MERCADOLIBRE INC
Form 10-Q
November 03, 2017


UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2017

-OR-

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission file number 001-33647

MercadoLibre, Inc.

(Exact name of Registrant as specified in its Charter)

| Delaware | 98-0212790 |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification Number) |

Arias 3751, 7th Floor

Buenos Aires, C1430CRG, Argentina

(Address of registrant's principal executive offices)

(+5411) 4640-8000

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files. Yes No

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See definition of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act:

| | | |
|---|---|---|
| Large accelerated filer | | Accelerated filer |
| Non-accelerated filer | (Do not check if a smaller reporting company) | Smaller reporting company |
| | | Emerging growth company |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

44,157,364 shares of the issuer's common stock, $0.001 par value, outstanding as of November 1, 2017.

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Interim Condensed Consolidated Financial Statements

as of September 30, 2017 and December 31, 2016

and for the nine and three-month periods

ended September 30, 2017 and 2016

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MercadoLibre, Inc.

Interim Condensed Consolidated Balance Sheets

As of September 30, 2017 and December 31, 2016

(In thousands of U.S. dollars, except par value)

(Unaudited)

| | September 30, 2017 | December 31, 2016 |
|---|---|---|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | $ 461,198 | $ 234,140 |
| Short-term investments | 175,165 | 253,321 |
| Accounts receivable, net | 28,564 | 25,435 |
| Credit cards receivables, net | 406,883 | 307,904 |
| Loans receivable, net | 51,843 | 6,283 |
| Prepaid expenses | 8,199 | 15,060 |
| Inventory | 2,309 | 1,103 |
| Other assets | 47,995 | 26,215 |
| Total current assets | 1,182,156 | 869,461 |
| Non-current assets: | | |
| Long-term investments | 45,550 | 153,803 |
| Property and equipment, net | 136,101 | 124,261 |
| Goodwill | 95,249 | 91,797 |
| Intangible assets, net | 24,642 | 26,277 |
| Deferred tax assets | 66,163 | 45,017 |
| Other assets | 68,431 | 56,819 |
| Total non-current assets | 436,136 | 497,974 |
| Total assets | $ 1,618,292 | $ 1,367,435 |
| Liabilities and Equity | | |
| Current liabilities: | | |
| Accounts payable and accrued expenses | $ 181,557 | $ 105,106 |
| Funds payable to customers | 519,420 | 370,693 |
| Salaries and social security payable | 61,168 | 48,898 |
| Taxes payable | 27,923 | 27,338 |
| Loans payable and other financial liabilities | 24,701 | 11,583 |
| Other liabilities | 1,400 | 6,359 |

| | | |
|---|---|---|
| Dividends payable | 6,624 | 6,624 |
| Total current liabilities | 822,793 | 576,601 |
| Non-current liabilities: | | |
| Salaries and social security payable | 22,124 | 16,173 |
| Loans payable and other financial liabilities | 309,444 | 301,940 |
| Deferred tax liabilities | 40,435 | 34,059 |
| Other liabilities | 17,340 | 9,808 |
| Total non-current liabilities | 389,343 | 361,980 |
| Total liabilities | $ 1,212,136 | $ 938,581 |
| Equity: | | |
| Common stock, $0.001 par value, 110,000,000 shares authorized, 44,157,364 shares issued and outstanding at September 30, 2017 and December 31, 2016 | $ 44 | $ 44 |
| Additional paid-in capital | 70,674 | 137,982 |
| Retained earnings | 612,269 | 550,641 |
| Accumulated other comprehensive loss | (276,831) | (259,813) |
| Total Equity | 406,156 | 428,854 |
| Total Liabilities and Equity | $ 1,618,292 | $ 1,367,435 |

The accompanying notes are an integral part of these interim condensed consolidated financial statements.

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MercadoLibre, Inc.

Interim Condensed Consolidated Statements of Income

For the nine and three-month periods ended September 30, 2017 and 2016

(In thousands of U.S. dollars, except for share data)

(Unaudited)

| | Nine Months Ended September 30 | | | | Three Months Ended September 30, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2017 | | 2016 | | 2017 | | 2016 | |
| Net revenues | $ | 961,117 | $ | 588,121 | $ | 370,661 | $ | 230,847 |
| Cost of net revenues | (444,879) | | (213,993) | | (194,834) | | (85,199) | |
| Gross profit | 516,238 | | 374,128 | | 175,827 | | 145,648 | |
| Operating expenses: | | | | | | | | |
| Product and technology development | (93,019) | | (72,223) | | (32,380) | | (26,066) | |
| Sales and marketing | (207,925) | | (107,743) | | (84,139) | | (39,723) | |
| General and administrative | (91,575) | | (64,061) | | (31,766) | | (26,150) | |
| Impairment of Long-Lived Assets | (2,837) | | (13,717) | | — | | — | |
| Total operating expenses | (395,356) | | (257,744) | | (148,285) | | (91,939) | |
| Income from operations | 120,882 | | 116,384 | | 27,542 | | 53,709 | |
| Other income (expenses): | | | | | | | | |
| Interest income and other financial gains | 37,020 | | 25,192 | | 14,200 | | 9,892 | |
| Interest expense and other financial losses | (19,686) | | (18,807) | | (6,709) | | (6,492) | |
| Foreign currency (loss) / gain | (19,475) | | (5,062) | | 1,622 | | (4,823) | |
| Net income before income tax expense | 118,741 | | 117,707 | | 36,655 | | 52,286 | |
| Income tax expense | (37,241) | | (32,690) | | (8,989) | | (13,374) | |
| Net income | $ | 81,500 | $ | 85,017 | $ | 27,666 | $ | 38,912 |

| | Nine Months Ended September 30 | | Three Months Ended September 30, | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| Basic EPS | | | | |
| Basic net income | | | | |
| Available to shareholders per common share | $ 1.85 | $ 1.93 | $ 0.63 | $ 0.88 |
| Weighted average of outstanding common shares | 44,157,364 | 44,157,215 | 44,157,364 | 44,157,341 |
| Diluted EPS | | | | |
| Diluted net income | | | | |
| Available to shareholders per common share | $ 1.85 | $ 1.93 | $ 0.63 | $ 0.88 |
| Weighted average of outstanding common shares | 44,157,364 | 44,157,215 | 44,157,364 | 44,157,341 |
| Cash Dividends declared (per share) | 0.450 | 0.450 | 0.150 | 0.150 |

The accompanying notes are an integral part of these interim condensed consolidated financial statements.

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MercadoLibre, Inc.

Interim Condensed Consolidated Statements of Comprehensive Income

For the nine and three-month periods ended September 30, 2017 and 2016

(In thousands of U.S. dollars)

(Unaudited)

| | Nine Months Ended September 30 | | | | Three Months Ended September 30, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2017 | | 2016 | | 2017 | | 2016 | |
| Net income | $ | 81,500 | $ | 85,017 | $ | 27,666 | $ | 38,912 |
| Other comprehensive (loss) income, net of income tax: | | | | | | | | |
| Currency translation adjustment | (17,945) | | (11,056) | | (5,180) | | (2,974) | |
| Unrealized net gains (losses) on available for sale investments | 340 | | 712 | | (1,413) | | 1,106 | |
| Less: Reclassification adjustment for losses on available for sale investments | (587) | | (672) | | — | | — | |
| Net change in accumulated other comprehensive loss, net of income tax | (17,018) | | (9,672) | | (6,593) | | (1,868) | |
| Total Comprehensive income | $ | 64,482 | $ | 75,345 | $ | 21,073 | $ | 37,044 |

The accompanying notes are an integral part of these interim condensed consolidated financial statements.

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MercadoLibre, Inc.

Interim Condensed Consolidated Statements of Cash Flow

For the nine-month periods ended September 30, 2017 and 2016

(In thousands of U.S. dollars)

(Unaudited)

| | Nine Months Ended September 30 | |
|---|---|---|
| | 2017 | 2016 |
| Cash flows from operations: | | |
| Net income | $ 81,500 | $ 85,017 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Unrealized Devaluation Loss, net | 28,463 | 5,162 |
| Impairment of Long-Lived Assets | 2,837 | 13,717 |
| Depreciation and amortization | 29,953 | 20,698 |
| Accrued interest | (16,391) | (12,643) |
| Non cash interest and convertible bonds amortization of debt discount and amortization of debt issuance costs | 9,234 | 9,122 |
| LTRP accrued compensation | 28,734 | 19,251 |
| Deferred income taxes | (14,769) | (5,895) |
| Changes in assets and liabilities: | | |
| Accounts receivable | (13,380) | (2,409) |
| Credit Card Receivables | (113,514) | (92,811) |
| Prepaid expenses | 6,800 | (272) |
| Inventory | (1,172) | (1,048) |
| Other assets | (31,528) | (15,865) |
| Accounts payable and accrued expenses | 71,794 | 13,852 |
| Funds payable to customers | 151,635 | 100,322 |
| Other liabilities | 3,703 | 136 |
| Interest received from investments | 18,490 | 11,348 |
| Net cash provided by operating activities | 242,389 | 147,682 |
| Cash flows from investing activities: | | |
| Purchase of investments | (3,180,633) | (2,548,060) |
| Proceeds from sale and maturity of investments | 3,371,543 | 2,525,118 |
| Payment for acquired businesses, net of cash acquired | — | (7,284) |

| | | | | |
|---|---|---|---|---|
| Purchases of intangible assets | (84) | | (49) | |
| Advance for property and equipment | (12,777) | | (6,129) | |
| Changes in principal of loans receivable, net | (46,951) | | — | |
| Purchases of property and equipment | (39,280) | | (55,510) | |
| Net cash provided by (used in) investing activities | 91,818 | | (91,914) | |
| Cash flows from financing activities: | | | | |
| Proceeds from loans payable and other financial liabilities | 13,153 | | 3,892 | |
| Payments on loans payable and other financing liabilities | (4,304) | | (6,492) | |
| Dividends paid | (19,871) | | (17,795) | |
| Purchase of convertible note capped call | (67,308) | | — | |
| Net cash used in financing activities | (78,330) | | (20,395) | |
| Effect of exchange rate changes on cash and cash equivalents | (28,819) | | (14,259) | |
| Net increase in cash and cash equivalents | 227,058 | | 21,114 | |
| Cash and cash equivalents, beginning of the period | $ | 234,140 | $ | 166,881 |
| Cash and cash equivalents, end of the period | $ | 461,198 | $ | 187,995 |

The accompanying notes are an integral part of these interim condensed consolidated financial statements.

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MercadoLibre, Inc.

Notes to Interim Condensed Consolidated Financial Statements (unaudited)

## 1. Nature of Business

MercadoLibre, Inc. ("MercadoLibre" or the "Company") was incorporated in the state of Delaware, in the United States of America in October 1999. MercadoLibre is the leading e-commerce company in Latin America, serving as an integrated regional platform and as an enabler of the necessary online and technology tools to allow businesses and individuals to trade products and services in the region. The Company enables commerce through its marketplace platform (including online classifieds for motor vehicles, vessels, aircraft, services and real estate), which allows users to buy and sell in most of Latin America.

Through MercadoPago, MercadoLibre enables individuals and businesses to send and receive online payments; through MercadoEnvios, MercadoLibre facilitates the shipping of goods from sellers to buyers; through our advertising products, MercadoLibre facilitates advertising services to large retailers and brands to promote their product and services on the web; through MercadoShops, MercadoLibre facilitates users to set-up, manage, and promote their own on-line web-stores under a subscription-based business model; and through MercadoCredito, MercadoLibre extends loans to specific merchants and consumers. In addition, MercadoLibre develops and sells software enterprise solutions to e-commerce business clients in Brazil.

As of September 30, 2017, MercadoLibre, through its wholly-owned subsidiaries, operated online ecommerce platforms directed towards Argentina, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, Peru, Mexico, Panama, Honduras, Nicaragua, Salvador, Portugal, Uruguay, Bolivia, Guatemala, Paraguay and Venezuela. Additionally, MercadoLibre operates an online payments solution directed towards Argentina, Brazil, Mexico, Venezuela, Colombia, Chile, Peru and Uruguay. It also offers a shipping solution directed towards Argentina, Brazil, Mexico, Colombia and Chile. In addition, the Company operates a real estate classified platform that covers some areas of State of Florida, in the United States of America.

## 2. Summary of significant accounting policies

### Basis of presentation

The accompanying unaudited interim condensed consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP) and include the accounts of the Company and its wholly-owned subsidiaries. These interim condensed consolidated financial statements are stated in U.S. dollars, except for amounts otherwise indicated. Intercompany transactions and balances with subsidiaries have been eliminated for consolidation purposes.

Substantially all net revenues, cost of net revenues and operating expenses, are generated in the Company's foreign operations. Operating income of foreign operations amounted to 96.7% and 99.9% of the consolidated amounts during the nine-month periods ended September 30, 2017 and 2016. Long-lived assets, Intangible assets and Goodwill located in the foreign jurisdictions totaled $247,401 thousands and $232,314 thousands as of September 30, 2017 and December 31, 2016, respectively.

These interim condensed consolidated financial statements reflect the Company's consolidated financial position as of September 30, 2017 and December 31, 2016. These financial statements also show the Company's consolidated statements of income and comprehensive income for the nine and three-month periods ended September 30, 2017 and 2016; and statement of cash flows for the nine-month periods ended September 30, 2017 and 2016. These interim condensed consolidated financial statements include all normal recurring adjustments that management believes are necessary to fairly state the Company's financial position, operating results and cash flows.

Because all of the disclosures required by U.S. GAAP for annual consolidated financial statements are not included herein, these unaudited interim condensed financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto for the year ended December 31, 2016, contained in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission ("SEC"). The condensed consolidated statements of income, of comprehensive income and of cash flows for the periods presented herein are not necessarily indicative of results expected for any future period. For a more detailed discussion of the Company's significant accounting policies, see note 2 to the financial statements in the Form 10-K. During the nine-month period ended September 30, 2017, there were no material updates made to the Company's significant accounting policies.

MercadoLibre, Inc.

Notes to Interim Condensed Consolidated Financial Statements (unaudited)

Foreign currency translation

All of the Company’s foreign operations have determined the local currency to be their functional currency, except for Venezuela since January 1, 2010, as described below. Accordingly, these foreign operating subsidiaries translate assets and liabilities from their local currencies into U.S. dollars by using period-end exchange rates while income and expense accounts are translated at the average rates in effect during the period, unless exchange rates fluctuate significantly during the period, in which case the exchange rates at the date of the transaction are used. The resulting translation adjustment is recorded as a component of other comprehensive (loss) income.

Venezuelan currency status

Pursuant to U.S. GAAP, the Company has transitioned its Venezuelan operations to highly inflationary status as from January 1, 2010, which requires that transactions and balances are re-measured as if the U.S. dollar was the functional currency for such operation. The cumulative three year inflation rate as from December 31, 2010 exceeded 100% at each period end. Thus, the Company continues to treat the economy of Venezuela as highly-inflationary.

On March 9, 2016 the Central Bank of Venezuela (“BCV”) issued the Exchange Agreement No.35. The agreement established a “protected” exchange rate (“DIPRO”) for certain transactions, such as but not limited to: imports of goods of the food and health sectors, as well as supplies associated with the production of said sectors; expenses relating to health treatments, sports, culture, scientific research, and other urgent matters defined by the exchange regulations. All foreign currency transactions not expressly provided in Exchange Agreement No.35 will be processed on the alternate foreign currency markets governed by the exchange regulations, at the floating supplementary market exchange rate (“DICOM”).

Additionally, the agreement established that the alternate foreign currency markets referred to in Exchange Agreement No.33 of February 10, 2015 (“SIMADI”) will continue to operate until replaced by others. From March 31, 2016 through June 30, 2016, the SIMADI exchange rate increased from 273 BsF per U.S. dollar to 628 BsF per U.S. dollar, a 130% increase in the exchange rate. As a consequence of the local currency devaluation, the Company recorded a foreign exchange loss of $4.9 million during the second quarter of 2016.

Considering the significant devaluation and the lower U.S. dollar-equivalent cash flows then expected from the Venezuelan business, the Company reviewed its long-lived assets (including non-current other assets), goodwill and intangible assets with indefinite useful life for impairment and concluded that the carrying value of certain real estate investments in Venezuela as of June 30, 2016 would not be fully recoverable. As a result, on June 30, 2016, the Company recorded an impairment of offices and commercial property under construction included within non-current other assets of $13.7 million. The carrying amount of offices and commercial property under construction was adjusted to its estimated fair value of approximately $12.5 million as of June 30, 2016, by using the market approach, and considering prices for similar assets.

On May 19, 2017, the BCV issued the Exchange Agreement No.38, which established a new foreign exchange mechanism under DICOM, replacing SIMADI. The new mechanism consists of auctions, administered by an auction committee, where sellers and buyers from the private sector may offer foreign currency under certain limits determined by the BCV.

In light of the disappearance of SIMADI (which closed at 728.0 per U.S. dollar), and the Company's inability to gain access to U.S. dollars under SIMADI, it started requesting U.S. dollars through DICOM. As a result, the Company expects to settle its transactions through DICOM going forward and concluded that the DICOM exchange rate should be used as from June 1, 2017 to measure its bolivar-denominated monetary assets and liabilities and to measure the revenues and expenses of the Venezuelan subsidiaries. Therefore, as of June 30, 2017, monetary assets and liabilities in Bolivares Fuertes ("BsF") were re-measured to the U.S. dollar using the DICOM closing exchange rate of 2640.0 BsF per U.S. dollar. As a consequence of the local currency devaluation, the Company recorded a foreign exchange loss of $22.0 million during the second quarter of 2017.

Considering the significant devaluation and the lower U.S. dollar-equivalent cash flows then expected from the Venezuelan business, the Company reviewed its long-lived assets (including non-current other assets), goodwill and intangible assets with indefinite useful life for impairment and concluded that the carrying value of certain real estate investments in Venezuela as of June 30, 2017 would not be fully recoverable. As a result, on June 30, 2017, the Company recorded an impairment of offices and commercial property under construction included within non-current other assets of $2.8 million. The carrying amount of offices and commercial property under construction was adjusted to its estimated fair value of approximately $9.7 million as of June 30, 2017, by using the market approach and considering prices for similar assets. As of September 30, 2017, the DICOM exchange rate was 3,345.0 BsF per U.S. dollar.

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MercadoLibre, Inc.

Notes to Interim Condensed Consolidated Financial Statements (unaudited)

Until 2010 the Company was able to obtain U.S. dollars for any purpose, including dividends distribution, using alternative mechanisms other than through the Commission for the Administration of Foreign Exchange Control (CADIVI). Those U.S. dollars, obtained at a higher exchange rate than the one offered by CADIVI, and held at U.S. bank accounts of its Venezuelan subsidiaries, were used until 2011 for dividend distributions from its Venezuelan subsidiaries. The Company has not distributed dividends from the Venezuelan subsidiaries since 2011.

The following table sets forth the assets, liabilities and net assets of the Company's Venezuelan subsidiaries, before intercompany eliminations of a net liability of $29,594 thousands and $ 15,843 thousands, as of September 30, 2017 and December 31, 2016 and net revenues for the nine-month periods ended September 30, 2017 and 2016:

| | September 30, | |
|---|---|---|
| | 2017 | 2016 |
| | (In thousands) | |
| Venezuelan operations | | |
| Net Revenues | $ 38,329 | $ 26,451 |

| | September 30, 2017 | December 31, 2016 |
|---|---|---|
| | (In thousands) | |
| Assets | 62,648 | 66,165 |
| Liabilities | (37,269) | (22,950) |
| Net Assets | $ 25,379 | $ 43,215 |

As of September 30, 2017, the net assets (before intercompany eliminations) of the Venezuelan subsidiaries amounted to 6.2% of consolidated net assets, and cash and investments of the Venezuelan subsidiaries held in local currency in Venezuela amounted to 2.2% of our consolidated cash and investments.

The Company's ability to obtain U.S. dollars in Venezuela is negatively affected by the exchange regulations in Venezuela that are described above and elsewhere in these interim condensed consolidated financial statements. In addition, its business and ability to obtain U.S. dollars in Venezuela would be negatively affected by additional material devaluations or the imposition of significant additional and more stringent controls on foreign currency exchange by the Venezuelan government.

Despite the current difficult macroeconomic environment in Venezuela, the Company continues to actively manage, through its Venezuelan subsidiaries, its investment in Venezuela.

Income and asset taxes

The Company is subject to U.S. and foreign income taxes. The Company accounts for income taxes following the liability method of accounting which requires the recognition of deferred tax liabilities and assets for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of assets and liabilities. Deferred tax assets are also recognized for tax loss carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets or liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is recorded when, based on the available evidence, it is more likely than not that all or a portion of the Company’s deferred tax assets will not be realized. The Company’s income tax expense consists of taxes currently payable, if any, plus the change during the period in the Company’s deferred tax assets and liabilities.

On August 17, 2011, the Argentine government issued a new software development law and on September 9, 2013 the regulatory decree was issued, which established the new requirement to become beneficiary of the new software development law. The decree establishes compliance requirements with annual incremental ratios related to exports of services and research and development expenses that must be achieved to remain within the tax holiday. The Company’s Argentine subsidiary has to achieve certain required ratios annually under the software development law in order to be eligible for the benefits mentioned below.

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MercadoLibre, Inc.

Notes to Interim Condensed Consolidated Financial Statements (unaudited)

On September 17, 2015, the Argentine Industry Secretary issued Resolution 1041/2015 approving the Company's application for eligibility under the new software development law for the Company's Argentinean subsidiary, Mercadolibre S.R.L. Furthermore, on September 18, 2016, the Argentine Industry Secretary issued Resolutions 93/2016 and 97/2016 approving the Company's application for eligibility under the new software development law for the Company's Argentinean subsidiaries, Neosur S.RL. and Business Vision S.A. As a result, the Company's Argentinean subsidiaries have been granted a tax holiday retroactive from September 18, 2014. A portion of the benefits obtained as beneficiaries of the new law is a relief of 60% of total income tax related to software development activities and a 70% relief in payroll taxes related to software development activities.

The benefits to the Company under the software development law will expire on December 31, 2019. As a result of the Company's eligibility under the new law, it recorded an income tax benefit of $17,672 thousands and $6,367 thousands during the nine and three-month periods ended September 30, 2017, respectively. Aggregate per share effect of the Argentine tax holiday amounted to $0.40 and $0.14 for the nine and three-month periods ended September 30, 2017, respectively. Furthermore, the Company recorded a labor cost benefit of $5,513 thousands and $2,016 thousands during the nine and three-month periods ended September 30, 2017, respectively. Additionally, $1,623 thousands and $587 thousands were accrued to pay software development law audit fees during the nine and three-month periods ended September 30, 2017, respectively. During the nine months period ended September 30, 2016, the Company recorded an income tax benefit of $16,018 thousands, a labor cost benefit of $4,173 thousands and $1,416 thousands were accrued to pay software development law audit fees. Additionally, during the third quarter of 2016, the Company recorded an income tax benefit of $6,823 thousands, a labor cost benefit of $2,167 thousands and $631 thousands were accrued to pay software development law audit fees. Aggregate per share effect of the Argentine tax holiday amounted to $0.46 and $0.20 for the nine and three-month periods ended September 30, 2016, respectively.

As of September 30, 2017 and December 31, 2016, the Company had included under non-current deferred tax assets the foreign tax credits related to the dividend distributions received from its subsidiaries for a total amount of $11,588 thousands and $13,515 thousands, respectively. Those foreign tax credits will be used to offset the future domestic income tax payable.

Accumulated other comprehensive loss

The following table sets forth the Company's accumulated other comprehensive loss as of September 30, 2017 and the year ended December 31, 2016:

| | September 30, 2017 | December 31, 2016 |
|---|---|---|
| | (In thousands) | |
| Accumulated other comprehensive loss: | | |

| | | |
|---|---|---|
| Foreign currency translation | $ (277,171) | $ (259,226) |
| Unrealized gains (losses) on investments | 518 | (909) |
| Estimated tax (loss) gain on unrealized gains (losses) on investments | (178) | 322 |
| | $ (276,831) | $ (259,813) |

The following tables summarize the changes in accumulated balances of other comprehensive loss for the nine-month period ended September 30, 2017:

| | Unrealized (Losses) Gains on Investments (In thousands) | Foreign Currency Translation | Estimated tax (expense) benefit | Total |
|---|---|---|---|---|
| Balances as of December 31, 2016 | $ (909) | $ (259,226) | $ 322 | $ (259,813) |
| Other comprehensive loss before reclassifications adjustments for gains (losses) on available for sale investments | 518 | (17,945) | (178) | (17,605) |
| Amount of gain (loss) reclassified from accumulated other comprehensive loss | 909 | — | (322) | 587 |
| Net current period other comprehensive income gain (loss) | 1,427 | (17,945) | (500) | (17,018) |
| Ending balance | $ 518 | $ (277,171) | $ (178) | $ (276,831) |

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MercadoLibre, Inc.

Notes to Interim Condensed Consolidated Financial Statements (unaudited)

| Details about Accumulated Other Comprehensive Loss Components | Amount of (Loss) Gain Reclassified from Accumulated Other Comprehensive Loss (In thousands) | | Affected Line Item in the Statement of Income |
|---|---|---|---|
| Unrealized losses on investments | $ | (909) | Interest expense and other financial losses |
| Estimated tax gain on unrealized losses on investments | 322 | | Income tax gain |
| Total reclassifications for the year | $ | (587) | Total, net of income taxes |

Impairment of long-lived assets

The Company reviews its long-lived assets (including non-current other assets) for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable.

As explained in section “Foreign Currency Translation” of the present Note to these interim condensed consolidated financial statements, Venezuelan currency experienced a steep devaluation in the second quarter of 2017 and 2016.

Considering this change in facts and circumstances and the lower U.S. dollar-equivalent cash flows expected from the Venezuelan business, and long-lived assets expected use, the Company concluded that certain real estate investments held in Caracas, Venezuela, should be impaired. The fair value of long-lived assets was estimated through market approach using level 3 inputs in the fair value hierarchy. These level 3 inputs included, but are not limited to, executed purchase agreements in similar assets and third party valuations. As a consequence, the Company estimated the fair value of the impaired long-lived assets, and recorded impairment losses of $2.8 million and $13.7 million on June 30, 2017 and June 30, 2016, respectively.

Use of estimates

The preparation of interim condensed consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates are used for, but not limited to accounting for allowance for doubtful accounts and chargeback provisions, recoverability of goodwill and intangible assets with indefinite useful life, useful life of long-lived assets and intangible assets, impairment of short-term and long-term investments, impairment of long-lived assets, compensation costs relating to the Company's long term retention plan, fair value of convertible debt note, recognition of income taxes and contingencies. Actual results could differ from those estimates.

Recently issued accounting pronouncements

In 2014, the Financial Accounting Standards Board ("FASB") issued new accounting guidance related to revenue recognition. This new standard will replace all current GAAP guidance on this topic and eliminate all industry-specific guidance. The new revenue recognition guidance provides a unified model to determine when and how revenue is recognized. The core principle is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration for which the entity expects to be entitled in exchange for those goods or services. In 2016, the FASB issued several amendments to the standard, including principal versus agent considerations when another party is involved in providing goods or services to a customer and the application of identifying performance obligations. The Company has substantially completed the assessment on the adoption of this standard concluding that it is not expected to have a material measurement impact on the Company´s financial statements. However, the Company continues assessing the potential impacts regarding the presentation of certain incentives recorded as an expense under current guidance.  The adoption of this standard will also require to expand and include certain additional disclosures. The standard is required to be applied either retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying it recognized at the date of initial application. The Company continues evaluating the transition method upon adoption. The Company will adopt the new revenue standard in its first quarter of 2018.

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On February 25, 2016 the FASB issued ASU 2016-02. The amendments in this update create Topic 842, Leases, which supersedes Topic 840, Leases. The core principle of Topic 842 is that a lessee should recognize the assets and liabilities that arise from leases. Previous GAAP did not require lease assets and lease liabilities to be recognized for most leases. A lessee should recognize in the statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. For leases with a term of 12 months or less, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. Topic 842 retains a distinction between finance leases and operating leases. The classification criteria for distinguishing between finance leases and operating leases are substantially similar to the classification criteria for distinguishing between capital leases and operating leases in the previous leases guidance. The result of retaining a distinction between finance leases and operating leases is that under the lessee accounting model in Topic 842, the effect of leases in the statement of comprehensive income and the statement of cash flows is largely unchanged from previous GAAP. Based on existing leases currently classified as operating leases, the Company expects to recognize on the statements of financial position right-of-use assets and lease liabilities. The amendments in this update are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is assessing the effects that the adoption of this accounting pronouncement may have on the Company’s financial statements.

On June 16, 2016 the FASB issued ASU 2016-13 “Financial Instruments-Credit Losses (Topic 326): Measurement of credit losses on financial instruments”. This update amends guidance on reporting credit losses for assets held at amortized cost basis and available for sale debt securities. For assets held at amortized cost basis, this update eliminates the probable initial recognition threshold in current GAAP and, instead, requires an entity to reflect its current estimate of all expected credit losses. For available for sale debt securities, credit losses should be measured in a manner similar to current GAAP, however this topic will require that credit losses be presented as an allowance rather than as a write-down. The new standard is effective for fiscal years beginning after December 15, 2019. The Company is assessing the effects that the adoption of this accounting pronouncement may have on its financial statements.

On October 24, 2016 the FASB issued “ASU 2016-16—Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory”. This update eliminates the prohibition on recognizing current and deferred income tax consequences for an intra-entity asset transfer until the asset or assets have been sold to an outside party. Consequently, this update requires recognition of the current and deferred income tax consequences of an intra-entity asset transfer when the transfer occurs. The new standard is effective for fiscal years beginning after December 15, 2017. The adoption of this standard is not expected to have a material impact on the Company´s financial statements.

On September 29, 2017 the FASB issued “ASU 2017-13—Revenue recognition (Topic 605), Revenue from contracts with customers (Topic 606), Leases (Topic 840), and Leases (Topic 842)”. This update addresses Transition Related to Accounting Standards Updates No. 2014-09, Revenue from Contracts with Customers (Topic 606), and No. 2016-02, Leases (Topic 842). This Update also supersedes SEC paragraphs pursuant the rescission of SEC Staff Announcement, “Accounting for Management Fees Based on a Formula”, effective upon the initial adoption of Topic 606, Revenue from Contracts with Customers, and SEC Staff Announcement, “Lessor Consideration of Third-Party Value Guarantees,” effective upon the initial adoption of Topic 842, Leases. The adoption of this standard is not expected to have a material impact on the Company´s financial statements.

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## 3. Net income per share

Basic earnings per share for the Company's common stock is computed by dividing, net income available to common shareholders attributable to common stock for the period by the weighted average number of common shares outstanding during the period.

On June 30, 2014, the Company issued 2.25% Convertible Senior Notes due 2019 (see Note 9 of these interim condensed consolidated financial statements for discussion regarding these debt notes). The conversion of these debt notes are included in the calculation for diluted earnings per share utilizing the "if converted" method. The effect of that conversion is not assumed for purposes of computing diluted earnings per share if the effect is antidilutive.

The denominator for diluted net income per share for the nine and three-month periods ended September 30, 2017 and 2016 does not include any effect from the 2014 and 2017 Capped Call Transactions (as defined below) because it would be antidilutive. In the event of conversion of any or all of the Notes, the shares that would be delivered to the Company under the Capped Call Transactions are designed to partially neutralize the dilutive effect of the shares that the Company would issue under the Notes. See Note 9 of these interim condensed consolidated financial statements and Note 17 of the financial statements as of December 31,2016 on Form 10-K for more details.

For the nine and three-month periods ended September 30, 2017 and 2016, the effects on diluted earnings per share were antidilutive and, as a consequence, they were not computed for diluted earnings per share.

Net income per share of common stock is as follows for the nine and three-month periods ended September 30, 2017 and 2016:

| | Nine Months Ended September 30, | | | | Three Months Ended September 30, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2017 | | 2016 | | 2017 | | 2016 | |
| | (In thousands) | | | | (In thousands) | | | |
| | Basic | Diluted | Basic | Diluted | Basic | Diluted | Basic | Diluted |
| Net income per common share | $ 1.85 | $ 1.85 | $ 1.93 | $ 1.93 | $ 0.63 | $ 0.63 | $ 0.88 | $ 0.88 |
| Numerator: | | | | | | | | |
| | $ 81,500 | $ 81,500 | $ 85,017 | $ 85,017 | $ 27,666 | $ 27,666 | $ 38,912 | $ 38,912 |

| | | | | |
|---|---|---|---|---|
| Net income | | | | |
| Denominator: | | | | |
| Weighted average of common stock outstanding for Basic earnings per share | 44,157,364 | 44,157,215 | 44,157,364 | 44,157,341 |
| Adjusted weighted average of common stock outstanding for Diluted earnings per share | 44,157,364 | 44,157,215 | 44,157,364 | 44,157,341 |

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Notes to Interim Condensed Consolidated Financial Statements (unaudited)

## 4. Goodwill and intangible assets

Goodwill and intangible assets

The composition of goodwill and intangible assets is as follows:

| | September 30, 2017 | | December 31, 2016 | |
|---|---|---|---|---|
| | (In thousands) | | | |
| Goodwill | $ | 95,249 | $ | 91,797 |
| Intangible assets with indefinite lives | | | | |
| - Trademarks | 13,153 | | 12,490 | |
| Amortizable intangible assets | | | | |
| - Licenses and others | 6,565 | | 8,738 | |
| - Non-compete agreement | 2,491 | | 1,787 | |
| - Customer list | 15,215 | | 14,580 | |
| - Trademarks | 1,854 | | 993 | |
| Total intangible assets | $ | 39,278 | $ | 38,588 |
| Accumulated amortization | (14,636) | | (12,311) | |
| Total intangible assets, net | $ | 24,642 | $ | 26,277 |

Goodwill

The changes in the carrying amount of goodwill for the nine-month period ended September 30, 2017 and the year ended December 31, 2016 are as follows:

| | Period ended September 30, 2017 | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Brazil | | Argentina | | Chile | | Mexico | | Venezuela | | Co |
| | (In thousands) | | | | | | | | | | |
| Balance, beginning of the | $ | 27,660 | $ | 6,587 | $ | 17,388 | $ | 29,342 | $ | 5,989 | $ |

| | | | | | | |
|---|---|---|---|---|---|---|
| period | | | | | | |
| - Effect of exchange rates changes | 245 | (809) | 783 | 3,158 | — | 50 |
| Balance, end of the period | $ 27,905 | $ 5,778 | $ 18,171 | $ 32,500 | $ 5,989 | $ |

| | Year ended December 31, 2016 | | | | | |
|---|---|---|---|---|---|---|
| | Brazil | Argentina | Chile | Mexico | Venezuela | Colombi |
| | (In thousands) | | | | | |
| Balance, beginning of year | $ 18,526 | $ 7,430 | $ 16,438 | $ 33,834 | $ 5,729 | $ |
| - Business acquisition | 5,635 | 700 | — | 190 | 260 | 57 |
| - Effect of exchange rates changes | 3,499 | (1,543) | 950 | (4,682) | — | 149 |
| Balance, end of the year | $ 27,660 | $ 6,587 | $ 17,388 | $ 29,342 | $ 5,989 | $ |

Intangible assets with definite useful life

Intangible assets with definite useful life are comprised of customer lists, non-compete and non-solicitation agreements, acquired software licenses, other acquired intangible assets including developed technologies and trademarks. Aggregate amortization expense for intangible assets totaled $1,182 thousands and $1,144 thousands for the three-month periods ended September 30, 2017 and 2016, respectively, while for the nine-month periods ended at such dates amounted to $3,247 thousands and $2,863 thousands, respectively.

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The following table summarizes the remaining amortization of intangible assets (in thousands of U.S. dollars) with definite useful life as of September 30, 2017:

| | | |
|---|---|---|
| For year ended 12/31/2017 | $ | 1,343 |
| For year ended 12/31/2018 | 4,475 | |
| For year ended 12/31/2019 | 2,201 | |
| For year ended 12/31/2020 | 956 | |
| Thereafter | 2,514 | |
| | $ | 11,489 |

5. Segment reporting

Reporting segments are based upon the Company's internal organizational structure, the manner in which the Company's operations are managed and resources are assigned, the criteria used by management to evaluate the Company's performance, the availability of separate financial information, and overall materiality considerations.

Segment reporting is based on geography as the main basis of segment breakdown to reflect the evaluation of the Company's performance defined by the management. The Company's segments include Brazil, Argentina, Mexico, Venezuela and other countries (such as Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, Panama, Honduras, Nicaragua, Salvador, Bolivia, Guatemala, Paraguay, Peru, Portugal, Uruguay and USA).

Direct contribution consists of net revenues from external customers less direct costs. Direct costs include costs of net revenues, product and technology development expenses, sales and marketing expenses, and general and administrative expenses over which segment managers have direct discretionary control, such as advertising and marketing programs, customer support expenses, allowances for doubtful accounts, payroll and third party fees. All corporate related costs have been excluded from the Company's direct contribution.

Expenses over which segment managers do not currently have discretionary control, such as certain technology and general and administrative costs are monitored by management through shared cost centers and are not evaluated in the measurement of segment performance.

The following tables summarize the financial performance of the Company's reporting segments:

| | Nine Months Ended September 30, 2017 | | | | | |
|---|---|---|---|---|---|---|
| | Brazil | Argentina | Mexico | Venezuela | Other Countries | Total |
| | (In thousands) | | | | | |
| Net revenues | $ 569,320 | $ 250,692 | $ 58,324 | $ 38,329 | $ 44,452 | $ |
| Direct costs | (390,008) | (150,973) | (95,683) | (16,841) | (37,052) | (690,557 |
| Impairment of Long-lived Assets | - | - | - | (2,837) | - | (2,837) |
| Direct contribution | 179,312 | 99,719 | (37,359) | 18,651 | 7,400 | 267,723 |
| Operating expenses and indirect costs of net revenues | | | | | | (146,841 |
| Income from operations | | | | | | 120,882 |
| Other income (expenses): | | | | | | |
| Interest income and other financial gains | | | | | | 37,020 |
| Interest expense and other financial losses | | | | | | (19,686) |
| Foreign currency losses | | | | | | (19,475) |
| Net income before income tax expense | | | | | | $ |

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MercadoLibre, Inc.

Notes to Interim Condensed Consolidated Financial Statements (unaudited)

| | Nine Months Ended September 30, 2016 | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Brazil | | Argentina | | Mexico | | Venezuela | | Other Countries | |
| | (In thousands) | | | | | | | | | |
| Net revenues | $ | 311,427 | $ | 185,885 | $ | 34,375 | $ | 26,451 | $ | 29, |
| Direct costs | (188,772) | | (105,217) | | (29,004) | | (12,691) | | (21,281) | |
| Impairment of Long-lived Assets | - | | - | | - | | (13,717) | | - | |
| Direct contribution | 122,655 | | 80,668 | | 5,371 | | 43 | | 8,702 | |
| | | | | | | | | | | |
| Operating expenses and indirect costs of net revenues | | | | | | | | | | |
| Income from operations | | | | | | | | | | |
| | | | | | | | | | | |
| Other income (expenses): | | | | | | | | | | |
| Interest income and other financial gains | | | | | | | | | | |
| Interest expense and other financial losses | | | | | | | | | | |
| Foreign currency losses | | | | | | | | | | |
| Net income before income tax | | | | | | | | | | |

expense

| | Three Months Ended September 30, 2017 | | | | | |
|---|---|---|---|---|---|---|
| | Brazil | Argentina | Mexico | Venezuela | Other Countries | Total |
| | (In thousands) | | | | | |
| Net revenues | $ 229,475 | $ 91,308 | $ 22,604 | $ 9,751 | $ 17,523 | $ 370,661 |
| Direct costs | (182,858) | (56,210) | (36,038) | (4,582) | (14,409) | (294,097) |
| Direct contribution | 46,617 | 35,098 | (13,434) | 5,169 | 3,114 | 76,564 |
| Operating expenses and indirect costs of net revenues | | | | | | (49,022) |
| Income from operations | | | | | | 27,542 |
| Other income (expenses): | | | | | | |
| Interest income and other financial gains | | | | | | 14,200 |
| Interest expense and other financial losses | | | | | | (6,709) |
| Foreign currency gains | | | | | | 1,622 |
| Net income before income tax expense | | | | | | $36,655 |

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MercadoLibre, Inc.

Notes to Interim Condensed Consolidated Financial Statements (unaudited)

| | Three Months Ended September 30, 2016 | | | | | |
|---|---|---|---|---|---|---|
| | Brazil | Argentina | Mexico | Venezuela | Other Countries | Total |
| | (In thousands) | | | | | |
| Net revenues | $131,003 | $69,983 | $11,807 | $6,885 | $11,169 | $230,847 |
| Direct costs | (77,012) | (39,026) | (10,353) | (3,462) | (7,943) | (137,796) |
| Direct contribution | 53,991 | 30,957 | 1,454 | 3,423 | 3,226 | 93,051 |
| Operating expenses and indirect costs of net revenues | | | | | | (39,342) |
| Income from operations | | | | | | 53,709 |
| Other income (expenses): | | | | | | |
| Interest income and other financial gains | | | | | | 9,892 |
| Interest expense and other financial losses | | | | | | (6,492) |
| Foreign currency losses | | | | | | (4,823) |
| Net income before income tax | | | | | | $52,286 |

expense

The following table summarizes the allocation of property and equipment, net based on geography:

| | September 30, 2017 | December 31, 2016 |
|---|---|---|
| | (In thousands) | |
| US property and equipment, net | $ 8,445 | $ 9,771 |
| Other countries | | |
| Argentina | 25,842 | 25,071 |
| Brazil | 67,351 | 55,706 |
| Mexico | 3,487 | 2,307 |
| Venezuela | 21,935 | 21,615 |
| Other countries | 9,041 | 9,791 |
| | $ 127,656 | $ 114,490 |
| Total property and equipment, net | $ 136,101 | $ 124,261 |

The following table summarizes the allocation of the goodwill and intangible assets based on geography:

| | September 30, 2017 | December 31, 2016 |
|---|---|---|
| | (In thousands) | |
| US intangible assets | $ 146 | $ 250 |
| Other countries goodwill and intangible assets | | |
| Argentina | 6,630 | 7,717 |
| Brazil | 30,400 | 31,170 |
| Mexico | 41,992 | 38,860 |
| Venezuela | 7,168 | 7,366 |
| Chile | 28,164 | 27,395 |
| Other countries | 5,391 | 5,316 |
| | $ 119,745 | $ 117,824 |
| Total goodwill and intangible assets | $ 119,891 | $ 118,074 |

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MercadoLibre, Inc.

Notes to Interim Condensed Consolidated Financial Statements (unaudited)

Consolidated net revenues by similar products and services for the nine and three-month periods ended September 30, 2017 and 2016 were as follows:

| | Nine-months Ended September 30, | | Three-months Ended September 30, | |
|---|---|---|---|---|
| Consolidated Net Revenues | 2017 | 2016 | 2017 | 2016 |
| | (In thousands) | | (In thousands) | |
| Marketplace | $ 582,475 | $ 341,749 | $ 227,269 | $ 134,374 |
| Non-marketplace (*) (**) | $ 378,642 | $ 246,372 | $ 143,392 | $ 96,473 |
| Total | $ 961,117 | $ 588,121 | $ 370,661 | $ 230,847 |

(*) Includes, among other things, Ad Sales, Classified Fees, Payment Fees, Shipping Fees and other ancillary services.

(**) Includes an amount of $232,426 thousands and $139,630 thousands of Payment Fees for the nine-month periods ended September 30, 2017 and 2016, respectively. Includes an amount of $92,254 thousands and $52,444 thousands of Payment Fees for the three-month periods ended September 30, 2017 and 2016, respectively.

6. Fair value measurement of assets and liabilities

The following table summarizes the Company’s financial assets and liabilities measured at fair value on a recurring basis as of September 30, 2017 and December 31, 2016:

| Description | Balances as of September 30, 2017 (In thousands) | Quoted Prices in active markets for identical Assets (Level 1) | Significant other observable inputs (Level 2) | Unobservable inputs (Level 3) | Balances as of December 31, 2016 | Quote active identi (Leve |
|---|---|---|---|---|---|---|
| Assets | | | | | | |
| Cash and Cash Equivalents: | | | | | | |
| Money Market Funds | $ 189,574 | $ 189,574 | $ — | $ — | $ 111,198 | $ |
| Investments: | | | | | | |
| Sovereign Debt Securities | $ 21,786 | $ 21,786 | $ — | $ — | $ 50,703 | $ |
| Corporate Debt Securities | 30,468 | 28,384 | 2,084 | — | 207,633 | 61,98 |
| Certificates of deposit | — | — | — | — | 35,374 | — |
| Total Financial Assets | $ 241,828 | $ 239,744 | $ 2,084 | $ — | $ 404,908 | $ |
| Liabilities: | | | | | | |
| Contingent considerations | $ — | $ — | $ — | $ — | $ 4,213 | $ |
| Long-term retention plan | 38,503 | — | 38,503 | — | 27,135 | — |
| Total Financial Liabilities | $ 38,503 | $ — | $ 38,503 | $ — | $ 31,348 | $ |

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Notes to Interim Condensed Consolidated Financial Statements (unaudited)

As of September 30, 2017 and December 31, 2016, the Company's financial assets valued at fair value consisted of assets valued using i) Level 1 inputs: unadjusted quoted prices in active markets (Level 1 instrument valuations are obtained from observable inputs that reflect quoted prices (unadjusted) for identical assets in active markets) and; ii) Level 2 inputs: obtained from readily-available pricing sources for comparable instruments as well as instruments with inactive markets at the measurement date.

As of September 30, 2017 and December 31, 2016, the Company´s liabilities were valued at fair value using level 2 inputs and level 3 inputs (valuations based on unobservable inputs reflecting Company assumptions). Fair value of contingent considerations are determined based on the probability of achievement of the performance targets arising from each acquisition, as well as the Company's historical experience with similar arrangements. For the nine-month period ended September 30, 2017, the Company recognized in earnings a gain of $3,164 thousands and a loss of $166 thousands within other comprehensive income, in relation with contingent considerations. In addition, during the nine-month period ended September 30, 2017, the Company settled contingent considerations for an amount of $1,215 thousands.

The unrealized net gains or loss on short term and long term investments are reported as a component of other comprehensive income. The Company does not anticipate any significant realized losses associated with those investments in excess of the Company's historical cost.

As of September 30, 2017 and December 31, 2016, the carrying value of the Company's financial assets and liabilities measured at amortized cost approximated their fair value mainly because of its short term maturity. These assets and liabilities included cash, cash equivalents and short-term investments (excluding money markets funds and corporate debt security), accounts receivable, credit cards receivable, loans receivable, funds payable to customers, other assets, accounts payable, salaries and social security payable (excluding variable LTRP), taxes payable, provisions and other liabilities (excluding contingent consideration). The convertible senior notes (liability component), the rest of the loans payable and other financial liabilities approximate their fair value because the interest rates are not materially different from market interest rates.

The following table summarizes the fair value level for those financial assets and liabilities of the Company measured at amortized cost as of September 30, 2017 and December 31, 2016:

| | Balances as of September 30, 2017 | Significant other observable inputs (Level 2) | Balances as of December 31, 2016 | Significant other observable inputs (Level 2) |
|---|---|---|---|---|
| | (In thousands) | | | |
| Assets | | | | |
| Time Deposits | $ 167,224 | $ 167,224 | $ 113,414 | $ 113,414 |

| | | | | |
|---|---|---|---|---|
| Accounts receivable | 28,564 | 28,564 | 25,435 | 25,435 |
| Credit Cards receivable | 406,883 | 406,883 | 307,904 | 307,904 |
| Loans receivable, net | 51,843 | 51,843 | 6,283 | 6,283 |
| Other assets | 89,097 | 89,097 | 58,900 | 58,900 |
| Total Assets | $ 743,611 | $ 743,611 | $ 511,936 | $ 511,936 |
| Liabilities | | | | |
| Accounts payable and accrued expenses | $ 181,557 | $ 181,557 | $ 105,106 | $ 105,106 |
| Funds payable to customers | 519,420 | 519,420 | 370,693 | 370,693 |
| Salaries and social security payable | 44,789 | 44,789 | 37,936 | 37,936 |
| Taxes payable | 27,923 | 27,923 | 27,338 | 27,338 |
| Dividends payable | 6,624 | 6,624 | 6,624 | 6,624 |
| Loans payable and other financial liabilities (*) | 334,145 | 334,145 | 313,523 | 313,523 |
| Other liabilities | 18,740 | 18,740 | 11,954 | 11,954 |
| Total Liabilities | $ 1,133,198 | $ 1,133,198 | $ 873,174 | $ 873,174 |

(*) The fair value of the convertible senior notes (including the equity component) is disclosed in Note 9.

As of September 30, 2017 and December 31, 2016, the Company held no direct investments in auction rate securities, collateralized debt obligations or structured investment vehicles, and does not have any non-financial assets or liabilities measured at fair value.

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Notes to Interim Condensed Consolidated Financial Statements (unaudited)

As of September 30, 2017 and December 31, 2016, the fair value of money market funds, short and long-term investments classified as available for sale securities are as follows:

| | September 30, 2017 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Cost | | Gross Unrealized Gains (1) | | Gross Unrealized Losses (1) | | Estimated Fair Value | |
| | (In thousands) | | | | | | | |
| Cash and cash equivalents | | | | | | | | |
| Money Market Funds | $ | 189,574 | $ | — | $ | — | $ | 189,574 |
| Total Cash and cash equivalents | $ | 189,574 | $ | — | $ | — | $ | 189,574 |
| Short-term investments | | | | | | | | |
| Corporate Debt Securities | 7,250 | | 1 | | (4) | | 7,247 | |
| Sovereign Debt Securities | 697 | | — | | (3) | | 694 | |
| Total Short-term investments | $ | 7,947 | $ | 1 | $ | (7) | $ | 7,941 |
| Long-term investments | | | | | | | | |
| Sovereign Debt Securities | $ | 21,196 | $ | — | $ | (104) | $ | 21,092 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Corporate Debt Securities | 23,210 | | 43 | | (32) | | 23,221 | |
| Total Long-term investments | $ | 44,406 | $ | 43 | $ | (136) | $ | 44,313 |
| Total | $ | 241,927 | $ | 44 | $ | (143) | $ | 241,828 |

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MercadoLibre, Inc.

Notes to Interim Condensed Consolidated Financial Statements (unaudited)

| | December 31, 2016 | | | |
|---|---|---|---|---|
| | Cost | Gross Unrealized Gains (1) | Gross Unrealized Losses (1) | Estimated Fair Value |
| | (In thousands) | | | |
| Cash and cash equivalents | | | | |
| Money Market Funds | $ 111,198 | $ — | $ — | $ 111,198 |
| Total Cash and cash equivalents | $ 111,198 | $ — | $ — | $ 111,198 |
| Short-term investments | | | | |
| Sovereign Debt Securities | $ 2,166 | $ — | $ — | $ 2,166 |
| Corporate Debt Securities | 102,509 | 26 | (168) | 102,367 |
| Certificates of deposit | 35,336 | 40 | (2) | 35,374 |
| Total Short-term investments | $ 140,011 | $ 66 | $ (170) | $ 139,907 |
| Long-term investments | | | | |
| Sovereign Debt Securities | $ 48,943 | $ — | $ (406) | $ 48,537 |
| Corporate Debt Securities | 105,632 | 90 | (456) | 105,266 |
| Total Long-term investments | $ 154,575 | $ 90 | $ (862) | $ 153,803 |
| Total | $ 405,784 | $ 156 | $ (1,032) | $ 404,908 |

(1) Unrealized gains (losses) from securities are attributable to market price movements, net foreign exchange losses and foreign currency translation. Management does not believe any remaining significant unrealized losses represent other-than-temporary impairments based on the evaluation of available evidence including the credit rating of the investments, as of September 30, 2017 and December 31, 2016.

The material portion of the Sovereign Debt Securities consists of U.S. Treasury Notes, which carry no significant risk.

As of September 30, 2017, the estimated fair values (in thousands of U.S. dollars) of cash equivalents, short-term and long-term investments classified by their effective maturities are as follows:

| | | |
|---|---|---|
| One year or less | 197,515 | |
| One year to two years | 20,331 | |
| Two years to three years | 16,847 | |
| Three years to four years | 7,135 | |
| Total | $ | 241,828 |

7. Commitments and Contingencies

Litigation and Other Legal Matters

The Company is subject to certain contingent liabilities with respect to existing or potential claims, lawsuits and other proceedings. The Company accrues liabilities when it considers probable that future costs will be incurred and such costs can be reasonably estimated. The proceeding-related reserve is based on developments to date and historical information related to actions filed against the Company. As of September 30, 2017, the Company had established reserves for proceeding-related contingencies and other estimated contingencies of $6,208 thousand to cover legal actions against the Company in which its management has assessed the likelihood of a final adverse outcome as probable. Expected legal costs related to litigations are accrued when the legal service is actually provided. In addition, as of September 30, 2017 the Company and its subsidiaries are subject to certain legal actions considered by the Company's management and its legal counsels to be reasonably possible for an aggregate amount up to $6,506 thousand.

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No loss amount has been accrued for such reasonably possible legal actions of which most significant (individually or in the aggregate) are described below and in note 15 is to the financial statements in the Form 10-K for the year ended December 31, 2016.

As of September 30, 2017, there were 56 lawsuits pending against our Argentine subsidiary in the Argentine ordinary courts and 1,856 pending claims in the Argentine Consumer Protection Agencies, where a lawyer is not required to file or pursue a claim.

As of September 30, 2017, there were 10 claims pending against our Mexican subsidiaries in the Mexican ordinary courts and 248 claims pending against our Mexican subsidiaries in the Mexican Consumer Protection Agencies, where a lawyer is not required to file or pursue a claim.

As of September 30, 2017, 700 legal actions were pending in the Brazilian ordinary courts. In addition, as of September 30, 2017, there were 4,016 cases still pending in Brazilian consumer courts. Filing and pursuing of an action before Brazilian consumer courts do not require the assistance of a lawyer.

On July 12, 2017, São Paulo tax authorities assessed taxes and fines against one of our Brazilian subsidiaries (iBazar) relating to "ICMS Publicidade" for the period from July 2012 to December 2013 in an amount of R$ 12.2 million or $ 3.7 million according to the exchange rate in effect at that time. The Company will present administrative defense against the authorities' claim. The opinion of the Company´s management, based on the opinion of external legal counsel, is that the risk of losing the case is reasonably possible, but not probable.

In most of the cases filed against the Company, the plaintiffs asserted that the Company was responsible for fraud committed against them, or responsible for damages suffered when purchasing an item on the Company's website, when using MercadoPago or MercadoEnvios, or when the Company invoiced them.

Other third parties have from time to time claimed, and others may claim in the future, that the Company was responsible for fraud committed against them, or that the Company has infringed their intellectual property rights. The underlying laws with respect to the potential liability of online intermediaries like the Company are unclear in the jurisdictions where the Company operates. Management believes that additional lawsuits alleging that the Company has violated copyright or trademark laws will be filed against the Company in the future.

Intellectual property and regulatory claims, whether meritorious or not, are time consuming and costly to resolve, require significant amounts of management time, could require expensive changes in the Company's methods of doing business, or could require the Company to enter into costly royalty or licensing agreements. The Company may be subject to patent disputes, and be subject to patent infringement claims as the Company's services expand in scope and complexity. In particular, the Company may face additional patent infringement claims involving various aspects of the payments businesses.

From time to time, the Company is involved in other disputes or regulatory inquiries that arise in the ordinary course of business. The number and significance of these disputes and inquiries are increasing as the Company's business expands and the Company grows larger.

Buyer protection program

The Company provides consumers with a buyer protection program (“BPP”) for all transactions completed through the Company’s online payment solution (“MercadoPago”). This program is designed to protect buyers in the Marketplace from losses due primarily to fraud or counterparty non-performance. The Company’s BPP provides protection to consumers by reimbursing them for the total value of the unfulfilled transaction, if a purchased item does not arrive or does not match the seller’s description. The Company is entitled to recover from the third-party carrier companies performing the shipping service certain amounts paid under the BPP. Furthermore, in some specific circumstances (i.e. Black Friday, Hot Sale), the Company enters into insurance contracts with third party insurance companies in order to cover contingencies that may arise from the BPP.

The maximum potential exposure under this program is estimated to be the volume of payments on the Marketplace, for which claims may be made under the Company’s existing user agreements. Based on historical losses to date, the Company does not believe that the maximum potential exposure is representative of the actual potential exposure. The Company records a liability with respect to losses under this program when they are probable and the amount can be reasonably estimated.

As of September 30, 2017, management's estimate of the maximum potential exposure related to the Company’s buyer protection program is $663,139 thousands, for which the Company recorded an allowance of $1,212 thousands as of that date.

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8. Long term retention plan ("LTRP")

On April 3, 2017, the Board of Directors, upon the recommendation of the Compensation Committee, adopted the 2017 Long-Term Retention Plan ("2017 LTRP"). In addition to the annual salary and bonus of each employee, certain employees ("Eligible Employees") are eligible to participate in the 2017 LTRP, which provides for the grant to an Eligible Employee of a cash-settled fixed (a "2017 LTRP Fixed Award") and a cash-settled variable award, (a "2017 LTRP Variable Award", and together with any 2017 LTRP Fixed Award, the "2017 LTRP Awards"). In order to receive payment in respect of the 2017 LTRP Awards, each Eligible Employee must satisfy the performance conditions established by the Board of Directors for such employee. If these conditions are satisfied, the Eligible Employee will, subject to his or her continued employment as of each applicable payment date, receive the full amount of his or her 2017 LTRP Awards, payable as follows:

- 2017 LTRP Fixed Award: The eligible employee will receive a fixed payment equal to 16.66% of his or her 2017 LTRP Fixed Award once a year for a period of six years starting in March 2018 (the "Annual Fixed Payment"); and
- 2017 LTRP Variable Award: On each date the Company pays the Annual Fixed Payment to the eligible employee, he or she will also receive a 2017 LTRP Variable Award payment equal to the product of (i) 16.66% of the applicable 2017 LTRP Variable Award and (ii) the quotient of (a) divided by (b), where (a), the numerator, equals the Applicable Year Stock Price (as defined below) and (b), the denominator, equals the 2016 Stock Price (as defined below). For purposes of the 2017 LTRP, the "2016 Stock Price" shall equal $164.17 (the average closing price of the Company´s common stock on the NASDAQ Global Market during the final 60-trading days of 2016) and the "Applicable Year Stock Price" shall equal the average closing price of the Company´s common stock on the NASDAQ Global Market during the final 60-trading days of the year preceding the applicable payment date for so long as the Company´s common stock is listed on the NASDAQ.

The following table summarizes the 2009, 2010, 2011, 2012, 2013, 2014, 2015, 2016 and 2017 long term retention plan accrued compensation expense for the nine and three-month periods ended September 30, 2017 and 2016, which are payable in cash according to the decisions made by the Board of Directors:

| | Nine Months Ended September 30, | | Three Months Ended September 30, | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| | (In thousands) | | (In thousands) | |
| LTRP 2009 | $ 29 | $ 648 | $ - | $ 352 |
| LTRP 2010 | 891 | 1,017 | 147 | 543 |
| LTRP 2011 | 1,422 | 1,275 | 229 | 672 |
| LTRP 2012 | 1,945 | 1,555 | 315 | 813 |
| LTRP 2013 | 3,809 | 3,380 | 711 | 1,689 |
| LTRP 2014 | 3,782 | 3,089 | 772 | 1,448 |
| LTRP 2015 | 4,680 | 3,846 | 1,063 | 1,663 |
| LTRP 2016 | 6,717 | 4,441 | 1,606 | 1,944 |
| LTRP 2017 | 5,459 | - | 1,823 | - |
| Total LTRP | $ 28,734 | $ 19,251 | $ 6,666 | $ 9,124 |

9. 2.25% Convertible Senior Notes Due 2019

On June 30, 2014, the Company issued $330 million of 2.25% convertible senior notes due 2019 (the “Notes”). The Notes are unsecured, unsubordinated obligations of the Company, which pay interest in cash semi-annually, on January 1 and July 1, at a rate of 2.25% per annum. The Notes will mature on July 1, 2019 unless earlier repurchased or converted in accordance with their terms prior to such date. The Notes may be converted, under specific conditions, based on an initial conversion rate of 7.9353 shares of common stock per $1,000 principal amount of Notes (equivalent to an initial conversion price of $126.02 per share of common stock), subject to adjustment as described in the indenture governing the Notes.

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Holders may convert their notes at their option at any time prior to January 1, 2019 only under the following circumstances: (1) during any calendar quarter commencing after the calendar quarter ending on September 30, 2014 (and only during such calendar quarter), if the last reported sale price of the common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price on each applicable trading day; (2) during the five business day period after any five consecutive trading day period (the "measurement period") in which the trading price per $1,000 principal amount of notes for each trading day of the measurement period was less than 98% of the product of the last reported sale price of the Company's common stock and the conversion rate on each such trading day; or (3) upon the occurrence of specified corporate events. On or after January 1, 2019 until the close of business on the second scheduled trading day immediately preceding the maturity date, holders may convert their notes at any time, regardless of the foregoing circumstances.

During the period from October 1, 2016 through December 31, 2016, 12 Notes were converted for a total amount of $12 thousands. During the period from April 1, 2017 through September 30, 2017, 16 Notes were converted for a total amount of $16 thousands. Additionally, during the third quarter of 2017, the conversion threshold was met again and the Notes became convertible at the holders' option beginning on October 1, 2017 and ending on December 31, 2017. The determination of whether or not the Notes are convertible must continue to be performed on a quarterly basis. Upon conversion, the Company will pay or deliver, as the case may be, cash, shares of the Company's common stock or a combination of cash and shares of the Company's common stock, at the Company's election. The intention of the Company is to share-settle the total amount due upon conversion of the Notes.

From October 1, 2017 to the date of issuance of these interim condensed consolidated financial statements, no additional conversion requests were made.

In connection with the issuance of the Notes, the Company paid $19.7 million and $67.3 million (including transaction expenses) in June 2014 and September 2017, respectively, to enter into capped call transactions with respect to shares of the common stock (the "Capped Call Transactions"), with certain financial institutions. The Capped Call Transactions are expected generally to reduce the potential dilution upon conversion of the Convertible Notes in the event that the market price of the common stock is greater than the strike price of the Capped Call Transactions. The cost of the Capped Call Transactions is included as a net reduction to additional paid-in capital in the stockholders' equity section of the consolidated balance sheets.

The total estimated fair value of the Notes was $687.9 million and $458.8 million as of September 30, 2017 and December 31, 2016, respectively. The fair value was determined based on the closing trading price per $100 of the Notes as of the last day of trading for the period. The Company considered the fair value of the Notes as of September 30, 2017 and December 31, 2016 to be a Level 2 measurement. The fair value of the Notes is primarily affected by the trading price of our common stock and market interest rates. Based on the $258.9 closing price of the Company's common stock on September 30, 2017, the if-converted value of the Notes exceeded their principal amount by $348.0 million.

The following table presents the carrying amounts of the liability and equity components related to the 2.25% Convertible Senior Notes Due 2019 as of September 30, 2017 and December 31, 2016:

| | September 30, 2017 | December 31, 2016 |
|---|---|---|
| | (In thousands) | |
| Amount of the equity component (1) | $ 45,808 | $ 45,808 |
| | | |
| 2.25% convertible senior notes due 2019 | $ 330,000 | $ 330,000 |
| Unamortized debt discount (2) | (17,909) | (25,097) |
| Unamortized transaction costs related to the debt component | (2,862) | (3,968) |
| Contractual coupon interest accrual | 5,569 | 7,425 |
| Contractual coupon interest payment | (3,713) | (7,425) |
| Net carrying amount | $ 311,085 | $ 300,935 |

(1) Net of $1,177 thousands of transaction costs related to the equity component of the Notes.

(2) As of September 30, 2017, the remaining period over which the unamortized debt discount will be amortized is 1.75 years.

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The following table presents the interest expense for the contractual interest, the accretion of debt discount and the amortization of debt issuance costs:

| | Nine-months period ended September 30, | | Three-months period ended September 30, | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| | (In thousands) | (In thousands) | (In thousands) | (In thousands) |
| Contractual coupon interest expense | $ 5,569 | $ 5,569 | $ 1,856 | $ 1,856 |
| Amortization of debt discount | 7,188 | 6,806 | 2,440 | 2,310 |
| Amortization of debt issuance costs | 1,106 | 998 | 381 | 344 |
| Total interest expense related to the Notes | $ 13,863 | $ 13,373 | | |