

Is Intrawest set to slide?

Some analysts say stock's price is too perfect

Jason Kirby, with files from Lori McLeod, Financial Post

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When Intrawest Corp. CEO Joe Houssian announced the golf and ski-club developer would double its dividend and buy back some of its shares this week, investors cheered like crowds at a World Cup ski race.

The company's shares shot up 5% to US\$25.48 on the New York Stock Exchange. The stock closed yesterday at US\$25.34 in New York -- up 2.4% this year -- and \$30.05 in Toronto, up 9.1%.

You can't ignore the bullish buzz around Intrawest perpetuated by several analysts. The company is deeply undervalued, they insist, and still offers plenty of upside after its recent rise. The most optimistic one-year price target is US\$44.

The share buyback hints at the rising influence of Intrawest's largest shareholder, Connecticut-based Pirate Capital LLC. The hedge fund, which owns roughly 9% of Intrawest shares, has publicly urged Intrawest to repurchase shares and ramp up the sale of its real estate. Pirate chief executive Tom Hudson, who praised Mr. Houssian at Intrawest's annual meeting this week, said he believes the shares are worth at least US\$40.

The bulls on Intrawest are feeling vindicated after hearing of the company's plans to repurchase 4.6 million shares and raise its dividend to 32 cents per share. But lurking among the bulls are a few bears, including long-time bearish analysts from **Veritas Investment Research Corp.**, who argue that Intrawest's performance is still far too dependent on one property -- the Whistler Blackcomb ski resort in British Columbia -- and that its other operations face challenges.

Anthony Scilipoti and **Dongwei Ye** of **Veritas** argue that Intrawest shares were already "priced for perfection" before the dividend hike. Investors are assuming a best-case scenario for Intrawest, including co-operative weather, stable real estate markets and the company's ability to turn its smaller resorts into winners like Whistler Blackcomb.

"While some have argued that the company is worth more in pieces, we are hard pressed to find enough information to support upside from current levels," said the analysts in a report released in October.

The last few years have been rough ones for the ski business in North America. According to **Veritas**, the number of skiers visiting Intrawest and its competitor, Colorado-based Vail Resorts Management Co., has been flat for five seasons. The loonie has compounded the problem by discouraging visits from foreign skiers and preventing Intrawest from hiking ticket prices. **Veritas** estimates the average ticket price for an Intrawest ski resort is about 30% lower than at Vail's resorts. This gap has widened since 1999.

More troubling, according to **Veritas**, are signs that Whistler is still propping up the company's ski segment.

Other than Whistler, Intrawest's other western ski resorts earn mostly mediocre marks in industry rankings. Ski Magazine ranks the Mammoth Mountain Ski Area in California in the top

10. But last month Inrawest sold much of its 59.5% stake in the resort to Starwood Capital Group Global LLC for a pretax profit of US\$101-million.

Veritas estimates Whistler's income before tax was US\$76-million in 2004. Yet after factoring in depreciation, interest and certain expenses, the research firm believes the entire mountain resort segment produced just US\$15-million before taxes. If that's the case, Inrawest's other resorts are money losers.

The company disagrees. John Currie, chief financial officer, said **Veritas** was wrong in its assumptions and that the firm's estimate of Whistler's earnings is inflated.

Veritas readily concedes it was forced to make certain assumptions. The company itself doesn't disclose the performance of its individual resorts for competitive reasons. Mr. Currie said Inrawest is also taking over marketing and purchasing for all its resorts, making it harder to break out each resort's performance.

"We disclose some high-level information," he said. "People always want to have more. We're not trying to be difficult -- it's just not that simple."

Even still, **Veritas** is convinced that Whistler, which it describes as "perhaps the best winter resort in North America," is propping up the resort business. The analysts noted Inrawest's mountain resort segment took a hit to its operating margins last year that coincided with the worst weather conditions at Whistler in 40 years.

"There is little doubt in our mind that the aggregate contribution from other resorts is negative and, therefore, not all the resorts are worthy of the same valuation multiple," the analysts said.

Inrawest's real estate development business has earned it a lot of attention, with bulls arguing there is undiscovered value in its real estate assets.

Veritas credits Inrawest with turning the real estate segment into its "golden goose" by leveraging its exposure through partnership arrangements. In 2003, the company formed Leisura Developments with JP Morgan Flemming and Manulife to build resorts. The partners provide the capital for construction and buy the land from Inrawest once the condo units have been presold. In return, Inrawest receives management and development fees.

Yet **Veritas** believes Inrawest's real estate segment is fully valued. Even though strong real estate prices have driven Inrawest's pretax profits per unit up 86% since 1999, **Veritas** said the company's margins, as a percentage of sales, have remained flat.

What's more, the 12,500 real estate units the company has sold so far have been at the Whistler resort. Going forward, more of the company's development projects will be at its other resorts. For instance Inrawest believes it can sell 30% more units at Tremblant than Whistler, even though Whistler, at 7,071 acres, dwarfs Tremblant at 627 acres. Meanwhile Mammoth, the resort Inrawest sold last month, accounts for 11% of its real estate pipeline.

Mr. Currie said he's not concerned about filling its production pipeline, with 18,000 units planned for 18 locations.

Mr. Currie said projects in France will account for 20% of Inrawest's real estate profit in 2006, while buyers are clamouring for its condominiums in Orlando and Maui. "Those two projects alone, that's \$450-million plus of real estate we're launching next month," he said. "That kind of thing makes me not too concerned about replacing Whistler."

As for the share buyback, **Mr. Scilipoti** called it "a welcome gesture." But not everyone is pleased. Don't forget that Inrawest has bondholders, too. At least one of them, who asked

not to be identified, said he is "appalled they announced the buyback as quickly as they did."

His concern is that the company plans to use money from its Mammoth sale and a joint development arrangement with Starwood to finance the buyback, but that those deals haven't been finalized. The deal is expected to close by the end of the year.

"Why don't you just go out and say publicly, 'We're giving some serious thought to doing a buyback once we get the proceeds and once the real estate at Mammoth is sold, and we deal with any formal obligations under our debt indentures?'" he asked.

Above all, bondholders want financial security, so some aren't pleased Intrawest is using its cash for buybacks and dividend hikes to satisfy Pirate and other equity investors. Losing this cash means losing a financial cushion.

But Mr. Currie said the company is under no obligation to buy back its shares if the Mammoth deal falls through. As for the timing of the buyback and dividend increase, he said it has nothing to do with pressure from Pirate Capital.

"We did our own analysis and said maybe the best investment for the company at this share price is to buy back stock," he said. "The fact shareholders applaud that doesn't mean we were pressured to do it."

But why buy back shares now that they're up 50% over the last 12 month? Why not buy when they were cheaper?

"We were coming right off a couple of years of people complaining our debt levels were too high," Mr. Currie said. "If we started buying back some shares we'd have lost credibility. It would be great if we could be buying at US\$16 a share. But we agree with a lot of the analysts who say the shares are still materially undervalued."

Those analysts laud Intrawest's efforts to get costs down, reduce debt and diversify its business. Some praise Intrawest for its 2004 acquisition of a 67% stake in Abercrombie & Kent, a luxury adventure travel business. In the first quarter, revenue at A&K grew 30%. "A&K has been a tremendous platform for us to grow and diversify," Mr. Currie said.

But is it all enough to warrant an even higher share price, as some analysts predict?

In an October report Sheila Broughton, an analyst with Pacific International Securities in Vancouver, had a target of US\$30 for the shares based on, among other measures, a multiple of six times earnings before interest, taxes, depreciation and amortization.

Mr. Scilipoti of Veritas calls Intrawest "a good company," but not a good buy. In its report, **Veritas** valued the company using a discounted free cash flow valuation. It excluded both minority interests in its resorts and joint venture interests in the real estate pipeline, and assumed the remaining business would grow free cash flow by 3%. The end result is a target of US\$23.50.

"Expect disappointments," **Veritas** said.