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Facebook Coin: What's The Realistic Angle?



BY RYAN TODD

It's that time of year, the post-earnings lull where equity analysts take time to digest new company information and either reaffirm their views or offer material changes to their theses. For some looking to make a splash, the occasional brow-raising bold calls trickle out as well.

This week, Barclays' internet analyst Ross Sandler released a note to clients which walked through his bullish view on Facebook Coin, suggesting the project could unlock as much as \$19 billion in incremental revenue by 2021, and a conservative base-case forecast of \$3 billion. That's not a typo.

Initially reported back in December by Bloomberg, Facebook's blockchain team has apparently been developing a stablecoin for payments within WhatsApp. More recently, the New York Times published a report, showing the surprising speed of development of Facebook's stablecoin. According to the report, Facebook had held talks with exchanges about listing its stablecoin, which will be pegged "to a basket of different foreign currencies, rather than just the dollar." Additionally, the Facebook blockchain team is prepared to launch this stablecoin in the first half of 2019, according to NYT.

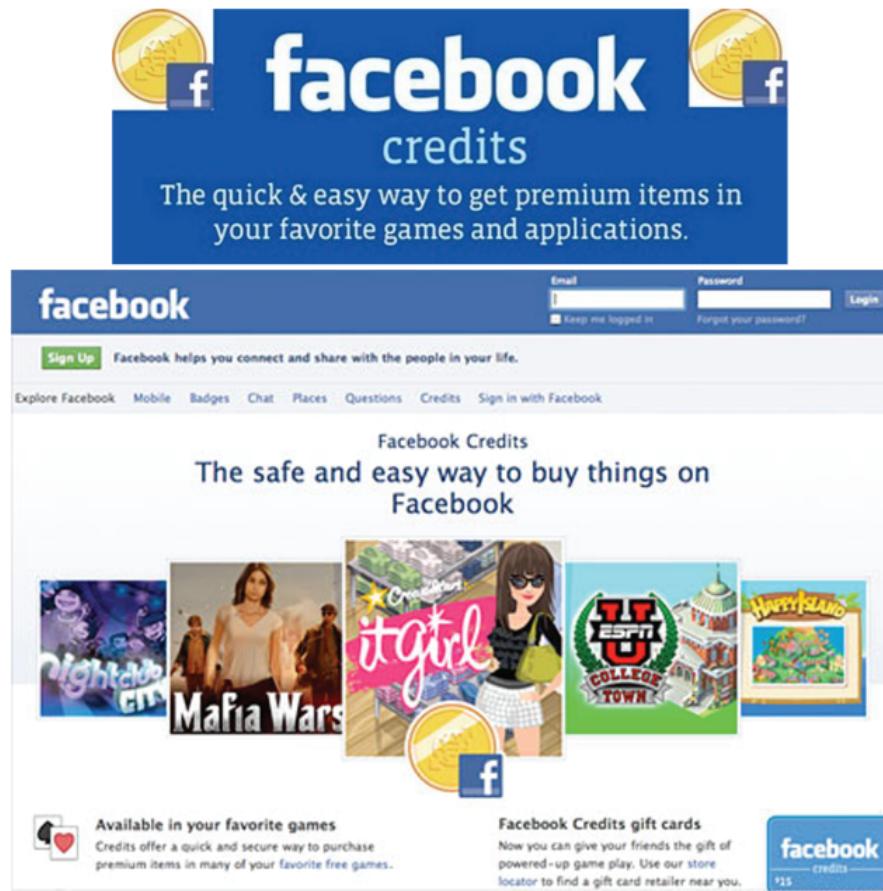
Here's what you need to know:

Facebook's experiment with Facebook Credits offers FB Coin clues

Based on Barclays' channel checks and note to investors, FB Coin may actually start out as a single purpose virtual token that mimics the functionality Facebook Credits offered in the early 2010s. Facebook Credits was a program that allowed the purchase of an in-platform token with a credit card/PayPal (\$1 = 10FB credits) in order to use as a currency for paid applications and in-game items. Over time the virtual currency transitioned to direct digital fiat.

The business model of this product mirrored Apple or Google's App developer revenue share where the distribution platform of the applications takes a percentage of the total purchase. In FB credits' case, Facebook took 30% of the developer revenue, according to Barclays.

Facebook Credits: The original "stablecoin" powered app ecosystem



Source: Facebook

Met with initial success, given a pre-mobile environment where Facebook could still maintain hold of its desktop platform (vs. mobile application running on iOS or Android), FB credits generated ~16% of company revenue in 2012 and \$0.80 in global payment Average Revenue Per User (ARPU), according to Barclays.

A micro-payments play for a revived game and app ecosystem?

While FB credits generated strong top-line revenue, one of the biggest problems with the product was the fact that Facebook had to give back a majority of that revenue to pay interchange fees, or the cost of running transactions over debit and credit networks such as Visa and MasterCard.

Considering interchange fees charged by networks start anywhere from \$0.10 minimum and tack on a percentage of the total purchase value, and the majority of in-game transactions were higher volume “micro-payments,” the profitability of the business was rather soft.

Current Interchange Fees

Visa Credit

| Retail Swipe | |
|----------------------------------|---------------|
| Visa CPS Retail | 1.510 % + 10¢ |
| Visa Rewards Traditional | 1.650 % + 10¢ |
| Visa Rewards Signature | 2.300 % + 10¢ |
| Visa Rewards Signature Preferred | 2.100 % + 10¢ |
| Visa Corporate | 2.100 % + 10¢ |
| Visa Business | 2.200 % + 10¢ |
| Visa Purchasing | 2.400 % + 10¢ |

MasterCard Credit

| Credit Swipe | |
|----------------|---------------|
| MC Consumer | 1.580 % + 10¢ |
| MC Enhanced | 1.730 % + 10¢ |
| MC World | 1.770 % + 10¢ |
| MC World Elite | 2.300 % + 10¢ |
| MC Corporate | 1.900 % + 10¢ |

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Source: <https://www.hostmerchantservices.com/current-us-interchange-rates/>

Fast-forward to a world of blockchain with stable and relatively instant transfers of value, and the business of virtual tokens for a refreshed game/app developer strategy may make more sense now. Furthermore, a permissioned blockchain (database) built by Facebook could theoretically allow FB to operate app payments outside the scope of mobile app store chokepoints, as well as bypass interchange fees set by the card networks in order to facilitate near-costless micro-payments.

As for the conundrum of bootstrapping usage across the hundreds of other payment/utility coins that have sprung up, Facebook's 2 billion-plus monthly active user base would enable instant adoption at scale.

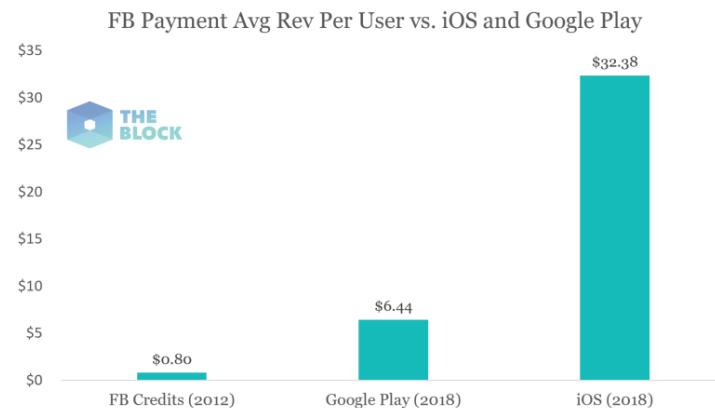
So how would this translate to the bottom line? According to Ross Sandler, assuming FB Coin generates (a somewhat big IF) similar global ARPU as FB credits at \$0.80 (U.S. was \$2.50), and gets 100% penetration within its estimated 2.9 billion-plus user base in 2021 (a HIGHLY unlikely outcome), then

the base case for incremental revenue generation would be ~\$2.4 billion.

However, if Facebook can succeed in reviving a new app and game ecosystem, competing for developer share against Apple and Google by offering “higher user engagement vs. avg visits to mobile OS app stores,” Sandler then assumes FB ARPU could match Google Play’s \$6.44 ARPU and unlock close to \$20 billion in incremental revenue. “Every additional ARPU dollar FB can grab, closes the gap between iOS/Google Play and drives \$3 billion in additional revenue.”

Let’s be honest, these are BIG ifs. Therefore, we’ve included a sensitivity table of both penetration rates and ARPUs to show a wider range of outcomes.

An angle that could be worth exploring further would be Facebook’s ability to charge micro-payments to use its platform, or access specific bundled news content. However, it appears neither of those assumptions came up during Barclays’ channel checks.



Source: Company reports, Barclays Research, The Block

Facebook Coin TAM Sensitivity Analysis

| Penetration Rate | 2018 | | 2021 | | 2021 Revenue at different ARPU assumptions (\$mm) | | | |
|------------------|-------------------|-------------------|--------------------|---------|---|----------|-----------------|--|
| | Total FB MAU (mm) | Total FB MAU (mm) | \$8.0 (FB Credits) | \$2.21 | \$3.62 | \$5.03 | \$6.44 (Google) | |
| 5% | 135 | 149 | \$119 | \$328 | \$538 | \$747 | \$956 | |
| 10% | 270 | 297 | \$238 | \$656 | \$1,075 | \$1,494 | \$1,913 | |
| 15% | 405 | 446 | \$356 | \$985 | \$1,613 | \$2,241 | \$2,869 | |
| 20% | 540 | 594 | \$475 | \$1,313 | \$2,150 | \$2,988 | \$3,825 | |
| 25% | 675 | 743 | \$594 | \$1,641 | \$2,688 | \$3,735 | \$4,782 | |
| 30% | 810 | 891 | \$713 | \$1,969 | \$3,225 | \$4,482 | \$5,738 | |
| 35% | 945 | 1,040 | \$832 | \$2,297 | \$3,763 | \$5,229 | \$6,694 | |
| 40% | 1,080 | 1,188 | \$950 | \$2,625 | \$4,301 | \$5,976 | \$7,651 | |
| 45% | 1,215 | 1,337 | \$1,069 | \$2,954 | \$4,838 | \$6,723 | \$8,607 | |
| 50% | 1,350 | 1,485 | \$1,188 | \$3,282 | \$5,376 | \$7,470 | \$9,563 | |
| 55% | 1,485 | 1,634 | \$1,307 | \$3,610 | \$5,913 | \$8,217 | \$10,520 | |
| 60% | 1,620 | 1,782 | \$1,426 | \$3,938 | \$6,451 | \$8,063 | \$11,476 | |
| 65% | 1,755 | 1,931 | \$1,544 | \$4,266 | \$6,988 | \$9,710 | \$12,432 | |
| 70% | 1,890 | 2,079 | \$1,663 | \$4,595 | \$7,526 | \$10,457 | \$13,380 | |
| 75% | 2,025 | 2,228 | \$1,782 | \$4,923 | \$8,064 | \$11,204 | \$14,345 | |
| 80% | 2,160 | 2,376 | \$1,901 | \$5,251 | \$8,601 | \$11,951 | \$15,301 | |
| 85% | 2,295 | 2,525 | \$2,020 | \$5,579 | \$9,139 | \$12,698 | \$16,258 | |
| 90% | 2,430 | 2,673 | \$2,138 | \$5,907 | \$9,676 | \$13,445 | \$17,214 | |
| 95% | 2,565 | 2,822 | \$2,257 | \$6,236 | \$10,214 | \$14,192 | \$18,170 | |
| 100% | 2,700 | 2,970 | \$2,376 | \$6,564 | \$10,751 | \$14,939 | \$19,127 | |

Source: Company Reports, The Block, Barclays Research

Note: Barclays assumed 2021 FB Monthly Active Users (MAU) and Base and Bull Case total FB coin revenue values

A way to enable low-cost payments within WhatsApp?

The low-hanging fruit for FB Coin may be a single-purpose micro payment token to start, but all signs are pointing towards grander ambitions. Given the recent NYT and Bloomberg reports of a stablecoin powering payments within WhatsApp, the growth in the size of the blockchain team (now over 60 employees on LinkedIn), and three separate leadership members counting experience from payments company PayPal (head of FB Blockchain David Marcus himself a former President at PayPal), we think this is a safe assumption.

There aren't a lot more details to work from at this point in time, but considering Zuckerberg's "envy" over WeChat's payments success (where payments revenue makes up more than 50% of the company revenue vs. 1% at FB, according to Sandler) and his deceleration on the latest earnings call to, "roll out Payment on WhatsApp in more countries," the consensus is Facebook is exploring every option on the table to accelerate its payment capabilities. FB Coin falls under that consideration.

But what about the competition?

The payments landscape is highly competitive and fragmented, both from incumbents and fintech challengers across the globe. A lot of questions surrounding how FB Coin expects to compete and differentiate itself within mobile and P2P payments are left to be answered.

- **Competition domestically:** While the micro-payment play seems less crowded, mobile payments are a different story. Square, PayPal, Apple Pay/Mobile Wallets, even Jamie Dimon suggested that JPM Coin could one day be retail focused, later lamenting how Square came up with an "adjacent" business line (dongle to process payments) that offered an opportunity to customers that JPM could have provided, but failed to. Take away is if there's a payments market not being served at the moment, Facebook's competitors aren't going to just stand by and let them have it.
- **Competition in Asia:** Realistically, this market is taken. Alipay has more than 700 million active users in China and an additional 200 million users overseas according to the China Daily. More than 40 million retailers support Alipay's QR code-based payment service. WeChat announced that its messaging app had reached 1 billion global active users in 2018 (also reported in English by ZDNet).
- **Fighting itself:** Finally, can't discount the fact that FB is knee-deep fighting itself, battling privacy and trust issues everywhere it looks. Will users trust the product enough to adopt? Will Facebook even see user base growth over the next two years? We're skeptical.

Implications for broader payments landscape if successful?

Ironically, the move to consider a version 2 of FB Credits due to the potential to offer profitable micro-payments capabilities and by-pass network fees, comes at a time when interchange fees from Visa and MasterCard are set to be raised in April.

If FB were to successfully pull this off, effectively build their own payment rail on-platform and box out Visa and MasterCard, how will other content platforms respond? I'd argue the most likely move would be to recreate a similar closed-payment stack. Would Apple and Google Play look to do something similar? Looking out 10 years, could this capability push back on Visa/MasterCard effective network duopoly? Or will regulatory movements like Australia considering banning interchange fees entirely become more globally accepted and mute the potential impact long-term? Only time will tell.

One thing's certain. U.S. merchants have engaged in years of anti-trust legal battles over how interchange fees are set and enforced by the world's largest payment networks. These networks operate with incredible pricing power, so much that interchange competition actually forces prices up over time, rather than down, in order to maximize company value. The current systems struggle to support micro-payments.

The potential for unlocking new value if a blockchain-based token system can facilitate micro-payments will be a fascinating trend to follow in payments. Whatever happens, FB Coin will be an interesting case study towards discovering some of these answers.