

PROFIT

Krazy Train

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Toronto's stately University Avenue is lined with Stalinesque office buildings built to house government agencies and insurance companies in respectable 1950s blandness. So, it comes as a shock to hit the 14th floor of one sandstone skyscraper and find a company called Kaboose that features bottles of Heinz ketchup in its reception area and a photo of Lucille Ball and Desi Arnaz in its boardroom — alongside an Apple poster that reads, "Think Different."

But then, Kaboose Inc. has never been a conformist kind of business. Founded in 1999 to create Internet content for kids, it challenged the dot-com slump by buying up kid-oriented websites. Then it changed focus from entertaining children to educating their moms. For a while, Kaboose's founders, Jason DeZwirek and Eric Yuzpe, had a lot of 'splaining to do. But now, with soaring ad revenue and 10 million users a month, they're starting to reap the rewards of thinking different — and no longer have to 'splain themselves to anyone.

"We're not trying to be everything to all people," says DeZwirek, Kaboose's hard-driving CEO. "We're all about moms of children under 12 — not women in general, not kids."

Clearly, Kaboose is all about strategy, too. After a few false starts, this is a company that has found its sweet spot — and is using strategic targeting, aggressive financing and creative partnerships to stand out in the treacherous shoals of the Internet. Sales have grown more than 1,000% since 2003. Just a year after going public through a humble reverse takeover on the TSX Venture Exchange, the firm has tapped the public markets for \$37 million and graduated to the TSX. And how's this for an incomplete list of business partners: Heinz, Mattel, McDonald's, Hewlett-Packard and Mercedes-Benz. As such, Kaboose is a good model for many other Canadian entrepreneurial businesses searching for gold on the Internet — or in any other overcrowded market in which patience and focus are the keys to success.

Kaboose's new niche demonstrates why the right focus goes a long way. Everyone wants to connect with Mom. In the U.S. alone, there are more than 20 million mothers of children under 12, making US\$1.5 trillion worth of buying decisions a year. Moms are avid Internet users, spending hours online every day researching information on parenting, health, education, baby care, fashion, food and movies. "One of the reasons Kaboose is successful is that we have a niche audience, but not a niche topic," says DeZwirek. Most specialty websites — technology or music sites, for example — appeal to a narrow range of advertisers. "Kaboose attracts all kinds of advertisers, in all categories," he says, "so there is much less risk."

The proof, as your mom might say, is in the pudding. Today, Kaboose boasts more than two million registered users (return visitors who can be tracked and cross-promoted by Kaboose and its advertisers). It's now North America's largest independent online media company in the kids-and-family market — a sector dominated by giants such as Disney, NBC Universal, AOL and MSN. Better still, advertising revenue has soared. For the nine months ended Sept. 30, 2006, Kaboose grew 200% to \$11.7 million in revenue. The company also reported its first ever quarterly profit, of \$500,000 — a \$1-million turnaround from the same period a year before.

But then, there's a lot of pressure on Kaboose to succeed. When it went public a year ago on the TSX Venture Exchange, it did so as Canada's only publicly traded, pure-play online media company. The Globe and Mail and the TSX both hailed Kaboose as a welcome symbol of economic diversification in a sea of junior-resource stocks. It was a heady debut for a company whose websites feature Christmas crafts and "New Parent No-No's." And it is also a useful reminder for other Canadian entrepreneurs that there's opportunity everywhere if you're willing to be patient, offer a high-quality product and ready to leap whenever you see an opening.

Although DeZwirek and Yuzpe were both just hitting 30 when they launched Kaboose, they had done their share of bobbing and weaving. They had previously worked together at Digital Fusion — a business co-founded with DeZwirek's father, Phillip — creating interactive content for CD-ROMs and interactive kiosks. (Among their products: a "spelling adventure" game published by Compton New Media, and CD-ROMs based on the music of children's entertainer Fred Penner.) When the Internet pushed CD-ROMs to the back of the shelf, Kaboose.com launched with a screenful of original kids' games (such as Hangman and "Fred Penner's Juke Box") — and no revenue.

Kaboose's strategy was to build interactive tools and games for other digital players. But even at the height of the Internet craze, DeZwirek couldn't raise the venture capital he needed. Once the market crashed in March 2000, DeZwirek busied himself at his father's other companies, an electronics manufacturer and a pollution-control company. But after Sept. 11, 2001, unexpected opportunity emerged. A handful of well-known, family-focused websites suddenly came up for sale. "Companies we'd greatly admired that had raised millions of dollars in venture-capital funding were suddenly available for a fraction of the price," says DeZwirek.

Seeing a chance to leave "work for hire" behind and build a new online company from the dot-com detritus, DeZwirek acquired three properties within six months: Zeeks.com, a kids' games site with 500,000 regular users; KidsDomain, a "family resource" site for kids and parents; and FunSchool, a developer of learning-based entertainment for kids from pre-school to Grade 6. Together, those firms had raised US\$60 million in venture capital. Kaboose's total cost: less than US\$1 million. "The expression 'pennies on the dollar' is just about right," says DeZwirek.

But this strategy was not without risk. Kaboose bid by phone, sight unseen, for the assets of Silicon Valley-based FunSchool, once rated the No. 1 Internet site for kids aged 2 to 11 before filing for bankruptcy in January 2002. (Its employees said the founder had turned down a multimillion-dollar bid from Disney in hope of getting US\$100 million.) Kaboose won the bidding by a margin of US\$1,800 against a group of former employees. When DeZwirek and Yuzpe showed up at the courthouse, they were handed a key to a storage locker containing all that was left of the company: a few boxes and a dozen computers. No one knew if the website's key assets — its programming, games and content — were there. But when the computers were checked out back in Toronto, the intellectual property was found intact, and FunSchool returned from the dead.

Over the next year, DeZwirek and Yuzpe created the Kaboose Network, aiming to win revenue through a paid-subscription network. Kaboose.com was relaunched as a portal leading to the other sites "where kids get on board the net" (thus, at last, explaining that name). Consumers remained wary of paying for content, but soon children's marketers such as Kellogg and Nintendo came knocking on the door to buy ad space. "Suddenly, we had a business," says DeZwirek.

Sales grew fast, but from a slow start: revenue more than doubled in 2003, but was still only \$1.2 million. Kaboose had lots of competition from huge media sites such as Disney, Yahoo! and Nickelodeon — and no licensed characters to compete with SpongeBob or Winnie the Pooh. Looking at its user statistics, however, Kaboose realized that its "mom" traffic on Kaboose and KidsDomain was growing faster than its kids' audience. The penny dropped: parents control a lot more disposable income than kids, and no big brands dominated their online media space.

Changing course to focus on information and activities for Mom proved a canny move. According to a study done for Disney, mothers now spend much more time on the Net than they do watching TV — 13 hours a week versus 7.6. In other surveys, 88% of moms online said they rely on the Web for parental advice, 80% go online to do consumer research and 85% click on online ads. These not-so-desperate housewives not only control the family purse strings, they are also eager to share their experience and knowledge with other wired women. As David Enberg, Kaboose's vice-president of sales, says, "Moms are taking advantage of all the Web has to offer because it makes it easier to do what they always have done — engage with other moms and plan their family life."

Kaboose's new strategy led to three acquisitions in two years. In 2005, it bought Birthday in a Box, a Gaithersburg, Md.-based online vendor of party supplies. In 2006, it acquired Two Peas in a Bucket, a Middleton, Wis.-based supplier of products for scrapbookers (mainly moms wanting creative ways of recording their family's milestones), and Boston-based BabyZone, the second-largest pregnancy and parenting U.S. website, with 100,000 pages of content and two million registered users.

To raise the money to compete in these leagues, Kaboose went public in November 2005 on the Venture Exchange, using the TSX's Capital Pool Company program, which offers a low-cost way to go public — and, if you wish, bypass the venture-capital stage. DeZwirek says Kaboose received lots of calls from venture capitalists, mainly in the States, who wanted to give Kaboose the capital to acquire more companies. But as Kaboose's first major investor, he drove most of them away by demanding to receive the same terms as the VCs required, such as preferred shares and guaranteed exits. "Having seen what happened to those other [dot-com] companies," he says, "I was very cautious of venture capital."

In November 2005, Kaboose raised \$10 million in a private placement and went public by doing a reverse takeover of a shell company listed on the venture exchange. Within three months, with its stock trading at just over \$1 a share, Kaboose graduated to the TSX itself. Three months later, in May, it raised \$37 million through a public offering at \$1.40 a share to finance the purchase of BabyZone. "Being public has been great for us," says DeZwirek. "It made it a lot easier for us to raise money."

For now, Kaboose's acquisition binge is over. There simply aren't that many significant players in the Mom Zone not already owned by major media. (NBC Universal scooped up iVillage, a women's portal, last May for US\$600 million.) With \$13 million in cash and no debt, Kaboose is eyeing "tuck-under" acquisitions that add new applications and tools, but most of its attention is focused on making sure all parts of the Kaboose Network work together.

Marketers in any industry could learn a lesson from how Kaboose's marketing cycle works. Some 60,000 pregnant women sign up each month for BabyZone's pregnancy calendar, which helps them track changes in their bodies and prepare for the new arrival. Regular e-mails letting people know what to expect in the seventh, eighth or ninth month are supplemented by additional information; in September, for instance, BabyZone sent 2.3 million e-mails about the best baby strollers to buy. The birth of a baby is also an impetus to take up scrapbooking, so new moms can expect to hear shortly from Two Peas.

Ten months after their due date, the new moms will be urged to prepare for baby's first birthday — through special offers from Birthday in a Box. Kaboose continues to stay in touch with moms and, later, their kids, by leading them through a progression of experiences and information throughout the network.

Kaboose is all about synergy. Before being acquired for US\$700,000, Birthday in a Box earned all of its US\$1.6 million in revenue from product sales. Now it earns ad revenue as well. Plus, a site redesign abetted by head office has seen sales jump some 80%. Site founder Laurie Wrigley, who started the company in her home in 1996, also appreciates the co-operative and "fun" management approach that Kaboose offers, which lets her maintain her local employees and autonomy following its 2005 purchase. "The environment is very entrepreneurial, so it's not that different from what I had been used to," says Wrigley. "They have a growth plan, they're moving forward, and they're very excited about what they do."

To keep the growth coming, Kaboose is now spending \$100,000 a month on Internet advertising of its own, primarily keyword search to help Web-surfers find information. DeZwirek believes that Kaboose's quality content is a big edge. Its freelancers produce timely articles of essential interest to kids and parents — most of them on "evergreen" subjects that never go stale, such as outdoor games, "Is it a cold or the flu?" and what to feed your toddler. To meet Internet users' growing demand for video content, Kaboose is now working to create 140 how-to videos for parents, as well as licensing content in partnership with other media companies.

Kaboose is also bulking up to take advantage of the social-networking power that has made huge winners of YouTube, MySpace and other sites on which users share their own content. "That's something we think we're well-positioned for," says DeZwirek, who sees Kaboose's 120,000 pages of content as "starters of conversations" that will be carried on through blogs, chat boards and photo-sharing capability.

Leading this charge is Two Peas. Besides selling themed paper, stamping kits and other scrapbooking accessories, it lets aspiring artists show off their work to each other in guest galleries and contests. Two Peas also offers chat zones for customers to ask questions, share scrapbooking tips and brag about their kids. In particular, the "NSBR Board" (non- scrapbook-related) allows members to critique their favourite TV shows, the recent U.S. election results and the many shortcomings of their spouses.

While chatboards sound 1997-ish, Kaboose considers them social-networking jewels. Online moms become very dependent on online networks; the research says half of them would rather access parenting and consumer information from peers than from "experts." If you're accustomed to sluggish Canadian message boards, you might be surprised by the power of large and engaged communities. When one Two Peas member asked for help choosing which outfit to wear to a job interview that morning, she received seven helpful responses within 10 minutes.

Of course, Kaboose reserves its greatest effort for selling ads and building relationships with marketers. From a no-go zone in 2002, the Web has emerged as a red-hot battleground: total Web advertising in the U.S. grew 30% last year, to US\$12.5 billion. In the first half of 2006, it grew another 36%. But in this war, winners take just about all: the top 10 websites took in 72% of overall ad revenue last year, and the top 50 soaked up 95%. With its 10 million visitors a month — representing about one-third of the online moms' market — DeZwirek believes Kaboose now has the clout to win the big deals.

Advertising is mainly sold from New York, where Kaboose has built a hugely experienced salesforce. (A single sales rep in Toronto sells ads for Kaboose's Canadian site.) As with any media sell, the focus is on relationships. The ketchup bottles in Kaboose's lobby are souvenirs of Kaboose's co-marketing deal with Heinz to launch the latter's Silly Squirts line of squeezable ketchup bottles. In return for promoting the new line and building a mini-site of creative recipes for cooking with ketchup, Kaboose got its name on 20 million Heinz labels. Today, Kaboose has close ties with such major marketers as Kellogg, Nestlé, Mattel, McDonald's, Hewlett-Packard, Sears, Old Navy, Merck Frosst and Mercedes-Benz.

Kaboose's next step is pushing e-commerce and referral income. A new e-commerce platform will offer Kaboose sites more powerful features, such as the ability to reconnect with users who abandon their shopping carts (a huge problem on the Net). Beyond that, Kaboose is trying to turn its relationships into cash; for instance, the next time it sends out two million e-mails about baby strollers, DeZwirek hopes BabyZone will include a "click to buy" link to a retail partner that will give Kaboose a piece of the action: "We think there are very significant opportunities to partner with retailers so they become the premier toy shop or stroller supplier on our website."

And then there's the rest of the world. Kaboose receives visitors from 100 countries, although it focuses only on those from the U.S. and Canada. DeZwirek sees huge opportunities in Germany, France, Italy and the U.K., but says the firm has so much to do in the U.S. it won't work on international sites until late 2007.

Stock analyst Ron Shuttleworth of Jennings Capital in Toronto says that, based on recent acquisitions and organic growth, he believes Kaboose could earn revenue of \$18.7 million in 2006 — nearly three times the prior year's level — and \$33 million in 2007. With that growth, finally, will come profitability. While Kaboose will likely lose \$2 million in 2006, on top of its \$3.3-million loss in 2005, Shuttleworth forecasts it will make a profit of \$4.6 million in 2007. He says Kaboose shares, which traded at \$1.50 for much of the past year, could reach \$2.90 within 12 months.

All of which could make Kaboose ripe for takeover. "We believe the company is an increasingly valuable acquisition target for international media conglomerates," Shuttleworth wrote in a November 1 report. "I do think that if we execute well, we probably will be a target," agrees DeZwirek. "I think we are becoming a threat to traditional media that have dominated this space historically." But he insists Kaboose was not created to be sold: "We are building our company to dominate our space."

Accompanying Sidebar article

HOW TO COMPETE WITH GIANTS

As a Canadian company with websites that rank it among the 10 biggest family-oriented properties on the Net, Toronto-based Kaboose Inc. is punching well above its weight class. Here's how it competes with the likes of Disney, Nickelodeon and AOL.

Look for the gap

When Kaboose realized it would never gain much traction against Disney and other branded media giants in the battle for children's attention on the Internet, it shifted focus to serving mothers — a huge market niche with no clear leaders.

Hire seasoned pros

Kaboose's U.S.-based sales team includes heavy hitters with experience at American Media Inc., Women's Day Special Interest Publications, BabyCenter (a larger competitor to Kaboose's BabyZone), Warner Bros., Disney (Paris) and Yahoo! Education.

Set higher standards

Every parent worries about what their kids are seeing and reading on the Net. At Zeeks, a games site for kids under 12, Kaboose employs home-based, 24-hour-a-day reviewers who approve every chat message before it's sent. That's unlike several well-known competitors that promise only to review kids' messages within 24 hours of their posting.

Don't pay everything upfront

When Kaboose made its most substantial acquisition, BabyZone, last spring, it paid US\$22 million upfront, with a US\$15.5 million earn-out provision over two years. That reduces Kaboose's cash needs, cuts the downside risk and gives BabyZone's owners-turned-employees real incentive to perform.

Think small

With local ads now one of the fastest-growing revenue sources on the Net, Kaboose is producing parents' activity guides and directories in 80 U.S. cities, which enables it to direct-market to thousands of local advertisers who wouldn't ordinarily buy space on a national website.

Think big

Kaboose CEO Jason DeZwirek says he's frustrated that so few Canadian Internet businesses try to crack the U.S.: "It's very short-sighted for any Canadian to focus just on the domestic market."