

CAVCO INDUSTRIES INC  
Form 10-Q  
February 08, 2012  
Table of Contents

**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 December 31, 2011

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 000-08822

**Cavco Industries, Inc.**

(Exact name of registrant as specified in its charter)

Edgar Filing: CAVCO INDUSTRIES INC - Form 10-Q

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

**56-2405642**  
(IRS Employer  
Identification No.)

**1001 North Central Avenue, Suite 800,**  
**Phoenix, Arizona**  
(Address of principal executive offices)

**85004**  
(Zip Code)

**(602) 256-6263**  
(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last year)

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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a small reporting company. See the definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one).

Large accelerated filer  Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

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

As of February 6, 2012, there were 6,890,796 shares of the registrant's common stock, \$.01 par value, issued and outstanding.

**Table of Contents**

**CAVCO INDUSTRIES, INC.**

**FORM 10-Q**

**December 31, 2011**

**Table of Contents**

	<b>Page</b>
<b><u>PART I. FINANCIAL INFORMATION</u></b>	
<b><u>Item 1. Financial Statements</u></b>	1
<u>Consolidated Balance Sheets as of December 31, 2011 (unaudited) and March 31, 2011</u>	1
<u>Consolidated Statements of Operations (unaudited) for the three and nine months ended December 31, 2011 and 2010</u>	2
<u>Consolidated Statements of Cash Flows (unaudited) for the nine months ended December 31, 2011 and 2010</u>	3
<u>Notes to Consolidated Financial Statements</u>	4 34
<b><u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b>	35 44
<b><u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u></b>	44 45
<b><u>Item 4. Controls and Procedures</u></b>	45
<b><u>PART II. OTHER INFORMATION</u></b>	
<b><u>Item 1. Legal Proceedings</u></b>	46
<b><u>Item 1A. Risk Factors</u></b>	46
<b><u>Item 6. Exhibits</u></b>	46
<b><u>SIGNATURES</u></b>	47
<b><u>EXHIBIT INDEX</u></b>	48

**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****CAVCO INDUSTRIES, INC.****CONSOLIDATED BALANCE SHEETS**

(Dollars in thousands)

	September 30, December 31, 2011 (Unaudited)	September 30, March 31, 2011
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 35,397	\$ 76,513
Restricted cash, current	6,271	436
Accounts receivable, net	12,928	6,571
Short term investments	5,121	
Current portion of consumer loans receivable, net	21,619	
Inventories	62,334	16,036
Assets held for sale	5,285	
Prepaid expenses and other current assets	7,919	2,495
Debtor-in-possession note receivable		40,060
Deferred income taxes	5,860	4,720
<b>Total current assets</b>	<b>162,734</b>	<b>146,831</b>
Restricted cash	452	
Investments	9,626	
Consumer loans receivable, net	101,578	
Inventory finance receivable, net	21,328	17,759
Property, plant and equipment, net	50,698	35,993
Goodwill and other intangibles, net	81,587	68,859
<b>Total assets</b>	<b>\$ 428,003</b>	<b>\$ 269,442</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities		
Accounts payable	\$ 8,421	\$ 3,495
Accrued liabilities	54,864	26,245
Construction lending lines	5,599	
Current portion of securitized financings	10,797	
Noncontrolling interest note payable		36,000
<b>Total current liabilities</b>	<b>79,681</b>	<b>65,740</b>
Securitized financings	83,376	
Deferred income taxes	13,327	17,214
Redeemable noncontrolling interest	85,228	35,819
Stockholders equity		
Preferred stock, \$.01 par value; 1,000,000 shares authorized; No shares issued or outstanding		

## Edgar Filing: CAVCO INDUSTRIES INC - Form 10-Q

Common stock, \$.01 par value; 20,000,000 shares authorized; Outstanding 6,890,796 and 6,817,606 shares, respectively	69	68
Additional paid-in capital	131,368	129,211
Retained earnings	34,974	21,390
Accumulated other comprehensive loss	(20)	
Total stockholders' equity	166,391	150,669
Total liabilities, redeemable noncontrolling interest and stockholders' equity	\$ 428,003	\$ 269,442

See accompanying Notes to Consolidated Financial Statements

**Table of Contents****CAVCO INDUSTRIES, INC.****CONSOLIDATED STATEMENTS OF OPERATIONS**

(Dollars in thousands, except per share amounts)

(Unaudited)

	September 30, Three Months Ended December 31,		September 30, Nine Months Ended December 31,	
	2011	2010	2011	2010
Net sales	\$ 114,564	\$ 39,612	\$ 343,553	\$ 133,005
Cost of sales	87,642	34,269	272,243	114,042
Gross profit	26,922	5,343	71,310	18,963
Selling, general and administrative expenses	20,535	5,275	59,113	16,000
Income from operations	6,387	68	12,197	2,963
Interest expense	(2,043)		(5,420)	
Other income	440	511	1,055	957
Gain on bargain purchase			22,009	
Income before income taxes	4,784	579	29,841	3,920
Income tax expense	(1,804)	(289)	(3,001)	(1,581)
Net income	2,980	290	26,840	2,339
Less: net income attributable to redeemable noncontrolling interest	1,303	266	13,256	1,117
Net income attributable to Cavco common stockholders	\$ 1,677	\$ 24	\$ 13,584	\$ 1,222
Net income per share attributable to Cavco common stockholders:				
Basic	\$ 0.24	\$ 0.00	\$ 1.98	\$ 0.19
Diluted	\$ 0.24	\$ 0.00	\$ 1.96	\$ 0.18
Weighted average shares outstanding:				
Basic	6,890,517	6,651,928	6,873,078	6,578,732
Diluted	6,951,958	6,841,802	6,936,054	6,860,385

See accompanying Notes to Consolidated Financial Statements

**Table of Contents****CAVCO INDUSTRIES, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Dollars in thousands)

(Unaudited)

	September 30, Nine Months Ended December 31, 2011	September 30, Nine Months Ended December 31, 2010
<b>OPERATING ACTIVITIES</b>		
Net income	\$ 26,840	\$ 2,339
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	4,233	1,024
Provision for credit losses	369	173
Deferred income taxes	268	(265)
Share-based compensation expense	695	509
Non-cash interest income	(1,373)	(214)
Non-cash interest expense	517	30
Gain on sale of property, plant and equipment including assets held for sale	(63)	(10)
Impairment of property, plant and equipment		248
Gain on bargain purchase	(22,009)	
Gain on sale of loans	(4,285)	
Loss on sale of investments	14	
Changes in operating assets and liabilities:		
Restricted cash	(363)	14
Accounts receivable	(3,235)	4,971
Consumer loans originated	(57,356)	
Principal payments on consumer loans receivable	7,442	
Proceeds from sales of consumer loans	57,979	
Inventories	931	(1,053)
Prepaid expenses and other current assets	(2,643)	(326)
Inventory finance receivable	(3,602)	(5,657)
Accounts payable and accrued liabilities	4,298	(4,034)
Net cash provided by (used in) operating activities	8,657	(2,251)
<b>INVESTING ACTIVITIES</b>		
Purchases of property, plant and equipment	(2,273)	(680)
Proceeds from sale of property, plant and equipment including assets held for sale	3,739	16
Purchase of Palm Harbor assets and certain liabilities, net of cash acquired	(67,639)	
Purchases of investments	(2,995)	
Proceeds from sale of investments	4,830	
Investment in debtor-in-possession note receivable	(6,238)	(38,302)
Proceeds from payoff of debtor-in-possession note receivable	45,301	
Net cash used in investing activities	(25,275)	(38,966)
<b>FINANCING ACTIVITIES</b>		
Proceeds from exercise of stock options	1,463	1,391
Net proceeds from construction lending line	1,625	

Edgar Filing: CAVCO INDUSTRIES INC - Form 10-Q

Proceeds from issuance of note payable			14,000
Payments on Virgo debt	(19,456)		
Payments on securitized financings	(8,130)		
Net cash (used in) provided by financing activities	(24,498)		15,391
Net decrease in cash and cash equivalents	(41,116)		(25,826)
Cash and cash equivalents at beginning of period	76,513		74,988
Cash and cash equivalents at end of period	\$ 35,397	\$ 49,162	
Supplemental disclosures of cash flow information:			
Cash paid during the period for income taxes	\$ 3,113	\$ 1,445	
Cash paid during the period for interest	\$ 5,138	\$	

See accompanying Notes to Consolidated Financial Statements



**Table of Contents**

**CAVCO INDUSTRIES, INC.**

**Notes to Consolidated Financial Statements**

**December 31, 2011**

(Unaudited)

**1. Basis of Presentation**

The accompanying unaudited Consolidated Financial Statements of Cavco Industries, Inc., and its subsidiaries (collectively, the Company or Cavco), have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) for Quarterly Reports on Form 10-Q and Article 10 of SEC Regulation S-X. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles (GAAP) in the United States of America have been condensed or omitted pursuant to such rules and regulations.

In the opinion of management, these statements include all of the normal recurring adjustments necessary to fairly state the Company's Consolidated Financial Statements. The Consolidated Statements of Operations and Consolidated Statements of Cash Flows for the interim periods are not necessarily indicative of the results or cash flows for the full year. Certain prior period amounts have been reclassified to conform to current period classification. The Company has evaluated subsequent events after the balance sheet date of December 31, 2011 through the date of the filing of this report with the SEC and other than entering into an agreement to sell an idled facility in Phoenix, Arizona as discussed below; there were no disclosable subsequent events. The Company suggests that these Consolidated Financial Statements be read in conjunction with the audited Consolidated Financial Statements and the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K filed with the SEC on June 3, 2011 (the Form 10-K).

During fiscal year 2010, the Company and an investment partner, Third Avenue Value Fund (Third Avenue), formed Fleetwood Homes, Inc. (Fleetwood Homes), with a contribution of \$35.0 million each for equal fifty-percent ownership interests. On August 17, 2009 (the Fleetwood Acquisition Date), Fleetwood Homes (i) acquired seven operating manufactured housing plants, two idle factories, all related equipment, accounts receivable, inventory, certain trademarks and trade names, intellectual property, and specified contracts and leases; and (ii) assumed express warranty liabilities pertaining to certain of the previous operations of a predecessor company.

The results of the Fleetwood Homes operations have been included in the Consolidated Financial Statements and the related Notes in accordance with the provisions of Financial Accounting Standards Board Accounting Standards Codification (FASB ASC) 810, *Consolidation* (ASC 810). Management has determined that, under GAAP, although Fleetwood Homes is only fifty-percent owned by the Company, Cavco has a controlling interest and is required to fully consolidate the results of Fleetwood Homes. The primary factors that contributed to this determination were Cavco's board and management control of Fleetwood Homes. To that end, members of Cavco's management hold all of the seats on the board of directors of Fleetwood Homes. In addition, as part of a management services agreement among Cavco, Fleetwood Homes and Third Avenue, Cavco provides all executive-level management services to Fleetwood Homes including, among other things, general management oversight, marketing and customer relations, accounting and cash management. Third Avenue's financial interest in Fleetwood Homes is considered a redeemable noncontrolling interest, and is designated as such in the Consolidated Financial Statements (see Note 22).

During fiscal year 2011, Fleetwood Homes, through its wholly-owned subsidiary, Palm Harbor Homes, Inc., a Delaware corporation (Palm Harbor or Palm Harbor Delaware), entered into an agreement (the Purchase Agreement) with Palm Harbor Homes, Inc., a Florida corporation, and certain of its subsidiaries (collectively Palm Harbor Florida) to purchase substantially all of the assets and assume specified liabilities of Palm Harbor Florida, pursuant to an auction process under Section 363 of the U.S. Bankruptcy Code. The effective date of the transaction was April 23, 2011 (the Acquisition Date), except for Palm Harbor's acquisition of the stock of Standard Casualty Co. The aggregate gross purchase price was \$83.9 million and is exclusive of transaction costs, specified liabilities assumed and post-closing adjustments (these adjustments have been recorded). Approximately \$45.3 million of the purchase price was used to retire the Debtor-In-Possession (DIP) loan previously made by Fleetwood Homes to Palm Harbor Florida. The purchase price was funded by Fleetwood Homes' cash on hand, along with equal contributions of \$36.0 million each from the Company and Third Avenue. On June 7, 2011, regulatory approval of the acquisition of Standard Casualty Co. was received from the Texas Department of Insurance and on June 10, 2011 (the SCC Acquisition Date), Palm Harbor Delaware completed the purchase of the insurance subsidiary.

**Table of Contents**

Palm Harbor Delaware acquired five operating manufactured housing production facilities, idled factories in nine locations, 49 operating retail locations, one office building, real estate, all related equipment, accounts receivable, customer deposits, inventory, certain trademarks and trade names, intellectual property, and specified contracts and leases. In addition, as of the Acquisition Date, Palm Harbor Delaware purchased all of the outstanding shares of CountryPlace Acceptance Corp., CountryPlace Mortgage, Ltd. and their wholly-owned finance subsidiaries (collectively, CountryPlace ). Palm Harbor Delaware also acquired all of the outstanding shares of Standard Casualty Co., Standard Insurance Agency, Inc. and Palm Harbor Insurance Agency of Texas, Inc. (collectively, Standard ). Further, Palm Harbor Delaware assumed certain liabilities of Palm Harbor Florida, including primarily debt facilities of the finance subsidiaries (see Note 21). The results of the Palm Harbor operations since the Acquisition Date and SCC Acquisition Date have been included in the Consolidated Financial Statements and the related Notes in accordance with the provisions of ASC 810.

During the quarter ended December 31, 2011, the Company sold two idled production facilities. The Buda, Texas facility sold for \$1.3 million, and the Casa Grande, Arizona facility sold for \$1.3 million, resulting in insignificant effects on the Consolidated Statements of Operations. As of December 31, 2011, \$1.4 million was reclassified from property, plant and equipment to assets held for sale related to the anticipated sale of an idled manufacturing facility located in Phoenix, Arizona. As of the date of filing, the Company has entered into an agreement, but the sale is not final.

Standard is domiciled in Texas and is primarily a specialty writer of manufactured home physical damage insurance. Standard holds insurance licenses in multiple states; however, a significant portion of its writings occurs in Texas. In addition to writing direct policies, Standard assumes and cedes reinsurance in the ordinary course of business (see Note 12).

CountryPlace originates single-family residential mortgages and services, for itself and others, conforming mortgages, non-conforming land-home mortgages and manufactured homes chattel loans. CountryPlace is authorized by the U.S. Department of Housing and Urban Development ( HUD ) to directly endorse Federal Housing Administration ( FHA ) Title I and Title II mortgage insurance, is approved by the Government National Mortgage Association ( GNMA or Ginnie Mae ) to issue GNMA-insured mortgage-backed securities, and is authorized to sell mortgages to, and service mortgages for, the Federal National Mortgage Association ( FNMA or Fannie Mae ). A conforming mortgage or loan is one that conforms to the guidelines of a government-sponsored enterprise, such as Fannie Mae, or a government agency, such as FHA; a non-conforming mortgage or loan does not conform to these guidelines (see Note 5).

*Revenue Recognition.* Revenue from homes sold to independent retailers is generally recognized when the home is shipped, at which time title passes to the independent retailer, and collectability is reasonably assured. Homes sold to independent retailers are generally either paid for prior to shipment or floorplan financed by the independent retailer through standard industry arrangements, which include repurchase agreements. Manufacturing sales financed under repurchase agreements are reduced by a provision for estimated repurchase obligations (see Note 14). The recognition of revenue from homes sold under inventory finance programs involving funds provided by the Company is deferred until such time that payment for the related inventory finance note receivable is received by the Company (see Note 6). Retail sales by Company-owned retail locations are recognized when the customer has entered into a legally binding sales contract, the home is delivered and permanently located at the customer's site, accepted by the customer, title has transferred and funding is reasonably assured.

At the Acquisition Date, management evaluated consumer loans receivable held for investment by CountryPlace to determine whether there was evidence of deterioration of credit quality and if it was probable that CountryPlace would be unable to collect all amounts due according to the loans' contractual terms. The Company also considered expected prepayments and estimated the amount and timing of undiscounted expected principal, interest and other cash flows. The Company determined the excess of the loan pool's scheduled contractual principal and contractual interest payments over the undiscounted cash flows expected as of the Acquisition Date as an amount that is not accreted into interest income (the non-accretable difference). The remaining difference is accreted into interest income over the remaining life of the loans (referred to as accretable yield). Interest income on consumer loans receivable is recognized as net sales.

---

**Table of Contents**

For loans originated by CountryPlace and held for sale, loan origination fees and gains or losses on sales are recognized upon sale of the loans as net sales.

Premium income from insurance policies issued and assumed by Standard is recognized over the contractual term. Premium amounts collected are amortized on a straight-line basis into net sales over the life of the policy. Premiums earned are net of reinsurance ceded. Policy acquisition costs are also amortized as cost of sales over the life of the policy.

*Consumer Loans Receivable.* Consumer loans receivable consists of manufactured housing loans originated by CountryPlace (securitized, held for investment, or held for sale) and construction advances on mortgages. CountryPlace was acquired on April 23, 2011 in conjunction with the Palm Harbor transaction. The fair value of consumer loans receivable was calculated as of the Acquisition Date, as determined by the present value of expected future cash flows, with no allowance for loan loss recorded.

Loans held for investment consist of loan contracts collateralized by the borrowers' homes and, in some instances, related land. Construction loans in progress are stated at the aggregate amount of cumulative funded advances. Loans held for sale consist of loan contracts collateralized by single-family residential mortgages. Loans held for sale are stated at the lower of cost or market on an aggregate basis. Loans held for sale are loans that, at the time of origination, are originated with the intent to resell in the mortgage market to investors, such as Fannie Mae, with which the Company has pre-existing purchase agreements, or to sell as part of a Ginnie Mae insured pool of loans. Certain direct loan origination costs for loans held for sale are expensed as incurred.

Prior to being acquired by the Company, on July 12, 2005 and March 22, 2007, CountryPlace completed two securitizations of factory-built housing loan receivables. These two securitizations were accounted for as financings, which use the portfolio method of accounting in accordance with ASC 310, *Receivables - Nonrefundable Fees and Other* (ASC 310). The securitizations included provisions for removal of accounts, retention of certain credit loss risk by CountryPlace and other factors that preclude sale accounting of the securitizations under ASC 860, *Transfers and Servicing*. Both securitizations were accounted for as securitized borrowings; therefore, the related consumer loans receivable and securitized financings were included in CountryPlace's financial statements. The Company acquired these balances during the first quarter of fiscal 2012 as a part of the Palm Harbor transaction. Since the Acquisition Date, the acquired consumer loans receivable and securitized financings are accounted for in a manner similar to ASC 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality* (ASC 310-30).

*Allowance for Loan Losses.* The primary portion of the allowance for loan losses reflects the Company's judgment of the probable loss exposure on our inventory finance receivable as of the end of the reporting period. The allowance for loan loss is developed at a portfolio level. A range of probable losses is calculated and the Company makes a determination of the best estimate within the range of loan losses. The Company has historically been able to resell repossessed homes, thereby mitigating loss experience. If a default occurs and collateral is lost, the Company is exposed to loss of the full value of the home loan. If the Company determines that it is probable that a borrower will default, a specific reserve is determined and recorded within the estimated allowance for loan loss. The Company recorded an allowance for loan loss of \$202,000 and \$169,000 at December 31, 2011 and March 31, 2011, respectively (see Note 6).

Another portion of the allowance for loan losses relates to consumer loans receivable originated by CountryPlace after the Acquisition Date. This allowance for loan losses reflects CountryPlace's judgment of the probable loss exposure on its loans originated since the Acquisition Date in the held for investment portfolio as of the end of the reporting period.

CountryPlace accounts for the loans that were in existence at the Acquisition Date in a manner similar to ASC 310-30. Management evaluated such loans as of the Acquisition Date to determine whether there was evidence of deterioration of credit quality and if it was probable that CountryPlace would be unable to collect all amounts due according to the loans' contractual terms.

Over the life of the loans, CountryPlace continues to estimate cash flows expected to be collected. CountryPlace evaluates at the balance sheet date whether the present value of its expected cash flows, determined using the effective interest rate, has decreased and, if so, recognizes an allowance for loan loss.

---

**Table of Contents**

subsequent to the Acquisition Date. The present value of any subsequent increase in the loan pool's actual cash flows expected to be collected is used first to reverse any existing allowance for loan loss. Any remaining increase in cash flows expected to be collected adjusts the amount of accretable yield recognized on a prospective basis over the loan pool's remaining life (see Note 5).

CountryPlace has modified payment amounts and/or interest rates for borrowers that, in management's judgment, exhibited the willingness and ability to continue to pay and met certain other conditions. CountryPlace considers a modified loan a troubled debt restructuring when two conditions are met: (i) the borrower is experiencing financial difficulty, and (ii) concessions are made by CountryPlace that it would not otherwise consider for a borrower with similar risk characteristics. CountryPlace no longer considers modified loans to be troubled debt restructurings once the modified loan is seasoned for six months, is not delinquent under the modified terms and is at a market rate of interest at the modification date.

*Investments.* Management determines the appropriate classification of its investment securities at the time of purchase. The Company's investments include marketable debt and equity securities that are held as available-for-sale. All investments classified as available-for-sale are recorded at fair value with any unrealized gains and losses reported in accumulated other comprehensive income (loss), net of tax if applicable. Realized gains and losses from the sale of securities are determined using the specific identification method.

Management regularly makes an assessment to determine whether a decline in value of an individual security is other-than-temporary. The Company considers the following factors when making its assessment: (i) the Company's ability and intent to hold the investment to maturity, or a period of time sufficient to allow for a recovery in market value; (ii) whether it is probable that the Company will be able to collect the amounts contractually due; and (iii) whether any decision has been made to dispose of the investment prior to the balance sheet date. Investments on which there is an unrealized loss that is deemed to be other-than-temporary are written down to fair value with the loss recorded in earnings.

*Goodwill and Other Intangibles.* The Company accounts for goodwill and other intangible assets in accordance with the provisions of FASB ASC 350, *Intangibles - Goodwill and Other* (ASC 350). As such, the Company tests goodwill annually for impairment by reporting unit and records an impairment charge if the implied fair value of a reporting unit, including goodwill, is less than its carrying value. As of December 31, 2011, all of the Company's goodwill of \$67.3 million is attributable to its manufacturing reporting unit. Certain intangibles are considered indefinite-lived and others are finite-lived and are amortized over their useful lives. Intangible assets are tested annually for impairment.

*Reserve for Property-Liability Insurance Claims and Claims Expense.* Standard establishes reserves for claims and claims expense (loss) on reported and unreported claims of insured losses. Standard's reserving process takes into account known facts and interpretations of circumstances and factors, including Standard's experience with similar cases, actual claims paid, historical trends involving claim payment patterns and pending levels of unpaid claims, loss management programs, product mix, contractual terms, changes in law and regulation, judicial decisions, and economic conditions. In the normal course of business, Standard may also supplement its claims processes by utilizing third party adjusters, appraisers, engineers, inspectors, and other professionals and information sources to assess and settle catastrophe and non-catastrophe related claims. The effects of inflation are implicitly considered in the reserving process. The applicable reserve balance was \$562,000 as of December 31, 2011.

*Incurred But Not Reported Liabilities.* Because reserves are estimates of unpaid portions of losses that have occurred, including incurred but not reported (IBNR) losses, the establishment of appropriate reserves, including reserves for catastrophes, is an inherently uncertain and complex process. The ultimate cost of losses may vary from recorded amounts, which are based on management's best estimates. The highest degree of uncertainty is associated with reserves for losses incurred in the current reporting period as it contains the greatest proportion of losses that have not been reported or settled. Standard regularly updates its reserve estimates as new information becomes available and as events unfold that may affect the resolution of unsettled claims. Changes in prior period reserve estimates are recorded in the period such changes are determined. The applicable reserve balance was \$140,000 as of December 31, 2011.

---

**Table of Contents**

*Other Income.* Other income totaled \$440,000 and \$511,000 for the three months ended December 31, 2011 and 2010, respectively. For the nine months ended December 31, 2011 and 2010, other income totaled \$1,055,000 and \$957,000, respectively. In fiscal 2012, other income consists of interest related to Debtor-in-Possession note receivable and inventory finance receivable balances, and of interest income earned on cash balances.

*Accumulated other comprehensive income (loss).* Accumulated other comprehensive income (loss) is comprised of unrealized gains and losses on available-for-sale investments.

*Recent Accounting Pronouncements.* In July 2010, the FASB issued Accounting Standards Update ( ASU ) 2010-20, *Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*, which requires entities to provide new disclosures in their financial statements about their financing receivables, including credit risk exposures and the allowance for credit losses on a disaggregated basis. In April 2011, the FASB issued ASU 2011-02, *A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring*. ASU 2011-02 clarifies when creditors should classify loan modifications as troubled debt restructurings. In addition, ASU 2011-02 deferred the effective date of the disclosures about troubled debt restructurings in ASU 2010-20 to periods beginning after June 15, 2011. As of December 31, 2011, the Company has adopted all of the aforementioned provisions of ASU 2010-20 and ASU 2011-02.

In December 2010, the FASB issued ASU 2010-29, *Business Combinations (Topic 805): Disclosure of Supplementary Pro Forma Information for Business Combinations*. The amendments in this update are effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. The amendments affected the Company's disclosures of pro forma information surrounding the Palm Harbor acquisition (see Note 21).

In May 2011, the FASB issued ASU 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS*. The amendments are effective for public companies for interim and annual periods beginning after December 15, 2011. This update changes the wording used to describe many of the requirements for measuring fair value and for disclosing information about fair value measurements. The amendments in this update result in common fair value measurement and disclosure requirements in GAAP and International Financial Reporting Standards ( IFRS ). The Company is currently evaluating the effect ASU 2011-04 will have on the Company's disclosures in the Notes to Consolidated Financial Statements.

In June 2011, the FASB issued ASU 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income*. The amendments in this update are effective for public companies for fiscal years, and interim periods within those years, beginning after December 15, 2011. In this update, an entity has the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. This update eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. The Company is currently evaluating the effect ASU 2011-05 will have on the Company's Consolidated Financial Statements and disclosures.

In September 2011, the FASB issued ASU 2011-08, *Intangibles - Goodwill and Other (Topic 350): Testing Goodwill for Impairment*. The amendments in this update are effective for public companies for fiscal years beginning after December 15, 2011. In this update, an entity has the option to first assess qualitative factors to determine that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, an entity determines it is more likely than not that the fair value of a reporting unit is less than its carrying amount, then it is required to perform the first step of the two-step impairment test. However, if an entity concludes otherwise, then performing the two-step impairment test is unnecessary. Early adoption is permitted. The Company is currently evaluating the effect ASU 2011-08 will have on the Company's Consolidated Financial Statements and disclosures.

**Table of Contents**

For a description of other significant accounting policies used by the Company in the preparation of its Consolidated Financial Statements, please refer to Note 1 of the Notes to Consolidated Financial Statements in the Form 10-K.

**2. Restricted Cash**

Restricted cash consists of the following (in thousands):

	September 30, December 31, 2011	September 30, March 31, 2011
Cash related to CountryPlace customer payments to be remitted to third parties	\$ 2,766	\$
Cash related to CountryPlace customers' principal and interest payments on securitized loans to be remitted to bondholders	2,358	
Cash related to retail homebuyer deposits held in trust	1,147	436
Other restricted cash	452	
	\$ 6,723	\$ 436

**3. Investments**

Available-for-sale securities were acquired during the first quarter of fiscal 2012 as a part of the Palm Harbor acquisition. In accordance with ASC 805, *Business Combinations* (ASC 805), the individual securities were valued at fair value as of the Acquisition Date and, therefore, no individual security has been in a continuous unrealized loss position for longer than 12 months as of December 31, 2011. The following table summarizes the Company's available-for-sale investment securities, gross unrealized gains and losses and fair value, aggregated by investment category (in thousands):

	September 30, Amortized Cost	September 30, December 31, 2011 Gross Unrealized Gains	September 30, December 31, 2011 Gross Unrealized Losses	September 30, Fair Value
U.S. Treasury and Government Agencies	\$ 1,279	\$ 10	\$	\$ 1,289
Mortgage-backed securities	4,583	16	(38)	4,561
States and political subdivisions	1,192	33		1,225
Corporate debt securities	3,938	6	(24)	3,920
Marketable equity securities	3,814	117	(179)	3,752
	\$ 14,806	\$ 182	\$ (241)	\$ 14,747

Based on the Company's ability and intent to hold the investments for a reasonable period of time sufficient for a forecasted recovery of fair value, the Company does not consider any investments to be other-than-temporarily impaired at December 31, 2011.

The Company's investments in marketable equity securities consist of investments in common stock of industrial and other companies (\$2.3 million of the total fair value and \$169,000 of the total unrealized losses) and bank trust, insurance, and public utility companies (\$1.5 million of the total fair value and \$10,000 of the total unrealized losses).

**Table of Contents**

The amortized cost and fair value of the Company's investment securities, by contractual maturity, are shown in the table below (in thousands). Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	September 30, December 31, 2011	September 30, Fair Value
	Amortized Cost	
Due in less than one year	\$ 1,373	\$ 1,369
Due after one year through five years	5,802	5,831
Due after five years through ten years	510	523
Due after ten years	3,307	3,272
Marketable equity securities	3,814	3,752
	\$ 14,806	\$ 14,747

Realized gains and losses from the sale of securities are determined using the specific identification method. Gross gains realized on the sales of investment securities for the three and nine months ended December 31, 2011 were approximately \$31,000 and \$51,000, respectively. Gross losses realized were approximately \$45,000 and \$65,000 for the three and nine months ended December 31, 2011, respectively.

**4. Inventories**

Inventories consist of the following (in thousands):

	September 30, December 31, 2011	September 30, March 31, 2011
Raw materials	\$ 19,160	\$ 10,208
Work in process	5,263	2,499
Finished goods and other	37,911	3,329
	\$ 62,334	\$ 16,036

**5. Consumer Loans Receivable**

The Company acquired consumer loans receivable during the first quarter of fiscal 2012 as part of the Palm Harbor transaction. Acquired consumer loans receivable held for investment were acquired at fair value and subsequently are accounted for in a manner similar to ASC 310-30. Consumer loans receivable held for sale are carried at the lower of cost or market value. The following table summarizes consumer loans receivable (in thousands):

	September 30, December 31, 2011
Loans held for investment (acquired on Acquisition Date)	\$ 113,317
Loans held for investment (originated after Acquisition Date)	215
Loans held for sale	4,693
Loans held construction advances on non-conforming mortgages	5,351

Edgar Filing: CAVCO INDUSTRIES INC - Form 10-Q

Consumer loans receivable	123,576
Deferred financing fees and other, net	(379)
Consumer loans receivable, net	\$ 123,197



**Table of Contents**

As of the Acquisition Date, management evaluated consumer loans receivable held for investment by CountryPlace to determine whether there was evidence of deterioration of credit quality and if it was probable that CountryPlace would be unable to collect all amounts due according to the loan's contractual terms. The Company also considered expected prepayments and estimated the amount and timing of undiscounted expected principal, interest and other cash flows. The Company determined the excess of the loan pool's scheduled contractual principal and contractual interest payments over all cash flows expected as of the Acquisition Date as an amount that cannot be accreted into interest income (the non-accretable difference). The remaining difference is accreted into interest income over the remaining life of the loans (referred to as accretable yield). Interest income on consumer loans receivable is recognized as net sales.

	September 30, December 31, 2011	September 30, Acquisition Date
Consumer loans receivable held for investment contractual amount	\$ 313,493	\$ 339,166
Purchase Discount		
Accretable	(107,376)	(118,335)
Non-accretable	(92,469)	(100,151)
Allowance for loan losses		
Less consumer loans receivable reclassified as other assets	(331)	
<b>Total consumer loans receivable held for investment (acquired on Acquisition Date), net</b>	<b>\$ 113,317</b>	<b>\$ 120,680</b>

Over the life of the loans, the Company continues to estimate cash flows expected to be collected by CountryPlace. At the balance sheet date, the Company evaluates whether the present value of expected cash flows, determined using the effective interest rate, has decreased and, if so, recognizes an allowance for loan loss subsequent to the Acquisition Date. The present value of any subsequent increase in the loan pool's actual cash flows expected to be collected is used first to reverse any existing allowance for loan loss. Any remaining increase in cash flows expected to be collected adjusts the amount of accretable yield recognized on a prospective basis over the loan pool's remaining life.

The changes in accretable yield on acquired consumer loans receivable held for investment were as follows:

	September 30, Three Months Ended December 31, 2011	September 30, Nine Months Ended December 31, 2011
Balance at the beginning of the period	\$ 111,381	\$
Additions		118,335
Accretion	(4,005)	(10,959)
<b>Balance at the end of the period</b>	<b>\$ 107,376</b>	<b>\$ 107,376</b>

CountryPlace's consumer loans receivable consists of fixed-rate, fixed-term, fully-amortizing single-family home loans. These loans are either secured by a manufactured home, excluding the land upon which the home is located (chattel property loans and retail installment sale contracts), or by a combination of the home and the land upon which the home is located (real property mortgage loans). The real property mortgage loans are primarily for manufactured homes. Combined land and home loans are further disaggregated by the type of loan documentation: those conforming to the requirements of Government-Sponsored Enterprises (GSEs), and those that are non-conforming. In most instances, CountryPlace's loans are secured by a first-lien position and are provided for the consumer purchase of a home. In rare instances CountryPlace may provide other types of loans in second-lien or unsecured positions. Accordingly, CountryPlace classifies its loans receivable as follows: chattel loans, conforming mortgages, non-conforming mortgages, and other loans.

**Table of Contents**

In measuring credit quality within each segment and class, CountryPlace uses commercially available credit scores ( FICO ). At the time of each loan s origination, CountryPlace obtained credit scores from each of the three primary credit bureaus, if available. To evaluate credit quality of individual loans, CountryPlace uses the mid-point of the available credit scores, or if only two scores are available, the Company uses the lower of the two. CountryPlace does not update credit bureau scores after the time of origination.

The following table disaggregates CountryPlace s gross consumer loans receivable as of December 31, 2011, for each class by portfolio segment and credit quality indicator (in thousands):

Asset Class Credit Quality Indicator	September 30, Consumer Loans Held for Investment			September 30, Construction Advances	September 30, Consumer Loans Held For Sale	September 30, Total
	September 30, Securitized 2005	September 30, Securitized 2007	September 30, Unsecuritized			
<b>Chattel loans</b>						
0-619	\$ 1,474	\$ 982	\$ 1,013	\$	\$	\$ 3,469
620-719	21,447	14,349	1,295			37,091
720+	24,833	16,772	786			42,391
<b>Subtotal</b>	<b>47,754</b>	<b>32,103</b>	<b>3,094</b>			<b>82,951</b>
<b>Conforming mortgages</b>						
0-619			419	1,146		1,565
620-719			1,124	2,563	2,814	6,501
720+			11	1,642	1,879	3,532
<b>Subtotal</b>			<b>1,554</b>	<b>5,351</b>	<b>4,693</b>	<b>11,598</b>
<b>Non-conforming mortgages</b>						
0-619	97	866	2,881			3,844
620-719	2,140	8,769	5,308			16,217
720+	2,265	5,132	1,550			8,947
<b>Subtotal</b>	<b>4,502</b>	<b>14,767</b>	<b>9,739</b>			<b>29,008</b>
<b>Other loans</b>						
<b>Subtotal</b>			<b>19</b>			<b>19</b>
	\$ 52,256	\$ 46,870	\$ 14,406	\$ 5,351	\$ 4,693	\$ 123,576

**Table of Contents**

Loan contracts secured by collateral that is geographically concentrated could experience higher rates of delinquencies, default and foreclosure losses than loan contracts secured by collateral that is more geographically dispersed. Consumer loans receivable are located in the key states shown below with the corresponding percentage of loans aged 61 days or more:

State	December 31, 2011	September 30,	September 30,	September 30,
		Portfolio concentration	Aging 61 days or more Percent of state's loan balance	Percent of total loan balance
Texas		42.8%	0.96%	0.41%
Florida		6.7%	3.22%	0.21%
New Mexico		6.6%	4.42%	0.29%
Arizona		6.2%	5.22%	0.32%
Alabama		5.5%	1.61%	0.09%
California		2.0%	0.00%	0.00%
All others		30.2%	3.16%	0.97%

100.0% 2.29%

The States of California, Florida and Arizona, and to a lesser degree Texas, have experienced economic weakness resulting from the decline in real estate values. The risks created by these concentrations have been considered by management in the determination of the accretable yield and the adequacy of any allowance for loan losses. Other than Texas, no other states had concentrations in excess of 10% of the principal balance of the consumer loans receivable as of December 31, 2011.

**6. Inventory Finance Receivables and Allowance for Loan Loss**

The Company's inventory finance receivables balance consists of two classes: (i) amounts loaned by the Company under participation inventory financing programs; and (ii) direct inventory financing arrangements for the home product inventory needs of our independent distribution base.

Under the terms of the participation programs, the Company provides loans to independent floorplan lenders, representing a significant portion of the funds that such financiers then lend to retailers to finance their inventory purchases of our products. The participation inventory finance receivables are unsecured general obligations of the independent floorplan lenders.

Under the terms of the direct inventory finance arrangements, the Company provides all of the inventory finance funds. The notes are secured by the inventory collateral and other security depending on the borrower's (retailer's) circumstances. The other terms of direct inventory finance arrangements vary depending on the needs of the borrower and the opportunity for the Company, but generally follow the same tenets as the participation programs.

Inventory finance receivables, net, consist of the following by class of financing receivable (in thousands):

	September 30, December 31, 2011	September 30, March 31, 2011
Direct inventory finance receivables	\$ 14,920	\$ 12,157
Participation inventory finance receivables	6,610	5,771
Allowance for loan loss	(202)	(169)
	\$ 21,328	\$ 17,759



**Table of Contents**

The Company evaluates the potential for loss from its participation inventory finance programs based on the independent lender's overall financial stability and has determined that an applicable allowance for loan loss was not needed at either December 31, 2011 or March 31, 2011.

With respect to the direct inventory finance notes receivable, the risk of loss is spread over numerous borrowers. Borrower inventory levels and activity are monitored in conjunction with third-party service providers, where applicable, to estimate the potential for loss on the related notes receivable, considering potential exposures including repossession costs, remarketing expenses, impairment of value and the risk of collateral loss. The Company has historically been able to resell repossessed unused homes, thereby mitigating loss experience. If a default occurs and collateral is lost, the Company is exposed to loss of the full value of the home loan. If the Company determines that it is probable that a borrower will default, a specific reserve is determined and recorded within the estimated allowance for loan loss. The Company recorded an allowance for loan loss of \$202,000 and \$169,000 at December 31, 2011 and March 31, 2011, respectively. The following table represents changes in the estimated allowance for loan losses, including related additions and deductions to the allowance for loan loss applicable to the direct inventory finance receivables (in thousands):

	September 30, Three Months Ended December 31, 2011		September 30, Three Months Ended December 31, 2010		September 30, Nine Months Ended December 31, 2011		September 30, Nine Months Ended December 31, 2010	
Balance at beginning of period	\$	185	\$	181	\$	169	\$	40
Provision for credit losses		17		117		33		258
Loans charged off, net of recoveries				(85)				(85)
Balance at end of period	\$	202	\$	213	\$	202	\$	213

The following table disaggregates inventory finance notes receivable and the estimated allowance for loan loss for each class of financing receivable by evaluation methodology (in thousands):

	September 30, Direct Inventory Finance December 31, 2011		September 30, Direct Inventory Finance March 31, 2011		September 30, Participation Inventory Finance December 31, 2011		September 30, Participation Inventory Finance March 31, 2011	
Inventory finance notes receivable:								
Collectively evaluated for impairment	\$	13,124	\$	11,116	\$		\$	
Individually evaluated for impairment		1,796		1,041		6,610		5,771
	\$	14,920	\$	12,157	\$	6,610	\$	5,771
Allowance for loan loss:								
Collectively evaluated for impairment	\$	(202)	\$	(169)	\$		\$	
Individually evaluated for impairment								
	\$	(202)	\$	(169)	\$		\$	

**Table of Contents**

Loans are subject to regular review and are given management's attention whenever a problem situation appears to be developing. Loans with indicators of potential performance problems are placed on watch list status and are subject to additional monitoring and scrutiny. Nonperforming status includes loans accounted for on a non-accrual basis and accruing loans with principal payments past due 90 days or more. The Company's policy is to place loans on nonaccrual status when interest is past due and remains unpaid 90 days or more or when there is a clear indication that the borrower has the inability or unwillingness to meet payments as they become due. Payments received on nonaccrual loans are recorded on a cash basis, first to interest and then to principal. Charge-offs occur when it becomes probable that outstanding amounts will not be recovered. At December 31, 2011, the Company did not have any loans on nonaccrual status and was not aware of any potential problem loans that would have a material effect on the inventory finance receivables balance. The following table disaggregates the Company's inventory finance receivables by class and credit quality indicator (in thousands):

	September 30, Direct Inventory Finance December 31, 2011	September 30, Inventory Finance March 31, 2011	September 30, Participation Inventory Finance December 31, 2011	September 30, Inventory Finance March 31, 2011
Risk profile based on payment activity:				
Performing	\$ 14,602	\$ 11,995	\$ 6,610	\$ 5,771
Watch list	318	162		
Nonperforming				
	\$ 14,920	\$ 12,157	\$ 6,610	\$ 5,771

The Company has concentrations of inventory finance notes receivable related to factory-built homes located in the following states, measured as a percentage of inventory finance receivables principal balance outstanding as of December 31, 2011 and March 31, 2011:

	September 30, December 31, 2011	September 30, March 31, 2011
Arizona	26.1%	21.9%
Texas	12.8%	18.0%
California	4.0%	9.0%

The States of California, Arizona, and to a lesser degree Texas, have experienced economic weakness. The risks created by these concentrations have been considered in the determination of the adequacy of the allowance for loan losses. The Company did not have concentrations in excess of 10% of the principal balance of the inventory finance receivables in any other states as of December 31, 2011 or March 31, 2011, respectively.

**Table of Contents****7. Property, Plant and Equipment**

Property, plant and equipment are carried at cost. Depreciation is calculated using the straight-line method over the estimated useful lives of each asset. Estimated useful lives for significant classes of assets are as follows: buildings and improvements 10 to 39 years, and machinery and equipment 3 to 25 years. Repairs and maintenance charges are expensed as incurred. Property, plant and equipment consist of the following (in thousands):

	September 30, December 31, 2011	September 30, March 31, 2011
Property, plant and equipment, at cost:		
Land	\$ 21,106	\$ 16,046
Buildings and improvements	25,102	19,672
Machinery and equipment	15,434	11,453
	61,642	47,171
Accumulated depreciation	(10,944)	(11,178)
Property, plant and equipment, net	\$ 50,698	\$ 35,993

During the nine months ended December 31, 2011, property, plant and equipment with a cost of \$3.2 million and accumulated depreciation of \$1.8 million was reclassified from property, plant and equipment to assets held for sale related to the anticipated sale of an idled manufacturing facility located in Phoenix, Arizona. As of the date of filing, the Company had entered into an agreement to sell the property, but the transaction has not yet closed. During the nine months ended December 31, 2011, assets held for sale of \$1.8 million, consisting of land located in Millersburg, Oregon, was reclassified to property, plant and equipment.

**8. Goodwill and Other Intangibles**

Intangible assets principally consist of goodwill, trademarks and trade names, state insurance licenses, customer relationships, technology, insurance business in force, and insurance policies and renewal rights. Goodwill, trademarks and trade names and state insurance licenses are indefinite-lived intangible assets and are tested for impairment annually and whenever events or circumstances indicate that more likely than not impairment has occurred. During the nine months ended December 31, 2011 and 2010, no impairment expense was recorded. Finite-lived intangibles are amortized over their estimated useful lives and are reviewed for possible impairment whenever events or changes in circumstances indicate that carrying amounts may not be recoverable. The value of customer relationships is amortized over 4 to 11 years, technology over 7 to 10 years, insurance business in force over one year and insurance policies and renewal rights over 15 years.

**Table of Contents**

Goodwill and other intangibles consist of the following (in thousands):

	September 30, Gross Carrying Amount	September 30, December 31, 2011 Accumulated Amortization	September 30, Net Carrying Amount	September 30, Gross Carrying Amount	September 30, March 31, 2011 Accumulated Amortization	September 30, Net Carrying Amount
<b>Indefinite lived:</b>						
Goodwill	\$ 67,346	\$	\$ 67,346	\$ 67,346	\$	\$ 67,346
Trademarks and trade names	6,250		6,250	800		800
State insurance licenses	1,100		1,100			
<b>Total indefinite-lived intangible assets</b>	<b>74,696</b>		<b>74,696</b>	<b>68,146</b>		<b>68,146</b>
<b>Finite lived:</b>						
Customer relationships	6,200	(931)	5,269	800	(87)	713
Insurance business in force	2,070	(1,642)	428			
Technology	900	(63)	837			
Insurance policies and renewal rights	374	(17)	357			
<b>Total goodwill and other intangible assets</b>	<b>\$ 84,240</b>	<b>\$ (2,653)</b>	<b>\$ 81,587</b>	<b>\$ 68,946</b>	<b>\$ (87)</b>	<b>\$ 68,859</b>

Amortization expense recognized on intangible assets during the three and nine months ended December 31, 2011 was \$880,000 and \$2.6 million, respectively. Amortization expense of \$14,000 and \$40,000 was recognized during the three and nine months ended December 31, 2010, respectively.

**9. Accrued Liabilities**

Accrued liabilities consist of the following (in thousands):

	September 30, December 31, 2011	September 30, March 31, 2011
Estimated warranties	\$ 9,899	\$ 9,371
Customer deposits	8,332	1,857
Salaries, wages and benefits	6,841	4,342
Unearned insurance premiums	5,528	
Deferred margin	4,192	4,305
Accrued insurance	2,733	1,731
Accrued taxes	1,789	707
Accrued volume rebates	1,207	885
Reserves related to consumer loans sold	1,186	
Reserve for repurchase commitments	748	597
Insurance loss reserves	562	
Other (various)	11,847	2,450
	<b>\$ 54,864</b>	<b>\$ 26,245</b>





**Table of Contents****10. Warranties**

Homes are generally warranted against manufacturing defects for a period of one year commencing at the time of sale to the retail customer. Estimated costs relating to home warranties are provided at the date of sale. The Company has recorded a liability for estimated future warranty costs relating to homes sold based upon management's assessment of historical experience factors, an estimate of the amount of homes in the distribution channel and current industry trends. Activity in the liability for estimated warranties was as follows (in thousands):

	September 30, Three Months Ended December 31, 2011	September 30, Three Months Ended December 31, 2010	September 30, Nine Months Ended December 31, 2011	September 30, Nine Months Ended December 31, 2010
Balance at beginning of period	\$ 10,809	\$ 11,891	\$ 9,371	\$ 13,891
Liability assumed with Palm Harbor transaction			1,932	
Charged to costs and expenses	1,797	890	7,259	3,176
Payments and deductions	(2,707)	(1,990)	(8,663)	(6,276)
Balance at end of period	\$ 9,899	\$ 10,791	\$ 9,899	\$ 10,791

**11. Debt Obligations**

The Company acquired securitized financings during the first quarter of fiscal 2012 as a part of the Palm Harbor acquisition. Acquired securitized financings were acquired at fair value, which resulted in a discount, and subsequently are accounted for a manner similar to ASC 310-30 to accrete the discount.

The Company considers expected prepayments and estimates the amount and timing of undiscounted expected principal, interest and other cash flows for consumer loans receivable held for investment to determine the expected cash flows on securitized financings and the contractual payments. The amount of contractual principal and contractual interest payments due on the securitized financings in excess of all cash flows expected as of the Acquisition Date cannot be accreted into interest expense (the non-accretable difference). The remaining amount is accreted into interest expense over the remaining life of the obligation (referred to as accretable yield).

	September 30, December 31, 2011	September 30, Acquisition Date
Securitized financings contractual amount	\$ 122,431	\$ 134,205
Purchase Discount		
Accretable	(28,258)	(32,072)
Non-accretable (1)		
Total securitized financings, net	\$ 94,173	\$ 102,133

<sup>(1)</sup> Because the contractual payments on securitized financing are determined by actual cash flows, the Company expects that there will not be a non-accretable difference.

Over the life of the loans, the Company continues to estimate cash flows expected to be paid on securitized financings. The Company evaluates at the balance sheet date whether the present value of its securitized financings, determined using the effective interest rate, has increased or decreased. The present value of any subsequent change in cash flows expected to be paid adjusts the amount of accretable yield recognized on a prospective basis over the securitized financing's remaining life.



**Table of Contents**

The changes in accretable yield on securitized financings were as follows:

	September 30, Three Months Ended December 31, 2011	September 30, Nine Months Ended December 31, 2011
Balance at the beginning of the period	\$ 29,779	\$
Additions		32,072
Accretion	(1,521)	(3,814)
Balance at the end of the period	\$ 28,258	\$ 28,258

On July 12, 2005, prior to the acquisition of Palm Harbor and CountryPlace, CountryPlace completed its initial securitization (2005-1) for approximately \$141.0 million of loans, which was funded by issuing bonds totaling approximately \$118.4 million. The bonds were issued in four different classes: Class A-1 totaling \$36.3 million with a coupon rate of 4.23%; Class A-2 totaling \$27.4 million with a coupon rate of 4.42%; Class A-3 totaling \$27.3 million with a coupon rate of 4.80%; and Class A-4 totaling \$27.4 million with a coupon rate of 5.20%. Maturity of the bonds is at varying dates beginning in 2006 through 2015 and were issued with an expected weighted average maturity of 4.66 years. For accounting purposes, this transaction was structured as a securitized borrowing. As of December 31, 2011, the Class A-1 and Class A-2 bonds had been retired.

On March 22, 2007, CountryPlace, completed its second securitization (2007-1) for approximately \$116.5 million of loans, which was funded by issuing bonds totaling approximately \$101.9 million. The bonds were issued in four classes: Class A-1 totaling \$28.9 million with a coupon rate of 5.484%; Class A-2 totaling \$23.4 million with a coupon rate of 5.232%; Class A-3 totaling \$24.5 million with a coupon rate of 5.593%; and Class A-4 totaling \$25.1 million with a coupon rate of 5.846%. The bonds mature at varying dates beginning in 2008 through 2017 and were issued with an expected weighted average maturity of 4.86 years. For accounting purposes, this transaction was also structured as a securitized borrowing. As of December 31, 2011, the Class A-1 and Class A-2 bonds had been retired.

**12. Reinsurance**

Standard is primarily a specialty writer of manufactured home physical damage insurance. Certain of Standard's premiums and benefits are assumed from and ceded to other insurance companies under various reinsurance agreements. The ceded reinsurance agreements provide Standard with increased capacity to write larger risks and maintain its exposure to loss within its capital resources. Standard remains obligated for amounts ceded in the event that the reinsurers do not meet their obligations. Substantially all of Standard's assumed reinsurance is with one entity.

The effects of reinsurance on premiums written and earned are as follows (in thousands):

	September 30, Three Months Ended December 31, 2011 Written	September 30, Three Months Ended December 31, 2011 Earned	September 30, SCC Acquisition Date to December 31, 2011 Written	September 30, SCC Acquisition Date to December 31, 2011 Earned
Direct premiums	\$ 578	\$ 395	\$ 1,207	\$ 806
Assumed premiums nonaffiliate	2,212	2,511	5,693	5,725
Ceded premiums nonaffiliate	(658)	(658)	(1,171)	(1,171)
Net premiums	\$ 2,132	\$ 2,248	\$ 5,729	\$ 5,360

Typical insurance policies written or assumed by Standard have a maximum coverage of \$300,000 per claim, of which Standard cedes \$240,000 of the risk of loss per reinsurance. Therefore, Standard maintains risk of loss limited to \$60,000 per claim on typical policies. Amounts are recoverable by Standard through reinsurance for catastrophic losses in excess of \$500,000 per occurrence up to a maximum of \$7.5 million in

the aggregate.

**Table of Contents****13. Income Taxes**

The Company's deferred tax assets primarily result from financial statement accruals not currently deductible for tax purposes and differences in the acquired basis of certain assets, and its deferred tax liabilities primarily result from tax amortization of goodwill and other intangible assets. The Company complies with the provisions of FASB ASC 740, *Income Taxes* (ASC 740), which clarifies the accounting for income taxes by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. ASC 740 also provides guidance on derecognizing, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. The amount of unrecognized tax benefits recorded by the Company is insignificant and the impact on the effective tax rate if all unrecognized tax benefits were recognized would be insignificant. The Company classifies interest and penalties related to unrecognized tax benefits in tax expense.

Income tax returns are filed in the U.S. federal jurisdiction and in several state jurisdictions. In July 2011, the Internal Revenue Service (IRS) completed its examination of the Company's federal income tax return for the fiscal year ended March 31, 2009. The examination resulted in an insignificant payment of additional taxes. The Company is no longer subject to examination by the IRS for years before fiscal year 2007. The Company believes that its income tax filing positions and deductions will be sustained on audit and does not anticipate any adjustments that will result in a material change to the Company's financial position. The total amount of unrecognized tax benefit related to any particular tax position is not anticipated to change significantly within the next 12 months. The provision for income taxes generally represents income taxes paid or payable for the current year plus the change in deferred taxes during the year.

**14. Commitments and Contingencies**

*Repurchase Contingencies.* The Company is contingently liable under terms of repurchase agreements with financial institutions providing inventory financing for retailers of its products. These arrangements, which are customary in the industry, provide for the repurchase of products sold to retailers in the event of default by the retailer. The risk of loss under these agreements is spread over numerous retailers. The price the Company is obligated to pay generally declines over the period of the agreement (generally 18 to 36 months, calculated from the date of sale to the retailer) and the risk of loss is further reduced by the resale value of the homes. The maximum amount for which the Company was contingently liable under such agreements approximated \$11.5 million at December 31, 2011, without reduction for the resale value of the homes. The Company applies FASB ASC 460, *Guarantees* (ASC 460), and FASB ASC 450-20, *Loss Contingencies* (ASC 450-20), to account for its liability for repurchase commitments. Under the provisions of ASC 460, the Company records the greater of the estimated value of the non-contingent obligation or a contingent liability for each repurchase arrangement under the provisions of ASC 450-20. The Company recorded an estimated liability of \$748,000 and \$597,000 at December 31, 2011 and March 31, 2011, respectively, related to these commitments.

*Letters of Credit.* To secure certain reinsurance contracts, Standard has an irrevocable letter of credit of \$5.0 million outstanding related to assumed premiums as assurance that Standard will fulfill its reinsurance obligations. This letter of credit is secured by certain of the Company's investments. Standard also maintains an irrevocable standby letter of credit of \$2.0 million related to a supply bond for a construction project for Palm Harbor Homes. CountryPlace maintains an irrevocable standby letter of credit of \$100,000 related to state licensing requirements. The Company maintains a \$100,000 outstanding letter of credit to satisfy the remaining requirements of the self-funded workers' compensation program which concluded on September 30, 2006. There have been no draws on any of the aforementioned letters of credit.

*Construction-Period Mortgages.* CountryPlace funds construction-period mortgages through periodic advances during the period of home construction. At the time of initial funding, CountryPlace commits to fully fund the loan contract in accordance with a predetermined schedule. Subsequent advances are contingent upon the performance of contractual obligations by the seller of the home and the borrower. Construction-period mortgages are carried in the consolidated balance sheet at the actual amount of cumulative advances, which are included in consumer loans receivable. The total loan contract amount, less cumulative advances, represents an off-balance sheet contingent commitment of CountryPlace to fund future advances.

**Table of Contents**

Loan contracts with off-balance sheet commitments are summarized below (in thousands):

	<b>September 30, December 31, 2011</b>
Construction loan contract amount	\$ 9,105
Cumulative advances	(5,351)
<b>Remaining construction contingent commitment</b>	<b>\$ 3,754</b>

*Representations and Warranties of Mortgages Sold.* CountryPlace sells loans to GSEs and whole-loan purchasers. In connection with these activities, CountryPlace provides to the GSEs and whole-loan purchasers, representations and warranties related to the loans sold. These representations and warranties generally relate to the ownership of the loan, the validity of the lien securing the loan, the loan's compliance with the criteria for inclusion in the sale transactions, including compliance with underwriting standards or loan criteria established by the buyer, and CountryPlace's ability to deliver documentation in compliance with applicable laws. Generally, representations and warranties may be enforced at any time over the life of the loan. Upon a breach of a representation, CountryPlace may be required to repurchase the loan or to indemnify a party for incurred losses. Repurchase demands and claims for indemnification payments are reviewed on a loan-by-loan basis to validate if there has been a breach requiring repurchase. CountryPlace manages the risk of repurchase through underwriting and quality assurance practices and by servicing the mortgage loans to investor standards. CountryPlace maintains a reserve for these contingent repurchase and indemnification obligations. This reserve of \$403,000 as of December 31, 2011, included in accrued liabilities, reflects management's estimate of probable loss. CountryPlace considers a variety of assumptions, including borrower performance (both actual and estimated future defaults), historical repurchase demands and loan defect rates to estimate the liability for loan repurchases and indemnifications. There were no claim requests during the nine months ended December 31, 2011, and one claim open for review for \$5,200 as of December 31, 2011.

*Interest Rate Lock Commitments.* In originating loans for sale, CountryPlace issues interest rate lock commitments ( IRLCs ) to prospective borrowers and third-party originators. These IRLCs represent an agreement to extend credit to a loan applicant, or an agreement to purchase a loan from a third-party originator, whereby the interest rate on the loan is set prior to loan closing or sale. These IRLCs bind CountryPlace to fund the approved loan at the specified rate regardless of whether interest rates or market prices for similar loans have changed between the commitment date and the closing date. As such, outstanding IRLCs are subject to interest rate risk and related loan sale price risk during the period from the date of the IRLC through the earlier of the loan sale date or IRLC expiration date. The loan commitments generally range between 30 and 180 days; however, borrowers are not obligated to close the related loans. As a result, CountryPlace is subject to fallout risk related to IRLCs, which is realized if approved borrowers choose not to close on the loans within the terms of the IRLCs. CountryPlace maintains a reserve for loan price adjustments related to this interest rate risk. The reserve of \$806,000 as of December 31, 2011 is included in accrued liabilities. In determining the adequacy of this reserve, CountryPlace considers recent fallout rate experience by type of origination source and forward loan pricing information provided by investors for various loan types and terms.

*Legal Matters.* The Company is party to certain legal proceedings that arise in the ordinary course and are incidental to its business. Certain of the claims pending against the Company in these proceedings allege, among other things, breach of contract and warranty, product liability and personal injury. Although litigation is inherently uncertain, based on past experience and the information currently available, management does not believe that the currently pending and threatened litigation or claims will have a material adverse effect on the Company's consolidated financial position, liquidity or results of operations. However, future events or circumstances currently unknown to management will determine whether the resolution of pending or threatened litigation or claims will ultimately have a material effect on the Company's consolidated financial position, liquidity or results of operations in any future reporting periods.

**Table of Contents****15. Stockholders' Equity**

The following table represents changes in stockholders' equity attributable to Cavco's stockholders and redeemable non-controlling interest for the nine months ended December 31, 2011 (dollars in thousands):

	September 30, Redeemable Noncontrolling Interest	September 30, Common Stock Shares	September 30, Equity Attributable to Cavco Stockholders Amount	September 30, Additional Paid-in Capital	September 30, Retained Earnings	September 30, Accumulated Other Loss	September 30, Total
Balance, March 31, 2011	\$ 35,819	6,817,606	\$ 68	\$ 129,211	\$ 21,390	\$	\$ 150,669
Stock option exercises		73,190	1	1,462			1,463
Share-based compensation				695			695
Note payable conversion	36,173						
Net income	13,256				13,584		13,584
Other comprehensive loss	(20)					(20)	(20)
Balance, December 31, 2011	\$ 85,228	6,890,796	\$ 69	\$ 131,368	\$ 34,974	\$ (20)	\$ 166,391

**16. Other Comprehensive Income**

The difference between net income and total comprehensive income for the three and nine months ended December 31, 2011 and December 31, 2010 is as follows (in thousands):

	September 30, Three Months Ended December 31, 2011	September 30, Three Months Ended December 31, 2010	September 30, Nine Months Ended December 31, 2011	September 30, Nine Months Ended December 31, 2010
Net income	\$ 2,980	\$ 290	\$ 26,840	\$ 2,339
Unrealized gain (loss) on available-for-sale investments, net of tax (1)	242		(40)	
Comprehensive income	\$ 3,222	\$ 290	\$ 26,800	\$ 2,339

(1) Pre-tax unrealized gain on available-for-sale investments for the three months ended December 31, 2011 was \$368,000. Pre-tax unrealized loss on available-for-sale investments for the nine months ended December 31, 2011 was \$60,000.

**17. Stock-Based Compensation**

The Company maintains stock incentive plans whereby stock option grants or awards of restricted stock may be made to certain officers, directors and key employees. The plans, which are shareholder approved, permit the award of up to 1,350,000 shares of the Company's common stock, of which 269,026 shares were still available for grant at December 31, 2011. When options are exercised, new shares of the Company's



## Edgar Filing: CAVCO INDUSTRIES INC - Form 10-Q

common stock are issued. Stock options may not be granted below 100% of the fair market value of the Company's common stock at the date of grant and generally expire seven years from the date of grant. Stock options and awards of restricted stock vest over a period determined by the plan administrator, typically a one to five year period. The stock incentive plans provide for accelerated vesting of stock options and removal of restrictions on restricted stock awards upon a change in control (as defined in the plans).

**Table of Contents**

Stock-based compensation cost charged against income for the three and nine months ended December 31, 2011, was approximately \$239,000 and \$695,000, respectively. The Company recorded stock-based compensation expense of \$182,000 and \$509,000 for the three and nine months ended December 31, 2010, respectively.

As of December 31, 2011, total unrecognized compensation cost related to stock options was approximately \$2.2 million and the related weighted-average period over which it is expected to be recognized is approximately 2.2 years.

The following table summarizes the option activity within the Company's stock-based compensation plans for the nine months ended December 31, 2011:

	<b>September 30, Number of Shares</b>
Outstanding at March 31, 2011	401,500
Granted	80,100
Exercised	(72,850)
Outstanding at December 31, 2011	408,750
Exercisable at December 31, 2011	170,025

A summary of restricted stock activity within the Company's share-based compensation plans and changes for the nine months ended December 31, 2011 is as follows:

	<b>September 30, Number of Shares</b>
Nonvested at March 31, 2011	498
Vested	(340)
Nonvested at December 31, 2011	158

**Table of Contents****18. Earnings Per Share**

Basic earnings per common share is computed based on the weighted-average number of common shares outstanding during the reporting period. Diluted earnings per common share is computed based on the combination of dilutive common share equivalents, comprised of shares issuable under the Company's share-based compensation plans and the weighted-average number of common shares outstanding during the reporting period. Dilutive common share equivalents include the dilutive effect of in-the-money options to purchase shares, which is calculated based on the average share price for each period using the treasury stock method. The following table sets forth the computation of basic and diluted earnings per share:

	September 30, Three Months Ended December 31, 2011	September 30, Three Months Ended December 31, 2010	September 30, Nine Months Ended December 31, 2011	September 30, Nine Months Ended December 31, 2010
Net income attributable to Cavco common stockholders	\$ 1,677	\$ 24	\$ 13,584	\$ 1,222
Weighted average shares outstanding:				
Basic	6,890,517	6,651,928	6,873,078	6,578,732
Common stock equivalents - treasury stock method	61,441	189,874	62,976	281,653
Diluted	6,951,958	6,841,802	6,936,054	6,860,385
Net income per share attributable to Cavco common stockholders:				
Basic	\$ 0.24	\$ 0.00	\$ 1.98	\$ 0.19
Diluted	\$ 0.24	\$ 0.00	\$ 1.96	\$ 0.18

Anti-dilutive common stock equivalents excluded from the computation of diluted earnings per share for the three months ended December 31, 2011 and 2010 were 20,427 and 9,036, respectively. There were 5,742 and 1,368 anti-dilutive common stock equivalents excluded from the computation of diluted earnings per share for the nine months ended December 31, 2011 and 2010, respectively.

**Table of Contents****19. Fair Value Measurements**

The book value and estimated fair value of the Company's financial instruments are as follows (in thousands):

	September 30, December 31, 2011	September 30, December 31, 2011	September 30, March 31, 2011	September 30, March 31, 2011
	Book Value	Estimated Fair Value	Book Value	Estimated Fair Value
Cash and cash equivalents (1)	\$ 35,397	\$ 35,397	\$ 76,513	\$ 76,513
Restricted cash (1)	6,723	6,723	436	436
Investments (2)	14,747	14,747		
Consumer loans receivable (3)	123,197	121,311		
Inventory finance receivable (4)	21,328	21,328	17,759	17,759
Construction lending line (4)	5,599	5,599		
Securitized financings (5)	94,173	97,456		

- (1) The fair value approximates book value due to the instruments' short term maturity.
- (2) The fair value is based on quoted market prices.
- (3) Includes consumer loans receivable held for investment, held for sale and construction advances. The fair value of the loans held for investment is based on the discounted value of the remaining principal and interest cash flows. The fair value of the loans held for sale approximates book value since the sales price of these loans is known as of December 31, 2011.
- (4) The fair value approximates book value based on current market rates and the revolving nature of the investments.
- (5) The fair value is estimated using recent transactions of asset-backed securities.

In accordance with ASC 820, *Fair Value Measurements and Disclosures* (ASC 820), fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. ASC 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

- Level 1 Quoted prices in active markets for identical assets or liabilities.
- Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. The Company had no level 3 securities as of December 31, 2011.

## Edgar Filing: CAVCO INDUSTRIES INC - Form 10-Q

The Company utilizes the market approach to measure fair value for its financial assets and liabilities. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.

**Table of Contents**

Assets measured at fair value on a recurring basis are summarized below (in thousands):

	September 30, Total	September 30, As of December 31, 2011 Level 1	September 30, As of December 31, 2011 Level 2	September 30, Level 3
Securities issued by the U.S Treasury and Government (1)	\$ 1,289	\$	\$ 1,289	\$
Mortgage-backed securities (1)	4,561		4,561	
Securities issued by states and political subdivisions (1)	1,225		1,225	
Corporate debt securities (1)	3,920		3,920	
Marketable equity securities (1)	3,752	3,752		

(1) Unrealized gains or losses on investments are recorded in accumulated other comprehensive loss at each measurement date. No significant transfers between Level 1 and Level 2 occurred during the nine months ended December 31, 2011. The Company's policy regarding the recording of transfers between levels is to record any such transfers at the end of the reporting period.

Assets and liabilities for which fair value is disclosed but not required to be recognized in the balance sheet on a recurring basis are summarized below (in thousands):

	September 30, Total	September 30, As of December 31, 2011 Level 1	September 30, As of December 31, 2011 Level 2	September 30, Level 3
Loans held for investment	\$ 113,566	\$	\$	\$ 113,566
Loans held for sale	5,070		5,070	
Loans held - construction advances	2,675			2,675
Inventory finance receivable	21,328			21,328
Construction lending facility	5,599		5,599	
Securitized financings	97,456		97,456	

The Company records impairment losses on long-lived assets held for sale when the fair value of such long-lived assets is below their carrying values. The Company records impairment charges on long-lived assets used in operations when events and circumstances indicate that long-lived assets might be impaired and the undiscounted cash flows estimated to be generated by those assets are less than their carrying amounts. The Company recorded no impairment charges on assets held for sale or used in operations during either the three or nine months ended December 31, 2011.

Assets measured on a nonrecurring basis also include impaired loans (nonaccrual loans) disclosed in Note 5 and loans held for sale. No recent sales have been executed in an orderly market of manufactured home loan portfolios with comparable product features, credit characteristics, or performance. Impaired loans are measured using Level 3 inputs that are calculated using discounted future cash flows. Loans held for sale are measured at the lower of cost or fair value using Level 2 inputs that consist of commitments on hand from investors. These loans are held for relatively short periods, typically no more than 45 days. As a result, changes in loan-specific credit risk are not a significant component of the change in fair value. The cost of loans held for sale is currently lower than the fair value.

ASC 825, *Financial Instruments* (ASC 825), requires disclosure of fair value information about financial instruments, whether or not recognized in the balance sheet, for which it is practicable to estimate fair value. Fair value estimates are made as of a specific point in time based on the characteristics of the financial instruments and the relevant market information. Where available, quoted market prices are used. In other cases, fair values are based on estimates using other valuation techniques. These techniques involve uncertainties and are significantly affected by the assumptions used and the judgments made regarding risk characteristics of various financial instruments, discount rates, estimates of future cash flows, future expected loss experience, and other factors. Changes in assumptions could significantly affect these estimates and the resulting fair values. Derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in an immediate sale of the instrument. Also, because of differences in methodologies and assumptions used to estimate fair values, the Company's fair values should not be compared to those of other companies.



**Table of Contents**

Under ASC 825, fair value estimates are based on existing financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Accordingly, the aggregate fair value amounts presented do not represent the underlying market value of the Company.

**20. Debtor-In-Possession Note Receivable**

On November 29, 2010, Fleetwood Homes, Inc. entered into a DIP Revolving Credit Agreement (the "DIP Agreement") and a Security Agreement (the "DIP Security Agreement") with Palm Harbor Florida and certain of its subsidiaries. Palm Harbor Florida was a manufacturer and marketer of factory-built housing and a provider of related financing and insurance. Also on November 29, 2010, Fleetwood Homes' newly-formed subsidiary, Palm Harbor Delaware, entered into an Asset Purchase Agreement (the "Purchase Agreement") with Palm Harbor Florida.

Palm Harbor Florida and those of its subsidiaries that were parties to the DIP Agreement and the Purchase Agreement filed for chapter 11 bankruptcy protection on November 29, 2010. Pursuant to the terms and conditions of the DIP Agreement, Fleetwood Homes agreed to provide up to \$55.0 million for a debtor-in-possession credit facility to finance Palm Harbor's reorganization under chapter 11 of the U.S. Bankruptcy Code. The DIP loan facility bore interest at 7% per annum. Palm Harbor Florida's obligations under the DIP Agreement were secured by a first position lien on substantially all of Palm Harbor Florida's assets. The credit facility was partially used by Palm Harbor Florida to extinguish its Textron Financial Corporation debt facility and to fund post-petition operations, commitments to customers, and employee obligations.

On April 23, 2011, the DIP credit facility was retired in conjunction with the closing of the acquisition of Palm Harbor Florida, discussed further below.

**21. Acquisition of Palm Harbor Homes, Inc.**

*Description of the Acquisition.* Fleetwood Homes, through its wholly-owned subsidiary, Palm Harbor Delaware, entered into the Purchase Agreement with Palm Harbor Florida to purchase substantially all of the assets, and assume specified liabilities, of Palm Harbor Florida, pursuant to an auction process under Section 363 of the U.S. Bankruptcy Code. On March 1, 2011, Palm Harbor Delaware was selected as the successful bidder in the court auction. The transaction was approved and a sale order entered by the U.S. Bankruptcy Court on March 4, 2011.

During the first quarter of fiscal year 2012, Palm Harbor Delaware completed the purchase of the Palm Harbor Florida assets and the assumption of specified liabilities pursuant to the Amended and Restated Asset Purchase Agreement dated March 1, 2011. The effective date of the transaction was April 23, 2011 (the "Acquisition Date"), except for Palm Harbor's acquisition of the stock of Standard Casualty Co., which occurred on June 10, 2011. The aggregate gross purchase price was \$83.9 million and is exclusive of transaction costs, specified liabilities assumed and post-closing adjustments. Of the purchase price, (i) approximately \$45.3 million was used to retire the debtor-in-possession loan previously made by Fleetwood Homes to Palm Harbor Florida; and (ii) \$13.4 million was deposited in escrow pending regulatory approval to transfer the stock of Standard Casualty Co. to Acquisition Co., at which time the escrowed funds were released to the Palm Harbor Florida estate. The purchase price was funded by Fleetwood Homes' cash on hand, along with contributions of \$36.0 million each from the Company and Third Avenue (see Note 23).

Palm Harbor Delaware acquired five operating manufactured housing production facilities, idled factories in nine locations, 49 operating retail locations, one office building, real estate, all related equipment, accounts receivable, customer deposits, inventory, certain trademarks and trade names, intellectual property, and specified contracts and leases. In addition, as of the Acquisition Date, Palm Harbor Delaware purchased all of the outstanding shares of CountryPlace Acceptance Corp., CountryPlace Mortgage, Ltd. and their wholly-owned finance subsidiaries. Palm Harbor Delaware also acquired all of the outstanding shares of Standard Insurance Agency, Inc. and Palm Harbor Insurance Agency of Texas, Inc. On June 7, 2011, regulatory approval of the acquisition of Standard Casualty Co. was received from the Texas Department of Insurance and on June 10, 2011 (the "SCC Acquisition Date"), Palm Harbor Delaware completed the purchase of Standard Casualty Co. Further, Acquisition Co. assumed certain liabilities of Palm Harbor Florida, including primarily debt facilities of the finance subsidiaries.



**Table of Contents**

The foregoing descriptions of the DIP Agreement, DIP Security Agreement, and Purchase Agreement do not purport to be complete and are qualified in their entirety by reference to the DIP Agreement, the DIP Security Agreement, and the Purchase Agreement which were filed as Exhibits 10.1, 10.2, and 10.3, respectively, to the Company's Current Report on Form 8-K filed with the SEC on November 29, 2010.

The purchase of the Palm Harbor Florida assets provides further operating capacity, increased home production capabilities and distribution, and entry into financial and insurance businesses specific to the Company's industry. The transaction further expanded the Company's geographic reach at a national level by adding factories and retail locations serving the Northwest, South Central, Southeast and Mid-Atlantic regions. The Company believes it will have the opportunity to achieve certain synergies and cost reductions by eliminating redundant processes and overhead.

*Acquisition Date Fair Value of Consideration Transferred.* The following table details the Acquisition Date fair value of the consideration transferred to acquire Palm Harbor (in thousands), of which \$74.0 million was in cash:

	<b>September 30, Acquisition Date Fair Value</b>
Cash advanced to Palm Harbor under DIP financing, credited to purchase	\$ 44,117
Paid-in-kind interest on DIP financing, credited to purchase price	1,184
Additional cash consideration	38,599
 Total consideration transferred	 \$ 83,900

*Recording of Assets Acquired and Liabilities Assumed.* The acquisition has been accounted for using the acquisition method of accounting which requires, among other things, that assets acquired and liabilities assumed be recognized at their fair values as of the acquisition date. The following table summarizes the provisional amounts recognized for assets acquired and liabilities assumed as of the Acquisition Date. Certain estimated values are not yet finalized (see below) and are subject to change, which could be significant. The allocation of the purchase price is still preliminary due to the short duration since the Acquisition Date and will be finalized upon completion of the analysis of the fair values of Palm Harbor's assets and specified liabilities. The Company will finalize the amounts recognized as we obtain the information necessary to complete the analysis. We expect to finalize these amounts as soon as possible but no later than one year from the Acquisition Date.

**Table of Contents**

The following table summarizes the provisional estimated fair values of the assets acquired and liabilities assumed at the acquisition dates (in thousands):

	September 30, Initial Estimate	September 30, Adjustments (3)	September 30, Revised Estimate
Cash and cash equivalents	\$ 15,077	\$	\$ 15,077
Restricted cash	5,924		5,924
Investments	16,636		16,636
Accounts receivable (1)	3,219		3,219
Inventories	42,034	5,195	47,229
Prepaid expenses and other assets	2,781		2,781
Property, plant and equipment	13,782		13,782
Assets held for sale	9,278		9,278
Consumer loans receivable	126,030		126,030
Deferred income tax assets	14,532		14,532
Intangible assets (2)	15,294		15,294
<b>Total identifiable assets acquired</b>	<b>\$ 264,587</b>	<b>\$ 5,195</b>	<b>\$ 269,782</b>
Accounts payable of the finance subsidiaries	\$ (1,917)	\$	\$ (1,917)
Accrued liabilities	(27,503)		(27,503)
Construction lending line	(3,974)		(3,974)
Securitized financings	(101,786)		(101,786)
Debt of the finance subsidiaries	(19,456)		(19,456)
Deferred income tax liabilities	(7,271)	(1,966)	(9,237)
<b>Total liabilities assumed</b>	<b>(161,907)</b>	<b>(1,966)</b>	<b>(163,873)</b>
Net identifiable assets acquired	102,680	3,229	105,909
Bargain purchase recognized	(18,780)	(3,229)	(22,009)
<b>Net assets acquired</b>	<b>\$ 83,900</b>	<b>\$</b>	<b>\$ 83,900</b>

- (1) The fair value of accounts receivables acquired is \$3,219, with the gross contractual amount being \$3,601. The Company determined that \$382 would be uncollectible.
- (2) Of the \$15,294 of acquired intangible assets, \$5,450 was assigned to trademarks and trade names and \$1,100 was assigned to state insurance licenses, which are considered indefinite-lived intangible assets and are not subject to amortization and \$8,744 was assigned to customer-related intangibles, technology and insurance business in force, policies and renewal rights, subject to a weighted-average useful life of approximately 5 years.
- (3) Accounting standards require that when the fair value of the net assets acquired exceeds the purchase price, resulting in a bargain purchase gain, the acquirer must reassess the reasonableness of the values assigned to all of the net assets acquired, liabilities assumed and consideration transferred. The Company has performed such a reassessment and has concluded that the values assigned for the Palm Harbor acquisition are reasonable. In the first quarter ended June 30, 2011, the Company originally reported a gain of \$18.8 million, which has been retrospectively adjusted to \$22.0 million as reflected in the table above, representing a \$0.23 increase in first quarter and year-to-date basic and diluted earnings per share. The increase in the gain was the result of a \$5.2 million revision to the value of retail

## Edgar Filing: CAVCO INDUSTRIES INC - Form 10-Q

finished goods. The gain on bargain purchase was not taxable, causing a variation in the customary relationship between income before income taxes and income tax expense for the nine month period ended December 31, 2011.

**Table of Contents**

In connection with the acquisition of Palm Harbor, approximately \$30 million was transferred from Fleetwood Homes to the Palm Harbor Florida estate at closing of the Palm Harbor transaction on April 23, 2011 and \$19.5 million was used to retire a certain debt obligation of the Company's new subsidiary, CountryPlace, on May 10, 2011 (including payoff of the loan, prepayment penalty and related legal fees).

During the three and nine months ended December 31, 2011, the Company recognized acquisition-related costs of \$1,000 and \$865,000, respectively. These costs were expensed as incurred. During the year ended March 31, 2011, the Company recognized \$272,000 of acquisition-related costs. These costs were recognized in selling, general and administrative expenses on the Consolidated Statement of Operations. The Company anticipates additional acquisition-related costs in the fiscal year ended March 31, 2012 related to the purchase of the Palm Harbor assets.

Because the Company purchased Palm Harbor out of bankruptcy, the fair value of identifiable assets acquired and specified liabilities assumed exceeded the fair value of the consideration transferred. In accordance with ASC 805, *Business Combinations*, the Company consequently reassessed the recognition and measurement of identifiable assets acquired and specified liabilities assumed and concluded that the valuation procedures and resulting measures were appropriate. As a result, the Company recognized a gain on bargain purchase of \$22.0 million in its consolidated statements of operations for the nine months ended December 31, 2011.

The recorded amounts are provisional and subject to change primarily as follows:

Amounts for inventory and property and equipment are pending completion of certain confirmation of physical existence, condition and valuation efforts.

Amounts for intangibles, property held for sale, consumer loans receivable, securitized financing obligation, deferred income taxes and accrued liabilities are pending finalization of valuation efforts.

A single estimate of fair value results from a complex series of judgments about future events and uncertainties and relies heavily on estimates and assumptions. Judgments used to determine the estimated fair value assigned to each class of assets acquired and liabilities assumed, as well as asset lives, can materially impact results of operations.

For the three months ended December 31, 2011, Palm Harbor contributed net sales of \$64.2 million and net income of \$1.5 million. For the period from the acquisition dates through December 31, 2011, the amounts included in the Company's consolidated statement of operations were \$197.1 million in net sales and net income of \$23.9 million, which included \$22.0 million related to gain on bargain purchase.

*Pro Forma Impact of Acquisition (unaudited).* The following table presents supplemental pro forma information as if the acquisition of Palm Harbor had occurred on April 1, 2010 (in thousands):

	September 30, Three Months Ended December 31, 2011	September 30, Consolidated Results Three Months Ended December 31, 2010	September 30, Consolidated Results Nine Months Ended December 31, 2011	September 30, Consolidated Results Nine Months Ended December 31, 2010
Net sales	\$ 114,564	\$ 95,648	\$ 358,055	\$ 337,361
Net income (loss) attributable to Cavco common stockholders	1,945	(1,698)	3,648	8,516
Diluted net income (loss) per share attributable to Cavco common stockholders	0.28	(0.26)	0.53	1.24

---

**Table of Contents**

The unaudited pro forma consolidated results were prepared using the acquisition method of accounting and are based on the historical financial information of Cavco and Palm Harbor, reflecting both Cavco and Palm Harbor results of operations for the three and nine months ended December 31, 2011 and 2010, respectively. The historical financial information has been adjusted to give effect to the pro forma events that are: (i) directly attributable to the acquisition; (ii) factually supportable; and (iii) expected to have a continuing impact on the combined results. The unaudited pro forma consolidated results are not necessarily indicative of what our consolidated results of operations actually would have been had we completed the acquisition on April 1, 2010. In addition, the unaudited pro forma consolidated results do not purport to project the future results of operations of the combined company nor do they reflect the expected realization of any cost savings associated with the acquisition, including the elimination of overhead costs. The results reflect primarily the following pro forma pre-tax adjustments:

Reclassification of amounts to conform to Cavco's accounting policies resulted in no impact to net income/(loss). Classification of income statement amounts were not impacted for the three months ended December 31, 2011. For the nine months ended December 31, 2011, net sales were grossed up by \$1.2 million, cost of sales were grossed up by \$1.1 million, SG&A decreased by \$428,000, interest expense increased by \$44,000, and other income decreased by \$445,000. For the nine months ended December 31, 2010, net sales were grossed up by \$14.6 million, cost of sales were grossed up by \$13.6 million, SG&A decreased by \$1.8 million, interest expense increased by \$484,000, and other income decreased by \$2.4 million.

Reclassification of amounts to conform to Cavco's accounting policies for revenue recognition in the retail sales process, resulting in the reclassification of net sales and cost of sales among periods. These revenue recognition adjustments resulted in decreases of net sales and cost of sales of \$203,000 and \$166,000 for the nine months ended December 31, 2011 and increases of \$8.6 million and \$6.2 million of net sales and cost of sales for the nine months ended December 31, 2010, net of adjustments for amounts deferred under Cavco's revenue recognition policy.

Elimination of Palm Harbor's historical interest expense related to Senior Convertible Notes discharged in bankruptcy, a note payable settled prior to the bankruptcy and a credit agreement that has been terminated and will not be a part of the Company's capitalization going forward. (\$239,000 and \$6.3 million in the nine months ended December 31, 2011 and 2010, respectively).

Elimination of \$1.9 million of costs incurred and \$187,000 of interest income in the nine months ended December 31, 2011. These are directly attributable to the bankruptcy and subsequent acquisition, and which do not have a continuing impact on the combined company's operating results. Included in these costs are advisory, legal and regulatory costs incurred by both legacy Cavco and legacy Palm Harbor and income and costs related to the debtor-in-possession financing that has been terminated.

Additional amortization expense (approximately \$111,000 and \$2.3 million for the nine months ended December 31, 2011 and 2010, respectively) related to the fair value of identifiable intangible assets acquired.

Reduction in depreciation expense (approximately \$128,000 and \$1.5 million for the nine months ended December 31, 2011 and 2010, respectively) related to the fair value adjustment to property, plant and equipment acquired.

Elimination of operating activities related to closed manufacturing facilities and retail locations that (i) were not purchased in the transaction or (ii) are held for sale as of the Date of Acquisition. The amounts eliminated included sales of \$645,000 and \$25.0 million, cost of sales of \$1.3 million and \$23.5 million, and SG&A of \$558,000 and \$8.4 million for the nine months ended December 31, 2011 and 2010, respectively.

In addition, all of the above adjustments were adjusted for the applicable tax impact.

## Table of Contents

### **22. Redeemable Noncontrolling Interest**

*Redeemable Noncontrolling Interest.* During fiscal year 2010, the Company and an investment partner, Third Avenue formed Fleetwood Homes, Inc., with an initial contribution of \$35.0 million each for equal fifty-percent ownership interests. On July 21, 2009, Fleetwood Homes entered into an asset purchase agreement with Fleetwood Enterprises, Inc. and certain of its subsidiaries to purchase certain assets and liabilities of its manufactured housing business.

The Company and Third Avenue subsequently contributed an additional \$36.0 million each in anticipation of the purchase of Palm Harbor, which was completed during the first quarter of fiscal year 2012. See Notes 21 and 23 for further information.

The results of the Fleetwood Homes and Palm Harbor operations have been included in the Consolidated Financial Statements and the related Notes since the respective acquisition dates in accordance with the provisions of ASC 810. Management has determined that, under GAAP, although Fleetwood Homes is only fifty-percent owned by the Company, Cavco has a controlling interest and is required to fully consolidate the results of Fleetwood Homes. The primary factors that contributed to this determination were Cavco's board and management control of Fleetwood Homes. To that end, members of Cavco's management hold all of the seats on the board of directors of Fleetwood Homes. In addition, as part of a management services agreement among Cavco, Fleetwood Homes and Third Avenue, Cavco provides all executive-level management services to Fleetwood Homes including, among other things, general management oversight, marketing and customer relations, accounting and cash management. Third Avenue's financial interest in Fleetwood Homes is considered a redeemable noncontrolling interest, and is designated as such in the Consolidated Financial Statements.

*Temporary Equity Classification.* ASC 480, *Distinguishing Liabilities from Equity*, includes guidance regarding the classification and measurement of redeemable securities, including a requirement that equity instruments that are not required to be classified as liabilities be classified as temporary equity and outside of permanent equity if they are redeemable (i) at a fixed or determinable price on a fixed or determinable date, (ii) at the option of the holder, or (iii) upon the occurrence of an event that is not solely within the control of the issuer.

In accordance with the Shareholder Agreement entered into among Fleetwood Homes and its shareholders (Cavco and Third Avenue), as amended on November 30, 2010 (the "Shareholder Agreement"), after the fifth anniversary of the Fleetwood Acquisition Date, (i.e. after August 17, 2014), or at any time after Fleetwood Homes has earned net income of at least \$10.0 million in each of its two most recently completed consecutive fiscal years, Third Avenue has the right ( "Put Right") to require Cavco to purchase all of Third Avenue's shares of Fleetwood Homes common stock for an amount based upon a calculation that is designed to approximate fair value. Likewise, Cavco has the right ( "Call Right") to require Third Avenue to sell all of its shares of Fleetwood Homes common stock based on the same timing and calculation as described above for the Put Right. The conditions for the Put Right or Call Right to become exercisable have not been met as of December 31, 2011.

---

**Table of Contents**

The purchase price to be payable by Cavco for the purchase of Third Avenue's shares pursuant to the exercise of the Put Right or the Call Right may be settled in cash or shares of common stock of Cavco. However, the circumstances under which net share settlement would be allowed are not solely within the control of Cavco. The availability of net share settlement is dependent upon a number of factors. For example, at the time of such purchase, Cavco's common stock must be listed on either the NASDAQ or the New York Stock Exchange. In the case of Third Avenue's exercise of its Put Right, Cavco may elect to pay all or a portion of such purchase price in the form of shares of common stock of Cavco. In the case of Cavco's exercise of its Call Right, Third Avenue may elect to receive all or a portion of such purchase price in the form of shares of common stock of Cavco. In addition, net share settlement would not be available if it were to lead to a change of control of Cavco. If either Cavco or Third Avenue makes such election, the shares of Cavco common stock to be issued to Third Avenue would be valued based on the average closing price of Cavco's common stock for the sixty most recent trading days. There is no explicit cap on the maximum number of common shares that could be potentially issuable upon redemption; therefore, Third Avenue's noncontrolling interest in Fleetwood Homes is classified as a temporary equity mezzanine item between liabilities and stockholders' equity.

The carrying amount is subject to adjustment, after attribution of net income or loss of Fleetwood Homes, if there are changes in the redemption value at the end of the reporting period. For the period since the Fleetwood Acquisition Date through December 31, 2011, the Company determined that the potential redemption value of the redeemable noncontrolling interest did not exceed its carrying value and no adjustment was needed.

**23. Convertible Note Payable**

On December 1, 2010, the Company and Third Avenue entered into separate convertible note payable agreements with their subsidiary, Fleetwood Homes, for \$14.0 million each, convertible to 200 shares of Fleetwood Homes, Inc. common stock at the successful close of the contemplated Palm Harbor transaction. The convertible notes were subsequently increased by \$22.0 million each, convertible to an additional 314.28 shares, for a total of \$36.0 million per note in the fourth quarter of fiscal 2011, convertible to 514.28 shares. The convertible notes bore interest of 2.5% per annum. Concurrent with the successful completion of the acquisition of Palm Harbor, all outstanding convertible notes were converted to shares of Fleetwood Homes, Inc. on April 23, 2011 and redeemable noncontrolling interest increased by \$36.0 million. Any right to interest income was forfeited by the note holders upon conversion in accordance with the terms of the agreements.

**24. Related Party Transactions**

At December 31, 2011, Third Avenue Management LLC beneficially owned approximately 12.1% of Cavco Industries, Inc. outstanding common shares and thus meets the definition of a principal owner under FASB ASC 850, *Related Party Disclosures* (ASC 850). Third Avenue Management LLC and Third Avenue are either directly or indirectly under common control. Third Avenue's participation in ownership of Fleetwood Homes, the Fleetwood Homes transaction, convertible note payable, and the subsequent Palm Harbor acquisition are therefore considered related party transactions in accordance with ASC 850.

**Table of Contents****25. Business Segment Information**

The Company operates principally in two segments: (1) factory-built housing, which includes manufactured housing, modular housing and retail operations and (2) financial services, which includes finance and insurance. The following table details net sales and income before income taxes by segment (in thousands):

	September 30, Three Months Ended December 31, 2011	September 30, 2010	September 30, Nine Months Ended December 31, 2011	September 30, 2010
<b>Net sales:</b>				
Factory-built housing	\$ 104,931	\$ 39,612	\$ 317,457	\$ 133,005
Financial services	9,633		26,096	
	\$ 114,564	\$ 39,612	\$ 343,553	\$ 133,005
<b>Income before income taxes:</b>				
Factory-built housing	\$ 5,115	\$ 1,786	\$ 7,693	\$ 7,250
Financial services	2,002		5,642	
General corporate charges	(2,333)	(1,207)	(5,503)	(3,330)
Gain on bargain purchase			22,009	
	\$ 4,784	\$ 579	\$ 29,841	\$ 3,920

	September 30, December 31, 2011	As of	September 30, March 31, 2011
<b>Total assets:</b>			
Factory-built housing	\$ 227,031		\$ 192,866
Financial services	165,542		
Corporate	35,430		76,576
	\$ 428,003		\$ 269,442



---

## **Table of Contents**

### **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

#### **Introduction**

The following should be read in conjunction with the Company's Consolidated Financial Statements and the related Notes that appear in Item 1 of this Report. References to "Note" or "Notes" refer to the Notes to the Company's Consolidated Financial Statements.

#### **Overview**

Headquartered in Phoenix, Arizona, the Company designs and produces factory-built housing products primarily distributed through a network of independent and company-owned retailers. We are the second largest producer of HUD code manufactured homes in the United States, based on reported wholesale shipments, and marketed under a variety of brand names including Cavco Homes, Fleetwood Homes, Palm Harbor Homes and Nationwide Homes. The Company is also a leading producer of park model homes, vacation cabins, modular homes, and systems-built commercial living structures. Our mortgage subsidiary, CountryPlace, is an approved Fannie Mae and Ginnie Mae seller/servicer and offers conforming mortgages to purchasers of factory-built and site-built homes. Our insurance subsidiary, Standard, provides property and casualty insurance to manufactured home owners.

#### **Company Growth**

On June 30, 2003, Cavco became a stand-alone publicly held company after previously operating as a wholly-owned subsidiary of Centex Corporation. Cavco's manufactured home factory and retail operations were historically located in and primarily served the Southwest and South Central United States housing markets.

On August 17, 2009, the Company and an investment partner, Third Avenue Value Fund ("Third Avenue"), acquired certain manufactured housing assets and liabilities of Fleetwood Enterprises, Inc. through their jointly owned corporation, Fleetwood Homes, Inc. ("Fleetwood Homes"), pursuant to an auction process under Section 363 of the U.S. Bankruptcy Code. The Company and Third Avenue each own 50% of Fleetwood Homes. Third Avenue Management is an investment advisor to Third Avenue Value Fund and is a principal stockholder of the Company, as described further in Notes 22 and 24.

On November 29, 2010, Fleetwood Homes, through its wholly-owned subsidiary, Palm Harbor Homes, Inc., a Delaware corporation ("Palm Harbor" or "Palm Harbor Delaware"), entered into an agreement (the "Purchase Agreement") with Palm Harbor Homes, Inc., a Florida corporation and certain of its subsidiaries ("Seller") to purchase substantially all of the assets and assume specified liabilities of Seller, pursuant to an auction process under Section 363 of the U.S. Bankruptcy Code. On April 23, 2011 (the "Acquisition Date"), Palm Harbor completed the purchase of Seller's assets and the assumption of specified liabilities, except for Palm Harbor's acquisition of the stock of Standard Casualty Co. ("Standard"), pursuant to the Amended and Restated Asset Purchase Agreement dated March 1, 2011. The aggregate gross purchase price was \$83.9 million and is exclusive of transaction costs, specified liabilities assumed and post-closing adjustments (these adjustments have been recorded). Of the purchase price, (i) approximately \$45.3 million was used to retire a debtor-in-possession loan previously made by Fleetwood Homes to Seller; and (ii) \$13.4 million was deposited in escrow pending regulatory approval to transfer the stock of Standard to Palm Harbor. The purchase price was funded by Fleetwood Homes' cash on hand along with equal contributions from the Company and Third Avenue. On June 7, 2011, regulatory approval of the acquisition of Standard was received from the Texas Department of Insurance and on June 10, 2011, Palm Harbor completed the purchase of Standard. See Notes 21 and 22 for further information.

Financial information for Fleetwood Homes is included in the Company's Consolidated Financial Statements and related Notes. The Company and Third Avenue have each contributed \$71.0 million in exchange for equal ownership interests in Fleetwood Homes. Although the Company holds a fifty-percent financial interest in Fleetwood Homes, its results of operations are required to be fully consolidated. Third Avenue's financial interest in Fleetwood Homes is considered a redeemable noncontrolling interest, and is designated as such in the Consolidated Financial Statements (see Notes 1 and 22).

---

## **Table of Contents**

The Palm Harbor transaction included five operating manufactured housing production facilities, idled factories in nine locations, 49 operating retail locations, one office building, real estate, all related equipment, accounts receivable, customer deposits, inventory, certain trademarks and trade names, intellectual property, specified contracts and leases, and certain liabilities including debt facilities of CountryPlace (see Note 21). Palm Harbor purchased all of the outstanding shares of CountryPlace Acceptance Corp. with its wholly-owned finance subsidiaries (collectively, CountryPlace ) and all of the outstanding shares of Standard. Neither Palm Harbor nor the Company incurred any debt in connection with the transaction, other than the assumed CountryPlace debt facilities.

The transaction further expanded the Company's geographic reach at a national level by adding factories and retail locations serving the Northwest, South Central, Southeast and Mid-Atlantic regions. The Company believes it will have the opportunity to achieve certain synergies and cost reductions by eliminating redundant processes and overhead.

Palm Harbor's brand recognition is accompanied by its reputation for producing high quality products with exceptional service after the sale. Strategically, the Palm Harbor transaction strengthens the Company's position in Texas and surrounding states, which has traditionally been among the strongest regions of demand for manufactured housing. We also gained a direct presence in Florida, another historically large market for our industry, which we had not been able to serve previously. Nationwide Homes, a Palm Harbor brand based in Virginia, builds an innovative and creative line of larger single and multi-story modular homes constructed to conform to state and local building codes. Nationwide Homes sells to local developers and development projects as well as individuals. Palm Harbor utilizes unique marketing capabilities including internet and other methods that may be expanded to other areas of the Company.

The purchase of the Palm Harbor assets also provides the Company entry into financial and insurance businesses specific to our industry. Standard is domiciled in Texas and is primarily a specialty writer of manufactured home physical damage insurance. Standard holds insurance licenses in multiple states; however, a significant portion of its writings occurs in Texas. In addition to writing direct policies, Standard assumes and cedes reinsurance in the ordinary course of business (see Note 12).

CountryPlace originates and services factory-built housing mortgage loans in connection with the retail sale of homes built and sold by the Company and others. The loans are secured by the underlying homes. CountryPlace services, for itself and others, conforming mortgages, non-conforming land-home mortgages and manufactured home chattel loans. CountryPlace is authorized by the U.S. Department of Housing and Urban Development ( HUD ) to directly endorse Federal Housing Administration ( FHA ) Title I and Title II mortgage insurance, is approved by the Government National Mortgage Association ( GNMA or Ginnie Mae ) to issue GNMA-insured mortgage-backed securities, and is authorized to sell mortgages to, and service mortgages for, the Federal National Mortgage Association ( FNMA or Fannie Mae ).

We are in the process of expanding our product offerings throughout the combined organization by sharing product designs, production methods and marketing strategies. The supportive response by our customer base to the Palm Harbor and Fleetwood Homes acquisitions has been encouraging. We expect to realize some operating efficiency improvements as a result of our larger size and buying power although for a period of time, transaction costs and transition related expenses will mask a portion of such savings. We plan to place a consistent focus on developing synergies among all operations. Overall, we believe that these expansions and improvements will be positive long-term strategic benefits for the Company.

Including the factories listed above, during the quarter ended December 31, 2011, the Company operated fifteen homebuilding facilities located in Phoenix, Arizona; Goodyear, Arizona; Nampa, Idaho; Woodburn, Oregon; Millersburg, Oregon; Riverside, California; Waco, Texas; Austin, Texas; Seguin, Texas; Fort Worth, Texas; Lafayette, Tennessee; Douglas, Georgia; Martinsville, Virginia; Rocky Mount, Virginia and Plant City, Florida. During the quarter ended December 31, 2011, the Company sold idled production facilities in Buda, Texas for \$1.3 million and in Casa Grande, Arizona for \$1.3 million resulting in net gains of \$9,000 and \$14,000, respectively. Subsequent to December 31, 2011, the Company entered into an agreement to sell an idled manufacturing facility located in Phoenix, Arizona.

---

## **Table of Contents**

Cash and cash equivalents of the Company totaled approximately \$35.4 million on December 31, 2011. We believe this level of capitalization should provide sufficient resources to the operations of the Company to endure continuing depressed market conditions and to establish a solid base for continued growth as circumstances improve.

### **Industry and Company Outlook**

The manufactured housing industry and the Company continue to operate at low production and shipment levels. According to data provided by the Manufactured Housing Institute ( MHI ), our industry shipped approximately 48,000 HUD code manufactured homes from January through November 2011 compared to 47,000 for the same period last year. In calendar 2010 and 2009, our industry shipped approximately 50,000 HUD code manufactured homes annually, the lowest levels since shipment statistics began to be recorded in 1959. This followed approximately 82,000 homes shipped in calendar year 2008, which was the previous low. Yearly home shipments from 2003 to 2009 were less than the annual home shipments for each of the 40 years from 1963 to 2002. For the past 10- and 20-year periods, annual home shipments averaged 117,000 and 207,000, respectively.

General economic challenges including low consumer confidence levels, unemployment and underemployment, constricted mortgage lending, and overall housing sector weakness need to improve to spur annual industry and Company shipment levels. Low consumer confidence in the U.S. economy is not conducive for potential customers to commit to a home purchase. In addition, sales of our homes have been negatively affected by high unemployment rates and underemployment. Consumer financing for the retail purchase of manufactured homes needs to become more available before marked emergence from current lows can occur. Restrictive underwriting guidelines, irregular appraisal processes, higher interest rates compared to site-built homes, regulatory burdens, reductions in the number of institutions lending to manufactured home buyers and limited secondary market availability for manufactured home loans are significant restraints to industry growth. We are working directly and through industry trade associations to encourage favorable legislative and government-sponsored enterprise action to address the mortgage financing needs of potential buyers of affordable homes. Although limited progress has been made in this area, a meaningful positive impact in the form of increased home orders at our factories has yet to be realized.

Competition from excess site-built home inventory is an issue that is also of concern. Surplus homes creating the oversupply have various sources. Lender inventories of repossessed site-built homes are significant and liquidation selling prices are often lower than the current cost to build a similar home. It has been reported that some on-site home builders are offering incentives to homebuyers in order to be competitive with lender foreclosure pricing in their sales areas. The resultant price points are low enough in many cases to compete with manufactured housing. In turn, competing manufactured home providers are aggressively pricing their products in efforts to obtain a portion of the contracted overall housing market. Lower home prices, restrictive underwriting guidelines, and slow sales activity have also had an adverse impact on the contingency contract process, wherein potential manufactured home buyers must sell their existing home in order to facilitate the purchase of a new factory built home.

The Company operated with low backlogs during the third quarter of fiscal year 2012. The backlog of sales orders at December 31, 2011 varied among our fifteen factories, but in total was \$10.9 million, or approximately two weeks of current production levels.

Inventory financing for the industry's retail distribution chain continues to be in short supply. Faced with illiquid capital markets in late calendar year 2008, each of the manufactured housing sector's remaining inventory finance lenders initiated significant changes, including one company's announcement to cease lending activities in this industry entirely. The involvement of others is subject to more restrictive terms that continue to evolve. As most retailers require financing to maintain inventories of homes, the Company partnered with several lenders to help provide this type of inventory financing. In connection with certain of these participation inventory finance programs, the Company provides a significant amount of the funds that independent financiers lend to distributors to finance retail inventories of our products. In addition, the Company has entered into direct inventory finance arrangements with distributors of our products wherein the Company provides all of the inventory finance funds (see Note 6). The Company's participation in inventory finance has increased the availability of manufactured home inventory financing to distributors of our

## **Table of Contents**

products. We believe that our expanding involvement in wholesale inventory financing is quite helpful to distributors and provides our product continued exposure to potential homebuyers while we endure intense competitive forces from other manufactured homebuilders. These initiatives support the Company's ongoing efforts to expand our distribution base in all of our markets with existing and new customers.

The two largest manufactured housing consumer demographics, young adults and those who are 55+ years old, are both growing. Household formation is estimated to increase as the young adult population rises with the growth in the 25 to 34-year-old age bracket, sometimes referred to as the echo-boom generation. This group is attracted by the affordability, diversity of style choices and flexibility as to the location of their home. The age 55 and older category is reported to be the fastest growing segment of the U.S. population. This group is similarly interested in the value proposition; however, they are also motivated by the low maintenance requirements of factory built homes, and by the lifestyle offered by planned communities that are specifically designed for manufactured-home owners in this age group.

The national rental vacancy rate has been reported to be low. Rental housing competes directly with many of our product offerings, and reductions in rental availability and increases in the cost of renting may have the effect of shifting interested buyers to other housing alternatives including manufactured homes.

With manufacturing facilities strategically positioned across the nation, we utilize local market research to design homes to meet the demands of our customers. We have the ability to customize floor plans and designs to fulfill specific needs. By offering a full range of homes from entry level models to large custom homes and with the ability to engineer designs in-house, we can accommodate virtually any customer request. In addition to homes built to the Federal HUD code, we construct modular homes which conform to state and local codes, park models and cabins, and light commercial buildings at many of our manufacturing facilities.

Company-wide, we have intensified our efforts to identify niche market opportunities where our diverse product lines and custom building capabilities provide our company with a competitive advantage. Green construction processes and environmentally-friendly building materials have long been a part of our home-building process and their popularity is expected to grow. We utilize building materials that, combined with our building process, we believe give us a green advantage over other home builders. Many of the homes we build meet Energy Star standards. Building green also significantly reduces greenhouse gas emissions without sacrificing features, style or comfort. From bamboo flooring and tankless water heaters to solar-powered homes, our products are diverse and tailored to a wide range of consumer interests. Innovation in housing design is a forte of the Company and we continue to introduce new models at competitive price points with expressive interiors and exteriors that complement home styles in the areas in which they are located.

Prospects are good for the systems-built housing industry, as it provides enhanced quality homes with better coordination of labor and well-controlled material usage resulting in lower cost to the consumer, compared to on-site construction methods. Our Company has a demonstrated ability to operate effectively and efficiently at low levels of capacity utilization characteristic of the industry currently. In addition, the Company has worked diligently to maintain a solid financial position. Our balance sheet strength should help us to avoid the liquidity problems faced by many other companies and enable us to act effectively as market opportunities present themselves.

We were named the 2011 Manufacturer of the Year by MHI, the factory-built home industry's national trade organization, for the second consecutive year. In addition, both Cavco and Palm Harbor received several design awards from MHI. These honors are a reflection of our valued employees, customers and vendors and we appreciate the recognition.

In January 2008, we announced a stock repurchase program. A total of \$10 million may be used to repurchase our outstanding common stock. The repurchases may be made in the open market or in privately negotiated transactions in compliance with applicable state and federal securities laws and other legal requirements. The level of repurchase activity is subject to market conditions and other investment opportunities. The plan does not obligate us to acquire any particular amount of common stock and may be suspended or discontinued at any time. The repurchase program will be funded using our available cash. No repurchases have been made under this program to date.

**Table of Contents****Regulatory Developments**

The American Housing Rescue and Foreclosure Prevention Act was enacted in 2008 to provide assistance by way of legislation for the housing industry, including the manufactured housing industry. Among other things, the act provides for increased loan limits for chattel (home-only Title I) loans to \$69,678, up 43% from the previous limit of \$48,600 set in 1992. New Federal Housing Administration (FHA) Title I program guidelines became effective on June 1, 2010. On June 10, 2010, the Government National Mortgage Association (Ginnie Mae) began accepting applications by lenders for participation as issuers of mortgage backed securities backed by Title I loans originated under the new program. Ginnie Mae released related pooling guidelines in November 2010. The issuance of these guidelines provides Ginnie Mae the ability to securitize manufactured home FHA Title I loans. This will allow lenders to obtain new capital, which can then be used to fund new loans for our customers. Chattel loans have languished in recent years and these changes are meant to broaden opportunities for prospective homeowners. However, a meaningful positive impact in the form of increased home orders at our factories has yet to be realized.

**Results of Operations*****Three and nine months ended December 31, 2011 compared to 2010***

*Net Sales.* Total net sales increased 189.2% to \$114.6 million for the three months ended December 31, 2011 compared to \$39.6 million for the comparable quarter last year. For the nine months ended December 31, 2011, sales increased 158.3% to \$343.6 million from \$133.0 million for the same period last year. The Palm Harbor operations were acquired on April 23, 2011, and from that date forward are included in the results of fiscal year 2012.

Factory-built housing net sales increased 164.9% to \$104.9 million from \$39.6 million for the comparable quarter last year. For the nine months ended December 31, 2011, factory-built housing net sales increased 138.7% to \$317.5 million from \$133.0 million for the same period last year. The financial services segment, consisting of CountryPlace and Standard, contributed \$9.6 million and \$26.1 million in net sales for the three and nine months ended December 31, 2011, respectively.

*Gross Profit.* Gross profit as a percent of sales increased to 23.5% for the three months ended December 31, 2011 from 13.5% for the same period last year and increased to 20.8% for the nine months ended December 31, 2011 from 14.3% last year. Including the Palm Harbor operations, the Company's combined factory-built housing operations sold 1,972 and 5,970 homes during the three and nine months ended December 31, 2011, respectively, compared to 1,139 and 3,691 homes during the comparable periods last year. While the average sales price per home improved, the improvement in gross profit was mainly the result of the added Palm Harbor retail business, and the finance and insurance subsidiaries, which are generally higher-margin businesses.

*Selling, General and Administrative Expenses.* Selling, general and administrative expenses increased 289.3% or \$15.3 million to \$20.5 million, or 17.9% of net sales, for the three months ended December 31, 2011 versus \$5.3 million or 13.3% of net sales, for the same period last year. For the nine-month period ended December 31, 2011, selling, general and administrative expenses increased 269.5% or \$43.1 million to \$59.1 million from \$16.0 million last year. The increase is primarily a result of the addition of the Palm Harbor businesses. Costs related to the acquisition of Palm Harbor Florida were \$1,000 and \$865,000 for the three and nine months ended December 31, 2011, respectively, and were expensed as incurred.

*Income Before Income Taxes.* Pre-tax income increased to \$4.8 million for the three months ended December 31, 2011 compared to \$579,000 for the comparable quarter last year. Included in income before income taxes for the three months ended December 31, 2011 were \$5.1 million from the factory-built housing segment and \$2.0 million from the financial services segment, offset by \$2.3 million of general corporate charges. Income before income taxes for the three months ended December 31, 2010 was \$579,000, including \$1.8 million of factory-built housing income, offset in part by \$1.2 million of general corporate charges. For the nine months ended December 31, 2011, income before income taxes of \$29.8 million consisted of \$7.7 million from the factory-built housing segment, \$5.6 million from the financial services segment, \$5.5 million of general corporate charges, and \$22.0 million of gain on bargain purchase (see Note 21). This compared to factory-built housing income for the nine months ended December 31, 2010 of \$7.3 million, offset by general corporate charges of \$3.3 million resulting in pre-tax income of \$3.9 million.

---

**Table of Contents**

*Interest Expense.* Interest expense of \$2.0 million and \$5.4 million for the three and nine months ended December 31, 2011, respectively, consisted of debt service on securitization financings connected to the CountryPlace Mortgage securitized manufactured home loan portfolios.

*Other Income.* Other income primarily represents interest income earned on inventory finance notes receivable and debtor-in-possession note receivable. Other income decreased 13.9% to \$440,000 for the three months ended December 31, 2011 as compared to \$511,000 during the prior year period. For the nine months ended December 31, 2011, other income increased 10.2% or \$98,000 to \$1.1 million from \$957,000 last year.

*Income Taxes.* For the three-month periods ended December 31, 2011 and 2010, the effective income tax rate was approximately 38% and 50%, respectively. For the nine-month periods ended December 31, 2011 and 2010, the effective income tax rate was approximately 10% and 40%, respectively. The gain on bargain purchase was not taxable, causing a variation in the customary relationship between income before income taxes and income tax expense for the nine month period ended December 31, 2011.

*Net Income.* Net income attributable to Cavco stockholders for the three and nine months ended December 31, 2011 was \$1.7 million and \$13.6 million, respectively, compared to \$24,000 and \$1.2 million for the comparable quarter and nine-month period last year, respectively. Net income attributable to Cavco stockholders for the nine months ended December 31, 2011 includes one half of the \$22.0 million bargain purchase gain recognized resulting from the Palm Harbor transaction, consistent with Cavco's ownership percentage of Fleetwood Homes.

See Note 21 for further discussion of the Palm Harbor transaction.

**Liquidity and Capital Resources (Dollars in thousands)**

We believe that cash and cash equivalents at December 31, 2011, together with cash flow from operations, will be sufficient to fund our operations and provide for growth for the next twelve months and into the foreseeable future. Because of the Company's sufficient cash position, the Company has not sought external sources of liquidity, such as a credit facility; however, depending on our operating results and strategic opportunities, we may need to seek additional or alternative sources of financing. There can be no assurance that such financing would be available on satisfactory terms, if at all. If this financing were not available, it could be necessary for us to reevaluate our long-term operating plans to make more efficient use of our existing capital resources. The exact nature of any changes to our plans that would be considered depends on various factors, such as conditions in the factory-built housing industry and general economic conditions outside of our control.

Projected cash to be provided by or used in operations in the coming year is largely dependent on sales volume. Operating activities provided \$8.7 million of cash during the nine months ended December 31, 2011, compared to requiring the use of \$2.3 million during the same period last year. Cash provided by operating activities during the current period was primarily the result of cash generated by the new finance subsidiaries, including proceeds from sales of consumer loans and collecting principal payments on consumer loans originated, as well as operating income before non-cash charges. These increases were supplemented by increases of accounts payable and accrued liabilities, offset in part by the volume of consumer loans originated and increases in inventory finance receivables, prepaid assets and accounts receivable. Cash used by operating activities during the nine months ended December 31, 2010 was primarily the result of net funding of inventory finance initiatives and decreases in accounts payable, offset in part by operating income before non-cash charges and collections of trade receivables.

Investing activities required the use of \$25.3 million of cash during the nine months ended December 31, 2011, compared to the use of \$39.0 million of cash during the same period last year. Cash used by investing activities in the current period was primarily for funds to complete the acquisition of the assets and assumption of specified liabilities of Palm Harbor Homes, Inc. under the asset purchase agreement and debtor-in-possession credit facility, as discussed in Notes 20 and 21, and capital expenditures in all of our operations, offset in part by proceeds from the sale of three idle facilities acquired in the Palm Harbor transaction. Cash used by investing activities in the prior year period was primarily for funds provided to Palm Harbor Florida under the debtor-in-possession credit facility, as discussed in Note 20.

**Table of Contents**

Financing activities required the use of \$24.5 million in cash during the nine months ended December 31, 2011, consisting of \$19.5 million used to retire a certain debt obligation of the Company's new subsidiary, CountryPlace Acceptance Corp., on May 10, 2011 (see Note 21), offset in part by \$1.5 million from the issuance of common stock under our stock incentive plans. Financing activities provided \$15.4 million in cash during the nine months ended December 31, 2010, consisting of \$14.0 million from the issuance of a convertible note payable to Third Avenue, which holds a redeemable noncontrolling interest in Fleetwood Homes (see Note 22), and \$1.4 million from the issuance of stock under our stock incentive plans.

**Contractual Obligations and Commitments**

The following table summarizes our contractual obligations at December 31, 2011, consisting of future payments under securitized financings and non-cancelable operating lease agreements. For additional information related to these obligations, see Notes 11 and 14 to the Consolidated Financial Statements. This table excludes long-term obligations for which there is no definite commitment period.

	September 30, Total	September 30, Less than 1 year	September 30, Payments Due by Period 1-3 Years (In thousands)	September 30, 3-5 Years	September 30, After 5 Years
<b>Debt obligations:</b>					
Securitized financing 2005-1 (1) (2)	\$ 60,813	\$ 7,807	\$ 13,447	\$ 11,013	\$ 28,546
Securitized financing 2007-1 (1) (2)	60,497	8,663	13,966	11,001	26,867
Construction lending lines (1)	5,599	5,599			
Commitments for future payments under noncancelable operating leases	9,941	4,085	4,680	1,172	4
<b>Total contractual obligations</b>	<b>\$ 136,850</b>	<b>\$ 26,154</b>	<b>\$ 32,093</b>	<b>\$ 23,186</b>	<b>\$ 55,417</b>

(1) Interest is calculated by applying contractual interest rates to month-end balances.

(2) The timing of these estimated payments fluctuates based upon various factors, including loan portfolio prepayment and default rates. The following table summarizes our contingent commitments at December 31, 2011, consisting of contingent repurchase obligations, letters of credit and remaining construction contingent commitments. For additional information related to these contingent obligations, see Note 14 to the Consolidated Financial Statements.

	September 30, Total	September 30, Less than 1 year	September 30, Contingent Payments Due by Period 1-3 Years (In thousands)	September 30, 3-5 Years	September 30, After 5 Years
Repurchase obligations (1)	\$ 11,474	\$ 9,780	\$ 1,694	\$	\$
Letters of credit (2)	7,200	7,200			
Construction contingent commitment (3)	3,754	3,754			
<b>Total contractual obligations</b>	<b>\$ 22,428</b>	<b>\$ 20,734</b>	<b>\$ 1,694</b>	<b>\$</b>	<b>\$</b>

(1)

## Edgar Filing: CAVCO INDUSTRIES INC - Form 10-Q

For a complete description of the contingent repurchase obligation, see Critical Accounting Policies Reserve for Repurchase Commitments in the Company's latest annual report. Although the commitments outstanding at December 31, 2011 have a finite life, these commitments are continually replaced as we continue to sell manufactured homes to retailers under repurchase and other recourse agreements with lending institutions which have provided wholesale floor plan financing to retailers.

- (2) While the current letters of credit have finite lives, they are subject to renewal based on their underlying requirements.
- (3) The total loan contract amount, less cumulative advances, represents an off-balance sheet contingent commitment of CountryPlace to fund future advances.



## **Table of Contents**

### **Critical Accounting Policies**

In Part II, Item 7 of our Form 10-K, under the heading *Critical Accounting Policies*, we have provided a discussion of the critical accounting policies that management believes affect its more significant judgments and estimates used in the preparation of our Consolidated Financial Statements. In addition, refer to the following accounting policies.

*Accretible Yield on Consumer Loans Receivable and Securitized Financings.* The Company acquired consumer loans receivable and securitized financings during the first quarter of fiscal 2012 as a part of the Palm Harbor transaction. Acquired consumer loans receivable held for investment and securitized financings were acquired at fair value, which resulted in a discount, and subsequently are accounted for a manner similar to ASC 310-30 to accrete the discount.

The Company considers expected prepayments and estimates the amount and timing of undiscounted expected principal, interest and other cash flows for consumer loans receivable held for investment to determine the expected cash flows on securitized financings and the contractual payments. The amount of contractual principal and contractual interest payments due on the securitized financings in excess of all cash flows expected as of the Acquisition Date cannot be accreted into interest expense (the non-accretible difference). The remaining amount is accreted into interest expense over the remaining life of the obligation (referred to as accretible yield).

### **Recent Accounting Pronouncements**

In July 2010, the FASB issued Accounting Standards Update ( ASU ) 2010-20, *Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*, which requires entities to provide new disclosures in their financial statements about their financing receivables, including credit risk exposures and the allowance for credit losses on a disaggregated basis. In April 2011, the FASB issued ASU 2011-02, *A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring*. ASU 2011-02 clarifies when creditors should classify loan modifications as troubled debt restructurings. In addition, ASU 2011-02 deferred the effective date of the disclosures about troubled debt restructurings in ASU 2010-20 to periods beginning after June 15, 2011. As of December 31, 2011, the Company has adopted all of the aforementioned provisions of ASU 2010-20 and ASU 2011-02.

In December 2010, the FASB issued ASU 2010-29, *Business Combinations (Topic 805): Disclosure of Supplementary Pro Forma Information for Business Combinations*. The amendments in this update are effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. The amendments affected the Company's disclosures of pro forma information surrounding the Palm Harbor acquisition (see Note 21).

In May 2011, the FASB issued ASU 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS*. The amendments are effective for public companies for interim and annual periods beginning after December 15, 2011. This update changes the wording used to describe many of the requirements for measuring fair value and for disclosing information about fair value measurements. The amendments in this update result in common fair value measurement and disclosure requirements in GAAP and International Financial Reporting Standards ( IFRS ). The Company is currently evaluating the effect ASU 2011-04 will have on the Company's disclosures in the Notes to Consolidated Financial Statements.

In June 2011, the FASB issued ASU 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income*. The amendments in this update are effective for public companies for fiscal years, and interim periods within those years, beginning after December 15, 2011. In this update, an entity has the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. This update eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. The Company is currently evaluating the effect ASU 2011-05 will have on the Company's Consolidated Financial Statements and disclosures.

## **Table of Contents**

In September 2011, the FASB issued ASU 2011-08, *Intangibles-Goodwill and Other (Topic 350): Testing Goodwill for Impairment*. The amendments in this update are effective for public companies for fiscal years beginning after December 15, 2011. In this update, an entity has the option to first assess qualitative factors to determine that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, an entity determines it is more likely than not that the fair value of a reporting unit is less than its carrying amount, then it is required to perform the first step of the two-step impairment test. However, if an entity concludes otherwise, then performing the two-step impairment test is unnecessary. Early adoption is permitted. The Company is currently evaluating the effect ASU 2011-08 will have on the Company's Consolidated Financial Statements and disclosures.

From time to time, new accounting pronouncements are issued by the FASB or the SEC that are adopted by the Company as of the specified effective dates. Unless otherwise discussed, management believes that the impact of recently issued standards, which are not yet effective, will not have a material impact on the Company's Consolidated Financial Statements upon adoption.

## **Forward-looking Statements**

Forward-looking statements involve risks, uncertainties and other factors, which may cause our actual results, performance or achievements to be materially different from those expressed or implied by such forward-looking statements. In addition to the Risk Factors described in Part I, Item 1A. *Risk Factors* in our Form 10-K, factors that could affect our results and cause them to materially differ from those contained in the forward-looking statements include, but are not limited to:

We operate in an industry that is currently experiencing a prolonged and significant downturn;

Tightened credit standards and curtailed lending activity by home-only lenders have contributed to a constrained consumer financing market, which may continue or could intensify;

The availability of wholesale financing for industry retailers is limited due to a reduced number of floor plan lenders and reduced lending limits;

Our operating results could be affected by market forces and declining housing demand;

We have incurred net losses in certain prior periods and there can be no assurance that we will generate income in the future;

A write-off of all or part of our goodwill could adversely affect our operating results and net worth;

The cyclical and seasonal nature of the manufactured housing industry causes our revenues and operating results to fluctuate, and we expect this cyclical and seasonality to continue in the future;

Our liquidity and ability to raise capital may be limited;

We have contingent repurchase obligations related to wholesale financing provided to industry retailers;

The manufactured housing industry is highly competitive, and competition may increase the adverse effects of industry conditions;

If we are unable to establish or maintain relationships with independent retailers who sell our homes, our sales could decline;

## **Table of Contents**

Our results of operations can be adversely affected by labor shortages and the pricing and availability of raw materials;

If the manufactured housing industry is not able to secure favorable local zoning ordinances, our sales could decline and our business could be adversely affected;

The loss of any of our executive officers could reduce our ability to execute our business strategy and could have a material adverse effect on our business and results of operations;

Certain provisions of our organizational documents could delay or make more difficult a change in control of our Company;

Volatility of stock price;

Deterioration in economic conditions in general and continued turmoil in the credit markets could reduce our earnings and financial condition;

We may not be able to successfully integrate Fleetwood Homes, Palm Harbor, and any future acquisition or attain the anticipated benefits of such acquisition and the acquisition of Fleetwood Homes, Palm Harbor and any future acquisition may adversely impact the Company's liquidity;

Our increasing participation in certain wholesale financing programs for the purchase of our products by industry retailers exposes us to additional risk of credit loss, which could adversely impact the Company's liquidity and results of operations; and

Our expansion of retail and manufacturing businesses and entry into new lines of business, namely manufactured housing consumer finance and insurance, through the Palm Harbor transaction could expose the Company to additional risks.

We may make additional written or oral forward-looking statements from time to time in filings with the SEC or in public news releases or statements. Such additional statements may include, but are not limited to, projections of revenues, income or loss, capital expenditures, acquisitions, plans for future operations, financing needs or plans, the impact of inflation and plans relating to our products or services, as well as assumptions relating to the foregoing.

Statements in this Report on Form 10-Q, including those set forth in this section, may be considered forward looking statements within the meaning of Section 21E of the Securities Act of 1934. These forward-looking statements are often identified by words such as estimate, predict, hope, may, believe, anticipate, plan, expect, require, intend, assume, and similar words.

Forward-looking statements contained in this Report on Form 10-Q speak only as of the date of this report or, in the case of any document incorporated by reference, the date of that document. We do not intend to publicly update or revise any forward-looking statement contained in this Report on Form 10-Q or in any document incorporated herein by reference to reflect changed assumptions, the occurrence of unanticipated events or changes to future operating results over time.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Market risk is the risk of loss arising from adverse changes in market prices and interest rates. We may from time to time be exposed to interest rate risk inherent in our financial instruments, but are not currently subject to foreign currency or commodity price risk. We manage our exposure to these market risks through our regular operating and financing activities.

Our operations are interest rate sensitive. As overall manufactured housing demand can be adversely affected by increases in interest rates, a significant increase in wholesale or mortgage interest rates may negatively affect the ability of retailers and home buyers to secure financing.

## Edgar Filing: CAVCO INDUSTRIES INC - Form 10-Q

Higher interest rates could unfavorably impact our revenues, gross margins and net earnings. Our business is also sensitive to the effects of inflation, particularly with respect to raw material and transportation costs. We may not be able to offset inflation through increased selling prices.

**Table of Contents**

CountryPlace is exposed to market risk related to the accessibility and terms of long-term financing of its loans. In the past, CountryPlace accessed the asset-backed securities market to provide term financing of its chattel and non-conforming mortgage originations. At present, asset-backed and mortgage-backed securitization markets are effectively closed to CountryPlace and other manufactured housing lenders. Accordingly, it is unlikely that CountryPlace can continue to securitize its loan originations as a means to obtain long-term funding. This inability to continue to securitize its loans caused CountryPlace to discontinue origination of chattel loans and non-conforming mortgages until other sources of funding are available.

We are also exposed to market risks related to our fixed rate consumer loans receivable balances. For fixed rate loans receivable, changes in interest rates do not change future earnings and cash flows from the receivables. However, changes in interest rates could affect the fair market value of the loan portfolio. Assuming CountryPlace's level of loans held for investment as of December 31, 2011 is held constant, a 10% increase in average interest rates would decrease the fair value of CountryPlace's portfolio by approximately \$5.7 million.

In originating loans for sale, CountryPlace issues interest rate lock commitments ( IRLCs ) to prospective borrowers and third-party originators. These IRLCs represent an agreement to extend credit to a loan applicant, or an agreement to purchase a loan from a third-party originator, whereby the interest rate on the loan is set prior to loan closing or sale. These IRLCs bind CountryPlace to fund the approved loan at the specified rate regardless of whether interest rates or market prices for similar loans have changed between the commitment date and the closing date. As such, outstanding IRLCs are subject to interest rate risk and related loan sale price risk during the period from the date of the IRLC through the earlier of the loan sale date or IRLC expiration date. The loan commitments generally range between 30 and 180 days; however, borrowers are not obligated to close the related loans. As a result, CountryPlace is subject to fallout risk related to IRLCs, which is realized if approved borrowers choose not to close on the loans within the terms of the IRLCs. Assuming CountryPlace's level of IRLCs is held constant, a 1% increase in average interest rates would increase the fair value of CountryPlace's obligations by approximately \$670,000.

Certain of our inventory finance notes receivable and securitized financings have fixed interest rates as well. For fixed rate instruments, changes in interest rates do not change future earnings and cash flows from the receivables. However, changes in interest rates could affect the fair market value of the loan portfolio.

**Item 4. Controls and Procedures**

(a) Disclosure Controls and Procedures

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 our disclosure controls and procedures (as defined in the Securities Exchange Act of 1934 ( Exchange Act ) Rules 13a-15(e) and 15d-15(e)). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered in this report, our disclosure controls and procedures were effective.

(b) Changes In Internal Control Over Financial Reporting

We completed the Palm Harbor transaction during the quarter ended June 30, 2011. Palm Harbor operates under its own set of systems and internal controls. We are separately maintaining Palm Harbor's systems and internal controls until we are able to incorporate them into our own systems and control environment. We currently expect to complete the integration of Palm Harbor's operations into our systems and control environment during fiscal year 2013.

Other than as described above, there have been no other changes in our internal controls over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) that occurred during the fiscal quarter ended December 31, 2011, which have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents**

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

Information regarding reportable legal proceedings is contained in Part I, Item 3, *Legal Proceedings*, in our Form 10-K. The following describes legal proceedings, if any, that became reportable during the quarter ended December 31, 2011, and, if applicable, amends and restates descriptions of previously reported legal proceedings in which there have been material developments during such quarter.

We are party to certain legal proceedings that arise in the ordinary course and are incidental to our business. Certain of the claims pending against us in these proceedings allege, among other things, breach of contract and warranty, product liability, construction defect and personal injury. Although litigation is inherently uncertain, based on past experience and the information currently available, management does not believe that the currently pending and threatened litigation or claims will have a material adverse effect on the Company's consolidated financial position, liquidity or results of operations. However, future events or circumstances currently unknown to management will determine whether the resolution of pending or threatened litigation or claims will ultimately have a material effect on our consolidated financial position, liquidity or results of operations in any future reporting periods.

**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 Form 10-K, which could materially affect our business, financial condition or future results. The risks described in this Report and in our Form 10-K are not the only risks facing our Company. 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 6. Exhibits**

See Exhibit Index.

All other items required under Part II are omitted because they are not applicable.

**Table of Contents**

**SIGNATURES**

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

**Cavco Industries, Inc.**

Registrant

February 7, 2012

/s/ Joseph H. Stegmayer  
Joseph H. Stegmayer  
Chairman, President and

Chief Executive Officer

(Principal Executive Officer)

February 7, 2012

/s/ Daniel L. Urness  
Daniel L. Urness  
Vice President, Treasurer and

Chief Financial Officer

(Principal Financial and Accounting Officer)



**Table of Contents**

**EXHIBIT INDEX**

<b>Exhibit No.</b>	<b>Exhibit</b>
31.1	Certification of the Principal Executive Officer Pursuant to Rule 13-14(a) under the Securities Exchange Act of 1934
31.2	Certification of the Principal Financial Officer pursuant to Rule 13-14(a) under the Securities Exchange Act of 1934
32	Certification of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002