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HEARD ON THE STREET

FirstService's Odd Mix Works

**How a Grab Bag of Businesses
Generates Big Profits**

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From selling real estate in Asia to building cabinets for Americans -- and cleaning a few swimming pools in between -- **FirstService** Corp. appears to be more of a hodgepodge of far-flung operations than a typical publicly traded company. Looks can be deceiving.

FirstService, which was started more than 30 years ago by a 17-year-old pool boy in Toronto, has morphed into an eclectic mix of shopping-mall landlords in Hong Kong, pest controllers in Florida and installers of security cameras in New York. Its model as a conglomerate of service businesses may seem out of sync with a market that pays \$175 a share for Google, but its earnings and share-price growth have been beyond the ordinary.

"It's a complex company," says Matt Litfin, an analyst at William Blair & Co. in Chicago. "But that complexity is where the opportunity lies if you're willing to do the work to understand the various platforms," says Mr. Litfin, who has an "outperform" rating on the stock. William Blair owns about 3.9% of FirstService, and has received some investment-banking fees from the company.

FirstService's shares, which are listed on Nasdaq Stock Market and the Toronto Stock Exchange, have risen 151% in the past five years, while the Nasdaq has declined 40% and the S&P 500 index has dropped 14%. FirstService split its stock last week to increase liquidity in trading of its shares.

In 4 p.m. trading yesterday on the Nasdaq, FirstService's shares rose seven cents to \$14.99.

While few U.S. analysts follow the company, despite more than 90% of its revenue coming from the U.S., some fund managers and analysts expect

FirstService will continue to show double-digit income growth in the long term, even excluding future acquisitions. They say the company is still undervalued, relative to some of its peers, particularly in the U.S.

"It's viewed, unfortunately, as a Canadian company," says Jon DeVos, a Vancouver-based analyst at Raymond James Ltd., the Canadian investment-advisory unit of Florida's Raymond James Financial Inc. Mr. DeVos has an "outperform" rating on the stock and no holdings.

Better known is **ServiceMaster Co.**, a \$3.8 billion market-cap competitor listed on the New York Stock Exchange. **Berkshire Hathaway Inc.**, run by billionaire investor Warren Buffett, disclosed in November that it added ServiceMaster's shares to its stock portfolio. ServiceMaster, based in Downers Grove, Ill., provides maintenance services such as landscaping and pest control under the TruGreen and Terminix brand names, respectively.

"ServiceMaster is a much larger version of FirstService, but it has been very disappointing," says Kent Gasaway, a fund manager at Kornitzer Capital Management in Shawnee Mission, Kansas, which manages \$4 billion in assets. "It's poorly managed, compared to FirstService." Kornitzer, which owns about 5% of FirstService according to the latest regulatory filings, has significantly scaled back its holdings in ServiceMaster, Mr. Gasaway says.

ServiceMaster shares, which have risen 41% in the past five years, trade at 22.5 times trailing earnings, according to financial database Capital IQ. FirstService shares, which have nearly tripled in the past 18 months, trade at 20.3 times.

With a market value of about \$450 million, FirstService has posted annualized revenue and income growth of about 20% over the past decade. Prior to its purchase earlier this month of Colliers International, a global real-estate broker and property manager, FirstService's revenue in its March-end fiscal 2004 amounted to about \$610 million, up 17% from the year earlier.

Analysts expect its 2005 revenue to reach about \$1 billion, including a \$90 million contribution from Colliers. About 35% of Colliers's \$289 million in revenue over the past 12 months to Sept. 30 come from the U.S., 28% from Canada, 25% from Australia and New Zealand and 12% from Asia -- where it was known as Colliers Jardine -- Europe and Latin America.

Among the 450,000 residential properties FirstService manages in the U.S. are luxury condominiums for middle-aged professionals and gated communities for retirees. That has attracted fund managers who see those folks as steady consumers of some of FirstService's home-improvement and maintenance offerings, such as California Closets and Paul Davis Restoration. Some 43% of its revenue come from its property-management sector and about 17% comes from its home-improvement franchises.

"More people are going to retire and move to these gated communities, and they'll need their lawns mowed and pools cleaned," says Kornitzer's Mr. Gasaway. "This is a growth business."

A fan of Berkshire's Mr. Buffett, FirstService's pool-boy-turned-chief executive, Jay Hennick, follows his favored model of buying companies that generate steady cash flows and require little capital expenditure. He buys controlling stakes in his targets -- usually 85%, except for Colliers, in which FirstService bought 70% -- and works with existing management whose equity stakes give them incentive to perform.

Cash from operating activities in 2004 was \$35 million, up from the previous year's \$30 million and \$25 million in 2002. FirstService drew down on an existing credit line to help pay the \$49 million for its 70% stake in Colliers, as well as to take on the real-estate broker's \$17 million in debt. With the Colliers acquisition, FirstService edged up its borrowing slightly and now has about \$200 million in net debt on its balance sheet, or 2.6 times its earnings before interest, taxes, depreciation and amortization. "They have a strong balance sheet. This level of debt is manageable," William Blair's Mr. Litfin says.

While analysts say rising interest rates will likely slow some of its home-improvement sales, Raymond James's Mr. DeVos says other income streams are less cyclical, such as fees from government security contracts and maintenance fees.

One area of business that does face some pressure is its business-services operation, which includes call-centers and contributes about 21% of FirstService's revenue. In 2002, the division's loss of drug-maker Merck as a client battered the share price, which has since recovered.

As with many service businesses, parts of the division face competition from Asia. While Mr. Hennick says he doesn't expect to start acquiring Asian businesses to service his clients, the company has started subcontracting some work to India.