

Hyperion Asset Management

Company Profile

Square, Inc. Class A

Main Business Activities

Square Inc. (Square) began providing point of sale (POS) hardware and software in 2009 that allowed merchants (retailers) to quickly accept card payments in a simple and affordable way. The Cash App was launched in 2013 with a peer to peer (P2P) offering similar to Venmo (owned by PayPal) however has evolved over time to include a range of other banking products and financial services.

The two separate ecosystems products/services include:

- 1) Seller ecosystem: A managed payments and POS service with numerous bolt on products that are designed to assist merchants of all sizes sell products and run their business. Square Capital and multiple other products/services sit within; and
- 2) Cash App ecosystem: Initially a P2P product but has evolved over time to now include, equity and bitcoin investing, a Cash Card (Debit Card), Boost (discount/rewards product), and direct deposit (faster to receive money vs. bank). The functionality and relevance of the offer is continuously expanded.

Key Value Proposition to Customers

Within its Seller Ecosystem, Square facilitates increasing sales at retailers and according to Jack Dorsey (CEO) Square is a sales company not a payments company. Square started with the goal of solving smaller merchants most critical needs (micro merchants needed to be able to accept card payments). Square's value proposition is specifically strong for retailers that utilise its combined hardware and software solution. Processing fees are priced broadly in line with competitors who do not offer the hardware piece of the puzzle and there are also no lock in contracts.

Square is now expanding its product range to include a suite of offerings (including Square Capital, Payroll, Invoicing) that mean a merchant can spend less time on administrative tasks. These additions should make Square more appealing over time to a wider range of retailers. Additionally, Square has been pivoting towards an increased focus on e-commerce which has accelerated during the COVID-19 pandemic, with the company undertaking numerous initiatives to assist traditional retailers move online.

Within the Cash App Ecosystem, the Cash App removes the need to visit traditional retail bank branches, assists individuals to manage their finances more efficiently, and provides access to core financial services specifically targeting the underbanked/unbanked. We estimate there are 50 million individuals without a credit rating in the U.S. and only 30% of individuals under the age of 30 have a credit card in the U.S.

Products are aimed at the following:

- 1) Storing/Sending/Receiving Funds (P2P, Direct Deposit);
- 2) Spending (Cash Card & Boost); and
- 3) Investing (Bitcoin and equities).

The product roadmap is informed by the customer's wants and needs. These products are affordable and able to be used by the underbanked/unbanked. Examples include:

- 1) Direct deposit product offers access to funds up to two days quicker versus a traditional bank;
- 2) P2P transfers are free; and
- 3) Equity investing offering allows for fractional share purchases.

Both products value proposition revolves around reducing friction and improving access to core financial services. Over time these applications may converge (creating a closed loop network) which will provide further value to both sellers and Cash App users. For example, drive Cash App users to sellers and provide rewards for Cash App users spending with Square sellers.

Sustainable Competitive Advantages and Outlook

Square's seller solutions are essentially aimed at being a one-stop shop for retailers who need a managed payments solution, POS offering and want a better way to manage their sales process, data, and information. Square also offers Payroll and lending solutions to its sellers which further entrenches it in their customers' business operations. Square's ease of use, quick setup and business productivity tools differentiate it from a standard payment processor. As more solutions are added more sellers should be attracted to the offering which means further investment in product additions can be made. This creates a flywheel effect and with more seller data, Square becomes better at solving its customers problems.

The Cash App's competitive advantage is based around its unique combination of financial services and products. It is a low friction, low cost, highly accessible product. These features attract users who tend to be loyal post adoption. There is more incentive for individuals to be attracted to the Cash App if their network (family and friends) is already using the product. As more products and services are added to the Cash App ecosystem the strength of the competitive advantage increases.

Overall Company Growth Options

Square's two ecosystems both have large total addressable markets (TAM) with significant opportunities to grow as penetration is low in both.

The Seller Ecosystem currently has less than 3% penetration of a greater than US\$100 billion revenue opportunity. This is broken down into 4 parts:

- 1) \$55 billion - Global Transaction Profit opportunity;
- 2) \$30 billion - Software opportunity;
- 3) \$12 billion - Square Capital (i.e. lending opportunity);
- 4) \$5 billion - Financial Services opportunity; and

This incorporates the development of new products, the opportunity to expand into new geographic regions as well as the potential to further penetrate large retailers, however, does not include the product innovation and expansion which will likely occur. Square has recently provided two examples of scaling the seller ecosystem in terms of region and product, launching into Ireland, and offering loans to its Australian sellers in April 2021. Given the size of the opportunity there are likely to be a number of new winners as we shift to a more digital world. Digital payment growth is high and will continue to grow for longer than just the next five to ten years. Square's active seller base is growing strongly (1.7 times compared to FY15) and gross profit per seller is increasing even faster (2.3 times compared to FY15).

2) Cash App currently has less than 2% penetration of a US\$63 billion revenue opportunity. This is broken down into three parts:

- 1) \$20 billion "sending" - P2P;
- 2) \$41 billion in "spending" - Cash Card and Boost Rewards; and
- 3) \$2 billion "investing" - Bitcoin and equities.

This estimate does not incorporate the development of new products and use cases as well as the opportunity to expand into new geographic regions. Acquiring new customers with existing products becomes easier as the user base expands. The product become more valuable due to the network effect and word of mouth. Monthly transacting actives have grown from 1 million in FY15 to 40 million at 2Q21 with average revenue per user (ARPU) having increased from essentially \$0 to \$50 per annum over the same period.

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