

## An Equity Note

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### What's Inside:

- *Building Conviction in Square (SQ)*
- *SQ's Closed Loop End State*
- *SQ & Ecosystem Connection*

### Companies Mentioned:

- *Block, Inc. (SQ)*

## Equity Note: Building An Alternate Reality w/ Square (SQ)

Square (SQ) is building one of the most exciting business ecosystems globally, and nobody seems to care. The stock is down 41% YTD and roughly 60% over the past year.

Today, you can buy the business for <3x NTM sales and 66x NTM Free Cash flow.

This *Equity Note* won't focus on this quarter's earnings or even this year's earnings estimates.

Instead, I want to paint a picture of what SQ might look like in an alternate reality, **where SQ closes the loop on consumer and SMB financial services.**

It is a reality where more money flows within SQ's ecosystem than outside it, virtually removing the need for legacy banking institutions.

The financial ramifications of this closed-loop ecosystem are enormous: **we're talking about a potential double-to-tripling of ARPU over the next 5-10 years and a shot at a \$1T market cap enterprise.**

We'll explain how SQ gets there by discussing:

- **Why investors can't envision SQ's alternate reality**
- **How SQ closes the loop with SMBs**
- **How SQ closes the loop with Consumers**
- **SQ's End Game**

Also, I've been battling a cold the last few days, so blame any mindless drivel on the Tylenol!

Let's get after it.

## **Why Investors Can't Fathom SQ's Alternate Reality**

Before we dive into *how* SQ creates this alternate reality, let's examine why investors can't imagine it in the first place.

SQ's ecosystem has two sides: **Consumer** and **SMB** (or Merchant).

Most professional investors have little-to-no engagement with SQ's products daily. The closest they get is at checkout at the local coffee shop. But even then, they're a passive participant in the process, ignorant of how much value is behind that commoditized payments terminal.

Here's why this matters. **The only way to truly appreciate SQ's alternate reality is to have first-hand interactions with both sides of the ecosystem.**

To do that, I'll guide you through both sides of SQ's ecosystem with a story about my friend and one of his employees.

One of my close friends owns/operates a local sailboat repair and maintenance business. The prior owner ran his business with pen and paper. We're talking about *mailing* invoices to customers and only accepting cash or checks for payment.

Old school stuff.

The first thing he did after he bought the place was install Square for Invoices and Payroll. Square is now the infrastructure of my friend's business. It's *the stickiest* service he's ever used.

Fast forward to a few weeks ago, he told me a story of a new employee he recently hired (we'll call him John). John was young (21) and a poster child for the underbanked population. He didn't go to college, worked a few odd jobs, never built credit.

So I asked him what bank John used for his direct deposit ... "*He used this thing called Cash App,*" my friend remarked.

That was the first time I had heard of *anyone* using Cash App for direct deposit. My only use case was sending \$20 to split a dinner bill with friends until then.

One day I drove by my buddy's business to ask John about his experience with Cash App.

I discovered John used Cash App for *everything*. He paid his bills and filed his taxes with Cash App. He even bought a few dollars worth of Bitcoin, you guessed it, through Cash App!

Call it scuttlebutt, curiosity, or sticking my nose where it didn't belong. My conversation with John transformed how I viewed Cash App and Square.

I saw *first-hand* the power of SQ from the merchant and the consumer sides. It just clicked.

That story was a long-winded way of saying first-hand experience *matters* when constructing alternative realities for companies and products. Armed with our first-hand knowledge, let's see how SQ closes the loop for merchants and consumers.

## How SQ Closes The Loop For Merchants

SQ began as a plastic card reader for Jim McKelvey (co-founder of Square) to accept a \$2,000 credit card transaction. It was a micro solution for a macro problem.

Today, SQ's card reader is only an iota of the platform's value proposition. There's Payroll, Invoicing, Marketing, Square Capital, and Business Banking.

SQ closes the loop for merchants by **providing everything a small business needs to operate and grow, all without legacy banking institution intervention.**

Moreover, SQ provides these services with radical simplicity and speed, which is Jack Dorsey's MO. Dorsey is obsessed with using software and automation to create simple, elegant product experiences.

### Example 1: Opening A Bank Account

Take account opening, for example. Here's the (rough) process for opening a bank account through a legacy institution:

- **Drive to a bank branch**
- **Tell a bank teller you want to open a business bank account**
- **Fill out a shit-ton of paperwork**
- **Provide tax documents (like SSN, corporate filings, etc.)**
- **Wait 3-5 business days and pray you filled out the forms properly**
- **Bank account open**

Now here's the process to open a Square Business Checking account:

- **Log in to Square Dashboard**
- **Select which bank account you want (Checking or Savings)**
- **Confirm that all information was correct (since SQ already has business tax information and personal owner information)**
- **Wait 3-5 minutes to receive "Bank Account Added" email**

These are two starkly different outcomes. But it goes a layer deeper. What if I want a new credit card? Or what if I want a loan?

Legacy banks have no rails to seamlessly offer ancillary products. To a legacy bank, asking for a credit card is like asking to open another account as a completely different person.

I love how this Former Cash App Finance Manager explains it (emphasis mine):

*"But then I come back two months later. I'm like, hey, I want a credit card.*

*Wells Fargo has me repeatedly apply as if I had no relationship with them and as if they don't know me at all. Why? Because the rails in those institutions don't really*

*talk to each other. And that's not something that is fixed easily because the guys who coded all that stuff are all retired at this point.*

*So it's not an easy fix for them. And so I go I apply for my credit card; it's a completely new process. I get approved, whatever. I'm happy, I come back, it's the same thing every time to want something. If I want a mortgage, it's the same thing. If I want a higher-ticket loan, it's the same thing. If I want an auto loan, it's the same thing."*

## Example 2: Applying For A Loan

Let's use Square Capital as another example. Square offers merchants loans based on transaction volumes.

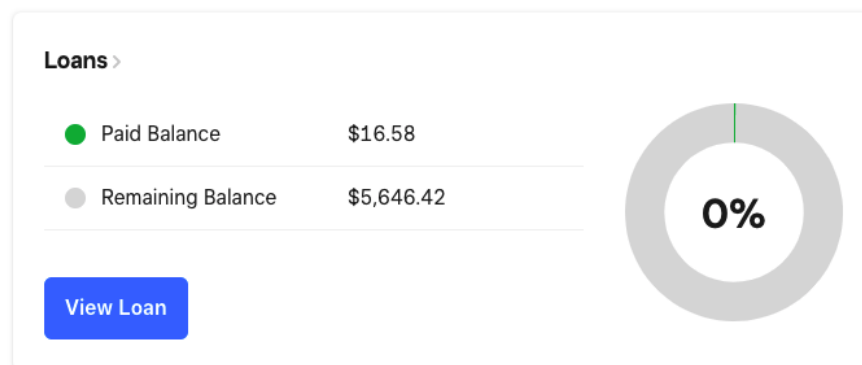
Square Loans are straightforward instruments. There are no late fees or interest payments. Square simply charges a Loan Fee and then takes a set percentage of merchant daily sales to repay the loan.

If the merchant fails to generate enough sales to repay the loan, SQ takes a fixed dollar amount from the merchant's bank account every 60 days.

We actually tried it on my buddy's business. We applied for a *small* \$5,000 loan with Square taking 3% of daily sales for repayment.

SQ had all the information they needed (tax documents and owner undisclosed), so the application process took (and I'm not exaggerating) 75 seconds.

Within 5 minutes, my friend received his approval email. The \$5K was transferred directly into his business bank account three days later (we applied on a Friday).



SQ also recently launched a [Business Debit Card](#), making it even easier for SQ merchants to access and spend funds.

Dorsey is quietly squeezing out legacy banking institutions by offering everything a small business owner needs. **Business checking and savings accounts** to store sales and

grow cash balances. **Loans** to fund growth or increase liquidity during slow seasons. And **Debit Cards** to instantly convert merchant sales to spending dollars.

Square offers SMB owners a radically simpler and better way to bank and manage their business. Legacy banks cannot compete.

### **This is just one-half of Square’s Alternate Reality.**

At no point in the above example would a Square merchant need a legacy bank. That’s how SQ closes the loop for SMBs and merchants. Let’s see how they do it in the consumer ecosystem.

## **How SQ Closes The Loop For Consumers**

Dorsey entered the consumer world through a commoditized P2P payments network, **Cash App**, like the plastic credit card reader for merchants. Many used Cash App to repay roommates for rent and split dinner tabs, as I mentioned earlier.

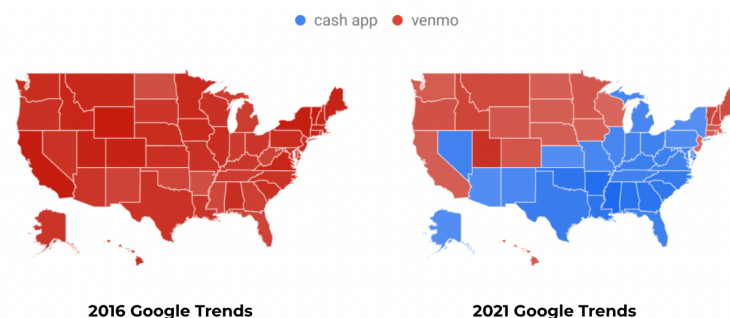
Cash App seeded its popularity/virality within the un/under-banked population.

Substack author Holyn explains [Cash App’s Trojan Horse strategy](#) (emphasis mine):

*“Fortunately, none of these people [underbanked/unbanked] have to open bank accounts, which can charge unknown fees and give limited access to funds due to a limited density of ATMs and physical locations. Instead, people can download Cash App ... and they have been for years. Cash App got its early traction in the mid-2010s from young un- and underbanked users in the southeast US. Since then, it has amassed almost as many users as Venmo and continues to grow its suite of products.”*

Cash App quickly gained traction during COVID, with Twitter users donating to random strangers via Cash App and rappers broadcasting their “CashTags” within songs.

You can see the viral growth effect in the heatmap below.



## Storming The Beach Via Underbanked Population

It's impossible to understate how important the unbanked/under-banked customer base is to Cash App's eventual mass-market success. Here's how Cash App's Former Finance manager puts it (emphasis added):

*"They are probably lower LTV customers [underbanked] than other people, but at the same time, **they are the people who probably would be willing to give you a chance a "challenger bank" or a new offering a chance**, because of how onerous it can be for those people in the legacy solutions and things like overdraft and things like that, that make being poor even more expensive.*

*These people probably, in many cases, **were desperate to believe that this new offering could be better than what they were suffering in the legacy solutions.** And so that willingness to experiment is important because **it gives you faster product customer feedback loops, which in turn helps you to iterate and improve the product faster.**"*

Let's go back to my buddy's employee, John. John is a card-carrying member of the under-banked community. He saw Cash App as a way to get everything he wants from a bank without the hassle of trying to open a legacy bank account.

With one download, John can get direct deposit into the app, pay for goods/services with the Cash App Debit Card (in-store, online, or via Apple Pay), invest in stocks/crypto, and file his taxes. All in one place.

In effect, **Dorsey did the hard thing first**. He built the network effect and virality by treating the Cash App like a consumer product. Only *then* did he back into banking services underneath such a consumer-driven product.

However, for Cash App to truly become a hundred billion-to-trillion-dollar business, it needs to cross the chasm from the underbanked to the rest of the population.

## Crossing The Chasm: How Cash App Becomes The Primary Banking Channel For Everyone

Cash App closes the loop by becoming the primary banking channel for every consumer. They do that by **transforming into a personal financial virtual assistant**.

Think about the data that Cash App has on its customers. It knows how much money you make (via direct deposit), how much you spend versus save/invest, and it knows *where* you spend and *how much* you spend on specific goods/services.

Imagine a world where Cash App offers personalized loans with repayment options as a percentage of bi-weekly direct deposits. They already do that with SMBs. Why not consumers?



Consumers would love this because Cash App offers a 10x better, faster, more straightforward loan application experience than traditional banks.

Heck, Cash App users can already automatically invest a percentage of their direct deposit in Bitcoin for free.

And now that SQ has its commercial banking license, personalized loans should be right around the corner.

That's how Cash App crosses the chasm from the underbanked to the general banking population.

*"Like for me, for example, between my Vanguard account, my Capital One account, I'm happy. I don't have glaring pain points. My willingness to experiment is a lot lower than that legacy customer.*

***However, I think if the platform grows into the stuff that we were talking about earlier in terms of the long-term road map, in terms of all the things that they could take on in consumer financial services more broadly, and they package that together into the virtual assistant money management platform that I was referring to earlier, then I might be enticed.***

*And so I think that the adoption in those higher-income demos will be on that longer-term story of how much value can you add by adding these incremental financial services." - Former Cash App Finance Manager*

Mark Goldberg of Index Ventures wrote a great [Twitter thread](#) on Cash App if you want to learn more about the opportunity.

We've explained how SQ closes the loop for both SMBs and Consumers. Like Thanos, SQ can't flex its true potential without one final gem, **Ecosystem Connection**.

## **SQ's End Game: Ecosystem Connection**

Ecosystem Connection is how SQ eliminates its dependence on legacy banks. It's how it becomes a trillion-dollar market cap company. And it's the final destination in our Alternate Reality journey.

SQ's End Game resembles the human heart in many ways. The heart takes blood in your body and circulates it to areas that need it for repair, contraction, or other functions.

Commerce is a lot like the human heart, too. Consumers take dollars and pay businesses for goods or services. Companies then use those dollars to pay employees, buy supplies, and invest in growing their operations. Employees then take those dollars and the cycle repeats.

All of commerce exists *within* SQ's SMB and Consumer ecosystems in our SQ End Game Reality. In other words, Square merchants maintain checking and savings accounts and use Square Payroll to pay employees.

Employees receive direct deposit via Cash App, which they use to spend on goods/services at other Square merchant establishments.

Cash App then offers discounts to users that spend at Square merchants through [Boost](#), further incentivizing Ecosystem-Connection driven commerce.

The best part about SQ's Ecosystem Connection is that everyone leaves the interaction happier.

Square Merchants gain access to more customers through Cash App's *Boost* Discovery program. And Cash App consumers score deals on things they already buy at places they might not have found without Cash App/Square.

## **SQ's Trillion-Dollar Opportunity**

Finally, SQ's End Game creates massive financial windfalls for the company. In our Alternate Reality, SQ generates a take rate on *all commerce interactions*. They generate massive profits on every ancillary product offered to SMBs and Consumers.

Moreover, they don't need to share that value with legacy financial institutions, which means more profits for SQ.

Let's use Cash App's ARPU to understand the value potential of this Alternate Reality.

Currently, Cash App generates a ~\$50 ARPU. What would ARPU look like if Cash App became the primary banking channel for consumers? Assume a primary Cash App user generates \$36,000/year in direct deposit income, which they get via Cash App.

Let's also assume a ~1% average take rate between interchange rates, crypto take rates and P2P payments.

In this example, **our primary Cash App user generates \$360 in ARPU versus the \$50 current ARPU.**

The greater the percentage of Primary Cash App users, the higher the ARPU. This represents tremendous operating leverage within Cash App's existing ~44M user base.

## **Concluding Thoughts: Badass Product + Killer Team = \$1T Potential**

SQ has assembled the best team to achieve its End Game goals. Jack Dorsey is a legit leader. I owe him an apology for routinely shitting on his Twitter management skills (you happy, Alex?).

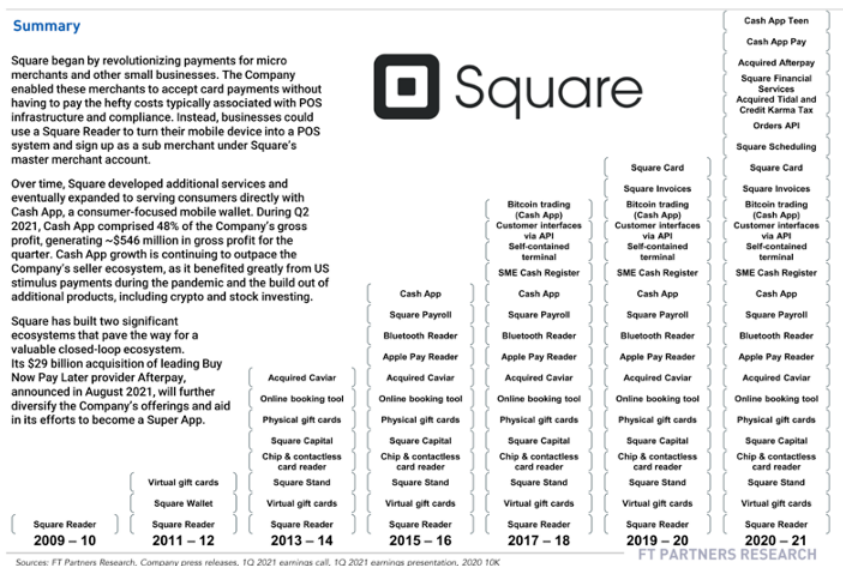


Here's how one Cash App employee defined Dorsey's management skills (emphasis added):

*"I've watched the narrative over the years in the public markets on Dorsey, he's not that engaged and he should be replaced, some investors think that, I don't agree at all. I think that what Dorsey did really well was he set up an organization where the organizational structure is very well thought out, the processes are very well thought out. The roles and responsibilities are clear. The incentives are excellent, and you put very high-caliber people at key points without this organization.*

*And then you set the thing in motion and what happens is it takes care of itself, the best ideas that Cash App bubble up organically from the bottom, they make their way up into lead PMs or the principal decision makers with some input from guys like Brian Grassadonia, who is the General Manager of Cash App."*

For such a large company (\$56B), SQ moves like a start-up. Check out their product development history below. It's mind-numbingly fast.



SQ is a unique combination of a once-in-a-generation founder, a world-class operating team, a \$1T addressable market, and an undemanding valuation (<3x NTM sales).

Focus on the Ecosystem Connection variables:

- Are they growing Cash App Users?
- Are Merchants using more products?
- Are Cash App users using more products?
- Is the company adding new/innovative features to create a 10x better experience?

Everything else is noise.

We're excited to make SQ one of our most significant positions over the coming weeks/months. I hope you're excited too.

## Portfolio Updates

### Sells

- **SOLD** Full position in Telefonica Brasil (VIV)
- **SHORTED & COVERED** UVXY FOMC Trade
- **SOLD** Full position in Natural Gas Futures
- **SOLD** Remaining Twitter (TWTR) Long
- **SOLD** Full position in Bonds (ZBM2022)
- **SOLD** Full Position in Corteva (CTVA)
- **BOUGHT** Starter Long in EPAM Systems (EPAM)
- **BOUGHT** Call option-like Long position in Northwest Biotherapeutics (NWBO)