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**Blue Falls Manufacturing:
Turning Market Knowledge
into a Competitive Edge
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**Small Business Policy Branch
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Blue Falls Manufacturing: Turning Market Knowledge into a Competitive Edge

Thorsby, Alberta

Est. 1994

www.arcticspas.com

THORSBY, ALBERTA — Blue Falls Manufacturing, a maker of portable hot tubs and spas, is located in the tiny community of Thorsby, Alberta — an area best known for kicking off Alberta’s oil and gas boom in 1947. Oil wells are not exactly what first comes to mind when thinking of hot tubs — think California in the 1960s — but that hasn’t stopped Blue Falls from growing to become one of the top 20 hot tub manufacturers in the world. In fact, the company has turned its location in northern Alberta, and Canada’s reputation for harsh winters, into a competitive advantage. Its line of Arctic Spas is uniquely positioned for use in climates where temperatures regularly dip below freezing.

“We’ve really been successful at being a niche product,” says Darcy Amendt, President and CEO of Blue Falls Manufacturing. “We looked at the product that we were selling and the products on the market, and tried to come up with some smarter methods for making our product more energy efficient.”

Darcy and five business partners — Jordan Beasley, Dennis Kellner, brothers James and John Keirstead, and Brent Macklin — purchased Blue Falls Manufacturing in 1997. In less than 10 years, the company has grown from a small, regional player with \$1.6 million in sales, to a large, well-branded company with annual sales of \$65 million in more than 26 countries around the world. Their success is due to a thorough understanding of the market, a commitment to research and development, and the development of a strong distribution network.

Before purchasing Blue Falls, all six partners had worked for the company’s predecessor in the early 1990s. At that time, the Edmonton-based company produced a small line of hot tubs under the Koko Beach name. In 1994, Koko Beach sold the assets of its manufacturing business to an Edmonton businessman who built a new plant and changed the company’s name to Blue Falls Manufacturing.

Darcy and Brent had left Koko Beach just before it was sold, and opened up a chain of successful hot tub stores in Calgary, Saskatoon, Regina and Edmonton. They continued

to purchase all their hot tubs from Blue Falls and eventually became the company's main customer. In one year alone, they purchased nearly 800 of the 900 hot tubs that Blue Falls produced.

“During the summer of 1996, between the store in Calgary and the stores in Saskatchewan, we had a difficult time getting enough product to sell,” says Darcy. They were also frustrated by the manufacturer's inability to keep up with trends in the hot tub industry. “We just demanded that changes be made that the original owner either didn't have the time or was unwilling to do, so he came to us with a proposal that we buy the business from him and take it over,” says Darcy.

Their experience as retailers gave Darcy and Brent a solid understanding of what consumers were looking for. They had a lot of ideas about how to make a better hot tub, and were keen to put those ideas to work. Darcy was especially attracted by the ability to take control of the end product. He knew that his success, as both a retailer and a manufacturer, depended on an ability to produce a hot tub that appealed to consumers. He also knew that he needed a strong team to help turn the struggling young company around.

“Darcy called and invited my brother John and me to join the company,” says James Keirstead, one of the original partners and now Vice-President of Marketing for Blue Falls. After leaving Koko Beach in 1994, James and John had moved to British Columbia where they opened up their own hot tub store. “He wanted me to come help run the plant and I said ‘Listen, you need sales, you don't need another operations guy.’ So John and I stayed in Vancouver on the sales side.” They sold their retail store and began to work full-time on recruiting dealers for Blue Falls Manufacturing.

Dennis Kellner, another partner, also got a call from Darcy. “I said ‘no’ the first time because I'd had such a bad experience with the previous hot tub company we all worked for,” says Dennis, now Vice-President of Operations. Darcy's vision and commitment won him over. “Part of the thing that works for us effectively is the fact that we all have very similar skills, and we also have very different skills.”

One thing the six partners shared was hands-on experience in both the manufacturing and retail sides of the hot tub industry. In the beginning, Darcy, Dennis and the Keirstead brothers concentrated on Blue Falls, while Brent and another partner, Jordan Beasley, remained in the retail stores. Although the stores were separate and independent from

Blue Falls Manufacturing, they continued to be the company's main customer during the first few years and represented a reliable source of steady cash flow while the partners concentrated on reorganizing the plant.

Of the original group, two have since left the company. As Blue Falls grew, Brent became more actively involved in the operations of the company, gradually turning over responsibility for the stores to Jordan. In 2002, Jordan left Blue Falls to take over the stores full-time. In 2005, John Keirstead also left to pursue other business interests.

NEW STRATEGIES FOR SUCCESS

Financial start-up

By the time Darcy and his partners took over Blue Falls Manufacturing in February 1997, the company had been losing money almost every year, and had \$180 000 outstanding on a \$200 000 line of credit. They paid \$250 000 for 90 percent of the operation, while the original owner held onto the remaining 10 percent. They financed the purchase of the company entirely through personal savings with all six partners contributing equally.

“We probably paid more than the business was worth at the time,” says James. “But it was less than it was worth to us, and I think that’s the real key. Because for us, we could see what could be done with this business.”

As with most small businesses, they ran it on a shoestring in the beginning. During the first year, all proceeds were pumped back into the company. “We lived on day-to-day cash flow financing,” says Darcy, doing whatever it took to keep the plant running. “It was ‘just-in-time’ production because we could only afford just-in-time,” says Dennis. He remembers rushing to retrofit pumps into the finished hot tub units just before they were shipped out because the company didn’t have a line of credit and had to wait until they could pay for the pumps in cash.

Pricing was also a key issue at the start. “The previous pricing structure didn’t allow for a sufficient margin on sales to adequately cover the cost of production,” says James, which was one of the reasons the company wasn’t making money. One of the first things the new owners did was to implement a modest price increase. Blue Falls’ main customers during that first year were the retail stores owned by Darcy and Brent, and they determined that the market was stable enough to withstand a price increase. “It didn’t have a huge impact on the retail organization, but it did have a significant impact on the

bottom line of our manufacturing operation,” says James. The increase gave them a quick injection of cash, and the company even managed to show a small profit by the end of that first year.

Streamlining manufacturing processes

“The very first day that I started, they threw me onto the production floor,” says Dennis. Until then, his experience in the hot tub industry had been mainly in sales. He worked his way through each stage of the manufacturing process, from purchasing and inventory control to applying fibreglass and assembling the final product to shipping and receiving. “I had to learn everybody’s job so that eventually, I would replace myself,” says Dennis. “And that’s what we’ve all done. We’ve all been able to replace ourselves so that we can now take care of a \$65 million company instead of a \$3 million one.”

The hands-on experience gave them a greater understanding of the day-to-day challenges of production, and was critical in helping them develop new products and streamline the manufacturing process. “You can have a design that looks beautiful, but if you can’t manufacture it cost-effectively or if it takes too long to build, then it won’t work,” says Dennis.

When the partners took over Blue Falls, they also inherited the previous company’s customers and dealers with older hot tub models that still needed to be serviced. At the time, the company’s inventory control system was non-existent. “We had 1100 components that we didn’t have part numbers for,” says Dennis. “Literally, it would take an hour just to figure out which part was needed.” They quickly implemented an inventory system to catalogue each piece of equipment for almost every model built since the original company was started in the late 1980s. It was a time-consuming job, but it allowed them to continue to service their network of existing dealers. They have since developed a sophisticated, computerized system that allows the company to track parts online from any location in the world.

Re-branding strategies

Product positioning was also an issue that had to be resolved. “The biggest thing we needed was sales,” says James. “Most of our sales were coming from the stores owned by Brent and Darcy. That was it. But how do you convince new retailers to take on a product from an unknown manufacturer with a rather unremarkable name and product?”

The owners decided to change the brand name to one that would set the brand apart from its competitors. Bringing their own twist to the hot tub market, they came up with the name “Arctic Spas,” which highlighted the ability of Blue Falls’ hot tubs to withstand extremely cold temperatures. They also designed a new logo featuring a polar bear and the tag line, “Engineered for the world’s harshest climates.” In an industry dominated by images of palm trees and sunshine, the new name and logo “definitely stood out,” says James.

Today, Blue Falls manufactures and sells a line of nine portable hot tubs and spas under its Arctic Spas brand and another four under its Coyote brand of spas. It also produces a line of cedar gazebos and accessories such as chairs, stools, end tables and cabinets.

Product development

The biggest change they made at the beginning was in the product itself. “When we took it over, I don’t think we built spas for two months after I came in,” says Darcy.

The portable hot tub market remains highly competitive, with more than 200 manufacturers in Canada and the United States competing for a fairly small but high-end luxury market. The majority of hot tub manufacturers are small, regionally-based companies with annual sales of \$5 to \$7 million. By the time Darcy and his partners acquired Blue Falls, the company had lagged behind in product development. The new owners quickly recognized that, in order to remain competitive, they needed to revamp and modernize the design and construction of their hot tubs. Ergonomic seating, improved jet performance and water purification systems, and greater energy efficiency were all factors that needed to be addressed.

“I like to think that we’re still retailers at heart,” says Darcy. “I know exactly what kind of struggles a retailer goes through, and a lot of the decisions that we make here are based on what we learned in our retail operations.”

One of the company’s most important developments was in the design and construction of a hot tub that provided greater insulation and improved energy efficiency. “Most manufacturers take the spa equipment and they put it outside of the spa or in some uninsulated compartment,” says Darcy. “What we do differently is put all that stuff inside the spa and insulate around it so any of the waste energy from pumps running or any

electrical consumption that's not turned into something useful is turned into heat and used to keep the spa hot. It's just common sense, really."

As for insulation, the standard practice in the hot tub industry is to spray insulating foam around the tub itself, leaving the pumps and other equipment exposed in the uninsulated space between the tub and the exterior cabinet. Rather than insulating the tub, Blue Falls came up with a way to insulate the entire cabinet so that everything inside was protected and any heat generated by the pumps and electrical equipment could be recovered and used to keep the spa warm.

Testing by the Alberta Research Council verified that the Arctic Spas model was 30 percent more energy efficient than the top competing brands tested, giving the company an important competitive advantage. As an added benefit, the unique design made the hot tub more easily accessible for repairs and maintenance, and for the installation of any new features.

While Arctic Spas hot tubs were specifically engineered to withstand below-freezing temperatures, they soon became the company's top selling item, regardless of climate zone. The very features that made Arctic Spas ideal for northern climates also appealed to the broader market where the extra insulation and improved energy efficiency meant a significant cost savings in electricity.

Water maintenance and cleanliness were also key. When they revamped the design of their hot tubs, they also updated the filtration system and developed a patented water purification system using ozone, a naturally-occurring form of oxygen that has been used in water treatment processes for years. The improvements gave Blue Falls a product they felt would give them the advantage they needed to grow their company.

Research and Development

Research and development continues to play an important role in Blue Falls Manufacturing. In 2003, the company purchased a 3-D rapid-prototyping system that allowed the company to use computer-aided design (CAD) software to create full-sized plastic prototypes of jets, controls and other spa parts. Using 3D modeling, the company was able to "virtually" test variations in seating positions, jet configurations and equipment placement. Outside of the University of Alberta, it was the first such system to

be purchased in the province of Alberta at the time, and the only one to be used strictly for commercial applications.

Developing their own prototypes in-house gave the company better control over quality and significantly reduced the time required to bring new products to market. The new system has since resulted in the development of several patented applications, including one for a new jet that reduces clogging.

“We initially began by designing spas made specifically for our cold Canadian weather, but as we have entered more and more regions and climates, this focus has shifted to developing new technologies applicable in any market,” says James. “We’re always looking for new designs, and new technologies. We make close to a hundred changes a year. We don’t know how not to do it. The whole culture here is an acceptance of change, an embracing of change. In order for us to be competitive, we need to be in the forefront of innovation.”

A GLOBAL VISION FOR GROWTH

European and overseas markets

From the very beginning, Blue Falls recognized that the export market was critical to the company’s continued growth and success. If they were serious about the long-term future of their business, they needed to get beyond Canada. “As a general rule, Canada is too small a market for us to become a world player in the hot tub manufacturing business,” says James. “There’s only so much product in Canada, and when we entered the market in 1997, there were 21 manufacturers making that product. There were only 35 000 spas sold in Canada last year, and when we first started, that number would have been fewer than 13 000.”

But where most Canadian companies look south to the United States, Blue Falls took a different approach — Europe, where the market for hot tubs was less developed and just beginning to open up. With limited resources and an unknown brand, Blue Falls believed that they had a better opportunity to position themselves overseas first before trying to compete directly with their larger U.S. competitors. In the United States, they were still a relatively small niche player in a market dominated by well-established brands. “Going over to Europe, even those well-entrenched, well-branded products in the United States

were unknown. So we looked at it and said, ‘wait a second; we can tell our story on an equal playing field and then we’ll come back to the U.S.’”

The company’s first export markets were Spain and Norway. Independent distributors had approached them while attending a major North American trade show in the fall of 1997. Blue Falls established distributorships in both countries, relying on the local distributors to recruit dealers and market the Arctic Spas line. However, as a small, relatively unknown company, they soon realized that the traditional distributor model didn’t give them the level of control they felt they needed to manage their brand and build consumer awareness.

“We realized the best distributor we could have, a distributor that could control the way the product was marketed, priced and serviced, would be us,” says Darcy. “We had always handled the distribution in Canada, and decided to apply that experience to the European market.” They severed their ties with the distributor in Spain and refocused on northern Europe where their innovative insulation system gave them a significant advantage over their competitors. They negotiated a new deal with their Norwegian distributor to form a joint partnership, opening up a warehouse and showroom in Tallinn, the capital of Estonia, to serve Scandinavia and Eastern Europe. “In Scandinavia, we’re the number one product, and that’s because we’re built to handle the cold,” says James.

During that time, they also opened up warehouses/showrooms in the United Kingdom and Australia. In the United Kingdom, they formed a joint venture with a long-time business colleague of Darcy’s to open up a warehouse and showroom in Birmingham, England’s second largest city. Sales took off almost immediately. Within six months, the Birmingham location grew from 13 000 square feet (1200 square metres) to 47 000 square feet (4370 square metres). They also established a joint venture with a distributor in Australia who had been referred to them through contacts in the hot tub industry.

The United Kingdom division of Blue Falls has since opened up a second warehouse and showroom location near Lyons, France, to better serve Western Europe. “Our warehouse in the United Kingdom has put us from nobody in the U.K. to the number one selling spa,” says James. The strategy of establishing a physical location in each of their key markets helped generate brand awareness by giving the company a permanent venue in which to showcase their products and keep enough stock on hand so that their overseas partners could fill customer orders quickly. The company now has four warehouse-showroom facilities in Europe and Australia, and more than 230 dealers serving

international markets in 26 countries, including Belgium, France, Italy, Scandinavia, Scotland, Australia and the United Kingdom, as well as Canada and the United States.

United States market

In 2006, export sales accounted for more than 57 percent of Arctic Spas' total annual sales. Sales in the U.K. alone were more than 20 percent of total sales, while the United States has grown to become the company's number one export market, accounting for more than 25 percent of total sales. The company attributes its growth in the United States in large part to the years spent establishing their brand in the European market. While the company has had dealers in the United States since 1997, distribution was spotty. "Even to this day, we are a small player in the U.S. market," says James. "But we're getting bigger. We're getting bigger mostly because we're the biggest hot tub manufacturer in Canada now, and we're one of the biggest in Europe, so our name has been going around. But getting into the U.S. has been a long, hard push because competition is very, very tough."

In addition to establishing exclusive dealerships throughout the United States — they now have more than 40 dealers in 31 states — Arctic Spas has also opened two corporate-owned locations as a strategy to further increase brand awareness and strengthen their presence in eastern United States. The company had identified Chicago and Boston as key markets: both were conveniently located at the centre of large regional trading areas, and both were mid-sized cities with the right demographics — college or university educated baby boomers with disposable incomes. Both cities were also proving difficult to penetrate using the traditional dealer system. Establishing their own stores would give Blue Falls greater control over the brand image and the stock, and would allow them to devote the resources they needed to develop and support the market properly.

Borrowing from the success of their European operation, the Boston location was established in 2003 as a joint venture with a local distributor. It also serves as the company's U.S. warranty centre, where it stocks parts for the company's U.S. dealers, cutting down on the time it would take for them to bring in parts from Canada.

The Chicago location was opened in 2004 as a stand-alone retail store managed by a local sales staff. James says that it's too early to tell if the company will open more corporate locations in the United States. He says that one of the biggest factors contributing to

Arctic Spas' success has been the entrepreneurial drive of its dealers and joint venture partners. On the flip side, one of the challenges has been how to foster that same kind of spirit in a corporate setting. "You really need an owner on-site with an entrepreneurial spirit to motivate and inspire staff," he says. "That's what we're wrestling with now."

BUILDING A STRONG RETAIL NETWORK

With all six original owners coming from a strong retail and sales background, it's not surprising that the company realized early on that their greatest strength was their dealers, who were also their biggest customers.

"If you want to be successful, you need customers," says James. "How do you keep customers? The best way to keep retailers is to help them make money. How you win in the long run is to teach your retailers. We teach our dealers how to be better retailers, not just how to sell our product. The more we can help them be successful, the more successful we will be," says James.

Blue Falls provides dealers with a comprehensive sales training and support program that makes it as easy as possible to learn everything they need to know about the retail hot tub business. "We're close to a franchise without actually being a franchise," says James. He says that they chose not to develop a franchise business because it didn't allow for the kind of entrepreneurial initiative they thought was essential to building a strong network. "Under a franchise model, the margins wouldn't be sufficient enough to generate an adequate profit for franchise owners after paying franchising fees and royalties" says James. "And if all stakeholders don't win, the relationship will never have a long-term future. One of the reasons our system works is that our dealers are committed and have an incentive to grow their businesses."

The company has developed an operating manual that is essentially a "how-to" guide to running a small business. It takes dealers through the process of setting up their business, from selecting the right retail location and negotiating the lease to hiring and training the right people and setting up appropriate administrative systems. A series of checklists and sample forms are included in the package of information, along with detailed product manuals.

"The biggest struggle we have in expanding dealers is the dealers themselves," says James. "If they follow the formulas and systems we've given them, they'll be successful."

Those companies that have followed the guidelines are now the company's top dealers," says James, such as Spa Experience in Washington and Oregon, and their Oakville, Ontario, dealer. "The Oakville business has been our training ground where we practice a lot of this stuff. It's now a multi-store chain, and we've been able to gather information on running a multiple-store operation, which is the first time we've been able to do any analysis. We see what works, and then take it back to the other dealers."

In addition to dealer support, Blue Falls provides sales and service training at the company's training facility in Genesee, a small community about 50 kilometres southwest of their main plant in Thorsby, Alberta. The one-week sessions have proved popular — and effective. "Our retailers were finding that they would send a sales guy for training, and when he came back, all of a sudden he was selling more product immediately," says James. The company now runs two training sessions per month, and "they are booked well in advance," says James.

Sales and marketing

Blue Falls Manufacturing has come a long way from the days when it was wrestling with the idea of a new name for its product. The company now has professionally designed brochures and a consumer website, www.arcticspas.com, with customized sites for North America, Australia, Europe and Eastern Europe. Product brochures are available in several languages, including French, Spanish, Swedish, Latvian, Norwegian and Estonian, and both the North American and Eastern European websites are in the process of being translated into French and Spanish. "We've gone from looking like a small, regional manufacturer to looking like a large company," says James. "That instils consumer confidence, which makes it easier for our retailers to sell product."

The company has also developed a separate website where dealers can log on and track their orders. The secure website also has an online tool that allows them to work with customers on customizing their hot tubs according to model, colour, jet configuration, and style of cabinetry.

In April 2005, Blue Falls launched its first mass consumer advertising campaign for television and radio in response to overwhelming support from its dealers. Dealers contributed 50 percent of the funding for the campaign, which was matched by the company. Satisfied with the results of that campaign, the company launched a second one in the spring of 2006 and plans to do both a spring and fall campaign in 2007. "We think

the results of our first two advertising campaigns were good,” says James. “I would say that we are now the most recognized brand of hot tubs in Canada.”

GROWING FOR THE FUTURE

Blue Falls has grown from \$1.6 million in sales in 1997 to more than \$65 million in 2005, from 15 employees to 300 employees, from producing 900 hot tubs a year to producing 10 000 a year. “Volume-wise, I don’t think that being number one will really be our goal,” says James. “We want to be known as the best company to work with. We want to have the best product. We want the best programs. We want our retailers to be the most successful. When we’ve met those goals, then I think we’ll be happy.”

By 2000, Blue Falls had outgrown its existing facility near downtown Edmonton. Alberta was booming, driving up Edmonton property prices and making it difficult to attract and maintain a skilled workforce in an economy dominated by high-paying jobs in the oil and gas industry. All of the owners had grown up in rural Alberta, so they were prepared to consider relocating to a smaller community where property was more affordable. They invited 30 communities to submit proposals, eventually deciding on Thorsby, Alberta, population 750. Located near Leduc, just 35 minutes south of Edmonton International Airport, Thorsby offered good transportation routes, a large tract of land at a reasonable price and access to a reliable pool of labour.

The company’s new 50 000 square foot (4650 square metre) facility opened on April 10, 2001. By 2003, they were forced to run a second shift to keep up with demand. They purchased a 90 000 square foot (8360 square metre) facility in Coleman, Alberta, and expanded the plant in Thorsby, building an additional 30 000 square feet (2790 square metres) of office, showroom and warehouse space.

Today, portable hot tubs are the fastest growing segment of the pool and spa market. According to the National Pool and Spa Institute, a trade association based in Virginia, the hot tub industry is a \$2.8 billion a year market and continues to grow, fuelled in part by more active lifestyles, a greater interest in health and well-being, and aging baby boomers who want to reduce stress and ease aching muscles and joints. With its focus on product quality and innovation, and its strategic locations in Europe, Australia, Canada and the United States, Arctic Spas is well-positioned to take advantage of this growing trend.

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