

Square Is a Leading Player in the Mobile Card Reader Market

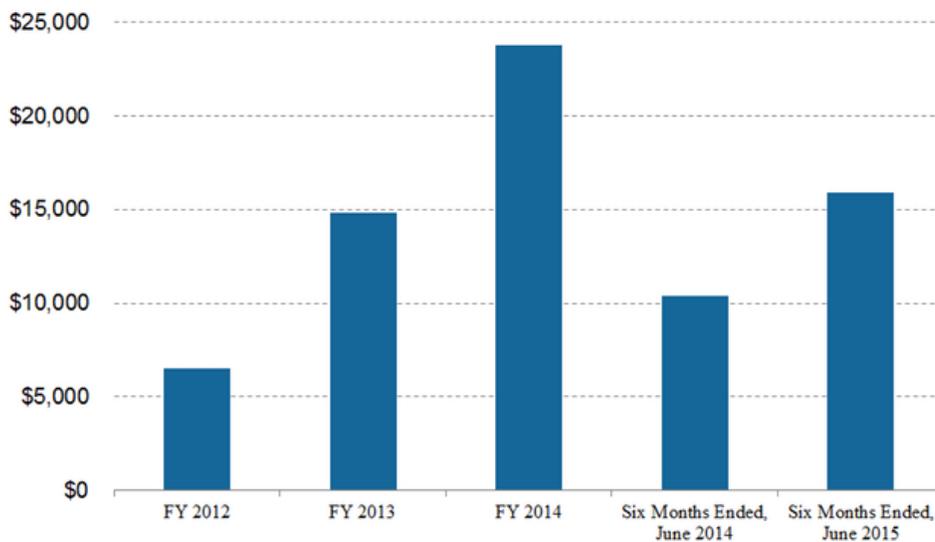
By Adam Rogers · Oct 16, 2015 10:07 am EDT

Company overview

Square was founded in 2009 by Twitter ([TWTR](#)) co-founder Jack Dorsey and Jim McKelvey. The firm is headquartered in San Francisco. The company's products enable anyone with a mobile device to accept card payment anywhere and anytime. Square generates 95% of its revenue from payments and point of sale (or POS) services.

Square's mission is to democratize commerce by leveling the playing field for sellers of all sizes. Square has also extended its products and services offerings to include financial and marketing services that help sellers track, run, and grow their businesses. In 2014, Amazon ([AMZN](#)) launched a credit card reader for merchants to use to conduct payments through a smartphone or tablet.

Gross Payment Value (\$ in Millions)



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Source: Square Filings

Steep increase in gross payment volumes

Currently, millions of sellers accept payment with Square including all types of businesses ranging from cabs to coffee shops, lawyers to landscapers, and retail stores to restaurants. Although the majority of the revenue has been generated in the United States, Square also provides services to sellers in Canada and Japan.

In 2014, sellers using Square processed a gross payment volume (or GPV) of \$23.8 billion generated by 446 million card payments from approximately 144 million payment cards. GPV for Square measures the total card payment transactions processed for sellers excluding card payments processed for Starbucks ([SBUX](#)) and Square's peer-to-peer service.

You can get exposure to Amazon by investing in the PowerShares QQQ ETF ([QQQ](#)) and the SPDR S&P 500 ETF ([SPY](#)). QQQ and SPY have 5.2% and 1.2% exposure to Amazon, respectively.

Square Faces Trade-Off between Security and Customer Convenience

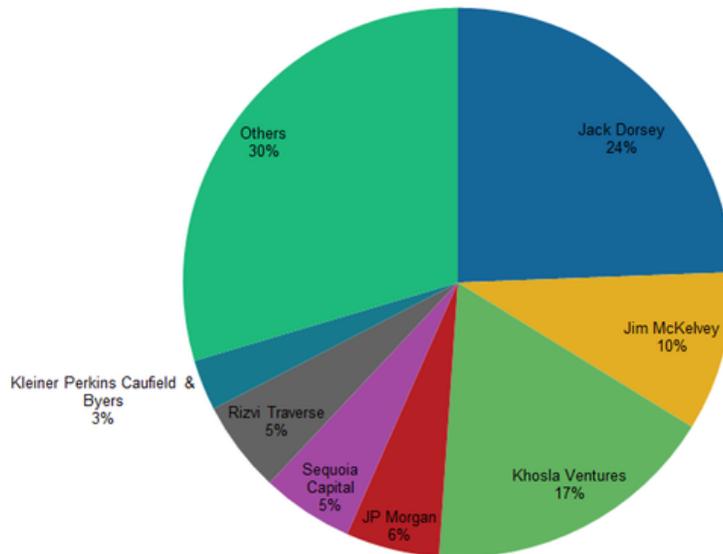
By Adam Rogers · Oct 16, 2015 10:08 am EDT

Company files for an IPO

On October 14, 2015, Square filed for an initial public offering (or IPO) in which the firm aims to raise \$275 million. According to a report from the *New York Times*, Square raised \$150 million at a valuation of \$6 billion last year. Prior to this valuation, Square had raised funding from a number of investors, including Starbucks (SBUX). Starbucks invested in Square in 2012 at a valuation of \$3.25 billion.

While Square posted a net loss of \$77.6 million for the six months ended June 30, 2015, the company is slowly inching towards profitability. In 2Q15, Square reported \$859,000 in adjusted EBITDA (earnings before interest, tax, depreciation, and amortization).

Square's Shareholding Pattern



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Source: Square Filings

Current shareholding pattern

While Jack Dorsey owns 24.4% of Square, the company's next largest individual shareholder is co-founder Jim McKelvey with 9.4%, followed by venture investor Khosla Ventures with a 17.3% stake in the firm. J.P. Morgan (JPM) owns 5.5% of the total shares while Sequoia Capital and Rizvi Traverse own 5.4% each. Kleiner Perkins Caufield & Byers own approximately 3% of the shares.

Exposure to fraud

Under its IPO filing, Square noted fraud as a primary risk factor. With respect to credit card fraud, Square holds some liability. The company stated, "When our products and services are used to process illegitimate transactions, and we settle those funds to sellers and are unable to recover them, we suffer losses and liability. As a greater number of larger sellers use our services, our exposure to material risk losses will increase. For example, in the three months ended March 31, 2015, we recorded a loss of approximately \$5.7 million related to fraud by a single seller using our payments services."

In order to deal with card fraud, credit card companies such as Visa (V) and MasterCard (MA) are forcing card issuers as well as vendors to switch from the insecure magnetic stripe card technology to the more efficient and secure "chip and pin" technology.

You can get exposure to Visa by investing in the SPDR S&P 500 ETF (SPY). SPY has a 0.82% exposure to Visa.

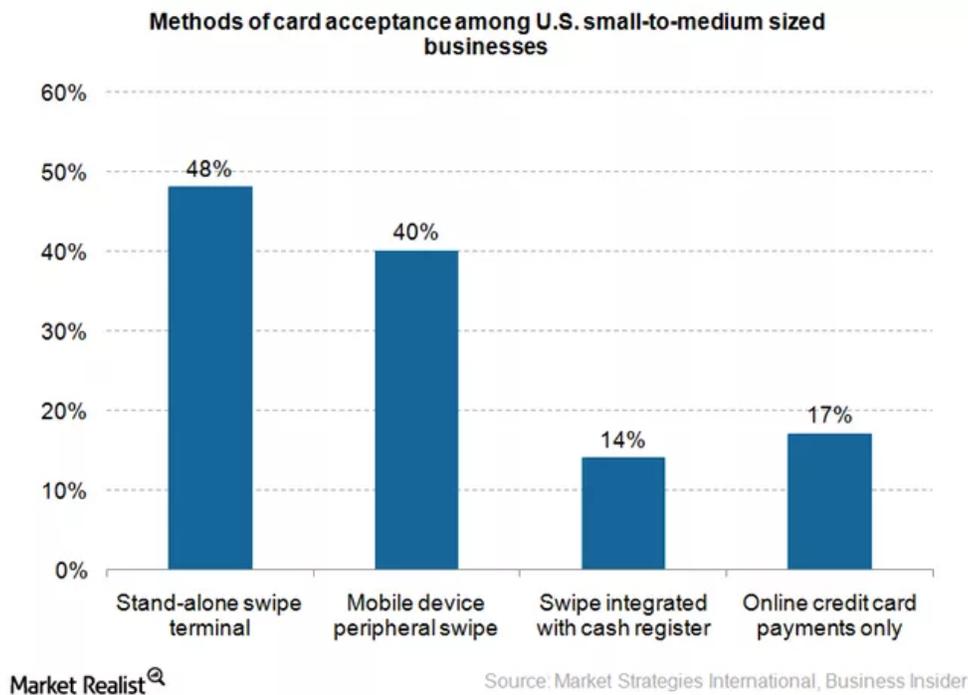
What Trends Are Affecting Square's Performance?

By Adam Rogers · Oct 16, 2015 10:09 am EDT

Increase in mobile payments

The transition from cash and checks to electronic and mobile payments has been increasing exponentially in the last few years. According to a Nilson Report published in 2014, consumer payments for fiscal 2013 totaled \$8.9 trillion in the United States. 55% were through payment cards, 17% through cash, and 11% through checks. In 2018, consumer payments are expected to reach \$11.4 trillion with payment cards growing to 66%, or \$7.6 trillion. Payments through cash and checks are expected to fall in the same period.

The rapid growth of mobile devices and app stores has increased accessibility to buyers and sellers. While 438 million mobile devices had access to the Internet in 2013, the figure is expected to increase to 690 million devices in 2018.



Local businesses expected to drive economy

According to the US Census Bureau's reports in 2012 and 2013, approximately 30 million small businesses generated 46% of the country's private sector output in fiscal 2010. As per Square's IPO filing, "These figures likely underestimate significant parts of the American economy. For example, they do not include the millions of businesses run by freelancers, artists, hobbyists, and others. We believe small businesses will continue to drive the economy as entrepreneurial activity creates millions of businesses each year. The Kauffman Index 2015 report estimates that in 2014 approximately 530,000 new entrepreneurs started businesses each month. Local businesses engage in significant commerce and are essential to the economy and character of local communities, acting as an on-ramp for anyone of any background to participate in economic growth."

Stiff competition in this segment

As we discussed in part one of this series, Amazon ([AMZN](#)) launched a credit card reader for merchants to use to conduct payments through a smartphone or tablet. Although this card reader is similar to Square's card reader, Amazon will try to undercut its competitors with low processing fees, according to a report from the *Wall Street Journal*. Amazon's 1.8% fee would be lower than Square's 2.8% and eBay ([EBAY](#)) PayPal's 2.7%.

Jack Dorsey was named interim CEO of Twitter

Earlier this year, Jack Dorsey was also announced as the interim CEO of Twitter ([TWTR](#)) after the company announced that its previous CEO, Dick Costolo, will step down. This has also been mentioned as a risk factor in the firm's IPO filing, and it remains to be seen whether the dual role will negatively affect Square's performance.

You can get exposure to Amazon by investing in the PowerShares QQQ ETF ([QQQ](#)) and the SPDR S&P 500 ETF ([SPY](#)). QQQ and SPY have 5.18% and 1.19% exposure to Amazon, respectively.

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