innovate more quickly and develop new products. It was at this point, a period of great internal dynamism, that we once again approached Meli in mid-2016. We quickly confirmed that this was a virtuous period for the Company and saw the enormous potential that e-commerce, still a fledgling business in the region, could offer to such a qualified group of executives.

The Company's trajectory at that point clearly already showed management's skill in successfully implementing a number of internal projects. During this virtuous phase, previously implemented initiatives were coming to fruition. Others were being launched, including i) an important change in the fee structure as the Company stopped charging for listings, only for sales; ii) a new listing option without listing fees for used products; iii) the option to pay in interest-free installments on credit cards; iv) the introduction of a "one-click" system to facilitate purchases on the site; and v) the inclusion of a shopping cart, making it possible to buy more than one item at a time.

The combination of a proven track record of executions and this new portfolio of promising initiatives led us to conclude that this was a unique opportunity to rejoin the Company's shareholder base. With a mixture of remorse at the long period of separation and satisfaction at this propitious second encounter, we invested in Meli once again in August of 2016, with shares at around $166. Since then we've increased our exposure; by mid-2017, the Company had become one of the largest positions in our portfolio.

Our increased position came in parallel with the perception that we were at a moment of crucial importance for the Company. Two recent projects seemed to have the potential to take it to a new level of growth entirely: the further development of *Mercado Envios* and the launch of *MercadoCrédito*.

As we've seen, the Company's agreement with the postal service proved advantageous for both the platform and its users, as it dealt with the key issues of capillary access and the first mile. But there were still refinements to be made. Delivery times, and dependence on a single logistical operator, with all its idiosyncrasies, still posed complications. That's how the Company, following in Amazon's footsteps, took two more steps forward in logistics. First, with *MercadoEnvios Coleta*, Meli started picking up items from sellers and taking them to a proprietary distribution center (DC), which then delivers them to consumers. This was a considerable advance; the Company no longer had to rely on the seller to go to a Correios branch and drop off the product, and it was now free to use other logistics operators. Next came a fulfillment solution where the product could be sent by sellers to Meli's DC even before transactions were made. The Company would take over the entire logistical process, from storing to packaging and delivery. The first mile vanishes in this scenario, and next-day or same-day delivery becomes viable. At the same time, the last mile no longer depends on a single supplier. Since the merchandise is already at Meli's DC, delivery can be executed by any carrier. Looking at other markets, it had become clear that further investment in fulfillment and a specific pick-up option for sellers who didn't sign up for fulfillment could generate a virtuous wave of engagement with the platform.

The second initiative involved using technology to provide access to financial services for sellers, based on the perception that a lack of financing at competitive prices was an important limiting factor on the platform's potential growth. This was *Mercado Crédito*, which both springs from and deepens the symbiotic relationship between Meli and its sellers. The platform has a behavioral track record for and extensive data on its sellers, a close relationship which practically suggests the possibility of selectively offering credit. The more active a given seller is, the greater their need for working capital. By taking sellers off overdraft banking, Meli opened the way up for major reciprocity, discouraging vendors from listing their products elsewhere. Indeed, evidence has shown that the availability of credit is tied to an increase in sales volume, a drop in sales churn, and rising satisfaction. By 2016, the Company would see a conversion rate on credit offers of 25%, interest in renewing credit lines from 70% of their base, and growth of 85% in sales for sellers to whom credit was offered.

Interestingly enough, this credit solution doesn't mean taking on traditional financial institutions. Quite the contrary. *MercadoCrédito* goes where banks prefer not to: small merchants. In this case, the thousands of active sellers on the platform. Some of them would never receive credit approvals, or even think to request them. Others can only take out loans as individuals (often resorting to overdraft banking), not as businesses. In Latin America, much of the population remains on the margin of the official financial system. Many countries in the region have extremely low loan/GDP ratios, on par with those for African nations. With a sophisticated knowledge of this group's behavior, distilled through tools that consider around 400 variables that measure sellers' performance on and engagement with the platform, Meli is able to offer sufficient credit at more affordable rates that are still profitable for the Company.

Initiatives to expand its payment and credit business beyond the marketplace itself were already underway. Here the inspiration came from Chinese companies, especially Alibaba, which had created Ant Financial, as well as Tencent's WeChat, and from Paypal, which at that time still belonged to eBay. By then we were also converts to the notion of alternatives to the distribution of financial products through traditional retail banking, and we looked favorably on these initiatives. Again, the platform's millions of dedicated participants gave Meli a rare understanding of a unique asset base. Capillarity and knowledge, as well as technological expertise, made the Company a strong and natural candidate to take part in this promising market. Here, as well, Meli tried to make headway in a segment of the market untouched by banks. Its first major initiative was offering an MPOS to smaller commercial establishments that are often cast aside when banks triage credit scores.[7] Meli then launched a payment solution via QR codes in Argentina,[8] a technological innovation that piggybacks off the convenience and mobility of cell phones to provide a simple, easy, and safe purchase process. With this move, Meli was now able to offer a complete transaction ecosystem, having taken control of payment, compensation, and settlement.

Another set of ongoing projects sought to strengthen origin and quality control for products listed and sold on the marketplace. Two in particular stand out: i) partnerships with brands, which offered to take down sellers hawking counterfeit goods, and ii) the *Lojas Oficiais* (Official Stores) project, an attempt to provide the platform with an online channel for well-recognized brands. *Lojas Oficiais* generated volume and quality

7 *In Dynamo Report 77, when we recounted our investment in Cielo and Redecard, we went into some detail on the business model of these acquirers, as well as the mechanics behind the functioning of the flow of transactions taken by these devices, or points of sale.*

8 *QR code, or quick response code, is a two-dimensional bar code linked to a product or service. When scanned by the MercadoPago app on a cell phone, it automatically makes the purchase and settles the transaction.*

DYNAMO COUGAR x IBOVESPA
(Performance – Percentage Change in US$ dollars)

Period	DYNAMO COUGAR* Year	DYNAMO COUGAR* Since Sep 1, 1993	IBOVESPA** Year	IBOVESPA** Since Sep 1, 1993
1993	38.8%	38.8%	7.7%	7.7%
1994	245.6%	379.5%	62.6%	75.1%
1995	-3.6%	362.2%	-14.0%	50.5%
1996	53.6%	609.8%	53.2%	130.6%
1997	-6.2%	565.5%	34.7%	210.6%
1998	-19.1%	438.1%	-38.5%	91.0%
1999	104.6%	1,001.2%	70.2%	224.9%
2000	3.0%	1,034.5%	-18.3%	165.4%
2001	-6.4%	962.4%	-25.0%	99.0%
2002	-7.9%	878.9%	-45.5%	8.5%
2003	93.9%	1,798.5%	141.3%	161.8%
2004	64.4%	3,020.2%	28.2%	235.7%
2005	41.2%	4,305.5%	44.8%	386.1%
2006	49.8%	6,498.3%	45.5%	607.5%
2007	59.7%	10,436.6%	73.4%	1,126.8%
2008	-47.1%	5,470.1%	-55.4%	446.5%
2009	143.7%	13,472.6%	145.2%	1,239.9%
2010	28.1%	17,282.0%	5.6%	1,331.8%
2011	-4.4%	16,514.5%	-27.3%	929.1%
2012	14.0%	18,844.6%	-1.4%	914.5%
2013	-7.3%	17,456.8%	-26.3%	647.9%
2014	-6.0%	16,401.5%	-14.4%	540.4%
2015	-23.3%	12,560.8%	-41.0%	277.6%
2016	42.4%	17,926.4%	66.5%	528.6%
2017	25.8%	22,574.0%	25.0%	685.6%

2018	DYNAMO COUGAR* Month	DYNAMO COUGAR* Year	IBOVESPA** Month	IBOVESPA** Year
JAN	8.6%	8.6%	16.3%	16.3%
FEB	-3.1%	5.2%	-2.0%	13.9%
MAR	-4.5%	0.4%	-2.4%	11.2%
APR	-5.2%	-4.8%	-3.7%	7.1%
MAY	-12.7%	-16.9%	-17.0%	-11.1%
JUN	-6.3%	-22.1%	-8.1%	-18.3%
JUL***	12.1%	-12.7%	10.2%	-10.0%

Average Net Asset Value for Dynamo Cougar
(Last 12 months): R$ 3,201,884,976

(*) The Dynamo Cougar Fund figures are audited by Price Waterhouse and Coopers and returns net of all costs and fees, except for Adjustment of Performance Fee, if due. (**) Ibovespa closing.. (***) Performance up to July, 20.

traffic, reinforced the platform's credibility, and created an alternative for buyers who didn't feel comfortable acquiring merchandise from smaller vendors. Renowned brands such as O Boticário, Johnson & Johnson, New Balance, L'Oreal, Sony, and Lego, to name a few, came on board and started offering their products on Meli's marketplace.

In parallel, based on the Company's success in Brazil, opportunities for growth were emerging in other countries across the region where *MercadoPago* and *MercadoEnvios* had low penetration rates.

All these initiatives are noteworthy individually. Together, they gave the platform tremendous dynamism and a mosaic of unprecedented opportunities. On the other hand, we knew that we were pushing into a region where tradeoffs between growth and financial statement performance were soon to emerge. Building the future strategic value of the platform would rely on this array of initiatives, which sought to win over sellers' loyalty and encourage engagement amongst buyers. These investments were treated as expenses, making for worse margins and operational results and transforming traditional valuation metrics into hurdles for investors less familiar with these dynamics.

We'll take a break here, out of self-control and respect for our readers' time, and return to the appropriation of results in the next Report. There, we'll delve deeper into the description of Mercado Libre's business model, discuss the challenges inherent in the Company's valuation, and analyze the most significant risks we envision for this investment.

Rio de Janeiro, July 24, 2018.

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