

# At holidays, Net photo business cranks up

## In fourth quarter, Shutterfly erases rest of year's losses

By Jefferson Graham  
USA TODAY

HAYWARD, Calif. — The crunch kicked in the morning after Halloween: 3 million photos of cute kids in their monster outfits uploaded to online photo service Shutterfly. A record 1.2 million prints were ordered that day.

**Technology** Thus began The Big Season. "From Halloween, it's straight on to Thanksgiving, holiday cards and calendars, and our lab's running 24 hours a day, seven days a week," Shutterfly CEO Jeffrey Housenbold says.

Shutterfly loses money in the first, second and third quarters but makes it all up in the fourth. "We are a classic seasonal business," Housenbold says.

The company expects to report revenue of \$56 million to \$59 million for the fourth quarter, up 37% to 44% over the same period last year.

This time of year, the online photo business is cut-throat. Discounters routinely undercut rivals on price. Do an online search for "4x6 prints," and prices can range from 19 cents at Shutterfly and 15 cents at Kodakgallery.com to 5 cents at Winkflash.

Housenbold says 7-year-old Shutterfly has survived by staying out of the price war and by diversifying. It spends more time promoting higher-margin photo gifts such as calendars, greeting cards and photo books than 4-by-6 prints.

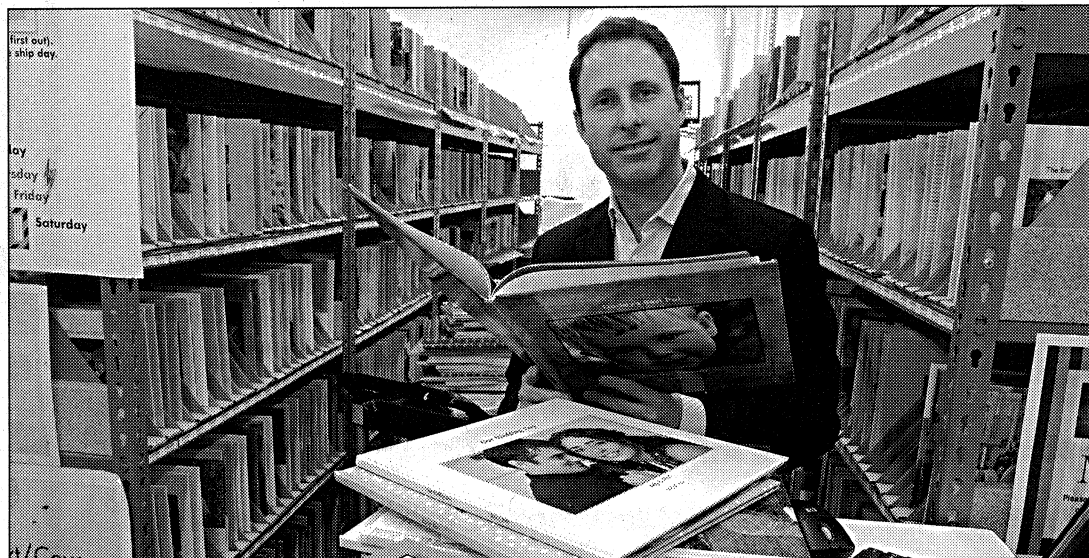
"They were the first ones to push into photo accessories in a big way, and they kept their customers loyal by continually expanding their offerings," says Chris Chute, an analyst at researcher IDC.

Chute says U.S. consumers this year will spend \$1.2 billion on online photo products — \$886 million for prints and \$297 million for accessories such as calendars, greeting cards and photo books.

Shutterfly, which went public earlier this year, sees its audience as the 1 million U.S. households that regularly use online photo services. IDC says 57% of U.S. consumers own digital cameras, up from 49% in 2005. "Shutterfly's numbers keep growing, quarter to quarter," says Imran Khan, an analyst at equity firm JPMorgan. "They've done a great job of attracting new customers and keeping older ones loyal."

The stock opened at \$15.55 in September and since late November has hovered around \$15. It closed Thursday at \$14.48.

Shutterfly launched in December 1999 as one of a handful of Silicon Valley-based websites devoted to selling photo prints online. Many have since closed.



By Fred Mertz for USA TODAY

**Shutterfly CEO:** Jeff Housenbold, at the company's photo-book-making facility, has stayed out of the price war.

Shutterfly remains the top independent.

It is neck-and-neck with Kodak's EasyShare Gallery (formerly Ofoto) in market share, researcher InfoTrends says. The other Silicon Valley survivor, Snapfish, now owned by Hewlett-Packard, is No. 3.

Dan Baum, an avid photographer and former engineer at Silicon Graphics, a once-highflying computer maker, got the idea of putting a photo lab online in 1999. He went to co-worker Eva Manolis to join him. Their former Silicon Graphics boss, Jim Clark, agreed to invest.

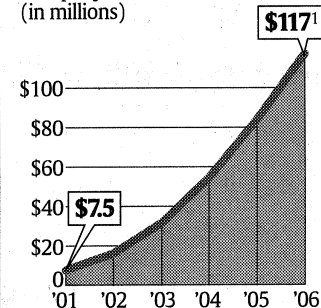
Clark still serves as Shutterfly's chairman and owns 40% of the company. Baum and Manolis left in 2003.

"It was very rough for a few years," says Clark, best known as the founder of Netscape, the Web browser that popularized the Internet. The economy soured, dot-com businesses struggled and many websites shuttered. What kept the company going? "I did," says Clark, who has invested \$30 million. "It was a matter of money. I kept reinvesting. I don't like to give up."

Baum, a vice president at software firm Adobe Systems, looks back in awe at the new kind of lab he set up for Shutterfly, one that enabled round-the-clock or-

### Shutterfly's revenue

Shutterfly's initial public offering raised \$80.9 million in 2006. Company revenue since 2001: (in millions)



1 — \$113 million to \$117 million projected  
Source: Shutterfly

By Adrienne Lewis, USA TODAY

ders. "We developed a level of automation the industry had never seen," he says. "This business is all about controlling your costs, and we developed the first end-to-end automated photo workflow."

After a consumer has ordered a product online, the order travels to computers here in suburban San Francisco. It then gets transmitted directly into Shutterfly's photo-processing machines.

Weeks before Christmas at the bustling lab, images of thousands of smiling babies and families spit out of photo machines at warp speed. Workers — yes, people do work here, too — trim large prints to fit onto calendars, assemble photo books and stuff them quickly into envelopes.

When Shutterfly began, it used two Konica photo printers capable of producing 300 4-by-6 prints an hour. Now, many industrial-size printers produce 20,000 prints an hour.

Several times a day, the U.S. Postal Service backs up one of its huge, supermarket-size delivery trucks to the Shutterfly loading dock.

"It's really intense this time of year," Clark says. "We have to do heavy-duty staffing and three shifts a day. But, in January, we can all rest. A bit."