

“If you really look at what Kaleidescape ...

... gives you in terms of product quality and support,” said a dealer who is no starry-eyed newcomer to the custom integration business but a pretty battle-hardened pro, “it really turns out to be a good value. Whether a particular customer can afford that value is a different story.” There has never been any argument that the Kaleidescape system is “seductive,” “sexy,” “fun,” and very easy to operate, but with a price tag of \$14,280 for an entry level system that holds up to 150 DVDs or 1,650 CDs, or a mix of the two, you don’t typically hear it described as “a good value.” The dealer has a point, though. If the customer can afford it, this system does deliver an outstanding experience, and it delivers it absolutely flawlessly and reliably. To quickly summarize, a **Kaleidescape** entertainment system consists of a 1U or 3U media server, a 1080p player, disc cartridges, proprietary operating software, a terrific user interface with which to access content, i.e. movies and music that can be searched by title, genre, actor/performer, director, or cover art; you can even select a favorite and ask the system to suggest movies or songs that are similar. You can read a synopsis and then, bypassing trailers and ads, click on “Play Movie” and start watching a film instantaneously.

THE DEALERS’ CHALLENGE: SUCCESSFULLY SELLING AN OUTSTANDING - AND OUTSTANDINGLY SUPPORTED - SYSTEM TO THE PROPER TARGET CLIENTELE

The typical client, agreed the 12 dealers I interviewed, is “a very wealthy person.” Many have families with children. They often have large existing DVD and CD libraries “but not a good way to store, catalog, manage and access them. They are sick of the clutter of hundreds of DVD/CD cases. They are sick of the DVDs getting scratched, or of DVDs being in the wrong case.” “They

have guest rooms or -suites in their homes, and they want to give their guests a way to access movies - almost like a hotel.” Ultimately, though, what it comes down to is viewing habits, one dealer suggested. “Why would I ever want this,” one of this dealer’s otherwise well qualified clients asked him. “I don’t watch movies more than once.” The Kaleidescape system therefore is most valuable for the serious collector of music and movies (who may also want to store and access his own home videos on the system).

The dealers in this sample have carried the Kaleidescape line anywhere from 2 months to 5 years (the company started shipping product in August 2003) and the way they



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characterized their business with Kaleidescape ran the gamut, from “very good,” “good,” “fine,” to “... a roller coaster,” or “flat,” even “down dramatically lately.”

When I asked them what they, as dealers, like about doing business with Kaleidescape, everybody mentioned the outstanding reliability. “Product reliability is the best!”

To quote a particularly satisfied dealer: “They are the only vendor I have ever worked with in over 20 years that has an incredibly sophisticated, cutting edge, top end, expensive, high performance product that works out of the box, goes together very easily, works consistently and continues to work. It is incredibly robust and trouble free.”

The other outstanding characteristic every dealer mentioned is the fact that Kaleidescape monitors the health of all systems via the Internet 24/7. “If a drive should go bad, we are often notified by Kaleidescape before the client - or we - realize there is a problem. We receive a replacement drive immediately. This is something I truly value. It has saved some of the systems we have installed from catastrophic failure.” Another dealer related a very similar story: “We received an email notification that one of the drives in a system we had sold was failing, and that they had already initiated the advance replacement and an RA number. It arrived within a day and a half. We went out and replaced the unit before it even failed. That kind of service is priceless.”

THE VENDOR’S CHALLENGE: IMPROVING RAPIDLY ON PARAMETERS BEYOND PRODUCT AND TECH SUPPORT

Dealers also commented that Kaleidescape has improved noticeably in a number of areas that until recently had not quite matched its stellar performance in the product, the technical support and the service areas. High up on the things-that-have-been-improved list is Kaleidescape’s extranet. With one exception and two abstentions (because they were personally not familiar with it) all other dealers in this sample gave the Kaleidescape extranet a thumbs up. “I was pleasantly surprised at how much their extranet has improved over the last 12-18 months,” said one dealer. Others added, “it’s improved a lot. It’s very good now.” “It’s very useful.” “Very well done.” “Definitely much better than most.” “Their extranet didn’t use to be the way it is today,” one dealer stressed. “The configurator, at one point - while it was a great idea - was very difficult to use and resulted in a lot of confusion and misquoting, and that hurt our profit margins.”

Another dealer reported a similar experience in the past: “The numbers didn’t jibe with what we thought they

should be. There were plenty of times when we were trying to reconcile our numbers with theirs when it came time to pay the bill. That’s gotten much better.” Several dealers also pointed out that the pricing structure has been simplified and the margins have gone up “a few points.” Actually, depending on the level a dealer is at, margins can exceed 40%, but a number of dealers noted that “we can’t sell all that many Kaleidescape systems in a year,” so Kaleidescape is not a huge contributor to overall profit in some dealerships. On the other hand, what definitely helps margins is that “with a Kaleidescape system we don’t have to go back and fix things. So, whatever margin we make on these systems we keep, because the hardware is so reliable. And that is significant.”

One of the dealers ticked off what he called the 3 original complaints about Kaleidescape: (1) super expensive product, (2) super low margins, (3) no exclusive distribution. “When you look at those 3 things today,” he said, “they have (1) lowered the price of admission, i.e. the price of an entry level system is now lower and, furthermore, a full blown system costs much less today and offers more storage than before. (2) They have improved the margins, and for very supportive dealers those margins can go above 40%. And (3) they have cleaned up the distribution. When I first bought in,” the dealer continued, “I bought a demo system, and I would sell people on it. And then other guys, who would kind of pick off my bid, would then become a dealer. So, in a small community like ours, all of a sudden you would have, like, 7 dealers. Today, they have tightened that up considerably. I think Kaleidescape, at this point, has figured out who the one-shot-wonders are and who the quality, supportive dealers are - and now they support the dealers who support them.”

Interestingly, the newest dealer in the group related the following: “Kaleidescape made it very clear to us that their history, which had been dealers signing up, buying one system - because they had already sold that - and then never selling another system, was not an acceptable business model anymore. Today, they also require that their dealers invest in a demo system.”

So - even without granting any dealer an exclusive, Kaleidescape has managed to get distribution under control. Most dealers said distribution “is not an issue. As a dealer, you have to have the customer base that is going to look at a product like this. You have to invest in demo equipment. You have to carry a variety of control systems. You have to be network-savvy.” Such requirements tend to automatically select competent dealers.

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THE WARM AND FUZZY FACTOR

To recruit dealers to interview for this article, I had sent out emails to a group of them, asking whether and when I could call them for input. One of those dealers emailed me back, *"We still sell a lot of Kaleidescape, but I don't really want to comment on the company ... they are not a real warm bunch."* Having personal relationships with your vendors is important to most dealers in this industry. Some dealers suggested that Kaleidescape can be too *"corporate,"* too *"inflexible."* Other dealers valiantly (though not always entirely convincingly) stated they really didn't need any *"warm-fuzziness."* Here are the comments from a dealer who described himself as having an *"engineering mindset."* Said he, *"I think Kaleidescape is a very disciplined company. There may not be a lot of emotion flowing from these guys. I use the word 'disciplined,' because I appreciate it. But my two partners in the business would likely agree with the dealers who feel these guys at Kaleidescape are a bunch of inflexible corporate drones that will not bend over backwards for you, though they totally agree with me on Kaleidescape's product and service strengths. But I find Kaleidescape's support documentation, the software modules they release, the help files, and - when you do get a live person on the phone - their tech support staff, all first rate. So I am thrilled that they have their ducks in a row."*

Of course, a personal relationship can be established with the local representative - and in the case of Kaleidescape, these are people who are employed by the vendor, not independent reps. The somewhat disconcerting finding here was that some dealers couldn't say enough positive things about their reps, while other dealers' heads were spinning from what they perceived as a "revolving door" policy. One of the dealers in the first group noted, *"our rep is just absolutely fantastic! Anything he can possibly do to make the relationship better - whether it be teaching, training for our techs or our sales people, problem solving, anything that he can do, he is here, and he is here in a heart beat."* That was the most enthusiastic dealer. Many of the others were happy enough, but 4 of the dealers complained that they were on their 3rd, 4th, even 5th rep in the span of 2-3 years, and often they saw no rhyme nor reason in all the changes, stating that reps who had been let go had, in the dealers' opinion, done a better job than those who replaced them. While two dealers reported having seen a lot of turnover in their territories, too, *"all of the reps we dealt with at Kaleidescape have been good reps who do the right thing."* *"I've been very lucky."* Nevertheless, too many changes make dealers insecure. *"It's one of our biggest concerns,"* said one dealer. *"They turned over a lot of good people - and not just reps."* Two additional dealers said that *"stabilizing the rep situation"*

should be a priority for the company.

LOOKING TO THE FUTURE

Initially, when the DVD Copy Control Association had sued Kaleidescape for breach of the license to the DVD CCA's content scrambling system, a number of dealers deferred bringing in the line, preferring to wait *"until the dust settled."* When the ruling came down from the Santa Clara Superior Court in California in March 2007 that Kaleidescape had not breached the license agreement, several of the dealers I spoke with now felt that *"things were going in the direction they really needed to go,"* and following that ruling they had decided to become dealers. They also professed to not be concerned about the DVD CCA's appeal. *"I am not worried about it at all,"* one of the dealers said. *"Kaleidescape already won. The genie is out of the bottle."* Furthermore, *"these are really the only guys that crossed the 't's' and dotted the 'i's,' and they were being held up [to be made an example of], where all the other computer-centered media guys were not adhering to the laws. Kaleidescape was the absolutely only alternative out there, if you wanted to be compliant."* Added another dealer, *"if people live by the letter of the law and do what is required of them when they sign their contracts, it takes the onus off Kaleidescape, because when a customer signs the contract that he is not going to make and distribute multiple copies, he is now contractually obligated to follow that. It's not a problem with our customers. They fully understand."*

When it comes to competition as well as to what they want from Kaleidescape in the future, dealers made essentially 3 points: (1) that if Kaleidescape had a less expensive music-only system that could, however, be managed and operated via the current system's stunning user interface, that would be eminently saleable. As one dealer had said, *"the fact that in the current configuration the music player does not have any video outputs is, I think, a huge oversight."* (2) that Kaleidescape introduce a Blu-ray player as soon as possible, and (3) that the real competition is on the content-that-can-be-downloaded-from-the- Internet front.

In the context of the DVD CCA lawsuit and appeal one of the dealers I spoke with had noted that *"a lot of this is kind of pointless anyway, because in a couple of years I think you will see optical media starting to disappear, since downloading will be more prevalent - even for HD movies."* Another dealer felt that while *"there is something to be said for downloading video content from the Internet, I personally think that business is still in its infancy and Kaleidescape still has at least a year or two to catch up with whatever they need to do."*

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Several dealers brought up companies that make streaming video available currently, such as Vudu or even Apple TV, and while they were quite clear on the shortcomings, as a business model, those dealers felt, this was the future, and one of them noted, *“Kaleidescape needs to offer something where customers can download over the Internet and store that content on their Kaleidescape system. That is very important. Actually,”* he added, *“it’s something they have been mumbling about from the very beginning!”* Another dealer made the same point: *“Supposedly, that is the premise the whole company was built on. The DVD was just an interim step. I think our clients are looking to Kaleidescape to be a resource where they can download HD movie content and have it on their Kaleidescape system. Long term, I think, that is more important than having a Blu-ray player.”*

KALEIDESCAPE RESPONDS

“It is inevitable that eventually the primary way that video content will be delivered is via the Internet, and I concur with the dealer who said that in the long term Internet content delivery is more important than Blu-ray,” said Cheena Srinivasan, co-founder and COO of Kaleidescape. *“However, a much more significant issue than this feature offering from us, is the availability of high quality video content for download, including related license agreements, DRM, etc.”* While he would not commit to a definite time-table, Srinivasan said that it would take much longer than one to two years before this usage model becomes a reality. *“It will take a lot of time for the content owners to make a substantial percentage of their high quality content available for Internet downloads.”*

With respect to a Blu-ray player, there is little chance that Kaleidescape will bring one to market before December 2009, and even that may be a stretch, because it depends on sufficient quantities of the proper chip sets to become available. *“It’s not that we are unwilling, but several of the very best technologies we wish to choose are not even available until early next year,”* Srinivasan pointed out. *“The only guys that are currently selling Blu-ray players are the founding companies of Blu-ray.”* Furthermore, the number of Blu-ray discs available right now is *“pitiful, compared to the number of DVDs.”*

When it comes to a music-only system that would compete with something like an AudioRequest Srinivasan said, *“our solution is not ideal as a music-only offering.”* In part, the reason for that is that *“our strength lies in video distribution, and we wanted to embrace music as part of movies and music, as opposed to treating music as a stand-alone entry level product, and then later figure out how to upgrade to movies.”* However, as of right now,

Srinivasan added, customers can synch all the content in their Kaleidescape system with their i-Pods - but not the other way around, i.e. someone who purchases lots of music from i-Tunes cannot synchronize from their PC or Mac to their Kaleidescape system, because the Kaleidescape players are not designed to decode MP3. *“But, absolutely, we intend to figure out a way to address that.”* Kaleidescape is equally willing to work on a mechanism, down the road, whereby people can do *“cluster to cluster copying,”* so clients with more than one residence will be able to access their movies in each of their homes, without having to load all of the content all over again, one by one. Also, ultimately, prices will come down further, and as that happens, *“our dealers will be able to sell Kaleidescape systems in a higher percentage of their projects, though our goal is not to get 100% penetration in all projects, that is just simply too difficult a goal to achieve.”*

Srinivasan spent a considerable amount of time commenting on why the company has had some problems with the rep force, and he acknowledged that he was aware of Kaleidescape’s image in the industry as being too corporate, too unbending, and generally scoring very low on the *“warm and fuzzy”* meter. He also agreed that Kaleidescape, with its high-powered Silicon Valley background, has made mistakes in hiring. All of those mistakes, in some sense, came down to poor matches, and having made the mistakes, the company has learned from them. If the impression in some circles is that Kaleidescape is *“ruthless,”* as Srinivasan put it, the reality is that they are a group of perfectionists that put in long hours and work extremely hard and therefore *“don’t like people who are problem reporters, rather than problem solvers.”* Reps who *“use socializing”* as their predominant mechanism to selling will be an extremely poor fit here. While Srinivasan agreed someone can be very competent, very efficient, yet still warm and friendly, it is very clear what the priorities at Kaleidescape are. *“For us, competency comes first. Being liked, second.”*

A PERSONAL VISIT TO SILICON VALLEY

Driving to Kaleidescape headquarters in Sunnyvale, CA on a brilliant July morning, we crossed *Innovation Drive*. The buildings we passed sport the logos of world famous high tech companies. It sets up an expectation. Entering Kaleidescape’s building, I am very quickly shown into a demo room and get a good look at top quality and razzle-dazzle: the Kaleidescape Entertainment System. Next, I have a chance to sit down with **Michael Malcolm** and **Cheena Srinivasan** and listen to them describe the beginning of this company that, for the first two years was simply called, *“The Next New Gig.”* Of course, Malcolm

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and Srinivasan are long term denizens of the Valley, having worked at, founded, grown, and sold off other high tech firms. Several of these companies designed and built products that all had something to do with networking and storage. Malcolm's own frustrating experience with his DVD collection led to the "Eureka" moment: He saw a market opportunity to which he could apply his and, ultimately, a carefully chosen team's competence. During those first two years a great deal of care went into defining the bedrock values for this company that would be "for keeps," not to be sold off as soon as it had reached a certain stage. No venture capitalists (VC's) were to be involved - only 13 investors that are totally committed to the company vision. "VC's talk about exit strategy from Day One," Srinivasan pointed out. In fact, fast-forward to today, and "The Next New Gig," 8 years after its founding has become the Gig of a Lifetime for both Malcolm and Srinivasan: "In spite of all the problems that we have faced, this is by far the most attractive, the most gratifying gig - and we are undeterred to build it into a 1/2 to 1 billion dollar business," the latter said.

At this point in the company's life much effort is put into executing flawlessly while scaling up. The location certainly helps. Silicon Valley offers and continuously attracts brilliant minds, and the intellectual firepower at Kaleidescape is fairly dazzling, and, personally, I found that very energizing. Of the 150 employees some 90% are college educated, Srinivasan noted, and in top management they all hold masters and doctoral degrees from elite universities like Stanford, MIT, UCLA, Berkeley and others. As group after group made their presentations over the next two days, discussed what they were working on, what was most evident was a high level of passion and excitement for improving and perfecting their work rather than discussion of technical minutiae (ok - let's assume they tailored it to their audience - me!)

I had expressed an interest in seeing Kaleidescape's local contract manufacturer, **Proworks**, and Kaleidescape's VP Manufacturing, **John Lio** and **David Longshore**, VP Sales & Business Management at Proworks gave me a tour, which turned out to be quite an eye-opener. This is a world class facility that is AS9100 (which incorporates ISO 9000) certified. During a recent re-certification the factory achieved a score of 100/100. A whole wall of certificates attests to the fact that the entire workforce is certified. The factory floor is laid out meticulously for highest quality and efficiency (but, of course, allows for flexibility). A job completion board showed 100% completion for the day and a 94% average on time completion for the last 10 days. As a contract manufacturer, Proworks has a number of clients, with Kaleidescape being among the top 3. Kaleidescape

provides Proworks with all appropriate test procedures and Kaleidescape employees can go on line and track every board and every system and see the test results. Proworks also keeps 30-90 days raw materials and parts on hand, and Kaleidescape manages the inventory. Actually, what is built is not an insubstantial amount. On the day I visited, Kaleidescape Players were stacked high and wide, ready for shipment. In less than a year Proworks is planning to open a manufacturing plant in India and, given the strong and well-tested hand-in-glove partnership they have with Kaleidescape, Proworks' Indian facility will become one avenue for Kaleidescape to scale up - though likely not the only one. Said Srinivasan, "the reason we rely on world class contract manufacturers is because when they wake up in the morning, all they think about is manufacturing efficiency. They have factories that work 24/7 in 2 or 3 shifts, if needed. They have the logistics down pat." But overseas manufacturing also makes strategic (and cost) sense, if you plan to expand your overseas business, Srinivasan added.

Over the last 3 years, Europe and the Middle East have grown to contribute about 30% to total revenues in 2007/8. In another 2-3 years that should come up to 50%. **Veronique Damien**, a multi-lingual Frenchwoman (she is fluent in English, German and Japanese, besides her native French) is the International Channel Sales Manager, responsible for signing on and training distributors and dealers overseas. Her intellectual firepower is a given, or she would not have made the grade at Kaleidescape, but what she might well impart to the atmosphere at Kaleidescape is a cultural sensitivity and empathy that comes from her background. Kaleidescape is already a culturally diverse company with a number of nationalities working together. No question, this company is intense - which can be exhilarating or exhausting, depending on circumstances. Kaleidescape's strengths - in terms of innovativeness, high quality performance and reliability, outstanding service and technical support - are demonstrated. Their ability and willingness to adapt and improve came across clearly during the dealer interviews. Quite a few Kaleidescape people mentioned that they work very hard and long hours, but they don't mind, because they see that everyone else is working equally hard. I have a sense, though, that as driven as everyone here is, the realization that work is not everything, is beginning to take hold. That will not rearrange the priorities at Kaleidescape, but it will expand the company's horizons. For more information go to www.kaleidescape.com or call (650) 625-6100.

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