

THE WALL STREET TRANSCRIPT

Questioning Market Leaders For Long Term Investors

FirstService Corporation (FSRV)



JOHN B. FRIEDRICHSEN, Senior Vice President and Chief Financial Officer of FirstService Corporation, joined the company as Vice President, Acquisitions in February 1998, a position that he held until May 2000 when he became Senior Vice President, Acquisitions. In September 2002, Mr. Friedrichsen was named Senior Vice President and Chief Financial Officer of FirstService. Prior to joining FirstService, from October 1996 to February 1998, Mr. Friedrichsen held the position of Vice President with Ernst & Young Corporate Finance Inc. in Toronto, where he was responsible for advising companies on a range of corporate finance matters, including the raising of capital and acquisitions. Prior to October 1996 and from June 1995, Mr. Friedrichsen held the position of Vice President at Canadian Corporate Funding Limited, a privately held merchant and investment bank based in Toronto, where he was responsible for advising companies on raising private capital. From May 1987 to June 1995, Mr. Friedrichsen held senior lending and credit positions with National Bank of Canada in the bank's commercial and corporate banking groups based in Toronto. Mr. Friedrichsen began his career in September 1984 with the chartered accounting firm Thorne Riddell, a predecessor firm of KPMG, where Mr. Friedrichsen obtained his Chartered Accountant designation.

(WAQ600) TWST: Could you tell us what FirstService is, what the business looks like today, and then give us a short history of the company?

Mr. Friedrichsen: FirstService is a diversified services company. We operate in four key areas: property services, consumer services, security services and, lastly, business services. What really ties FirstService and our operating segments together is a theme of recurring revenues. We generate significant recurring revenues in each of our service lines. We have long-term relationships with our customers, either through contracts or contract-like relationships. We don't manufacture or distribute any hard goods of any significance, only those that would be ancillary to the services we provide. As long as we're providing services at a quality level that our clients expect, we can continue operating and growing our business with predictable results over the long term.

We're not a capital-intensive business. Our biggest expense is our people. We try to leverage our people and, as a result, we have

a highly variable cost structure that allows us to adapt to changes in business conditions. In the event that business should turn down in any one of our segments, it allows us to be very flexible on the cost side. We generate a lot of high free cash flow as a result of not being a capital-intensive business, so most of what we generate we can then reinvest in our businesses. We're an acquisitive company, but if the investment opportunities are not there, we look to improve our balance sheet by applying our high free cash flow to debt reduction.

We have a very disciplined growth strategy. Historically we have grown our business half internally and half through acquisition. If you look at us on a historical basis, we've averaged growth of about 20% per year since we went public 10 years ago. I think on a go-forward basis as we get larger, in order to be prudent, our growth will probably be more in the 15%-20% range annually, at least over the next five years, but that's still a fairly significant rate of growth.

We are a company that has significant ownership by its management team. At the FirstService level and within our sub-

subsidiary companies, management owns about 30% of the equity. As a result, we are aligned with our outside shareholders in terms of looking to grow this business in a prudent way and with a long-term perspective.

TWST: I believe you have approximately 11,000 employees.

Mr. Friedrichsen: Yes. The number is somewhere between 11,000 and 13,000-14,000 during our peak months. We do have some seasonality in our business, and during our peak months (which would be from April to September), we would employ on the upper end of that range.

TWST: Is there opportunity to cross-sell and provide the full range of services to the individual client?

Mr. Friedrichsen: Certainly in our property management and consumer services areas those opportunities exist. We've had success in selling services to our property management clients that are provided by businesses operating within our consumer services area. Those range from lawn care services to painting services to closet installation and organization solutions, the latter through our California Closets group which is the originator of the organized closet solution. Within our business services segment we provide outsourced services such as fulfillment of promotional materials, rebating and loyalty program administration, and other customer support functions. We have several clients that have benefited from the cross-selling of services within this group.

In our property services area, just to give you a sense of our area of focus, we are the largest residential property manager of owner-occupied residences in the US. We manage about 400,000 units in 2,000 communities. We operate in several markets, including the mid-Atlantic (stretching from Washington, DC, up through New York), southern Florida, where we have a significant presence from Palm Beach down through Miami and also the Tampa area, and finally in Phoenix, Arizona. The communities we serve consist of condominiums, co-ops, townhouses, and gated developments of single-family homes. Our client is typically an association, which is governed by a Board of Directors elected by residents living in one of these communities, to oversee certain requirements that a residential community would have. Our core service offering includes assistance with the financial administration of the budget — the monies that are collected to provide certain services in common for the community of single-family homes, condos or townhouses. However we also cross-sell other services, including landscaping, plumbing, HVAC, as well as painting and restoration services primarily in the Sunbelt.

We are by far the leader in this segment, even though we have only about a 3% market share. This is a significant growth area for us, and one that is experiencing very good market growth.

TWST: What's the retention record? It would seem that on the residential side that could be a kind of capricious customer.

Mr. Friedrichsen: We've had some very, very good success in terms of retaining business across our different operating segments, and on the property management side in particular. Our

retention record would be in excess of 90%. These contracts and relationships we have with many of our customers have been in place a long period of time. It's a testament to our strong, customer-focused management teams.

Our customers are not only demanding, but they are growing in number, which is a nice problem to have! A significant portion of new residential construction in the US is in some form of community association. A growing market due, in part, to the aging population's preference for the type of residential living that our communities offer. It's also a market that's highly fragmented. Our nearest competitor would probably be a quarter of our size.

Our size and scale allows us to do some things that give us a competitive advantage in terms of servicing and retaining our customers. We can hire better people. We can invest more in technology to assist in better service delivery to our customers. And we have the resources and expertise to develop and offer new services that our competition can't.

As I mentioned previously, we've been able to provide services beyond the traditional property management function. This capability provides our customers with a comprehensive service solution and at the same time allows us to wrap ourselves around our customers and strengthen our relationships.

TWST: What's the outlook for the industry at this point? How fragmented is the competition?

Mr. Friedrichsen: The outlook for all of our segments is excellent. In property services, as I've already discussed, the overall market continues to grow as new residential communities are being built. In consumer services, we've certainly benefited from greater consumer spending over the last couple of years. We think we will continue to experience very good growth in this segment of our operations. As in property services, we're market leaders in our consumer services area, having developed a highly successful service delivery system based on franchising. We have in excess of 1,800 franchisees that have made investments in their own businesses and we, as franchisor, provide them with support to continue to grow their businesses. We think we have an excellent model here and a very good situation in terms of future growth potential.

Everybody knows that security has certainly received a lot more attention over the last couple of years, and that's an area that's been a very good growth area for us. This is a market driven by concerns about security and improvements in technology. We're not focused on the residential security systems area, but on integrated security systems for commercial applications, which are higher-end systems that large businesses and institutions use to protect their employees and property. While the security services industry is very fragmented as well, there are some large competitors in this sector. Tyco, through ADT and Simplex-Grinnell, would be one of them. There have been some new entrants in this business, too. Ingersoll-Rand has recently entered the business and United Technologies, through their acquisition of Chubb. After this group and a couple of

others, we are the next-largest provider of integrated security services in North America. The outlook for us here remains solid as well.

The last area I'd like to talk about in terms of future opportunities is our business services area. This area is one that is probably a little bit more economically sensitive than our other businesses. It's a business that, when you look at it in relation to the other three segments that we operate in, probably has more operating leverage. We have higher fixed costs here primarily due to larger facilities and related expenses. It's an area that's been a little bit softer in recent years as the economic environment in which we've been operating has been more challenging. We certainly saw some volume declines in this business over the last couple of years.

But we think that we're in a very good position now. We have excess capacity in our fulfillment and customer support facilities that will generate incremental profitability as we improve utilization. There's some very good upside opportunity in this segment, but it's an area in which our growth and results are going to be more dependent on the continuing economic recovery. Until recently, our business services segment was the biggest profit contributor to FirstService. It's still a major contributor, but not the largest contributor currently.

TWST: As you've paid down debt and strengthened the balance sheet over the past year, what's left to be done there?

Mr. Friedrichsen: We recently completed a \$50 million private placement of notes due in 2015, with amortization beginning in 2012. We managed to secure this layer of long-term debt financing, which followed a successful \$100 million financing in 2001, on very attractive terms and it will support our growth going forward. As for the rest of the balance sheet, being a service company, we don't have significant investments in either inventory or fixed assets. As a result, our businesses are not big consumers of capital.

Last year, for instance, we spent just under \$11 million on capital expenditures. This year (March 31st y/e) it will probably be around \$12 million. Our free cash flow last year was somewhere around \$32 million. This year, it will be in the range of \$33-\$34 million. This leaves us with a significant amount of cash available to re-deploy.

I said at the outset that we're an acquisitive company. Over the last couple of years, the pace of acquisitions has been slower as we decided back in mid 2001 to really focus internally. We completed a large acquisition in our business services area in March 2001, and our focus then was to integrate that acquisition and really focus more internally than externally. We still completed some smaller acquisitions, but at a much slower pace.

We recently initiated a renewed emphasis on acquisitions and over the next 12-24 months, we're probably going to spend well in excess of what we have over the last couple of years. In the last two years, we've been paying down debt and using our free cash flow to improve our balance sheet, but we think now is a very good time to be looking at adding additional businesses to the existing four service lines we're in, or perhaps even a new service line with good growth prospects.

TWST: Introduce us to your top-level management team. What are the bench strengths and skill sets there?

Mr. Friedrichsen: Based on our track record of consistent operating performance and growth, I think we have a very strong team, both at the FirstService level and within our operating companies. It's a team that's been together for a number of years and, unlike a lot of large companies, the senior management teams in each of our four operating segments are significant shareholders in the businesses they operate day to day. These businesses operate on a decentralized basis, with the management teams given a high degree of operating autonomy. We think this really provides a lot of motivation to continue growing their businesses, not only the top line, but the bottom line as well. They've got a significant financial stake in the results of these businesses that aligns their interests with those of FirstService. I think this is somewhat unique amongst public companies and it's certainly a very important part of our overall business model.

We run a very lean organization. That's part of our culture. We are always looking for ways to strengthen our team, but very careful in terms of adding or promoting the right people, both at the subsidiary and FirstService levels.

It's a fairly tight team of less than a dozen managers at the FirstService level. Jay Hennick is the CEO, Founder and the largest shareholder. He's fully engaged on a day-to-day basis in the business and has had a huge influence on what FirstService is today. He is a real driver of the business and spends a great deal of his time challenging and motivating the heads of our different segments; evaluating new growth opportunities; and looking for ways to build value for our shareholders.

Scott Patterson, our former CFO, stepped up to lead our business services area, a little over a year ago. It was an area where we needed to complete some integration and that really needed full-time attention at a senior level. Scott's driving the integration of these different business areas and service lines within business services, with the goal of offering our clients a greater breadth of services and reducing our costs where possible.

Before taking on the CFO responsibilities last year, I headed up acquisitions for five years. This experience provided me with a very good perspective on our companies and the management teams of our different businesses.

Tim Greener is our head of integration, which is an important function given that we are an acquisition-oriented company. We need an executive like Tim Greener, who has his own team, that gets involved in assisting all of our companies either in immediate post-acquisition integration challenges or in realizing margin enhancement opportunities to increase their profitability.

Roman Kocur, who recently joined us as Vice President, Acquisitions, and Doug Cooke, our Corporate Controller and Treasurer, round out the senior management team and are supported by a young and talented team of managers at FirstService with strong backgrounds in finance and experience in dealing with entrepreneurial businesses.

TWST: What's the agenda over the next 12-24 months? What accomplishments would make that time frame a success from your perspective?

Mr. Friedrichsen: Over the next year or two we will focus on supporting our operating companies in achieving internal growth at a rate in the 5%-10% range. I think that's an achievable target for us given the markets we operate in. However, we need to augment this with some additional growth through acquisitions such that we can bring total growth rate to 15% or better over the next couple of years. That would be a real success for us.

Our acquisitions are likely going to be small acquisitions within our segments. But if we come across a fifth service line that has the same characteristics as our existing businesses, we'll certainly pursue a larger acquisition—one that would become a platform for further growth down the road. While this certainly could happen, it doesn't need to happen for us to be successful over the next couple of years.

TWST: Do you see the shareholder base changing or evolving? Have you been able to attract any institutional following?

Mr. Friedrichsen: Most of our following is institutional. We have a shareholder base that has been quite loyal over the years. They're long-term shareholders. However, we also think there's lots of interest out there from potential new shareholders in FirstService. Certainly as we continue to grow we're going to attract more institutional shareholders. We're at a point now where we generate so much significant free cash flow that, outside of a large acquisition, there probably isn't a requirement to raise any new additional equity. While raising new equity would clearly help us expand our shareholder base, we're not going to dilute our shareholders unless it ultimately results in generating additional shareholder value.

TWST: What has been the investor relations program's focus so far? What new priorities will you have as you put that program together over 2004-2005?

Mr. Friedrichsen: On the investor relations side, we probably could do a better job. It's certainly something we're going to spend a little bit more attention on. Over this last year, both Jay Henrick and I have been out on a few occasions visiting directly with institutional shareholders. We're going to continue to do that and probably increase this over the next 12 months. We're also going to revisit our level of corporate communication in general and look at stepping up the frequency of our press releases.

Again, I think it's important for us to maintain a presence. We know that there's a lot of competition in the capital markets and a lot of good companies out there. We need to ensure that we get in front of people and present the story. I think whenever we do that, we have very, very good feedback on our track record, our plan, our management team and generally, our business model. It's an intriguing story.

TWST: What are a few statements you feel would compel investors to review FirstService, include it in their current portfolio and within their longer-term investment strategy?

Mr. Friedrichsen: One thing that we haven't talked about is valuation. When you look at FirstService and how we have performed, particularly through a challenging economy in the US and in Canada over the last 24 months; our business fundamentals; the way we operate our business; the way we have grown our business; and, our plans to grow in the future, we're undervalued. If you look at some of the other publicly traded service companies, whether it's ServiceMaster, ABM, Rollins, Roto-Rooter, Iron Mountain or some of the property services companies, like Trammell Crow or Jones Lang LaSalle, the p/e multiples that are being accorded these companies start in the low 20s and extend much higher. We're being valued at 15 times, which is a significant discount to these companies.

While we'll generate over \$600 million in revenue for our year ending March 31, 2004, and somewhere around \$18-\$19 million in profits, in our minds, we've just started. I think for anybody looking for an investment with some excellent upside potential over the next several years, FirstService has got to be considered a pretty compelling investment opportunity.

FirstService is a company that has delivered superior results over a period of several years. We've got a management team that is focused on growing the right way. Management has a significant investment in this business, so we are aligned with our shareholders in building long-term value. Our future growth is not elusive; to us the path is clear. We think that the market will eventually reward FirstService with an expansion of our p/e multiple, providing an investor in FirstService today with an interesting opportunity.

TWST: Thank you.

JOHN B. FRIEDRICHSEN
CFO
FirstService Corporation
1140 Bay Street
Suite 4000
Toronto, Ontario M5S 2B4
Canada
(416) 960-9500
(416) 960-5333 - FAX
www.firstservice.com