

Internet & Social Media

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This Week in Social Media - Dinner w/ David Kirkpatrick, Adgregate & Meeting w/ Facebook Phone Maker INQ

We believe Social Media and its associated technologies will change the world to a larger degree than is currently appreciated on Wall Street. Furthermore, we believe that for the foreseeable future, the news flow on the sector will be highly positive. To keep investors abreast of the latest developments in the sector, we publish this weekly newsletter on all things Social.

In this issue:

- **David Kirkpatrick, "The facebook Effect," Highlights:**
 - **700 Million Isn't Cool, 7 Billion Is Cool.** Facebook strives to register everyone in the world to achieve ultimate goal of ubiquity.
 - **Constant Innovation Fuels Growth.** Innovation is an obsession at Facebook.
 - **More Meaningful Revenue Streams Are Emerging.** Facebook commerce can add meaningful revenues to Facebook's top line with Facebook Credits becoming an increasingly important currency.

- **John Underwood, Adgregate, Highlights:**
 - **Creating a Seamless User Experience.** Adgregate builds retailer store fronts that keep customer on Facebook throughout the purchase experience.
 - **Facebook a Testing Ground.** Retailers are more willing to experiment on the Facebook platform than on their existing websites due to the limited downside of failure.

- **Frank Meehan, INQ's Facebook Phone, Highlights:**
 - **A More Powerful Mobile Facebook Experience.** INQ getting significant input from Facebook to create and iterate towards an ideal mobile experience.

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On Wednesday, March 9th, Wedbush hosted a dinner with David Kirkpatrick, the author of “the facebook Effect” and John Underwood, COO of Adgregate, a company that helps leading retailers establish and operate store fronts on Facebook. Here are our notes from the dinner discussion:

David Kirkpatrick – Author of “The Facebook Effect”



As a senior technology editor at Fortune magazine for 20 years, David Kirkpatrick had met with hundreds of high-powered execs who told him they were going to take over the world. When Kirkpatrick met Mark Zuckerberg for the first time in September 2006, Facebook had just nine million members and Mark Zuckerberg was 22 years old. By the time the meeting ended, Kirkpatrick believed, for the first time in his career, that the exec on other side of the table might actually succeed in fundamentally changing the planet.

When the two met, it was immediately clear to Kirkpatrick that Zuckerberg was singularly focused on achieving his massive vision to bring Facebook to everyone, everywhere, all the time. Two days prior to the meeting, Facebook had debuted its News Feed feature (now widely seen as the greatest innovation in the history of social networking). The launch of this feature was met with huge pushback from users. Kirkpatrick expected Zuckerberg to be unnerved by the growing stream of vitriol spewing forth from his members. However, Zuckerberg was completely unflustered and undeterred because instead of listening to what his members were screaming about, he was analyzing what the Facebook users were actually doing, and the News Feed implementation was dramatically improving all the engagement metrics Zuckerberg was focused on.

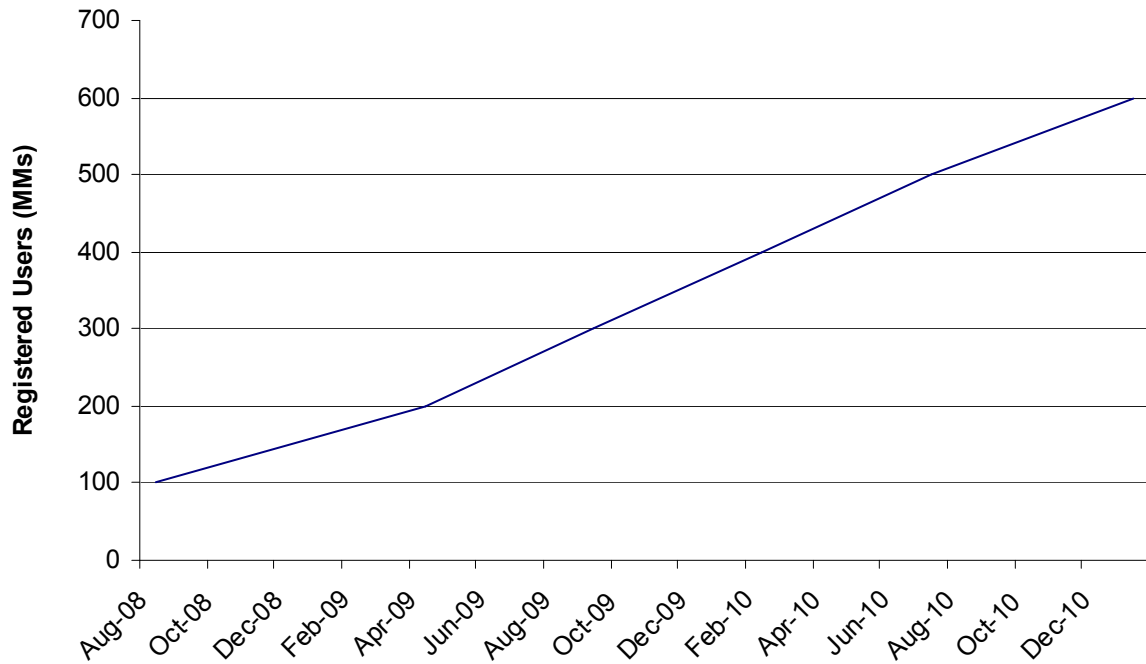
Kirkpatrick viewed Zuckerberg’s calm in the face of outrage by his users as extraordinary. Said Kirkpatrick, “greatness isn’t achieved by followers, it’s leaders, leaders with vision driven by data.” Kirkpatrick was impressed, however when he mentioned to Zuckerberg how much he resembled some of the great business leaders Kirkpatrick had met over the years, Zuckerberg recoiled. Not only did Zuckerberg not view himself as a “business person”, but moreover, Zuckerberg believed “business people” possessed core qualities (like a focus on wealth) that if embraced, would hinder his ability to execute his vision.

A key to Facebook’s success is the focus on growth over monetization. Zuckerberg believes that growth is paramount, as scale is a major defense against competitors. Kirkpatrick believes that Facebook is fixated on reaching all seven billion people on the planet, and in that sense, reaching 700 million users is just a start.

To achieve the goal of ubiquity, Zuckerberg has embraced innovation as the fuel that enables the company to execute this vision. At Facebook, innovation is not done in cycles or starts and stops, rather it is constant. Facebook continues to believe that if they aren’t innovating, they will be passed by someone who is. It’s this constant innovation that enabled Facebook to crush Myspace, and it’s innovation that will continue to drive Facebook forward at an ever increasing pace.

Figure 1: Facebook Wants to Register Everyone

Facebook Registered Users (MMs)



Source: Company data, Wedbush Securities, Inc.

Recent events in the Middle East have been termed “Facebook Revolutions.” Kirkpatrick believes that Zuckerberg is pleased with the positive impact that Facebook has had in Egypt and other countries, but Zuck is reluctant to talk about it. While Facebook’s ability to democratize governments around the world makes great copy, Zuck worries that fear of Facebook’s impact could cause repressive governments to block Facebook and prevent broad swaths of potential users from utilizing Facebook. Zuckerberg wants Facebook to be in China, and he’s willing to work with the Chinese government to provide the control required by the government. This is a very different tact from other companies, like Google, whose political views can take precedence over reach.

Figure 2: Social Media Playing a Role in Revolutions



Source: Patrick Chapatte

Kirkpatrick believes that companies are just starting to realize how broadly Facebook is changing the business landscape. Hallmark was blown away by the five million Valentines exchanged through Farmville. Banks are considering the potential impact that Facebook Credits will have on their industry. Netflix shares dropped 5% when Warner Bros began testing streaming movies over Facebook. As these experiences permeate more industries, Kirkpatrick believes more companies will dedicate ever greater resources to both leverage and to fight Facebook.

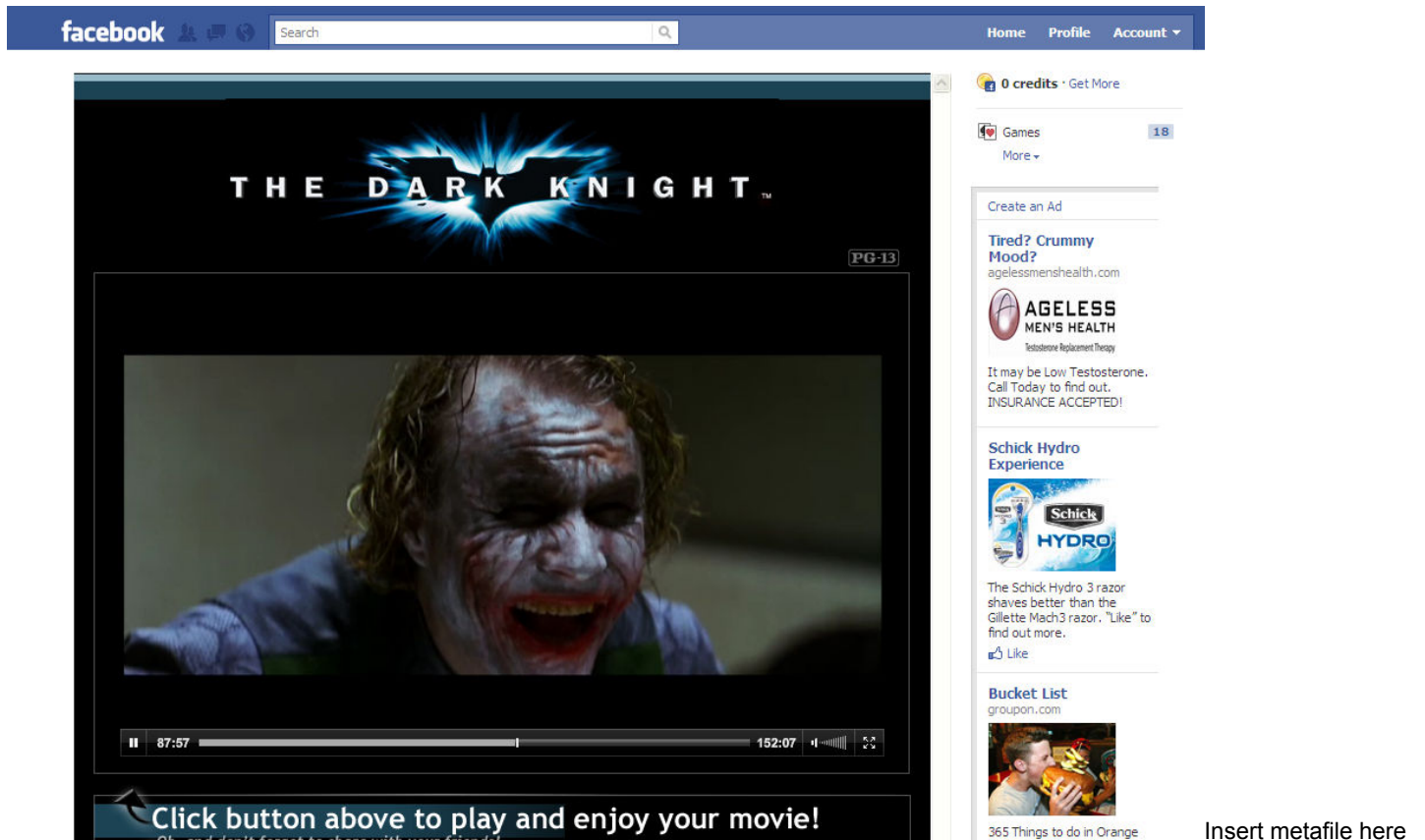
Finally, Kirkpatrick stated that while most of the focus has been on Facebook's ability to generate revenue through advertising, he believes that Credits will also be a massive revenue generator. Kirkpatrick believes that the 30% fee for Facebook credits is largely being re-invested into the platform to enhance the infrastructure and drive even more transactions.

Kirkpatrick points out that Facebook Credits are available in 92 countries and given the lack of transactional user fees for Facebook Credits, Facebook Credits is really facilitating micro-payments, greatly accelerating the pace of small transactions on the Facebook platform. Kirkpatrick also noted the rising popularity of acquiring credits without paying for them, by getting paid for actions (e.g. taking a survey). Kirkpatrick stated senior marketers at companies like Coke believe that costumers will eventually by Coke with Facebook Credits. Kirkpatrick believes that if Facebook were to begin processing payments outside of their own platform, Paypal could be significantly affected.

A dinner guest asked about the potential for Facebook to drive revenue through subscription models. Kirkpatrick believes that Facebook would never regress to a subscription-based model for its core service given the negative impact on ubiquity.

Kirkpatrick believes that the biggest potential loser in the face of the rise of Facebook is Google. Because Bing has close ties with Facebook, it can leverage the social data from the graph to optimize search results. (Despite Kirkpatrick's view, we remain bullish on Google, but we sincerely appreciate the dialogue).

Figure 3: Facebook Credits/Commerce Cropping Up in New Arenas



Source: Facebook.com

John Underwood – COO, Adgregate



Aggregate launched in mid-2010, to help retailers sell on Facebook. Today, Adgregate has over 50 clients among the top Internet 500 retailers.

Retailers pay Adgregate a startup fee, as a percentage of the transactions consummated. Many retailers have accumulated large numbers of fans on Facebook.

Figure 4: Top 10 Retailers on Facebook by Fans

Retailer	Fans (as of 2/2011)
Starbucks	19,414,892
Victoria's Secret	11,302,939
Zara	7,925,184
McDonald's	7,032,398
H&M	6,117,222
Taco Bell	5,400,586
Subway	4,665,760
Lacoste	4,494,849
Hollister Co	4,185,570
Forever 21	3,973,181

Source: Mainstream.com

While Fanpages are an important part of any companies Facebook/social media presence, a holistic approach also includes having a retail presence within the Facebook environment which enables direct monetization of the fan base on Facebook.com. By enabling brands to build a storefront within Facebook itself, Adgregate can increase conversion and customer engagement. Transactions can occur on the retailer’s Fanpage, as well as in the News Feed.

Payments are made with credit cards, as opposed to Facebook credits, which to date have only been used to buy virtual goods. Adgregate has established close relationships with Semantic, MacAfee and other security providers to ensure that the entire transaction is completely secure and integrates well with a company’s eCommerce backend. This facilitates scalability.

Underwood believes that Facebook sees Adgregate as adding utility to the Facebook ecosystem. Underwood believes that if Facebook were to enable the use of Facebook Credits for social commerce, while also lowering the current 30% fee charged for virtual goods transactions, eCommerce on the Facebook platform would take off.

Adgregate is analogous to GSI Commerce, which enables retailers to build a retail presence on the web by building web sites (i.e. customizing GSI’s front-end) and handling fulfillment and payments (the back-end). GSI has yet to offer solutions for retailers on Facebook. Underwood believes GSI will try to enter the Facebook retailing space, but he feels that this transition will be challenging as it is outside of GSI’s core focus. The rapidly changing Facebook ecosystem presents challenge, and Underwood feels that the pace of change creates even greater difficulty for companies with legacy infrastructures and more rigid processes.

Underwood said that many retailers are eager to experiment within the new vertical. Freed from the constraints of benchmarks and targets that they are used to managing to, companies are more willing to test on Facebook than they are to try new things on their own more established websites.

Figure 5: Store Front of Adgregate Retailer on Facebook

facebook

Home Profile Account



Sierra Trading Post

Wall Info **Shop** Newsroom Offers Notes DealFlyer E...

0 credits · Get more

Games 18

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Microsoft Store

 The newest Microsoft Store is opening soon at South Coast Plaza in Costa Mesa, stop by the grand opening on March 24th!

Like · 25,878 people like this.

Source: Facebook.com

FRANK MEEHAN – CEO, INQ

The maker of the soon to be released Facebook phone.

INQ, a fully owned subsidiary of Hutchison Whampoa, was founded in 2008 by Frank Meehan, who was previously General Manager of 3G Handsets and Applications for Hutchison Whampoa. INQ is backed by Li Ka-shing who is Chairman of Hutchison Whampoa and is also an investor in Facebook and Spotify. Last Tuesday, I had the pleasure of spending an hour with Frank Meehan, CEO of INQ, to discuss the first Facebook branded phone.

In addition to getting a lesson on China (e.g. Chinese tech companies are built to scale, U.S. companies are largely built to flip), thoughtful insight in to the social ecosystem (Frank also sits on the Board of Spotify among others), I got a personal preview of the phone, which is set to debut in the first week of April in the UK with Carphone.

A few things are important to note:

- Hutchinson's major shareholder is also a shareholder in Facebook, so the phone had significant input from Facebook.
- INQ is a software company, so the company is well positioned to continually iterate the phone.
- The phone operates on the Android platform.
- The phone is incredibly sleek, but it's the functionality that impresses the most. To those whose lives are centered around Facebook and their friends, I believe that the phone will be extremely popular. It's simply optimized for the experience of interacting over Facebook. The phone learns who your closest friends are, and optimizes the experience to provide that content in a very compelling (iPad-like) format.

Figure 6: Image of INQ's Facebook Phone



Source: INQMobile.com

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eBay	EBAY	NEUTRAL	\$30.36	\$31

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1) 08/16/10	2) 10/12/10	3) 12/13/10
Underperform \$525	Neutral \$575	Outperform \$750



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