

Great Wolf Resorts, Inc.
Form 10-Q
November 06, 2006

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2006

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

Commission File Number 000-51064

GREAT WOLF RESORTS, INC.

(Exact name of registrant as specified in its charter)

Delaware

*(State or other jurisdiction of incorporation or
organization)*

51-0510250

(I.R.S. Employer Identification No.)

122 West Washington Avenue

Madison, Wisconsin 53703

(Address of principal executive offices)

53703

(Zip Code)

(608) 661-4700

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer" and "large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The number of shares outstanding of the issuer's common stock was 30,510,308 as of November 6, 2006.

Great Wolf Resorts, Inc.
Quarterly Report on Form 10-Q
For the Quarter Ended September 30, 2006
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GREAT WOLF RESORTS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except per share amounts)

| | September 30, 2006 (Unaudited) | December 31, 2005 |
|---|---|----------------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 48,960 | \$ 54,782 |
| Accounts receivable, net of allowance for doubtful accounts of \$204 and \$95 | 1,965 | 2,506 |
| Accounts receivable affiliates | 1,108 | 12,825 |
| Inventory | 2,316 | 2,254 |
| Other current assets | 6,907 | 1,996 |
| | | |
| Total current assets | 61,256 | 74,363 |
| Property and equipment, net | 449,863 | 385,391 |
| Investment in affiliates | 25,709 | 43,207 |
| Other assets | 14,985 | 11,741 |
| Other intangible assets | 23,829 | 23,829 |
| Goodwill | 66,995 | 66,995 |
| | | |
| Total assets | \$ 642,637 | \$ 605,526 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current liabilities: | | |
| Current portion of long-term debt | \$ 2,000 | \$ 1,928 |
| Accounts payable | 17,397 | 18,183 |
| Accrued expenses | 11,964 | 9,311 |
| Accrued expenses affiliates | 494 | 3,576 |
| Advance deposits | 6,150 | 5,680 |
| Gift certificates payable | 1,605 | 2,126 |
| Other current liabilities | | 126 |
| | | |
| Total current liabilities | 39,610 | 40,930 |
| Mortgage debt | 139,107 | 102,542 |
| Junior subordinated debentures | 51,550 | 51,550 |
| Other long-term debt | 12,249 | 12,308 |
| Other long-term liabilities | 391 | 391 |
| Deferred tax liability | 25,623 | 25,800 |
| Deferred compensation liability | 1,891 | 1,501 |
| | | |
| Total liabilities | 270,421 | 235,022 |

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| | | |
|--|------------|------------|
| Minority interest | 6,404 | 6,593 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Common stock, \$0.01 par value, 250,000,000 shares authorized, 30,505,308 shares, and 30,277,308 issued and outstanding, at September 30, 2006 and December 31, 2005, respectively | 305 | 303 |
| Additional paid in capital | 396,219 | 394,212 |
| Preferred stock, \$0.01 par value, 10,000,000 shares authorized, no shares issued or outstanding | | |
| Accumulated deficit | (28,512) | (28,255) |
| Deferred compensation | (2,200) | (2,349) |
| Total stockholders' equity | 365,812 | 363,911 |
| Total liabilities and stockholders' equity | \$ 642,637 | \$ 605,526 |

See accompanying notes to condensed consolidated financial statements.

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GREAT WOLF RESORTS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited; dollars in thousands, except per share data)

| | Three months ended | | Nine months ended | |
|---|--------------------|-----------|-------------------|-----------|
| | September 30, | | September 30, | |
| | 2006 | 2005 | 2006 | 2005 |
| Revenues: | | | | |
| Rooms | \$ 24,363 | \$ 22,459 | \$ 68,503 | \$ 57,559 |
| Food and beverage | 5,723 | 5,268 | 16,695 | 14,487 |
| Other hotel operations | 5,805 | 5,423 | 16,234 | 14,132 |
| Management and other fees | 888 | | 1,629 | |
| Management and other fees related parties | 853 | | 2,250 | |
| Sales of condominiums | | 25,862 | | 25,862 |
| | 37,632 | 59,012 | 105,311 | 112,040 |
| Other revenue from managed properties | 3,147 | | 9,131 | |
| Total revenues | 40,779 | 59,012 | 114,442 | 112,040 |
| Operating expenses by department: | | | | |
| Rooms | 3,134 | 2,884 | 9,008 | 8,478 |
| Food and beverage | 4,682 | 4,454 | 14,037 | 12,444 |
| Other | 4,529 | 3,958 | 12,868 | 11,204 |
| Other operating expenses: | | | | |
| Selling, general and administrative | 9,382 | 5,173 | 31,983 | 19,738 |
| Property operating costs | 5,313 | 6,393 | 14,888 | 16,799 |
| Depreciation and amortization | 6,430 | 6,286 | 18,697 | 19,520 |
| Cost of sales of condominiums | | 16,780 | | 16,780 |
| Loss on sale of property | 375 | | 953 | |
| | 33,845 | 45,928 | 102,434 | 104,963 |
| Other expenses from managed properties | 3,147 | | 9,131 | |
| Total operating expenses | 36,992 | 45,928 | 111,565 | 104,963 |
| Net operating income | 3,787 | 13,084 | 2,877 | 7,077 |
| Interest income | (863) | (319) | (2,315) | (967) |
| Interest expense | 1,817 | 1,720 | 5,399 | 4,744 |
| Income (loss) before income taxes, minority interests, and equity in loss (earnings) of unconsolidated affiliates | 2,833 | 11,683 | (207) | 3,300 |
| Income tax expense (benefit) | 1,102 | 4,674 | (83) | 1,330 |
| Minority interests, net of tax | (77) | (2) | (114) | (2) |
| Equity in loss (earnings) of unconsolidated affiliates, net of tax | (280) | | 247 | |

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| | | | | |
|--|------------|------------|------------|------------|
| Net income (loss) | \$ 2,088 | \$ 7,011 | \$ (257) | \$ 1,972 |
| Net income (loss) per share-basic | \$ 0.07 | \$ 0.23 | \$ (0.01) | \$ 0.07 |
| Net income (loss) per share-diluted | \$ 0.07 | \$ 0.23 | \$ (0.01) | \$ 0.07 |
| Weighted average common shares outstanding: | | | | |
| Basic | 30,370,229 | 30,132,896 | 30,272,674 | 30,132,896 |
| Diluted | 30,370,229 | 30,132,936 | 30,272,674 | 30,234,887 |

See accompanying notes to the condensed consolidated financial statements.

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GREAT WOLF RESORTS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited; dollars in thousands)

| | Nine months ended | |
|--|--------------------------|-------------|
| | September 30, | |
| | 2006 | 2005 |
| Operating activities: | | |
| Net income (loss) | \$ (257) | \$ 1,972 |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Depreciation and amortization | 18,697 | 19,520 |
| Non-cash employee compensation expense (revenue) | 2,392 | (1,553) |
| Loss on sale of property | 953 | |
| Equity in loss of unconsolidated affiliates | 411 | |
| Minority interests | (190) | (3) |
| Deferred tax (benefit) expenses | (176) | 1,331 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable and other assets | 1,956 | (2,727) |
| Accounts payable, accrued expenses and other liabilities | (7,716) | (9,741) |
| Net cash provided by operating activities | 16,070 | 8,799 |
| Investing activities: | | |
| Capital expenditures for property and equipment | (77,197) | (95,692) |
| Cash distributions from unconsolidated affiliates | 18,902 | |
| Investment in affiliates | (357) | |
| Proceeds from sale of assets | 2,045 | |
| Increase in restricted cash | (1,257) | (1,295) |
| Decrease in escrows | 554 | 1,024 |
| Net cash used in investing activities | (57,310) | (95,963) |
| Financing activities: | | |
| Principal payments on long-term debt | (1,360) | (49,597) |
| Proceeds from issuance of long-term debt | 37,938 | 75,677 |
| Payment of loan costs | (1,160) | (1,678) |
| Net cash provided by financing activities | 35,418 | 24,402 |
| Net decrease in cash and cash equivalents | (5,822) | (62,762) |
| Cash and cash equivalents, beginning of period | 54,782 | 79,409 |
| Cash and cash equivalents, end of period | \$ 48,960 | \$ 16,647 |

Supplemental Cash Flow Information-

| | | |
|---|----------|-----------|
| Cash paid for interest, net of capitalized interest | \$ 4,527 | \$ 3,595 |
| Cash paid for income taxes | \$ 329 | \$ 1,128 |
| Non-cash items: | | |
| Land contributed for minority interest | \$ | \$ 6,660 |
| Construction in process accruals | \$ 5,785 | \$ 11,534 |

See accompanying notes to the condensed consolidated financial statements.

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GREAT WOLF RESORTS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited, dollars in thousands, except per share amounts)

1. ORGANIZATION

The terms Great Wolf Resorts, us, we and our are used in this report to refer to Great Wolf Resorts, Inc.

Business Summary

We are a family entertainment resort company that provides our guests with a high-quality vacation at an affordable price. We are the largest owner, operator and developer in North America of drive-to family resorts featuring indoor waterparks and other family-oriented entertainment activities. Our resorts generally feature approximately 270 to 400 family suites that sleep from six to ten people and each includes a wet bar, microwave oven, refrigerator and dining and sitting area. We provide a full-service entertainment resort experience to our target customer base: families with children ranging in ages from 2 to 14 years old that live within a convenient driving distance of our resorts. We operate under our Great Wolf Lodge and Blue Harbor Resort brand names. Our resorts are open year-round and provide a consistent and comfortable environment where our guests can enjoy our various amenities and activities.

We provide our guests with a self-contained vacation experience and focus on capturing a significant portion of their total vacation spending. We earn revenues through the sale of rooms, which includes admission to our indoor waterpark, and other revenue-generating resort amenities. Each of our resorts features a combination of the following revenue-generating amenities: themed restaurants, an ice cream shop and confectionery, full-service spa, game arcade, gift shop and meeting space. We also generate revenues from licensing arrangements, management fees and other fees with respect to properties owned in whole or in part by third parties.

The following table presents an overview of our portfolio of operating resorts and resorts announced or under construction. As of September 30, 2006, we operate seven Great Wolf Lodge resorts (our signature northwoods-themed resorts), and one Blue Harbor Resort (a nautical-themed property).

| | Ownership | | Guest | Condo | Indoor Entertainment Area(1) (Approx. sq.ft) |
|---|-------------------|----------------|---------------|--------------|---|
| | Percentage | Opening | Suites | Units | |
| Existing Resorts: | | | | | |
| Wisconsin Dells, WI | 30% | 1997 | 309 | 77 | 102,000 |
| Sandusky, OH | 30% | 2001 | 271 | | 41,000 |
| Traverse City, MI | 100% | 2003 | 281 | | 51,000 |
| Kansas City, KS | 100% | 2003 | 281 | | 49,000 |
| Sheboygan, WI | 100% | 2004 | 183 | 64 | 54,000 |
| Williamsburg, VA | 100% | 2005 | 301(2) | | 66,000 |
| Pocono Mountains, PA | 100% | 2005 | 401 | | 91,000 |
| Niagara Falls, ONT (3) | | April 2006 | 406 | | 94,000 |
| Resorts Announced or Under Construction: | | | | | |
| Mason, OH (4) | 84% | Late 2006 | 401 | | 93,000 |
| Grapevine, TX(5) | 100% | Late 2007 | 404 | | 98,000 |
| Grand Mound, WA(6) | 49% | Early 2008 | 393 | | 78,000 |

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- (1) Our indoor entertainment areas generally include our indoor waterpark, game arcade, children s activity room and fitness room, as well as our Aveda concept spa in the resorts that have such amenities.

- (2) We plan to add an additional 103 guest suites as well as new waterpark attractions at our Williamsburg property. Construction for the expansion began in May 2006 with expected completion of the waterpark attractions in late 2006 and the additional guest suites in early 2007.

- (3) An affiliate of Ripley Entertainment, Inc. (Ripley), our licensee, owns this resort. We have granted Ripley a license to use

the Great Wolf Lodge name for this resort through April 2016. We manage the resort on behalf of Ripley and also provide central reservation services.

- (4) We have entered into a joint venture agreement with a subsidiary of CBS Corporation (CBS), to build this resort and attached conference center. We will operate the resort under our Great Wolf Lodge brand and have a majority of the equity in the project. CBS has a minority equity interest in the development. Construction on the resort began in July 2005 with expected completion of the resort in late 2006 and the conference center in early 2007.

- (5) We are developing a Great Wolf

Lodge resort in Grapevine, Texas. The northwoods themed, six-story resort will provide a comprehensive package of first-class destination lodging amenities and activities. Construction on the resort began in June 2006 with expected completion in late 2007.

- (6) We have entered into a joint venture agreement with The Confederated Tribes of the Chehalis Reservation to build this resort. We will operate the resort under our Great Wolf Lodge brand. The Confederated Tribes of the Chehalis Reservation will lease the land needed for the resort to the joint venture, and they will have a majority equity interest in the joint venture. Construction on the resort began

in October 2006
with expected
completion in
early 2008.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General We have prepared these unaudited interim financial statements according to the rules and regulations of the Securities and Exchange Commission. Accordingly, we have omitted certain information and footnote disclosures that are normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America. These interim financial statements should be read in conjunction with the financial statements, accompanying notes and other information included in our Annual Report on Form 10-K for the year ended December 31, 2005.

The accompanying unaudited condensed consolidated interim financial statements reflect all adjustments, which are of a normal and recurring nature, necessary for a fair presentation of the financial condition and results of operations and cash flows for the periods presented. The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions. Such estimates and assumptions affect the reported amounts of assets and liabilities, as well as the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Our actual results could differ from those estimates. The results of operations for the interim periods are not necessarily indicative of the results to be expected for the entire year.

Principles of Consolidation Our consolidated financial statements include our accounts and the accounts of all of our majority owned subsidiaries. As part of our consolidation process, we eliminate all significant intercompany balances and transactions.

Investment in Affiliates We use the equity method to account for our investments in unconsolidated joint ventures, as we do not have a controlling interest. Net income or loss is allocated between the partners in the joint ventures based on the hypothetical liquidation at book value method (HLBV). Under the HLBV method, net income or loss is allocated between the partners based on the difference between each partner's claim on the net assets of the partnership at the end

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and beginning of the period, after taking into account contributions and distributions. Each partner's share of the net assets of the partnership is calculated as the amount that the partner would receive if the partnership were to liquidate all of its assets at net book value and distribute the resulting cash to creditors and partners in accordance with their respective priorities.

Minority Interest We record the non-owned equity interests of our consolidated subsidiaries as minority interests on our consolidated balance sheets. The minority ownership interest of our earnings or loss, net of tax, is classified as *Minority interests* in our Condensed Consolidated Statements of Operations.

Income Taxes At the end of each interim reporting period, we estimate the effective tax rate expected to be applicable for the full fiscal year. The rate determined is used in providing for income taxes on a year-to-date basis.

Segments We are organized into a single operating division. Within that operating division, we have three reportable segments in 2006: resort ownership/operation, resort third-party management and condominium sales. The resort ownership/operation segment derives its revenues from the ownership/operation of our consolidated owned resorts; the resort third-party management segment derives its revenue from management, license and other related fees from unconsolidated managed resorts; and the condominium sales segment derives its revenues from sales of condominium units to third-part owners. We evaluate the performance of each segment based on earnings before interest, income taxes, and depreciation and amortization (EBITDA), excluding minority interests and equity in earnings of unconsolidated affiliates.

The following summarizes significant financial information regarding our segments:

| | Resort Ownership/ Operation | Resort Third- Party Management | Condominium Sales | Other | Totals per Financial Statements |
|---|--|---|------------------------------|--------------|--|
| Three months ended September 30, 2006 | | | | | |
| Revenues | \$ 35,891 | \$ 4,888 | \$ | \$ | \$ 40,779 |
| EBITDA, excluding certain items | 9,865 | 1,741 | (120) | (1,269) | \$ 10,217 |
| Depreciation and amortization | (6,294) | | | (136) | (6,430) |
| Interest expense, net | | | | | (954) |
| Income before income taxes, minority interests, and equity in earnings of unconsolidated affiliates | | | | | \$ 2,833 |
| Additions to long-lived assets | 27,248 | | | 194 | \$ 27,442 |

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| | Resort Ownership/ Operation | Resort Third- Party Management | Condominium Sales | Other | Totals per Financial Statements |
|---|--|---|------------------------------|--------------|--|
| Nine months ended September 30, 2006 | | | | | |
| Revenues | \$ 101,432 | \$ 13,010 | \$ | \$ | \$ 114,442 |
| EBITDA, excluding certain items | 26,473 | 3,879 | (268) | (8,510) | \$ 21,574 |
| Depreciation and amortization | (18,336) | | | (361) | (18,697) |
| Interest expense, net | | | | | (3,084) |
| Loss before income taxes, minority interests, and equity in loss of unconsolidated affiliates | | | | | \$ (207) |
| Additions to long-lived assets | 76,682 | | | 515 | \$ 77,197 |
| Total assets | 527,692 | | | 114,945 | \$ 642,637 |
| Three months ended September 30, 2005 | | | | | |
| Revenues | \$ 33,150 | \$ | \$ 25,862 | \$ | \$ 59,012 |
| EBITDA, excluding certain items | 18,032 | | 9,082 | (7,744) | \$ 19,370 |
| Depreciation and amortization | (6,128) | | | (158) | (6,286) |
| Interest expense, net | | | | | (1,401) |
| Income before income taxes, minority interests, and equity in unconsolidated affiliates | | | | | \$ 11,683 |
| Additions to long-lived assets | 39,526 | | | 104 | \$ 39,630 |
| Nine months ended September 30, 2005 | | | | | |
| Revenues | \$ 86,178 | \$ | \$ 25,862 | \$ | \$ 112,040 |

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| | | | | |
|---|----------|-------|---------|------------|
| EBITDA, excluding certain items | 26,131 | 9,082 | (8,616) | \$ 26,597 |
| Depreciation and amortization | (19,055) | | (465) | (19,520) |
| Interest expense, net | | | | (3,777) |
| Income before income taxes, minority interests, and equity in unconsolidated affiliates | | | | \$ 3,300 |
| Additions to long-lived assets | 95,283 | | 409 | \$ 95,692 |
| Total assets | 625,756 | | 23,891 | \$ 649,647 |

The Other items in the table above represent corporate-level activities that do not constitute a reportable segment. Total assets at the corporate level primarily consist of cash, our investment in affiliates, and intangibles. Goodwill is included in our resort ownership/operation segment.

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Recent Accounting Pronouncements In July 2006, the FASB issued FASB Interpretation No. 48 (FIN 48) Accounting for Uncertainty in Income Taxes which prescribes a recognition threshold and measurement process for recording in the financial statements uncertain tax positions taken or expected to be taken in a tax return. Additionally, FIN 48 provides guidance on the derecognition, classification, accounting in interim periods and disclosure requirements for uncertain tax positions. The accounting provisions of FIN 48 will be effective for us beginning January 1, 2007. We are currently evaluating the impact of the adoption of this statement.

In September 2006, the FASB issued Statement of Financial Accounting Standards 157, Fair Value Measurements (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. We are currently evaluating the impact of the adoption of this statement.

3. INVESTMENT IN AFFILIATES

On March 2, 2006, our joint venture with CNL entered into a loan agreement and borrowed \$63,000. The loan is secured by the joint venture's interests in its owned Great Wolf Lodge resorts in Wisconsin Dells, Wisconsin and Sandusky, Ohio. Pursuant to the joint venture agreement, the joint venture distributed to us 30% of the net loan proceeds, or approximately \$18,600.

4. SHARE-BASED COMPENSATION

Effective January 1, 2006, we adopted Statement of Financial Accounting Standards 123(R), *Share-Based Payment* (SFAS 123(R)), using the modified prospective application transition method. Before we adopted SFAS 123(R), we accounted for share-based compensation in accordance with Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*. Other than for the expense related to our deferred compensation shares and our non-vested shares, no share-based employee compensation cost has been reflected in net income prior to January 1, 2006.

We recognized \$720 and \$2,392, net of estimated forfeitures, in share-based compensation expense (revenue) for the three and nine months ended September 30, 2006, respectively. The total income tax benefit (expense) recognized related to share-based compensation was \$288 and \$957 for the three and nine months ended September 30, 2006, respectively. We recognize compensation expense on grants of share-based compensation awards on a straight-line basis over the requisite service period of each award recipient. As of September 30, 2006, total unrecognized compensation cost related to share-based compensation awards was \$5,188, which we expect to recognize over a weighted average period of approximately 2.6 years.

The Great Wolf Resorts 2004 Incentive Stock Plan (the Plan) authorizes us to grant up to 3,380,520 options, stock appreciation rights or shares of our common stock to employees and directors. At September 30, 2006, there were 1,909,926 shares available for future grants under the Plan.

We anticipate having to issue new shares of our common stock for stock option exercises.

Stock Options

We have granted non-qualified stock options to purchase our common stock under the Plan at prices equal to the fair market value of the common stock on the grant dates. The exercise price for certain options granted under the plans may be paid in cash, shares of common stock or a combination of cash and shares. Stock options expire ten years from the grant date and vest ratably over three years.

We recorded stock option expense of \$305 and \$1,292 for the three and nine months ended September 30, 2006, respectively. The per share weighted average fair value of stock options granted during the nine months ended September 30, 2005 was

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\$9.38. There were no stock options granted during the nine months ended September 30, 2006. We estimated the fair value of each stock option on the date of grant using the Black-Scholes pricing model and the following assumptions:

| | Nine months ended September 30, 2005 |
|---|---|
| Dividend yield | |
| Weighted average, risk free interest rate | 3.65% |
| Weighted average, expected life of option | 6.0 years |
| Expected stock price volatility | 40.00% |

We used an expected dividend yield of 0% as we do not currently pay a dividend and do not contemplate paying a dividend in the foreseeable future. The weighted average, risk free interest rate is based on the U.S. Treasury note rate at the beginning of the period. The weighted average expected life of our options is based on the simplified calculation allowed under SFAS 123(R). Due to our formation in December 2004, our expected stock price volatility is estimated using daily returns data for the five-year period ending on the grant date for a group of peer companies.

A summary of stock option activity during the nine months ended September 30, 2006 is:

| | Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Life |
|------------------------------------|---------------|--|--|
| Number of shares under option: | | | |
| Outstanding at beginning of period | 1,471,834 | \$ 17.45 | |
| Granted | | | |
| Exercised | | | |
| Forfeited | (353,333) | \$ 17.03 | |
| Outstanding at end of period | 1,118,501 | \$ 17.58 | 8.25 years |
| Exercisable at end of period | 418,853 | \$ 17.51 | 8.25 years |

At September 30, 2006, all of our option grant prices were above our stock price. Therefore, we believe there was no intrinsic value for our outstanding or exercisable shares at September 30, 2006.

Market Condition Share Awards

Certain officers and key employees are eligible to receive shares of our common stock in payment of market condition share awards granted to them in accordance with the terms thereof. During the nine months ended September 30, 2006, 81,820 market condition share awards were granted. No market condition share awards were granted during the three months ended September 30, 2006. Grantees of market condition shares will be eligible to receive shares of our common stock based on our common stock's performance in calendar year 2006 relative to a small cap stock index, as designated by the Compensation Committee of the Board of Directors. No market condition share awards were outstanding as of September 30, 2005.

We recorded share based expense of \$129 and \$353 for the three and nine months ended September 30, 2006, respectively. The per share fair value of market condition shares granted during the nine months ended September 30, 2006 was \$5.76 and was determined using a Monte Carlo simulation and the following assumptions:

| | |
|---|--------|
| Dividend yield | |
| Weighted average, risk free interest rate | 4.12% |
| Expected stock price volatility (peer group of companies) | 31.00% |

Expected stock price volatility (small-cap stock index)

17.50%

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We used an expected dividend yield of 0% as we do not currently pay a dividend and do not contemplate paying a dividend in the foreseeable future. The weighted average, risk free interest rate is based on the one-year T-bill rate. Our expected stock price volatility was estimated using daily returns data for the three-year period ending on the grant date for peer group companies. The expected stock price volatility for the small cap stock index was estimated using three-year return averages.

Performance Share Awards

Certain officers and key employees are eligible to receive shares of our common stock in payment of performance share awards granted to them in accordance with the terms thereof. During the nine months ended September 30, 2006, 27,273 performance share awards were granted. No performance share awards were granted during the three months ended September 30, 2006. Grantees of performance shares will be eligible to receive shares of our common stock based on the achievement of certain individual and departmental performance criteria in 2006. We recorded share based expense of \$82 and \$228 for the three and nine months ended September 30, 2006, respectively. The per share fair value of performance shares granted during the nine months ended September 30, 2006 was \$11.03, which represents the fair value of our common stock on the grant date. No performance share awards were outstanding as of September 30, 2005.

Deferred Compensation Awards

Pursuant to their employment arrangements, certain executives received bonuses upon completion of the initial public offering of our common stock in 2004 (the IPO). Executives receiving bonus payments totaling \$2,200 elected to defer those payments pursuant to our deferred compensation plan. To satisfy this obligation, we contributed 129,412 shares of our common stock to the trust that holds the assets to pay obligations under our deferred compensation plan. The fair value of that stock at the date of contribution was \$2,200. In accordance with the provisions of EITF Issue No. 97-14, Accounting for Deferred Compensation Arrangements Where Amounts Earned Are Held in a Rabbi Trust and Invested, we have recorded the fair value of the shares of common stock, at the date the shares were contributed to the trust, as a reduction of our stockholders' equity. Also, as prescribed by EITF Issue No. 97-14, we account for the change in fair value of the shares held in the trust as a charge to compensation cost. We recorded share based expense (revenue) of (\$6) and \$214 for the three and nine months ended September 30, 2006, respectively and shared based revenue of \$1,307 and \$1,553 for the three and nine months ended September 30, 2005, respectively.

Non-vested Shares

We have granted non-vested shares to certain employees and our directors. Shares vest between three and five years. We valued the non-vested shares at the closing market value of our common stock on the date of grant. A summary of non-vested shares activity for the nine months ended September 30, 2006 is as follows:

| | Shares | Weighted Average Grant Date Fair Value | Aggregate Intrinsic Value |
|--|---------------|---|--|
| Non-vested shares balance at beginning of period | 15,000 | \$10.09 | |
| Granted | 231,000 | \$11.43 | |
| Forfeited | (3,000) | | |
| Vested | | | |
| Non-vested shares balance at end of period | 243,000 | \$11.47 | \$ 99 |

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We recorded share based expense of \$210 and \$305 for the three and nine months ended September 30, 2006, respectively. There were no non-vested shares outstanding at September 30, 2005.

Prior Year Pro Forma Expense

The following table illustrates the effect on net income and earnings per share as if the fair value-based method provided by SFAS No. 123, *Accounting for Stock-Based Compensation*, had been applied for all outstanding and unvested awards for periods prior to the adoption of SFAS 123(R):

| | Three Months Ended September 30, 2005 | Nine months ended September 30, 2005 |
|--|--|---|
| Net income, as reported | \$ 7,011 | \$ 1,972 |
| Compensation expense, SFAS 123 fair value method | (382) | (1,069) |
| Pro forma net income | \$ 6,629 | \$ 903 |
| Pro forma net income per share basic | \$ 0.22 | \$ 0.03 |
| Pro forma net income per share diluted | \$ 0.22 | \$ 0.03 |
| Actual net income per share basic | \$ 0.23 | \$ 0.07 |
| Actual net income per share diluted | \$ 0.23 | \$ 0.07 |

5. PROPERTY AND EQUIPMENT

Property and equipment consist of the following:

| | September 30, 2006 | December 31, 2005 |
|-----------------------------------|-----------------------------------|----------------------------------|
| Land and improvements | \$ 31,458 | \$ 38,735 |
| Building and improvements | 147,986 | 150,184 |
| Furniture, fixtures and equipment | 183,433 | 167,691 |
| Construction in process | 123,390 | 46,448 |
| | 486,267 | 403,058 |
| Less accumulated depreciation | (36,404) | (17,667) |
| Property and equipment, net | \$ 449,863 | \$ 385,391 |

Depreciation expense was \$6,326 and \$6,103 for the three months ended September 30, 2006 and 2005, respectively. Depreciation expense was \$18,737 and \$16,851 for the nine months ended September 30, 2006 and 2005, respectively.

6. LONG-TERM DEBT

Long-term debt consists of the following:

| | September 30, 2006 | December 31, 2005 |
|---|-----------------------------------|----------------------------------|
| Long-Term Debt: | | |
| Traverse City/Kansas City mortgage loan | \$ 73,106 | \$ 73,979 |
| Sheboygan mortgage loan | 28,541 | 28,939 |
| Mason construction loan | 37,937 | |

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| | | |
|--|------------|------------|
| Other mortgage debt | 1,523 | 1,552 |
| Junior subordinated debentures | 51,550 | 51,550 |
| Other Debt: | | |
| City of Sheboygan bonds | 8,346 | 8,288 |
| City of Sheboygan loan | 3,903 | 4,020 |
| | 204,906 | 168,328 |
| Less current portion of long-term debt | (2,000) | (1,928) |
| | \$ 202,906 | \$ 166,400 |

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Traverse City/Kansas City Mortgage Loan This loan is secured by our Traverse City and Kansas City resorts. The loan bears interest at a fixed rate of 6.96%, is subject to a 25-year principal amortization schedule, and matures in January 2015. The loan has customary financial and operating debt compliance covenants, including a minimum debt service coverage ratio, representing the combined EBITDA (adjusted for non-recurring items, unusual items, infrequent items and asset impairment charges) of the two resorts divided by their combined annual interest expense and principal amortization. The loan also has customary prohibitions on our ability to prepay the loan prior to maturity. We were in compliance with all covenants under this loan at September 30, 2006.

Sheboygan Mortgage Loan This loan is secured by our Sheboygan resort. The loan matures in January 2008, bears interest at a floating rate of prime plus 200 basis points (total rate of 10.25% as of September 30, 2006), and is subject to a 20-year principal amortization schedule. The loan has customary covenants associated with a single asset mortgage. There are no prohibitions or fees associated with the prepayment of the loan principal. We were in compliance with the mortgage loan covenants at September 30, 2006.

Mason Construction Loan In December 2005 we closed on a \$76,800 loan to construct the Great Wolf Lodge in Mason, Ohio. The loan is secured by a first mortgage on the Mason, Ohio property and matures in December 2008. The loan also has two one-year extensions after the initial 3-year term available at our option. The lenders have a construction and debt service guaranty from us. In conjunction with the debt service guaranty, we must maintain a maximum ratio of long-term debt to consolidated trailing twelve month adjusted EBITDA of 6.50x and a minimum tangible net worth of \$200,000 or greater. The construction guaranty expires at the opening date of the resort and the debt service guaranty expires once the resort achieves a trailing cash flow threshold. The loan bears interest at a floating rate of 30 day LIBOR plus a spread of 265 basis points (total rate of 7.97% as of September 30, 2006). The loan is interest only during the initial three-year term and then is subject to a 25-year amortization schedule in the extension years. The loan has

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customary covenants associated with an individual mortgaged property. There are no prohibitions or fees associated with the repayment of the loan principal. We were in compliance with the loan covenants at September 30, 2006.

Junior Subordinated Debentures In March 2005 we completed a private offering of \$50,000 of trust preferred securities (TPS) through Great Wolf Capital Trust I (the Trust), a Delaware statutory trust which is our subsidiary. The securities pay holders cumulative cash distributions at an annual rate which is fixed at 7.80% through March 2015 and then floats at LIBOR + 310 basis points thereafter. The securities mature in March 2035 and are callable at no premium after March 2010. In addition, we invested \$1,500 in the Trust's common securities, representing 3% of the total capitalization of the Trust.

The Trust used the proceeds of the offering and our investment to purchase from us \$51,550 of our junior subordinated debentures with payment terms that mirror the distribution terms of the trust securities. The costs of the trust preferred offering totaled \$1,600, including \$1,500 of underwriting commissions and expenses and \$100 of costs incurred directly by the Trust. The Trust paid these costs utilizing an investment from us. These costs are being amortized over a 30-year period. The proceeds from our debenture sale, net of the costs of the trust preferred offering and our investment in the Trust, were \$48,400. We used the net proceeds to retire the Pocono Mountains construction loan.

As a result of the issuance of a revision to FASB Interpretation No. 46R, Consolidation of Variable Interest Entities and the accounting profession's application of the guidance provided by the FASB, issue trusts, like the Trust, are generally variable interest entities. We have determined that we are not the primary beneficiary under the Trust, and accordingly we do not include the financial statements of the Trust in our consolidated financial statements.

Based on the foregoing accounting authority, our consolidated financial statements present the debentures issued to the Trust as long-term debt. Our investment in the Trust is accounted as a cost investment and is included in other assets. For financial reporting purposes, we record interest expense on the corresponding debentures in our consolidated statements of operations.

City of Sheboygan Bonds The City of Sheboygan (the City) bonds represent the face amount of bond anticipation notes (BANs) issued by the City in November 2003 in conjunction with the construction of the Blue Harbor Resort in Sheboygan, Wisconsin. In accordance with the provisions of EITF Issue No. 91-10, we have recognized as a liability the obligations for the BANs. The notes bear interest at an annual rate of 3.95% and mature in 2008. The notes are not a general obligation of the City and are payable from (a) the proceeds of bond anticipation notes or other funds appropriated by the City for the payment of interest on the BANs and (b) the proceeds to be delivered from the issuance and sale of securities by the City. We have an obligation to fund payment of these BANs. Our obligation to fund repayment of the notes will be satisfied by certain minimum guaranteed amounts of room tax payments to be made by the Blue Harbor Resort through 2028.

City of Sheboygan Loan The City of Sheboygan loan amount represents a loan made by the City in 2005 in conjunction with the construction of the Blue Harbor Resort in Sheboygan, Wisconsin. The loan is noninterest bearing and matures in 2018. Our obligation to repay the loan will be satisfied by certain minimum guaranteed amounts of real and personal property tax payments to be made by the Blue Harbor Resort through 2018.

Future Maturities Future principal requirements on long-term debt and other long-term liabilities are as follows:

| | Through September 30, |
|------------|--------------------------------------|
| 2007 | \$ 2,000 |
| 2008 | 29,445 |
| 2009 | 39,559 |
| 2010 | 1,742 |
| 2011 | 1,872 |
| Thereafter | 130,288 |
| Total | \$ 204,906 |

7. EARNINGS PER SHARE

We calculate our basic earnings per common share by dividing net income (loss) available to common shareholders by the weighted average number of shares of common stock outstanding. Our diluted earnings per common share assumes the issuance of common stock for all potentially dilutive stock equivalents outstanding using the treasury stock method. In periods in which we incur a net loss, we exclude potentially dilutive stock equivalents from the computation of diluted weighted average shares outstanding as the effect of those potentially dilutive items is anti-dilutive.

The trust that holds the assets to pay obligations under our deferred compensation plan has 129,412 shares of our common stock. In accordance with the provisions of EITF Issue No. 97-14, Accounting for Deferred Compensation Arrangements Where Amounts Earned Are Held in a Rabbi Trust and Invested, we treat those shares of common stock as treasury stock for purposes of our earnings per share computations and therefore we exclude them from our basic and diluted earnings per share calculations. Basic and diluted earnings per common share are as follows:

| | Three months ended | | Nine months ended | |
|--|---------------------------|-------------|--------------------------|-------------|
| | September 30, | | September 30, | |
| | 2006 | 2005 | 2006 | 2005 |
| Net income (loss) attributable to common shares | \$ 2,088 | \$ 7,011 | \$ (257) | \$ 1,972 |
| Weighted average common shares outstanding basic | 30,370,229 | 30,132,896 | 30,272,674 | 30,132,896 |
| Weighted average common shares outstanding diluted | 30,370,229 | 30,132,936 | 30,272,674 | 30,234,887 |
| Net income (loss) per share basic | \$ 0.07 | \$ 0.23 | \$ (0.01) | \$ 0.07 |
| Net income (loss) per share diluted | \$ 0.07 | \$ 0.23 | \$ (0.01) | \$ 0.07 |

Options to purchase 1,118,501 shares of common stock were not included in the computations of diluted earnings per share for the three months and nine months ended September 30, 2006, because the exercise prices for the options were greater than the average market price of the common shares during that period. There were 109,093 shares of common stock that were not included in the computation of diluted earnings per share for the three and nine months ended September 30, 2006, because the market and/or performance criteria related to these shares had not been met at September 30, 2006.

Table of Contents**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion should be read in conjunction with the financial statements and notes thereto appearing elsewhere in this report. We make statements in this section that are forward-looking statements within the meaning of the federal securities laws. For a complete discussion of forward-looking statements, see the section in Item 1 of our Annual Report on Form 10-K entitled, *Forward-Looking Statements*. All dollar amounts in this discussion, except for per share data and operating statistics, are in thousands.

Overview

The terms Great Wolf Resorts, us, we and our are used in this report to refer to Great Wolf Resorts, Inc. *Business.* We are a family entertainment resort company that provides our guests with a high-quality vacation at an affordable price. We are the largest owner, operator and developer in North America of drive-to family resorts featuring indoor waterparks and other family-oriented entertainment activities. Our resorts generally feature approximately 270 to 400 family suites that sleep from six to ten people and each includes a wet bar, microwave oven, refrigerator and dining and sitting area. We provide a full-service entertainment resort experience to our target customer base: families with children ranging in ages from 2 to 14 years old that live within a convenient driving distance of our resorts. We operate under our Great Wolf Lodge and Blue Harbor Resort brand names. Our resorts are open year-round and provide a consistent and comfortable environment where our guests can enjoy our various amenities and activities.

We provide our guests with a self-contained vacation experience and focus on capturing a significant portion of their total vacation spending. We earn revenues through the sale of rooms, which includes admission to our indoor waterpark, and other revenue-generating resort amenities. Each of our resorts features a combination of the following revenue-generating amenities: themed restaurants, an ice cream shop and confectionery, full-service spa, game arcade, gift shop and meeting space. We also generate revenues from licensing arrangements, management fees and other fees with respect to properties owned in whole or in part by third parties.

The following table presents an overview of our portfolio of operating resorts and resorts announced or under construction. As of September 30, 2006, we operate seven Great Wolf Lodge resorts (our signature northwoods-themed resorts), and one Blue Harbor Resort (a nautical-themed property).

| | Ownership | | Guest | Condo | Indoor Entertainment Area(1) |
|---|-------------------|----------------|---------------|--------------|-------------------------------------|
| | Percentage | Opening | Suites | Units | (Approx. sq.ft) |
| Existing Resorts: | | | | | |
| Wisconsin Dells, WI | 30% | 1997 | 309 | 77 | 102,000 |
| Sandusky, OH | 30% | 2001 | 271 | | 41,000 |
| Traverse City, MI | 100% | 2003 | 281 | | 51,000 |
| Kansas City, KS | 100% | 2003 | 281 | | 49,000 |
| Sheboygan, WI | 100% | 2004 | 183 | 64 | 54,000 |
| Williamsburg, VA | 100% | 2005 | 301(2) | | 66,000 |
| Pocono Mountains, PA | 100% | 2005 | 401 | | 91,000 |
| Niagara Falls, ONT (3) | | April 2006 | 406 | | 94,000 |
| Resorts Announced or Under Construction: | | | | | |
| Mason, OH (4) | 84% | Late 2006 | 401 | | 93,000 |
| Grapevine, TX(5) | 100% | Late 2007 | 404 | | 98,000 |
| Grand Mound, WA(6) | 49% | | 393 | | 78,000 |

Early
2008

- (1) Our indoor entertainment areas generally include our indoor waterpark, game arcade, children s activity room and fitness room, as well as our Aveda concept spa in the resorts that have such amenities.
- (2) We plan to add an additional 103 guest suites as well as new waterpark attractions at our Williamsburg property. Construction for the expansion began in May 2006 with expected completion of the waterpark attractions in late 2006 and the additional guest suites in early 2007.
- (3) An affiliate of Ripley Entertainment, Inc. (Ripley), our licensee, owns this resort. We have granted Ripley a license to use

the Great Wolf Lodge name for this resort through April 2016. We manage the resort on behalf of Ripley and also provide central reservation services.

- (4) We have entered into a joint venture agreement with a subsidiary of CBS Corporation (CBS), to build this resort and attached conference center. We will operate the resort under our Great Wolf Lodge brand and have a majority of the equity in the project. CBS has a minority equity interest in the development. Construction on the resort began in July 2005 with expected completion of the resort in late 2006 and the conference center in early 2007.

- (5) We are developing a Great Wolf

Lodge resort in Grapevine, Texas. The northwoods themed, six-story resort will provide a comprehensive package of first-class destination lodging amenities and activities. Construction on the resort began in June 2006 with expected completion in late 2007.

- (6) We have entered into a joint venture agreement with The Confederated Tribes of the Chehalis Reservation to build this resort. We will operate the resort under our Great Wolf Lodge brand. The Confederated Tribes of the Chehalis Reservation will lease the land needed for the resort to the joint venture, and they will have a majority equity interest in the joint venture. Construction on the resort began

in October 2006
with expected
completion in
early 2008.

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Industry Trends. We operate in the family entertainment resort segment of the travel and leisure industry. The concept of a family entertainment resort with an indoor waterpark was first introduced to the United States in Wisconsin Dells, Wisconsin, and has evolved there over the past 16 years. In an effort to boost occupancy and daily rates, as well as capture off-season demand, hotel operators in the Wisconsin Dells market began expanding indoor pools and adding waterslides and other water-based attractions to existing hotels and resorts. The success of these efforts prompted several local operators to build new, larger destination resorts based primarily on this concept.

We believe that these properties, which typically are themed and include other resort features such as arcades, retail shops and full food and beverage service in addition to the indoor waterpark, have historically outperformed standard hotels in the market. We believe that the rate premiums and increased market share in the Wisconsin Dells for hotels and resorts with some form of an indoor waterpark can be attributed to several factors, including the ability to provide a year-round vacation destination without weather-related risks, the wide appeal of water-based recreation and the favorable trends in leisure travel discussed below.

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While no standard industry definition for a family entertainment resort featuring an indoor waterpark has developed, we generally consider resorts with at least 200 rooms featuring indoor waterparks larger than 30,000 square feet, as well as a variety of water slides and other water-based attractions, to be competitive with our resorts. A recent survey by Hotel & Leisure Advisors identified a total of 12 indoor waterpark destination resorts in the United States that are expected to open in 2006.

We believe recent vacation trends favor drive-to family entertainment resorts featuring indoor waterparks, as the number of families choosing to take shorter, more frequent vacations that they can drive to have increased in recent years.

Outlook. We believe that only Great Wolf Resorts has established a U.S.-wide portfolio of family entertainment resorts featuring indoor waterparks and no other operator or developer has such a portfolio. We intend to continue to expand our portfolio of owned resorts throughout the United States and to selectively seek licensing and management opportunities domestically and internationally. The resorts we are currently constructing and plan to develop in the future require significant industry knowledge and substantial capital resources. Several of our resorts compete directly with other similar family entertainment resorts.

Our primary business objective is to increase long-term stockholder value. We believe we can increase stockholder value by executing our internal and external growth strategies. Our primary internal growth strategies are to: maximize total resort revenue; minimize costs by leveraging our economies of scale; and build upon our existing brand awareness and loyalty in order to compete more effectively. Our primary external growth strategies are to: capitalize on our first-mover advantage by being the first to develop and operate family entertainment resorts featuring indoor waterparks in our selected target markets; focus on development and strategic growth opportunities by seeking to develop 10-15 resorts over the next six years with us being the sole or partial owner, selectively consider opportunities to sell partial or whole interests in our owned and operating properties, and target selected licensing and joint venture opportunities; and continue to innovate by leveraging our in-house expertise, in conjunction with the knowledge and experience of our third-party suppliers and designers.

In attempting to execute our internal and external growth strategies, we are subject to a variety of business challenges and risks. These challenges include: development and licensing of properties; increases in costs of constructing, operating and maintaining our resorts; competition from other entertainment companies, both within and outside our industry segment; and external economic risks, including family vacation patterns and trends. We seek to meet these challenges by providing sufficient management oversight to site selection, development and resort operations, concentrating on growing and strengthening awareness of our brand and demand for our resorts, and maintaining our focus on safety.

During the third quarter of 2006, we experienced operating results of key consolidated operating metrics within the ranges we had projected for the period. For the remainder of 2006, we do expect, however, that our Traverse City and Sandusky resorts will continue to be affected by adverse general economic circumstances in the Michigan/Ohio region (such as bankruptcies of several major companies and/or large announced layoffs by major employers) and increased competition that has occurred in these markets over the past two years. The Michigan/Ohio region includes cities that have historically been the Traverse City and Sandusky resorts' largest suppliers of customers. We believe the adverse general economic circumstances in the region have negatively impacted overall discretionary consumer spending in that region over the past year and may continue to do so going forward. We believe this has and may continue to have an impact on the operating performance of our Traverse City and Sandusky resorts. Also, we have experienced a slower-than-expected occupancy ramp-up and lower-than-expected average daily room rates at our Sheboygan, Wisconsin property since its opening in 2004. We believe this operating weakness has been primarily attributable to the fact that the overall development of Sheboygan as a tourist destination continues to lag behind our initial expectations. We believe this has impacted and will likely continue to impact the consumer demand for our indoor waterpark resort in that market and the operations of the resort.

Revenue and Key Performance Indicators. We seek to generate positive cash flows and net income from each of our owned resorts. Our rooms revenue represents sales to guests of room nights at our resorts, and is the largest contributor to

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our cash flows and profitability. Rooms revenue accounted for approximately 68% of our total resort revenue for the nine months ended September 30, 2006. We employ sales and marketing efforts to increase overall demand for rooms at our resorts. We seek to optimize the relationship between room rates and occupancies through the use of yield management techniques that attempt to project demand in order to selectively increase room rates during peak demand. These techniques are designed to assist us in managing our higher occupancy nights to achieve maximum rooms revenue and include such practices as:

Monitoring our historical trends for occupancy and estimating our high occupancy nights;

Offering the highest discounts to previous guests in off-peak periods to build customer loyalty and enhance our ability to charge higher rates in peak periods;

Structuring rates to allow us to offer our previous guests the best rate while simultaneously working with a promotional partner or offering internet specials;

Monitoring sales of room types daily to evaluate the effectiveness of offered discounts; and

Offering specials on standard suites and yielding better rates on larger suites when standard suites sell out. In addition, we seek to maximize the amount of time and money spent on-site by our guests by providing a variety of revenue-generating amenities.

We have several key indicators that we use to evaluate the performance of our business. These indicators include the following:

Occupancy;

Average daily room rate, or ADR;

Revenue per available room, or RevPAR;

Total revenue per available room, or Total RevPAR;

Total revenue per occupied room, or Total RevPOR; and

Earnings before interest, taxes, depreciation and amortization, or EBITDA.

Occupancy, ADR and RevPAR are commonly used measures within the hospitality industry to evaluate hotel operations and are defined as follows:

Occupancy is calculated by dividing total occupied rooms by total available rooms.

ADR is calculated by dividing total rooms revenue by total occupied rooms.

RevPAR is the product of occupancy and ADR.

Total RevPAR and Total RevPOR are defined as follows:

Total RevPAR is calculated by dividing total revenue by total available rooms.

Total Rev POR is calculated by dividing total revenue by total occupied rooms.

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Occupancy allows us to measure the general overall demand for rooms at our resorts and the effectiveness of our sales and marketing strategies. ADR allows us to measure the effectiveness of our yield management strategies. While ADR and RevPAR only include rooms revenue, Total RevPOR and Total RevPAR include both rooms revenue and other revenue derived from food and beverage and other amenities at our resorts. We consider Total RevPOR and Total RevPAR to be key performance indicators for our business because we derive a significant portion of our revenue from food and beverage and other amenities. For the nine months ended September 30, 2006, approximately 32% of our total resort revenues consisted of non-rooms revenue.

We use RevPAR and Total RevPAR to evaluate the blended effect that changes in occupancy, ADR and Total RevPOR have on our profitability. We focus on increasing ADR and Total RevPOR because those increases can have the greatest positive impact on our profitability. In addition, we seek to maximize occupancy, as increases in occupancy generally lead to greater total revenues at our resorts, and maintaining certain occupancy levels is key to covering our fixed costs. Increases in total revenues as a result of higher occupancy are, however, typically accompanied by additional incremental costs (including housekeeping services, utilities and room amenity costs). In contrast, increases in total revenues from higher ADR and Total RevPOR are typically accompanied by lower incremental costs, and result in a greater increase in profitability.

We also use EBITDA as a measure of the operating performance of each of our resorts. EBITDA is a supplemental financial measure, and is not defined by accounting principles generally accepted in the United States of America, or GAAP. See **Non-GAAP Financial Measures** below for further discussion of our use of EBITDA and a reconciliation to net income.

Recent Accounting Pronouncements

In July 2006, the FASB issued FASB Interpretation No. 48 (FIN 48) **Accounting for Uncertainty in Income Taxes** which prescribes a recognition threshold and measurement process for recording in the financial statements uncertain tax positions taken or expected to be taken in a tax return. Additionally, FIN 48 provides guidance on the derecognition, classification, accounting in interim periods and disclosure requirements for uncertain tax positions. The accounting provisions of FIN 48 will be effective for us beginning January 1, 2007. We are currently evaluating the impact of the adoption of this statement.

In September 2006, the FASB issued Statement of Financial Accounting Standards 157, **Fair Value Measurements (SFAS 157)**. SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. We are currently evaluating the impact of the adoption of this statement.

Non-GAAP Financial Measures

We use EBITDA as a measure of our operating performance. EBITDA is a supplemental non-GAAP financial measure. EBITDA is commonly defined as net income plus (a) net interest expense, (b) income taxes, and (c) depreciation and amortization.

EBITDA as calculated by us is not necessarily comparable to similarly titled measures presented by other companies. In addition, EBITDA (a) does not represent net income or cash flows from operations as defined by GAAP; (b) is not necessarily indicative of cash available to fund our cash flow needs; and (c) should not be considered as an alternative to net income, operating income, cash flows from operating activities or our other financial information as determined under GAAP.

We believe EBITDA is useful to an investor in evaluating our operating performance because:

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a significant portion of our assets consists of property and equipment that are depreciated over their remaining useful lives in accordance with GAAP. Because depreciation and amortization are non-cash items, we believe that presentation of EBITDA is a useful measure of our operating performance;

it is widely used in the hospitality and entertainment industries to measure operating performance without regard to items such as depreciation and amortization; and

we believe it helps investors meaningfully evaluate and compare the results of our operations from period to period by removing the impact of items directly resulting from our asset base, primarily depreciation and amortization, from our operating results.

Our management uses EBITDA:

as a measurement of operating performance because it assists us in comparing our operating performance on a consistent basis as it removes the impact of items directly resulting from our asset base, primarily depreciation and amortization, from our operating results;

for planning purposes, including the preparation of our annual operating budget;

as a valuation measure for evaluating our operating performance and our capacity to incur and service debt, fund capital expenditures and expand our business; and

as one measure in determining the value of other acquisitions and dispositions.

Using a measure such as EBITDA has material limitations. These limitations include the difficulty associated with comparing results among companies and the inability to analyze certain significant items, including depreciation and interest expense, which directly affect our net income or loss. Management compensates for these limitations by considering the economic effect of the excluded expense items independently, as well as in connection with its analysis of net income.

The following table reconciles net income (loss) to EBITDA for the periods presented.

| | Three months ended | | Nine months ended | |
|-------------------------------|---------------------------|------------------|--------------------------|------------------|
| | September 30, | | September 30, | |
| | 2006 | 2005 | 2006 | 2005 |
| Net income (loss) | \$ 2,088 | \$ 7,011 | \$ (257) | \$ 1,972 |
| Adjustments: | | | | |
| Interest expense, net | 954 | 1,401 | 3,084 | 3,777 |
| Income tax expense (benefit) | 1,340 | 4,675 | (172) | 1,332 |
| Depreciation and amortization | 6,430 | 6,286 | 18,697 | 19,520 |
| EBITDA | \$ 10,812 | \$ 19,373 | \$ 21,352 | \$ 26,601 |

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Results of Operations

General

Our results of operations for the three months ended September 30, 2006 and 2005 are not directly comparable due to the opening of our Great Wolf Lodge in the Pocono Mountains in October 2005, and the sale of 70% interests in each of our Wisconsin Dells and Sandusky resorts in October 2005 to a third party.

Our financial information includes:

our corporate entity that provides resort development and management services;

our Wisconsin Dells, Sandusky, Traverse City, Kansas City, Sheboygan, Williamsburg, Pocono Mountains, and Niagara Falls operating resorts (we sold 70% interests in each of our Wisconsin Dells and Sandusky resorts in October 2005);

equity interests in resorts in which we have ownership interests but which we do not consolidate; and

our resorts that are under construction which we will consolidate.

Revenues. Our revenues consist of:

lodging revenue, which includes rooms, food and beverage, and other department revenues from our resorts;

management fee and other revenue from resorts, which includes fees received under our management and license agreements; and

other revenue from managed properties. We employ the staff at our managed properties (except for the Niagara Falls resort). Under our management agreements, the resort owners reimburse us for payroll, benefits and certain other costs related to the operations of the managed properties. Emerging Issues Task Force, or EITF, Issue No. 01-14, *Income Statement Characteristics of Reimbursements for Out-of-Pocket Expenses* (EITF 01-14), establishes standards for accounting for reimbursable expenses in our statements of operations. Under this pronouncement, the reimbursement of payroll, benefits and costs is recorded as revenue on our statements of operations, with a corresponding expense recorded as other expenses from managed properties.

Operating Expenses. Our departmental operating expenses consist of rooms, food and beverage and other department expenses.

Our other operating expenses include the following items:

selling, general and administrative expenses, which are associated with the operations and management of resorts and which consist primarily of expenses such as corporate payroll and related benefits, operations management, sales and marketing, finance, legal, information technology support, human resources and other support services, as well as general corporate expenses;

property operation and maintenance expenses, such as utility costs and property taxes;

depreciation and amortization; and

other expenses from managed properties, which are recorded as an expense in accordance with EITF 01-14.

Three months ended September 30, 2006 compared with the three months ended September 30, 2005

The following table shows key operating statistics for our resorts for the three months ended September 30, 2006 and 2005:

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| | All Properties | | Same Store Comparison (b) | | |
|---------------------|---------------------------|---------------------------|----------------------------------|----------------------------|----------|
| | (a) | | | | |
| | Three months ended | Three months ended | Three months ended | Increase (Decrease) | |
| | September 30, 2006 | September 30, 2006 | September 30, 2005 | \$ | % |
| Occupancy | 73.4% | 73.7% | 67.3% | N/A | 9.5% |
| ADR | \$ 242.67 | \$218.21 | \$ 223.19 | \$ (4.98) | (2.2)% |
| RevPAR | \$ 178.17 | \$160.76 | \$ 150.13 | \$10.63 | 7.1% |
| Total RevPOR | \$ 358.76 | \$320.43 | \$ 327.60 | \$ (7.17) | (2.2)% |
| Total RevPAR | \$ 263.40 | \$236.07 | \$ 220.37 | \$15.70 | 7.1% |

(a) Includes results for properties that were open for any portion of the period, for all owned and/or managed resorts.

(b) Same store comparison includes properties that were open for the full periods in 2006 and 2005 (that is, our Wisconsin Dells, Sandusky, Traverse City, Kansas City, Sheboygan, and Williamsburg resorts).

In 2005 we opened two resorts: our Williamsburg resort opened in March 2005 and our Pocono Mountains resort opened in October 2005. Also in October 2005 we sold 70% equity interests in our Wisconsin Dells and Sandusky resorts to a third party. Following the sale of the 70% interests in these two resorts, we no longer consolidate those resorts' operations in our operating results, but instead account for them under the equity method, through equity in unconsolidated affiliates. As a result, total revenue, rooms revenue and other revenue for the three month periods ended September 30, 2006 and September 30, 2005 are not directly comparable.

Presented below are selected amounts from the statements of operations for the three months ended September 30, 2006 and 2005:

| | Three months ended September 30, | | |
|-------------------------------------|---|-------------|--------------------------------|
| | 2006 | 2005 | Increase (Decrease) |
| Revenues | \$40,779 | \$59,012 | \$(18,233) |
| Operating expenses: | | | |
| Departmental operating expenses | 12,345 | 11,296 | 1,049 |
| Selling, general and administrative | 9,382 | 5,173 | 4,209 |
| Property operating costs | 5,313 | 6,393 | (1,080) |
| Depreciation and amortization | 6,430 | 6,286 | 144 |
| Cost of sales of condominiums | | 16,780 | (16,780) |
| Net operating income | 3,787 | 13,084 | (9,297) |
| Net interest expense | 954 | 1,401 | (447) |
| Income tax expense | 1,102 | 4,674 | (3,572) |
| Net income | 2,088 | 7,011 | (4,923) |

Revenues. Total revenues decreased primarily due to our having no revenue related to sales of condominiums during the three months ended September 30, 2006 when we had such sales revenue in 2005, and by the reduction in resort revenue due to the sale of 70% of our equity interests in our Wisconsin Dells and Sandusky resorts in October 2005. These decreases were partially offset by revenues related to the Pocono Mountains resort, which opened in October 2005, and management and other fees and other revenues from managed properties related to our joint venture with CNL Income Properties, Inc. (CNL).

Revenue from sales of condominiums at our Wisconsin Dells resort was \$25,862 for the three months ended September 30, 2005. We had no similar revenue during the three months ended September 30, 2006.

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Total revenues for the Pocono Mountains resort for the three months ended September 30, 2006 were \$1,210 greater than total revenues for the Wisconsin Dells and Sandusky resorts for the three months ended September 30, 2005. Our Williamsburg resort revenues increased \$1,702 for the three months ended September 30, 2006 as compared to September 30, 2005 due to increased marketing efforts.

Total management and other fees related to the CNL joint venture were \$853 for the three months ended September 30, 2006.

Other revenue from managed properties was \$3,147 for the three months ended September 30, 2006. We had no similar revenue for the three months ended September 30, 2005.

Operating expenses. Total operating expenses decreased primarily due to our having no cost of sales of condominiums during the three months ended September 30, 2006 when we had such costs in 2005, and by the reduction in resort expenses due to the sale of our Wisconsin Dells and Sandusky resorts in October 2005. These decreases were partially offset by an increase in expenses related to the Pocono Mountains resort, which opened in October 2005 and other expense from managed properties related to the CNL joint venture.

Total departmental operating expenses for the Pocono Mountains resort for the three months ended September 30, 2006 were \$559 greater than total departmental expenses for the Wisconsin Dells and Sandusky resorts for the three months ended September 30, 2005.

Total selling, general and administrative expenses for the Pocono Mountains resort for the three months ended September 30, 2006 were \$733 greater than total selling, general and administrative expenses for the Wisconsin Dells and Sandusky resorts for the three months ended September 30, 2005. During the three months ended September 30, 2006 our corporate selling, general and administrative expenses included increases over the three months ended September 30, 2005 related to share based compensation of \$2,027.

Total property operating costs (exclusive of opening costs) for the Pocono Mountains resort for the three months ended September 30, 2006 were \$712 less than total property operating costs (exclusive of opening costs) for the resorts in Wisconsin Dells and Sandusky for the three months ended September 30, 2005. Opening costs primarily related to our Mason Family, Grapevine and Grand Mound resorts were \$1,282 for the three months ended September 30, 2006, as compared to \$2,142 for the three months ended September 30, 2005 related to our resorts in the Pocono Mountains and the condominiums in Wisconsin Dells.

Total depreciation increased due to the opening of our resort in the Pocono Mountains and additional property and equipment purchases at our other resorts. Total depreciation and amortization for the Pocono Mountains resort for the three months ended September 30, 2006 was \$101 greater than total depreciation and amortization for the Wisconsin Dells and Sandusky resorts for the three months ended September 30, 2005.

Cost of sales of condominiums of \$16,780 relates to the condominiums sold at our Wisconsin Dells resort during the three months ended September 30, 2005. We did not incur similar charges during the three months ended September 30, 2006.

Net operating income. Net operating income for the three months ended September 30, 2006 decreased \$9,297 to \$3,787 from \$13,084 for the three months ended September 30, 2005.

Net income. Net income decreased due to the following:

A decrease in operating income from \$13,084 for the three months ended September 30, 2005 to \$3,787 for the three months ended September 30, 2006.

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This decrease was partially offset by:

A decrease in net interest expense of \$447 mainly due to higher interest income in the three months ended September 30, 2006 as compared to the three months ended September 30, 2005.

A reduction of \$3,572 in income tax expense recorded in the three months ended September 30, 2006 as compared to the three months ended September 30, 2005.

Nine months ended September 30, 2006 compared with the nine months ended September 30, 2005

The following table shows key operating statistics for our resorts for the nine months ended September 30, 2006 and 2005:

| | All Properties (a) | | Same Store Comparison (b) | | |
|---------------------|---|---|---|----------------------------|----------|
| | Nine months ended September 30, 2006 | Nine months ended September 30, 2006 | Nine months ended September 30, 2005 | Increase (Decrease) | |
| | | | | \$ | % |
| Occupancy | 67.8% | 66.6% | 65.5% | N/A | 1.7% |
| ADR | \$ 237.85 | \$ 198.48 | \$ 206.12 | \$ (7.64) | (3.7)% |
| RevPAR | \$ 161.29 | \$ 132.22 | \$ 135.01 | \$ (2.79) | (2.1)% |
| Total RevPOR | \$ 355.76 | \$ 299.71 | \$ 306.99 | \$ (7.28) | (2.4)% |
| Total RevPAR | \$ 241.24 | \$ 199.66 | \$ 201.08 | \$ (1.42) | (0.7)% |

(a) Includes results for properties for properties that were open for any portion of the period, for all owned and/or managed resorts.

(b) Same store comparison includes properties that were open for the full periods in 2006 and 2005 (that is, our Wisconsin Dells, Sandusky, Traverse City, Kansas City, and Sheboygan resorts).

In 2005 we opened two resorts: our Williamsburg resort opened in March 2005 and our Pocono Mountains resort opened in October 2005. Also in October 2005 we sold 70% equity interests in our Wisconsin Dells and Sandusky

resorts to a third party. Following the sale of the 70% interests in these two resorts, we no longer consolidated those resorts' operations in our operating results, but instead accounted for them under the equity method, through equity in unconsolidated affiliates. As a result, total revenue, rooms revenue and other revenue for the nine month periods ended September 30, 2006 and September 30, 2005 are not directly comparable.

Presented below are selected amounts from the statements of operations for the nine months ended September 30, 2006 and 2005:

| | Nine months ended | | Increase (Decrease) |
|-------------------------------------|--------------------------|-------------|--------------------------------|
| | September 30, | | |
| | 2006 | 2005 | |
| Revenues | \$ 114,442 | \$ 112,040 | \$ 2,402 |
| Operating expenses: | | | |
| Departmental operating expenses | 35,913 | 32,126 | 3,787 |
| Selling, general and administrative | 31,983 | 19,738 | 12,245 |
| Property operating costs | 14,888 | 16,799 | (1,911) |
| Depreciation and amortization | 18,697 | 19,520 | (823) |
| Cost of sales of condominiums | | 16,780 | (16,780) |
| Loss on sale of assets | 953 | | 953 |
| Net operating income | 2,877 | 7,077 | (4,200) |
| Net interest expense | 3,084 | 3,777 | (693) |
| Income tax expense (benefit) | (83) | 1,330 | (1,413) |
| Net income (loss) | (257) | 1,972 | (2,229) |

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Revenues. Total revenues increased primarily due to revenues related to the Williamsburg and Pocono Mountains resorts, which opened in March 2005 and October 2005, respectively; and management and other fees and other revenues from managed properties related to our joint venture with CNL Income Properties, Inc. (CNL). These increases were partially offset by there being no revenue related to sales of condominiums during the nine months ended September 30, 2006, as there was for the nine months ended September 30, 2005, and by the reduction in resort revenue due to the sale of 70% of our equity interests in our Wisconsin Dells and Sandusky resorts in October 2005.

Total revenues for the Williamsburg and Pocono Mountains resorts were \$59,955 for the nine months ended September 30, 2006 as compared to \$13,049 for the nine months ended September 30, 2005.

Total management and other fees related to the CNL joint venture were \$2,250 for the nine months ended September 30, 2006.

Other revenue from managed properties was \$9,131 for the nine months ended September 30, 2006. We had no similar revenue for the nine months ended September 30, 2005.

Revenue from sales of condominiums at our Wisconsin Dells resort was \$25,862 for the nine months ended September 30, 2005. We had no similar revenue during the nine months ended September 30, 2006.

Total revenues for the Wisconsin Dells and Sandusky resorts were \$29,607 for the nine months ended September 30, 2005.

Operating expenses. Total operating expenses increased primarily due to the increase in operating expenses in Williamsburg and Pocono Mountains resorts, which opened in March 2005 and October 2005, respectively; and other expense from managed properties related to the CNL joint venture. These increases were partially offset by there being no cost of sales of condominiums during the nine months ended September 30, 2006, as there was for the nine months ended September 30, 2005 and by the reduction in resort expenses due to the sale of our Wisconsin Dells and Sandusky resorts in October 2005.

Total departmental operating expenses for the Williamsburg and Pocono Mountains resorts were \$21,154 for the nine months ended September 30, 2006 as compared to \$5,563 for the nine months ended September 30, 2005. Total departmental expenses for the Wisconsin Dells and Sandusky resorts were \$10,892 for the nine months ended September 30, 2005.

Total selling, general and administrative expenses for the Williamsburg and Pocono Mountains resorts were \$12,782 for the nine months ended September 30, 2006 as compared to \$2,644 for the nine months ended September 30, 2005. Total selling, general and administrative expenses for the Wisconsin Dells and Sandusky resorts were \$6,620 for the nine months ended September 30, 2005. During the nine months ended September 30, 2006 our corporate selling, general and administrative expenses included increases over that of the nine months ended September 30, 2005 related to share based compensation of \$3,945, compensation-related expenses of \$1,646 due to increased staffing at our corporate office and \$1,811 related to professional fees.

Total property operating costs (exclusive of opening costs) for the Williamsburg and Pocono Mountains resorts were \$5,405 for the nine months ended September 30, 2006. Total property operating costs (exclusive of opening

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costs) for the resorts in Wisconsin Dells and Sandusky were \$4,144 for the nine months ended September 30, 2005. Opening costs related primarily to our Pocono Mountains, Mason Family, Grapevine and Grand Mound resorts and the resort in Niagara Falls were \$3,021 for the nine months ended September 30, 2006, as compared to \$6,282 for the nine months ended September 30, 2005 related to our resorts in Williamsburg and the Pocono Mountains and the condominiums in Wisconsin Dells.

Total depreciation and amortization for the Williamsburg and Pocono Mountains resorts was \$9,791 for the nine months ended September 30, 2006 as compared to \$5,390 for the nine months ended September 30, 2005. Total depreciation and amortization for the Wisconsin Dells and Sandusky resorts was \$5,772 for the nine months ended September 30, 2005. During the nine months ended September 30, 2005 we also had amortization expense of \$2,116 related to loan fee write offs. There were no similar write offs during the nine months ended September 30, 2006.

Cost of sales of condominiums of \$16,780 relates to the condominiums sold at our Wisconsin Dells resort during the nine months ended September 30, 2005. We did not incur a similar charge during the nine months ended September 30, 2006.

Loss on sale of real estate of \$953 during the nine months ended September 30, 2006 relates to finalization of the accounting for the sale of 70% of our equity interests in the Wisconsin Dells and Sandusky resorts in October 2005. No similar loss was recognized during the nine months ended September 30, 2005.

Net operating income. Net operating income for the nine months ended September 30, 2006 decreased \$4,200 to \$2,877 from \$7,077 for the nine months ended September 30, 2005.

Net loss. We had a net loss for the nine months ended September 30, 2006 as compared to net income for the nine months ended September 30, 2005 due to the following:

A decrease in operating income from \$7,077 for the nine months ended September 30, 2005 to \$2,877 for the nine months ended September 30, 2006.

This decrease was partially offset by:

A decrease in net interest expense of \$693 mainly due to higher interest income during the nine months ended September 30, 2006 as compared to the nine months ended September 30, 2005.

A reduction of \$1,413 in income tax expense recorded in the nine months ended September 30, 2006 as compared to the nine months ended September 30, 2005.

Segments

We are organized into a single operating division. Within that operating division, we have three reportable segments in 2006: resort ownership/operation, resorts third-party management and condominium sales. The resort ownership/operation segment derives its revenues from the ownership/operation of our consolidated owned resorts; the resort third-party management segment derives its revenue from management, license and other related fees from unconsolidated managed resorts; and the condominium sales segment derives its revenues from sales of condominium units to third-party owners. We evaluate the performance of each segment based on earnings before interest, income taxes, and depreciation and amortization (EBITDA), excluding minority interests and equity in earnings of unconsolidated affiliates.

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| | Three months ended September 30, | | | Nine months ended September 30, | | |
|---------------------------------|----------------------------------|----------|------------------------|---------------------------------|----------|------------------------|
| | 2006 | 2005 | Increase (Decrease) | 2006 | 2005 | Increase (Decrease) |
| Resort | | | | | | |
| Ownership/Operation | | | | | | |
| Revenues | \$35,891 | \$33,150 | \$ 2,741 | \$101,432 | \$86,178 | \$ 15,254 |
| EBITDA, excluding certain items | 9,865 | 18,032 | (8,167) | 26,473 | 26,131 | 342 |
| Resort Third-Party Mgmt | | | | | | |
| Revenues | 4,888 | | 4,888 | 13,010 | | 13,010 |
| EBITDA, excluding certain items | 1,741 | | 1,741 | 3,879 | | 3,879 |
| Condominium Sales | | | | | | |
| Revenues | | 25,862 | (25,862) | | 25,862 | (25,862) |
| EBITDA, excluding certain items | (120) | 9,082 | (9,202) | (268) | 9,082 | (9,350) |
| Other | | | | | | |
| Revenues | | | | | | |
| EBITDA, excluding certain items | (1,269) | (7,744) | 6,475 | (8,510) | (8,616) | 106 |

The Other items in the table above represent corporate-level activities that do not constitute a reportable segment.

Liquidity and Capital Resources

We had total indebtedness of \$204,906 and \$168,328 as of September 30, 2006 and December 31, 2005, respectively as summarized as follows:

| | September 30, 2006 | December 31, 2005 |
|---|--------------------------|-------------------------|
| Long-Term Debt: | | |
| Traverse City/Kansas City mortgage loan | \$ 73,106 | \$ 73,979 |
| Sheboygan mortgage loan | 28,541 | 28,939 |
| Mason construction loan | 37,937 | |
| Other mortgage debt | 1,523 | 1,552 |
| Junior subordinated debentures | 51,550 | 51,550 |
| Other Debt: | | |
| City of Sheboygan bonds | 8,346 | 8,288 |
| City of Sheboygan loan | 3,903 | 4,020 |
| | 204,906 | 168,328 |
| Less current portion of long-term debt | (2,000) | (1,928) |
| Total long-term debt | \$ 202,906 | \$ 166,400 |

Traverse City/Kansas City Mortgage Loan This loan is secured by our Traverse City and Kansas City resorts. The loan bears interest at a fixed rate of 6.96%, is subject to a 25-year principal amortization schedule, and matures in

January 2015. The loan has customary financial and operating debt compliance covenants, including a minimum debt service coverage ratio, representing the combined EBITDA (adjusted for non-recurring items, unusual items, infrequent items and asset impairment charges) of the two resorts divided by their combined annual interest expense and principal amortization. The loan also has customary prohibitions on our ability to prepay the loan prior to maturity. We were in compliance with all covenants under this loan at September 30, 2006.

Sheboygan Mortgage Loan This loan is secured by our Sheboygan resort. The loan matures in January 2008, bears interest at a floating rate of prime plus 200 basis points (total rate of 10.25% as of September 30, 2006), and is subject to a 20-year principal amortization schedule. The loan has customary covenants associated with a single asset mortgage. There

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are no prohibitions or fees associated with the prepayment of the loan principal. We were in compliance with the mortgage loan covenants at September 30, 2006.

Mason Construction Loan In December 2005 we closed on a \$76,800 loan to construct the Great Wolf Lodge in Mason, Ohio. The loan is secured by a first mortgage on the Mason, Ohio property and matures in December 2008. The loan also has two one-year extensions after the initial 3-year term available at our option. The lenders have a construction and debt service guaranty from us. In conjunction with the debt service guaranty, we must maintain a maximum ratio of long-term debt to consolidated trailing twelve month adjusted EBITDA of 6.50x and a minimum tangible net worth of \$200,000 or greater. The construction guaranty expires at the opening date of the resort and the debt service guaranty expires once the resort achieves a trailing cash flow threshold. The loan bears interest at a floating rate of 30 day LIBOR plus a spread of 265 basis points (total rate of 7.97% as of September 30, 2006). The loan is interest only during the initial three-year term and then is subject to a 25-year amortization schedule in the extension years. The loan has customary covenants associated with an individual mortgaged property. There are no prohibitions or fees associated with the repayment of the loan principal. We were in compliance with the loan covenants at September 30, 2006.

Junior Subordinated Debentures In March 2005 we completed a private offering of \$50,000 of trust preferred securities (TPS) through Great Wolf Capital Trust I (the Trust), a Delaware statutory trust which is our subsidiary. The securities pay holders cumulative cash distributions at an annual rate which is fixed at 7.80% through March 2015 and then floats at LIBOR + 310 basis points thereafter. The securities mature in March 2035 and are callable at no premium after March 2010. In addition, we invested \$1,500 in the Trust's common securities, representing 3% of the total capitalization of the Trust.

The Trust used the proceeds of the offering and our investment to purchase from us \$51,550 of our junior subordinated debentures with payment terms that mirror the distribution terms of the trust securities. The costs of the trust preferred offering totaled \$1,600, including \$1,500 of underwriting commissions and expenses and \$100 of costs incurred directly by the Trust. The Trust paid these costs utilizing an investment from us. These costs are being amortized over a 30-year period. The proceeds from our debenture sale, net of the costs of the trust preferred offering and our investment in the Trust, were \$48,400. We used the net proceeds to retire the Pocono Mountains construction loan.

As a result of the issuance of a revision to FASB Interpretation No. 46R, Consolidation of Variable Interest Entities and the accounting profession's application of the guidance provided by the FASB, issue trusts, like the Trust, are generally variable interest entities. We have determined that we are not the primary beneficiary under the Trust, and accordingly we do not include the financial statements of the Trust in our consolidated financial statements.

Based on the foregoing accounting authority, our consolidated financial statements present the debentures issued to the Trust as long-term debt. Our investment in the Trust is accounted as a cost investment and is included in other assets. For financial reporting purposes, we record interest expense on the corresponding debentures in our consolidated statements of operations.

City of Sheboygan Bonds The City of Sheboygan (the City) bonds represent the face amount of bond anticipation notes (BANs) issued by the City in November 2003 in conjunction with the construction of the Blue Harbor Resort in Sheboygan, Wisconsin. In accordance with the provisions of EITF Issue No. 91-10, we have recognized as a liability the obligations for the BANs. The notes bear interest at an annual rate of 3.95% and mature in 2008. The notes are not a general obligation of the City and are payable from (a) the proceeds of bond anticipation notes or other funds appropriated by the City for the payment of interest on the BANs and (b) the proceeds to be delivered from the issuance and sale of securities by the City. We have an obligation to fund payment of these BANs. Our obligation to fund repayment of the notes will be satisfied by certain minimum guaranteed amounts of room tax payments to be made by the Blue Harbor Resort through 2028.

City of Sheboygan Loan The City of Sheboygan loan amount represents a loan made by the City in 2005 in conjunction with the construction of the Blue Harbor Resort in Sheboygan, Wisconsin. The loan is noninterest bearing and

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matures in 2018. Our obligation to repay the loan will be satisfied by certain minimum guaranteed amounts of real and personal property tax payments to be made by the Blue Harbor Resort through 2018.

Future Maturities Future principal requirements on long-term debt are as follows:

| | Through September 30, |
|------------|--------------------------------------|
| 2007 | \$ 2,000 |
| 2008 | 29,445 |
| 2009 | 39,559 |
| 2010 | 1,742 |
| 2011 | 1,872 |
| Thereafter | 130,288 |
| Total | \$ 204,906 |

Short-Term Liquidity Requirements

Our short-term liquidity requirements consist primarily of funds necessary to pay operating expenses, including: recurring maintenance, repairs and other operating expenses necessary to properly maintain and operate our resorts;

property taxes and insurance expenses;

interest expense and scheduled principal payments on outstanding indebtedness;

general and administrative expenses; and

income taxes.

Historically, we have satisfied our short-term liquidity requirements through operating cash flows and cash on hand. We believe that cash provided by our operations, together with cash on hand, will be sufficient to fund our requirements for working capital, capital expenditures and debt service for the next twelve months.

Long-Term Liquidity Requirements

Our long-term liquidity requirements consist primarily of funds necessary to pay for: scheduled debt maturities;

capital contributions and loans to unconsolidated joint ventures;

renovations, expansions and other non-recurring capital expenditures that need to be made periodically to our resorts; and

costs associated with the development of new resorts.

We expect to meet these needs through existing working capital, cash provided by operations and a combination of mortgage financing on properties being developed, proceeds from investing activities (such as the sale of newly-constructed condominiums at our existing resorts or sale of majority ownership interest in certain resorts), additional borrowings under future credit facilities, and the issuance of equity instruments, including common stock, or additional or replacement debt, if market conditions permit. We believe these sources of capital will be sufficient to provide for our long-term capital needs.

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Our largest long-term expenditures are expected to be for capital expenditures for development of future resorts. Our capital expenditures for resorts currently operating and under development were \$77,196 for the nine months ended September 30, 2006. We expect to have approximately \$43,000 of such expenditures in the remainder of 2006 and \$123,000 in 2007. As discussed above, we expect to meet these requirements through a combination of cash provided by operations, cash on hand, proceeds from investing activities and new and/or existing mortgage financing on properties being developed.

Off Balance Sheet Arrangements

We have a joint venture in which we are a limited partner with a 30% ownership interest. We account for this unconsolidated joint venture using the equity method of accounting. At September 30, 2006, the joint venture had aggregate outstanding indebtedness to third parties of approximately \$63,000. This loan is a mortgage loan that is non-recourse to us. This joint venture owns two resorts, Great Wolf Lodge-Wisconsin Dells, Wisconsin and Great Wolf Lodge-Sandusky, Ohio. As capital may be required to fund the activities of these resorts, we may be required to fund in the future the joint venture's share of the costs not funded by the majority owner of the joint venture, the joint venture's operations or outside financing. Based on the nature of the activities conducted in the joint venture, management cannot estimate with any degree of accuracy amounts that we may be required to fund in the long-term. Management does not currently believe that any additional future funding of this joint venture will have an adverse effect on our financial condition, however, as we do not expect to make significant future capital contributions to this joint venture.

Contractual Obligations

The following table summarizes our contractual obligations as of September 30, 2006:

| | Total | Payment Terms | | | |
|-----------------------------|-------------------|-------------------------|------------------|------------------|--------------------------|
| | | Less Than 1 Year | 1-3 Years | 3-5 Years | More Than 5 Years |
| Debt Obligations(1) | \$ 204,906 | \$ 2,000 | \$ 69,004 | \$ 3,614 | \$ 130,288 |
| Operating Lease Obligations | 1,274 | 426 | 818 | 30 | |
| Construction Contracts | 65,995 | 52,950 | 13,045 | | |
| Total | \$ 272,175 | \$ 55,376 | \$ 82,867 | \$ 3,644 | \$ 130,288 |

(1) Includes \$8,346 of fixed rate debt recognized as a liability related to certain bonds issued by the City of Sheboygan and \$3,903 of fixed rate debt recognized as a liability related to a loan from the City of Sheboygan. These liabilities

will be satisfied
by certain future
minimum
guaranteed
amounts of real
and personal
property tax
payments and
room tax
payments to be
made by our
Sheboygan
resort.

As we develop future resorts, we expect to incur significant additional debt and construction contract obligations.

Working Capital

We had \$48,960 of available cash and cash equivalents and working capital of \$21,646 (current assets less current liabilities) at September 30, 2006, compared to the \$54,782 of available cash and cash equivalents and \$33,433 of working capital at December 31, 2005.

Cash Flows

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| | 2006 | 2005 | Increase (Decrease) |
|---|-------------|-------------|--------------------------------|
| Net cash provided by operating activities | \$ 16,070 | \$ 8,799 | \$ 7,271 |
| Net cash used in investing activities | (57,310) | (95,963) | 38,653 |
| Net cash provided by financing activities | 35,418 | 24,402 | 11,016 |

Operating Activities. The increase in net cash provided by operating activities resulted primarily from the difference in our non-cash employee compensation expense of \$2,392 for the nine months ended September 30, 2006, as compared to non-cash employee compensation revenue of \$1,553 for the nine months ended September 30, 2005, and in the change in accounts receivable and other assets.

Investing Activities. The decrease in net cash used in investing activities for the nine months ended September 30, 2006, as compared to the nine months ended September 30, 2005, resulted primarily from a cash distribution of approximately \$18,600 from the CNL joint venture representing our share of proceeds from a mortgage loan placed on the joint venture resorts and a decrease in capital expenditures.

Financing Activities. The increase in net cash provided by financing activities resulted primarily from an increase in loan proceeds net of principal payments in the nine months ended September 30, 2006 versus the nine months ended September 30, 2005.

Inflation

Our resort properties are able to change room and amenity rates on a daily basis, so the impact of higher inflation can often be passed along to customers. However, a weak economic environment that decreases overall demand for our products and services could restrict our ability to raise room and amenity rates to offset rising costs.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our future income, cash flows and fair values relevant to financial instruments are dependent upon prevailing market interest rates. Market risk refers to the risk of loss from adverse changes in market prices and interest rates. In the future, we may use derivative financial instruments to manage or hedge interest rate risks related to our borrowings. We do not intend to use derivatives for trading or speculative purposes and anticipate entering into derivative contracts only with major financial institutions with investment grade credit ratings.

Our earnings are also affected by the changes in our interest rates due to the impact those changes have on our interest income from cash and short-term investments, and our interest expense from variable-rate debt instruments. As of September 30, 2006, we had total indebtedness of approximately \$204,906. This debt consisted of:

\$73,106 of fixed rate debt secured by two of our resorts. This debt bears interest at 6.96%.

\$28,541 of variable rate debt secured by one of our resorts. This debt bears interest at a floating rate equal to prime plus 200 basis points. The total rate was 10.25% at September 30, 2006.

\$51,550 of subordinated debentures that bear interest at a fixed rate of 7.80% through March 2015 and then at a floating rate of LIBOR plus 310 basis points thereafter. The securities mature in March 2035.

\$37,937 of variable rate debt secured by one of our resorts. This debt bears interest at a floating rate of 30 day LIBOR plus a spread of 265 basis points. The total rate was 7.97% at September 30, 2006.

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\$8,346 of fixed rate debt (effective interest rate of 10.67%) recognized as a liability related to certain bonds issued by the City of Sheboygan and \$3,903 of noninterest bearing debt recognized as a liability related to a loan from the City of Sheboygan. These liabilities will be satisfied by certain future minimum guaranteed amounts of real and personal property tax payments and room tax payments to be made by the Sheboygan resort; and

\$1,523 of other fixed rate debt.

As of September 30, 2006, we estimate the total fair value of the indebtedness described above to be \$14,568 less than their total carrying values, due to the terms of the existing debt being different than those terms we believe would currently be available to us for indebtedness with similar risks and remaining maturities.

If the prime rate and/or LIBOR were to increase by 1% or 100 basis points, the increase in interest expense on our variable rate debt would decrease future earnings and cash flows by approximately \$667 annually. If the prime rate were to decrease by 1% or 100 basis points, the decrease in interest expense on our variable rate debt would be approximately \$667 annually.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures designed to provide reasonable assurance that information in our reports under the Securities Exchange Act of 1934, as amended (the Exchange Act) is recorded, processed, summarized and reported within the time periods specified pursuant to the SEC's rules and forms. Disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, include controls and procedures designed to ensure that information required to be disclosed by us in the reports we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system are met.

We carried out an evaluation, under the supervision and with the participation of our management including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the third quarter of 2006. In making this evaluation, we considered matters discussed below relating to internal control over financial reporting. After consideration of the matters discussed below, we have concluded that our disclosure controls and procedures were not effective as of September 30, 2006, because of the material weakness related to controls around the determination and reporting of the provision for income taxes, as described below. As reported in our Annual Report on Form 10-K for the fiscal year ended December 31, 2005, we identified a material weakness in our internal control over financial reporting related to the collection of sufficient and reliable data necessary to determine the deferred tax accounts and income tax provision in circumstances where we have entered into significant non-routine business transactions. As of September 30, 2006, we have not fully remediated this material weakness. As we may be unable to confirm fully whether we have remediated this material weakness until preparation of our 2006 annual tax provision, we anticipate that this material weakness may continue to exist through the end of 2006 or later.

Remediation of Material Weaknesses

As discussed in Item 9A of our Form 10-K for the year ended December 31, 2005, there was a material weakness in our internal control over financial reporting related to the collection of sufficient and reliable data necessary to determine the deferred tax accounts and income tax provision in circumstances where we have entered into significant non-routine business transactions. Through the date of this filing, we have taken steps to improve our internal controls

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around our tax accounting and tax accounts reconciliation processes, procedures and controls, including reconciling all current and deferred tax asset and liability accounts quarterly and planning to reconcile the associated temporary differences to underlying support at least annually. We believe we have taken appropriate steps necessary to begin to remediate this material weakness relating to our tax accounting and tax reconciliation processes, procedures and controls. Certain of the corrective processes, procedures and controls, however, relate to annual controls that cannot be tested until the preparation of our 2006 annual tax provision. Accordingly, we will continue to monitor the effectiveness of these processes, procedures and controls and will make any further changes we deem appropriate.

Changes In Internal Control

During the period covered by this quarterly report on Form 10-Q, other than as noted above in this item 4, there have been no changes to our internal control over financial reporting that are reasonably likely to materially affect our internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are involved in litigation from time to time in the ordinary course of our business. We do not believe that the outcome of any such pending or threatened litigation will have a material adverse effect on our financial condition or results of operations. However, as is inherent in legal proceedings where issues may be decided by finders of fact, there is a risk that unpredictable decisions adverse to the Company could be reached.

ITEM 1A. RISK FACTORS

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2005, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing us. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

The exhibits listed below are incorporated herein by reference to prior SEC filings by the Registrant or are included as exhibits in this Form 10-Q.

Exhibit

Number

Description

- | | |
|-----|--|
| 2.1 | Form of Merger Agreement (Delaware) (incorporated herein by reference to Exhibit 2.1 to the Company's Registration Statement on Form S-1 filed August 12, 2004) |
| 2.2 | Form of Merger Agreement (Wisconsin) (incorporated herein by reference to Exhibit 2.2 to the Company's Registration Statement on Form S-1 filed August 12, 2004) |

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| Exhibit Number | Description |
|---------------------------|--|
| 3.1 | Form of Amended and Restated Certificate of Incorporation for Great Wolf Resorts, Inc. dated December 9, 2004 (incorporated herein by reference to Exhibit 3.1 to the Company's Registration Statement on Form S-1 filed August 12, 2004) |
| 3.2 | Form of Amended and Restated Bylaws of Great Wolf Resorts, Inc. effective September 12, 2006 (incorporated herein by reference to Exhibit 4.1 to the Company's Current Report on Form 9-K filed September 18, 2006) |
| 4.1 | Form of the Common Stock Certificate of Great Wolf Resorts, Inc. (incorporated herein by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-1 filed October 21, 2004) |
| 4.2 | Junior Subordinated Indenture, dated as of March 15, 2005, between Great Wolf Resorts, Inc. and JP Morgan Chase Bank, National Association, as trustee (incorporated herein by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed March 18, 2005) |
| 4.3 | Amended and Restated Trust Agreement, dated as of March 15, 2005, by and among Chase Manhattan Bank USA, National Association, as Delaware trustee; JP Morgan Chase Bank, National Association, as property trustee; Great Wolf Resorts, Inc., as depositor; and James A. Calder, Alex P. Lombardo and J. Michael Schroeder, as administrative trustees (incorporated herein by reference to Exhibit 4.2 to the Company's Current Report on Form 8-K filed March 18, 2005) |
| 10.1 | Loan Agreement, dated July 28, 2006, between Great Wolf Lodge of Grapevine, LLC, as borrower and Merrill Lynch Capital and HSH Nordbank, as lender (incorporate by reference to Exhibit 99.1 to the Company's Current Report on Form 9-K filed July 31, 2006) |
| 31.1* | Certification of Chief Executive Officer of Periodic Report Pursuant to Rule 13a-14(a) and Rule 15d-14(a) |
| 31.2* | Certification of Chief Financial Officer of Periodic Report Pursuant to Rule 13a-14(a) and Rule 15d-14(a) |
| 32.1* | Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350 |
| 32.2* | Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350 |

* Filed herewith.

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

GREAT WOLF RESORTS, INC.

/s/ James A. Calder

James A. Calder

Chief Financial Officer

(Duly authorized officer)

(Principal Financial and Accounting Officer)

Dated: November 6, 2006