

CAVCO INDUSTRIES INC.  
Form 10-Q  
November 08, 2018

UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q  
(Mark One)

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

For the quarterly period ended September 29, 2018

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)  
Delaware 56-2405642  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

3636 North Central Avenue, Suite 1200  
Phoenix, Arizona 85012  
(Address of principal executive offices, including  
zip code)  
602-256-6263  
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant 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 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   
Emerging Growth Company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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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 November 2, 2018, 9,098,159 shares of Registrant's Common Stock, \$.01 par value, were outstanding.

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## PART 1. FINANCIAL INFORMATION

## Item 1. Financial Statements

## CAVCO INDUSTRIES, INC.

## CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except per share amounts)

|   | September 29,<br>2018 | March 31,<br>2018 |
|---|-----------------------|-------------------|
|   | (Unaudited)           |                   |
| <b>ASSETS</b>   |                       |                   |
| Current assets:   |                       |                   |
| Cash and cash equivalents   | \$ 195,488            | \$ 186,766        |
| Restricted cash, current  | 13,754                | 11,228            |
| Accounts receivable, net  | 38,097                | 35,043            |
| Short-term investments  | 13,462                | 11,866            |
| Current portion of consumer loans receivable, net   | 31,327                | 31,096            |
| Current portion of commercial loans receivable, net   | 10,909                | 5,481             |
| Inventories   | 111,502               | 109,152           |
| Prepaid expenses and other current assets   | 34,169                | 27,961            |
| Total current assets  | 448,708               | 418,593           |
| Restricted cash   | 453                   | 1,264             |
| Investments   | 33,149                | 33,573            |
| Consumer loans receivable, net  | 62,021                | 63,855            |
| Commercial loans receivable, net  | 22,920                | 11,120            |
| Property, plant and equipment, net  | 65,108                | 63,355            |
| Goodwill and other intangibles, net   | 82,856                | 83,020            |
| Total assets  | \$ 715,215            | \$ 674,780        |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                       |                   |
| Current liabilities:  |                       |                   |
| Accounts payable  | \$ 25,676             | \$ 23,785         |
| Accrued liabilities   | 130,083               | 126,500           |
| Current portion of securitized financings and other   | 40,969                | 26,044            |
| Total current liabilities   | 196,728               | 176,329           |
| Securitized financings and other  | 15,159                | 33,768            |
| Deferred income taxes   | 8,580                 | 7,577             |
| Stockholders' equity:   |                       |                   |
| Preferred stock, \$.01 par value; 1,000,000 shares authorized; No shares issued or outstanding                        | —                     | —                 |
| Common stock, \$.01 par value; 40,000,000 shares authorized; Outstanding 9,097,359 and 9,044,858 shares, respectively | 91                    | 90                |
| Additional paid-in capital  | 248,138               | 246,197           |
| Retained earnings   | 246,723               | 209,381           |
| Accumulated other comprehensive income (loss)   | (204                  | ) 1,438           |
| Total stockholders' equity  | 494,748               | 457,106           |
| Total liabilities and stockholders' equity  | \$ 715,215            | \$ 674,780        |
| See accompanying Notes to Consolidated Financial Statements   |                       |                   |

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CAVCO INDUSTRIES, INC.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Dollars in thousands, except per share amounts)

(Unaudited)

|   | Three Months Ended |               | Six Months Ended |               |
|---|--------------------|---------------|------------------|---------------|
|   | September 30,      | September 30, | September 30,    | September 30, |
|   | 2018               | 2017          | 2018             | 2017          |
| Net revenue   | \$241,530          | \$ 200,507    | \$487,933        | \$ 407,323    |
| Cost of sales   | 192,114            | 165,953       | 387,041          | 330,803       |
| Gross profit  | 49,416             | 34,554        | 100,892          | 76,520        |
| Selling, general and administrative expenses                          | 30,035             | 26,153        | 59,248           | 52,458        |
| Income from operations  | 19,381             | 8,401         | 41,644           | 24,062        |
| Interest expense  | (941 )             | (1,021 )      | (1,913 )         | (2,069 )      |
| Other income, net   | 1,077              | 1,119         | 3,922            | 2,157         |
| Income before income taxes  | 19,517             | 8,499         | 43,653           | 24,150        |
| Income tax expense  | (3,941 )           | (2,317 )      | (8,386 )         | (6,215 )      |
| Net income  | \$15,576           | \$ 6,182      | \$35,267         | \$ 17,935     |
| Comprehensive income:   |                    |               |                  |               |
| Net income  | \$15,576           | \$ 6,182      | \$35,267         | \$ 17,935     |
| Reclassification adjustment for net losses (gains) realized in income | 24                 | (383 )        | 24               | (459 )        |
| Applicable income taxes   | (5 )               | 134           | (5 )             | 161           |
| Net change in unrealized position of investments                      | (57 )              | 2,275         | (51 )            | 1,442         |
| Applicable income taxes   | 12                 | (867 )        | 11               | (540 )        |
| Comprehensive income  | \$15,550           | \$ 7,341      | \$35,246         | \$ 18,539     |
| Net income per share:   |                    |               |                  |               |
| Basic   | \$1.72             | \$ 0.69       | \$3.89           | \$ 1.99       |
| Diluted   | \$1.67             | \$ 0.67       | \$3.80           | \$ 1.96       |
| Weighted average shares outstanding:                                  |                    |               |                  |               |
| Basic   | 9,079,679          | 9,020,834     | 9,064,007        | 9,013,917     |
| Diluted   | 9,304,188          | 9,181,899     | 9,287,730        | 9,171,515     |

See accompanying Notes to Consolidated Financial Statements

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CAVCO INDUSTRIES, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Dollars in thousands)  
(Unaudited)

|   | Six Months Ended<br>September 29,<br>2018 |   | September 30,<br>2017 |   |
|---|---|---|-----------------------|---|
| <b>OPERATING ACTIVITIES</b>   |   |   |                       |   |
| Net income  | \$ 35,267                                 |   | \$ 17,935             |   |
| Adjustments to reconcile net income to net cash provided by operating activities: |   |   |                       |   |
| Depreciation and amortization   | 2,274                                     |   | 1,950                 |   |
| Provision for credit losses   | 459                                       |   | 676                   |   |
| Deferred income taxes   | 863                                       |   | (1,267)               | ) |
| Stock-based compensation expense  | 2,115                                     |   | 1,535                 |   |
| Non-cash interest income, net   | (409)                                     | ) | (526)                 | ) |
| Gain on sale of property, plant and equipment, net                                | (51)                                      | ) | (88)                  | ) |
| Gain on investments and sale of loans, net  | (5,457)                                   | ) | (5,047)               | ) |
| Changes in operating assets and liabilities:                                      |   |   |                       |   |
| Accounts receivable   | (3,057)                                   | ) | (5,512)               | ) |
| Consumer loans receivable originated  | (64,479)                                  | ) | (66,273)              | ) |
| Proceeds from sales of consumer loans   | 62,245                                    |   | 59,243                |   |
| Principal payments on consumer loans receivable                                   | 6,522                                     |   | 7,540                 |   |
| Inventories   | (2,350)                                   | ) | (5,733)               | ) |
| Prepaid expenses and other current assets   | (4,703)                                   | ) | (12,448)              | ) |
| Commercial loans receivable   | (17,321)                                  | ) | (5,355)               | ) |
| Accounts payable and accrued liabilities  | 5,890                                     |   | 22,055                |   |
| Net cash provided by operating activities   | 17,808                                    |   | 8,685                 |   |

INVESTING  
ACTIVITIES

|   |         |   |         |   |
|---|---------|---|---------|---|
| Purchases of property, plant and equipment          | (3,876) | ) | (1,779) | ) |
| Payments for Lexington Homes, net                   | —       |   | (564)   | ) |
| Proceeds from sale of property, plant and equipment | 64      |   | 411     |   |
| Purchases of investments                            | (4,042) | ) | (5,162) | ) |
| Proceeds from sale of investments                   | 4,684   |   | 4,925   |   |
| Net cash used in investing activities               | (3,170) | ) | (2,169) | ) |

FINANCING  
ACTIVITIES

|   |            |   |            |   |
|---|------------|---|------------|---|
| Payments from exercise of stock options                               | (173)      | ) | (1,583)    | ) |
| Proceeds from secured financings and other                            | 226        |   | 4,963      |   |
| Payments on securitized financings                                    | (4,254)    | ) | (4,322)    | ) |
| Net cash used in financing activities                                 | (4,201)    | ) | (942)      | ) |
| Net increase in cash, cash equivalents and restricted cash            | 10,437     |   | 5,574      |   |
| Cash, cash equivalents and restricted cash at beginning of the period | 199,258    |   | 144,839    |   |
| Cash, cash equivalents and restricted cash at end of the period       | \$ 209,695 |   | \$ 150,413 |   |

Supplemental disclosures of cash flow information:

|                                     |           |  |          |  |
|-------------------------------------|-----------|--|----------|--|
| Cash paid for income taxes          | \$ 12,381 |  | \$ 7,861 |  |
| Cash paid for interest              | \$ 1,300  |  | \$ 1,508 |  |
| Assets acquired under capital lease | \$ —      |  | \$ 1,749 |  |

See accompanying Notes to Consolidated Financial Statements

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CAVCO INDUSTRIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 U.S. generally accepted accounting principles ("GAAP") 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. Certain prior period amounts have been reclassified to conform to current period classification. The Company has evaluated subsequent events after the balance sheet date through the date of the filing of this report with the SEC; and except for the events set forth in the Notes to the Consolidated Financial Statements ("Notes") 16 and 22 and Part II, Item 5, Other Information, of the Company's Quarterly Report on Form 10-Q for the period ended September 29, 2018 ("Form 10-Q"), there were no disclosable subsequent events. These Consolidated Financial Statements should be read in conjunction with the audited Consolidated Financial Statements and the Notes included in the Company's 2018 Annual Report on Form 10-K for the year ended March 31, 2018, filed with the SEC on May 30, 2018 ("Form 10-K").

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the Consolidated Financial Statements and the accompanying Notes. Actual results could differ from those estimates. The Consolidated Statements of Comprehensive Income and Consolidated Statements of Cash Flows for the interim periods are not necessarily indicative of the results or cash flows for the full year. The Company operates on a 52-53 week fiscal year ending on the Saturday nearest to March 31 of each year. Each fiscal quarter consists of 13 weeks, with an occasional fourth quarter extending to 14 weeks, if necessary, for the fiscal year to end on the Saturday nearest to March 31. The Company's current fiscal year will end on March 30, 2019.

The Company operates principally in two segments: (1) factory-built housing, which includes wholesale and retail systems-built housing operations, and (2) financial services, which includes manufactured housing consumer finance and insurance. The Company designs and builds a wide variety of affordable manufactured homes, modular homes and park model RVs in 20 factories located throughout the United States, which are sold to a network of independent retailers, through the Company's 38 Company-owned retail stores and to community owners and developers. Our financial services group is comprised of a mortgage subsidiary, CountryPlace Acceptance Corp. ("CountryPlace"), and an insurance subsidiary, Standard Casualty Co. ("Standard Casualty"). CountryPlace is an approved Federal National Mortgage Association ("FNMA" or "Fannie Mae") and Federal Home Loan Mortgage Corporation ("FHLMC" or "Freddie Mac") seller/servicer, and a Government National Mortgage Association ("GNMA" or "Ginnie Mae") mortgage-backed securities issuer which offers conforming mortgages, non-conforming mortgages and home-only loans to purchasers of factory-built homes. Standard Casualty provides property and casualty insurance to owners of manufactured homes.



#### Adoption of New Accounting Standards.

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606) ("ASC 606"), which requires entities to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. We adopted ASC 606 using the modified retrospective method for contracts that were not completed as of April 1, 2018, and recorded a reduction of \$600,000 to accrued liabilities and a corresponding increase to retained earnings related to gross margin on home sales that were previously deferred for the cumulative effect of the adoption. Prior periods were not restated. There were no significant changes to processes or internal controls as a result of the adoption of ASC 606. See Note 2 for additional information.

In January 2016, the FASB issued ASU 2016-01, Financial Instruments (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities ("ASU 2016-01"). The Company adopted ASU 2016-01 on April 1, 2018 using the modified retrospective transition method. Upon adoption, we reclassified \$1.6 million in gains, net of tax, related to available-for-sale equity investment securities from accumulated other comprehensive income to retained earnings as a cumulative-effect adjustment. Under the new guidance, these securities will continue to be measured at fair value; however, the changes in unrealized net holding gains and losses will be reported in earnings. Comparative information continues to be reported under the accounting standards in effect for the period. The effect of the change for the three and six months ended September 29, 2018 was a decrease of \$276,000 and an increase of \$1.4 million to income before income taxes, respectively, which is either included in Net revenue or Other income, net on the Consolidated Statements of Comprehensive Income, depending on the nature of the investment.

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash (a consensus of the FASB Emerging Issues Task Force) ("ASU 2016-18"), which requires restricted cash to be included with cash and cash equivalents when reconciling beginning and ending cash on the statement of cash flows. We adopted ASU 2016-18 on April 1, 2018 using the retrospective transition method. The comparative information in our Consolidated Statements of Cash Flows has been adjusted accordingly. The impact from adoption of this guidance was not material to our Consolidated Statements of Cash Flows. The following table provides a reconciliation of cash, cash equivalents and restricted cash reported within the accompanying Consolidated Balance Sheets to the combined amounts shown on the Consolidated Statements of Cash Flows (in thousands):

|                           | September 29, September 30, |            |
|---------------------------|-----------------------------|------------|
|                           | 2018                        | 2017       |
| Cash and cash equivalents | \$ 195,488                  | \$ 136,788 |
| Restricted cash, current  | 13,754                      | 12,899     |
| Restricted cash           | 453                         | 726        |
|                           | \$ 209,695                  | \$ 150,413 |

#### Accounting Standards Issued But Not Yet Adopted.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842) ("ASU 2016-02"). ASU 2016-02 will be effective beginning with the first quarter of the Company's fiscal year 2020, with early adoption permitted. The amendments require balance sheet recognition of leased assets and lease liabilities for most leases, and recognition of expenses in the income statement in a manner similar to current accounting treatment. In addition, disclosures of key information about leasing arrangements are required. Upon adoption, leases will be recognized and measured at the beginning of the earliest period presented using a modified retrospective approach. The Company does not plan to early adopt the guidance and is currently evaluating the effect ASU 2016-02 will have on the Company's Consolidated Financial Statements and disclosures.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments ("ASU 2016-13"). ASU 2016-13 changes the impairment model for most financial assets and certain other instruments to base measurement on expected losses through a forward-looking model rather than a model based on incurred losses. The guidance also requires increased disclosures. ASU 2016-13 will be effective beginning with the first quarter of the Company's fiscal year 2021 and is to be applied using a modified retrospective transition method with early adoption permitted. The Company does not plan to early adopt the guidance and is currently evaluating the effect ASU 2016-13 will have on the Company's Consolidated Financial Statements and disclosures.

In March 2017, the FASB issued ASU 2017-08, Receivables — Nonrefundable Fees and Other Costs (Subtopic 310-20), Premium Amortization on Purchased Callable Debt Securities ("ASU 2017-08"), which requires the premium on callable debt securities to be amortized to the earliest call date as opposed to the contractual life of the security. ASU 2017-08 will be effective beginning with the first quarter of the Company's fiscal year 2020. The Company is currently evaluating the effect ASU 2017-08 will have on the Company's Consolidated Financial Statements and disclosures.

From time to time, new accounting pronouncements are issued by the FASB and other regulatory bodies 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.

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 on Form 10-K.

## 2. Revenue from Contracts with Customers

As discussed in Note 1, we adopted ASC 606 on April 1, 2018. Our revenue recognition practices under ASC 606 do not differ materially from prior practices. Under ASC 606, revenues are recognized when a good or service is transferred to a customer. A good or service is transferred when, or as, the customer obtains control of that good or service. Revenues are based on the consideration we expect to receive in connection with our promises to deliver goods and services to our customers.

**Factory-Built Housing Revenue Recognition - Wholesale.** 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 upon shipment or floor plan financed by the independent retailer through standard industry financing arrangements, which can include repurchase agreements. Manufacturing sales financed under repurchase agreements are reduced by a provision for estimated repurchase obligations (see Note 16).

Prior to the adoption of ASC 606, revenue from homes sold under commercial loan programs involving funds provided by the Company were either deferred until such time that payment for the related commercial loan was received by the Company or recognized when the home was shipped and title transferred, depending on the nature of the program and borrower. Upon adoption of ASC 606, we generally recognize home sales revenue upon shipment and transfer of title, as it is probable that substantially all of the consideration in exchange for the goods or services transferred to the customer will be collected. One consideration under the guidance requires the evaluation of the financing component of the related loan program. If it is determined that the interest rate charged under the loan program is less than the market rate, the Company will reduce the transaction price by an amount for deferred interest. In these cases, interest income will be accrued and recognized over the life of the loan using the effective interest method. A significant amount of the Company's loan programs are offered at market rates.

**Factory-Built Housing Revenue Recognition - Retail.** Sales by Company-owned retail locations are generally 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 probable.

Site Improvements on Retail Sales. Under previous guidance, the Company recorded the sales of subcontracted ancillary services, such as preparation of the home site or other exterior enhancements, net of associated costs. Such services are provided as a convenience to the customer. As the Company is involved in the selection of subcontractors, under ASC 606, we have concluded that it is appropriate to recognize the sale of these ancillary services on a gross basis. The revenues associated with these programs for the three months ended September 29, 2018 and September 30, 2017 were \$6.2 million and \$5.0 million, respectively. The revenues associated with these programs for the six months ended September 29, 2018 and September 30, 2017 were \$12.8 million and \$10.1 million, respectively.

Additional Items. Expected consideration, and therefore revenue, reflects reductions for returns, allowances, and other incentives, some of which may be contingent on future events. Additionally, we have a volume rebate program under which certain sales to retailers, builders and developers can qualify for cash rebates generally based on the level of sales attained during a twelve-month period. Volume rebates are accrued at the time of sale and are recorded as a reduction of revenue.

In customer contracts for retail sales of manufactured homes, consideration includes certain state and local excise taxes billed to customers when those taxes are levied directly upon us by the taxing authorities. Expected consideration excludes sales and other taxes collected on behalf of taxing authorities. We elect to treat consideration for shipping performed as a fulfillment activity. Therefore, revenue includes consideration for shipping and other fulfillment activities performed prior to the customer obtaining control of the goods.

Practical Expedients and Exemptions. We generally expense sales commissions when incurred because the amortization period would be one year or less. These costs are recorded within selling, general and administrative expenses. In addition, we do not disclose the value of unsatisfied performance obligations for contracts with an expected length of one year or less.

Financial Services Revenue Recognition. Financial services revenue is generally not within the scope of ASC 606, with the exception of insurance agency commissions received from third-party insurance companies. The Company recognizes such revenue upon execution of the insurance policy, where the Company has no future or ongoing obligation.

Disaggregation of Revenue. The following table summarizes customer contract revenues disaggregated by reportable segment and the source of the revenue for the three and six months ended September 29, 2018 (in thousands). All revenue from customers is recognized at a point in time, either when the customer takes delivery or when a third-party insurance contract is executed, as more fully discussed above. Other items included in our consolidated revenues are primarily related to financial services, including manufactured housing consumer finance and insurance, which are not within the scope of ASC 606. See Form 10-K for revenue recognition policies related to these items.

|  | September 29, 2018       |                        |
|--|--------------------------|------------------------|
|  | Three<br>Months<br>Ended | Six<br>Months<br>Ended |
| Factory-built housing  |                          |                        |
| U.S. Housing and Urban Development code homes  | \$ 184,687               | \$ 371,003             |
| Modular homes  | 23,901                   | 46,348                 |
| Park model RVs   | 5,979                    | 17,706                 |
| Other (1)  | 12,527                   | 24,799                 |
| Net revenue from factory-built housing   | 227,094                  | 459,856                |
| Financial services   |                          |                        |
| Insurance agency commissions received from third-party insurance companies   | 643                      | 1,275                  |
| Other  | 13,793                   | 26,802                 |
| Net revenue from financial services  | 14,436                   | 28,077                 |
| Total Net revenue  | \$ 241,530               | \$ 487,933             |
| (1) Other factory-built housing revenue from ancillary products and services including used homes, freight and other services. |                          |                        |

Impacts on Consolidated Financial Statements. The impact to our consolidated financial statements as a result of ASC 606 implementation are as follows (in thousands):

| September 29, 2018         |                |             |   |
|----------------------------|----------------|-------------|---|
| Consolidated Balance Sheet | As<br>Reported | Adjustments | Balance<br>without<br>ASC 606<br>Adoption |
| Accrued liabilities        | \$ 130,083     | \$ 2,007    | \$ 132,090                                |
| Total current liabilities  | 196,728        | 2,007       | 198,735                                   |
| Deferred income taxes      | 8,580          | (549 )      | 8,031                                     |
| Retained earnings          | 246,723        | (1,458 )    | 245,265                                   |
| Total stockholders' equity | 494,748        | (1,458 )    | 493,290                                   |

  

| Three Months Ended September 29,<br>2018       |                |             |   |
|--|----------------|-------------|---|
| Consolidated Statement of Comprehensive Income | As<br>Reported | Adjustments | Balance<br>without<br>ASC 606<br>Adoption |
| Net revenue                                    | \$ 241,530     | \$ (9,160 ) | \$ 232,370                                |
| Cost of sales                                  | 192,114        | (8,691 )    | 183,423                                   |
| Gross profit                                   | 49,416         | (469 )      | 48,947                                    |
| Selling, general and administrative expenses   | 30,035         | (136 )      | 29,899                                    |
| Income from operations                         | 19,381         | (333 )      | 19,048                                    |
| Income before income taxes                     | 19,517         | (333 )      | 19,184                                    |
| Income tax expense                             | (3,941 )       | 76 )        | (3,865 )                                  |
| Net income                                     | 15,576         | (257 )      | 15,319                                    |

Six Months Ended September 29,  
2018

| Consolidated Statement of Comprehensive Income | As<br>Reported | Adjustments  | Balance<br>without<br>ASC 606<br>Adoption |
|--|----------------|--------------|---|
| Net revenue                                    | \$487,933      | \$ (22,829 ) | \$465,104                                 |
| Cost of sales                                  | 387,041        | (21,080 )    | 365,961                                   |
| Gross profit                                   | 100,892        | (1,749 )     | 99,143                                    |
| Selling, general and administrative expenses   | 59,248         | (444 )       | 58,804                                    |
| Income from operations                         | 41,644         | (1,305 )     | 40,339                                    |
| Income before income taxes                     | 43,653         | (1,305 )     | 42,348                                    |
| Income tax expense                             | (8,386 )       | 301          | (8,085 )                                  |
| Net income                                     | 35,267         | (1,004 )     | 34,263                                    |

### 3. Restricted Cash

Restricted cash consists of the following (in thousands):

|   | September 29,<br>2018 | March 31,<br>2018 |
|---|-----------------------|-------------------|
| Cash related to CountryPlace customer payments to be remitted to third parties                    | \$ 11,838             | \$ 9,180          |
| Cash related to CountryPlace customer payments on securitized loans to be remitted to bondholders | 979                   | 1,311             |
| Other restricted cash   | 1,390                 | 2,001             |
|   | \$ 14,207             | \$ 12,492         |

Corresponding amounts are recorded in accounts payable and accrued liabilities for customer payments, deposits and other restricted cash.

### 4. Investments

Investments consist of the following (in thousands):

|                                    | September 29,<br>2018 | March 31,<br>2018 |
|------------------------------------|-----------------------|-------------------|
| Available-for-sale debt securities | \$ 14,900             | \$ 16,181         |
| Marketable equity securities       | 12,409                | 10,405            |
| Non-marketable equity investments  | 19,302                | 18,853            |
|                                    | \$ 46,611             | \$ 45,439         |

The Company's investments in marketable equity securities consist of common stock holdings of industrial and other companies.

Non-marketable equity investments includes \$15.0 million as of September 29, 2018 and March 31, 2018, of contributions to equity-method investments in community-based initiatives that buy and sell our homes and provide home-only financing to residents of certain manufactured home communities. Other non-marketable investments include investments in other distribution operations.

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The following tables summarize the Company's available-for-sale debt securities, gross unrealized gains and losses and fair value, aggregated by investment category (in thousands):

September 29, 2018

|   | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|---|-------------------|------------------------------|-------------------------------|---------------|
| U.S. Treasury and government debt securities    | \$300             | \$ —                         | \$ (10 )                      | \$290         |
| Residential mortgage-backed securities          | 7,714             | —                            | (207 )                        | 7,507         |
| State and political subdivision debt securities | 5,499             | 90                           | (108 )                        | 5,481         |
| Corporate debt securities                       | 1,646             | 1                            | (25 )                         | 1,622         |
|   | \$15,159          | \$ 91                        | \$ (350 )                     | \$14,900      |

March 31, 2018

|   | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|---|-------------------|------------------------------|-------------------------------|---------------|
| U.S. Treasury and government debt securities    | \$300             | \$ —                         | \$ (7 )                       | \$293         |
| Residential mortgage-backed securities          | 7,654             | —                            | (155 )                        | 7,499         |
| State and political subdivision debt securities | 6,377             | 109                          | (149 )                        | 6,337         |
| Corporate debt securities                       | 2,081             | 1                            | (30 )                         | 2,052         |
|   | \$16,412          | \$ 110                       | \$ (341 )                     | \$16,181      |

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The following tables show the gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position (in thousands):

|   | September 29, 2018  |                   |                     |                   |            |                   |
|---|---------------------|-------------------|---------------------|-------------------|------------|-------------------|
|   | Less than 12 Months |                   | 12 Months or Longer |                   | Total      |                   |
|   | Fair Value          | Unrealized Losses | Fair Value          | Unrealized Losses | Fair Value | Unrealized Losses |
| U.S. Treasury and government debt securities    | \$290               | \$ (10 )          | \$ —                | \$ —              | \$290      | \$ (10 )          |
| Residential mortgage-backed securities          | 2,738               | (51 )             | 4,764               | (156 )            | 7,502      | (207 )            |
| State and political subdivision debt securities | 1,097               | (18 )             | 2,478               | (90 )             | 3,575      | (108 )            |
| Corporate debt securities                       | 515                 | (6 )              | 855                 | (19 )             | 1,370      | (25 )             |
|   | \$4,640             | \$ (85 )          | \$ 8,097            | \$ (265 )         | \$12,737   | \$ (350 )         |

|   | March 31, 2018      |                   |                     |                   |            |                   |
|---|---------------------|-------------------|---------------------|-------------------|------------|-------------------|
|   | Less than 12 Months |                   | 12 Months or Longer |                   | Total      |                   |
|   | Fair Value          | Unrealized Losses | Fair Value          | Unrealized Losses | Fair Value | Unrealized Losses |
| U.S. Treasury and government debt securities    | \$293               | \$ (7 )           | \$ —                | \$ —              | \$293      | \$ (7 )           |
| Residential mortgage-backed securities          | 3,185               | (52 )             | 3,909               | (103 )            | 7,094      | (155 )            |
| State and political subdivision debt securities | 2,224               | (40 )             | 2,180               | (109 )            | 4,404      | (149 )            |
| Corporate debt securities                       | 1,384               | (12 )             | 367                 | (18 )             | 1,751      | (30 )             |
|   | \$7,086             | \$ (111 )         | \$ 6,456            | \$ (230 )         | \$13,542   | \$ (341 )         |

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 September 29, 2018.

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

|  | September 29, 2018 |            |
|--|--------------------|------------|
|  | Amortized Cost     | Fair Value |
| Due in less than one year              | \$698              | \$680      |
| Due after one year through five years  | 3,557              | 3,465      |
| Due after five years through ten years | 375                | 361        |
| Due after ten years                    | 2,815              | 2,887      |
| Mortgage-backed securities             | 7,714              | 7,507      |
|  | \$15,159           | \$14,900   |

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We recognize investment gains and losses on debt securities when we sell or otherwise dispose of securities on a specific identification method. There were no gross gains or losses realized during the three and six months ended September 29, 2018. There were no gross gains or losses realized for the three months ended September 30, 2017. During the six months ended September 30, 2017, there were no gross gains realized and \$10,000 in gross losses realized.

Beginning in fiscal year 2019, we have recognized unrealized gains and losses on marketable equity securities from changes in market prices during the period as a component of earnings in the Consolidated Statements of Comprehensive Income. The net investment gains and losses for the three and six months ended September 29, 2018 and September 30, 2017 are as follows (in thousands):

|   | Three Months Ended<br>September 29,<br>2018 |        | Six Months Ended<br>September 30,<br>2017 |        |
|---|---|--------|---|--------|
| Marketable equity securities:                         |   |        |   |        |
| Net (losses) gains on securities held                 | \$ (312)                                    | \$ —   | \$ 1,298                                  | \$ —   |
| Net losses on securities sold                         | (13 )                                       | —      | (53 )                                     | —      |
| Gross realized gains                                  | —   | 570    | —   | 735    |
| Gross realized losses                                 | —   | (51 )  | —   | (112 ) |
| Total net (loss) gain on marketable equity securities | \$ (325)                                    | \$ 519 | \$ 1,245                                  | \$ 623 |

## 5. Inventories

Inventories consist of the following (in thousands):

|                          | September 29,<br>2018 | March 31,<br>2018 |
|--------------------------|-----------------------|-------------------|
| Raw materials            | \$ 36,560             | \$ 36,124         |
| Work in process          | 14,143                | 13,670            |
| Finished goods and other | 60,799                | 59,358            |
|                          | \$ 111,502            | \$ 109,152        |

## 6. Consumer Loans Receivable

The following table summarizes consumer loans receivable (in thousands):

|   | September 29,<br>2018 | March 31,<br>2018 |
|---|-----------------------|-------------------|
| Loans held for investment (at Acquisition Date)               | \$ 47,948             | \$ 51,798         |
| Loans held for investment (originated after Acquisition Date) | 23,469                | 21,183            |
| Loans held for sale   | 13,258                | 12,830            |
| Construction advances   | 11,001                | 11,088            |
| Consumer loans receivable                                     | 95,676                | 96,899            |
| Deferred financing fees and other, net                        | (1,917 )              | (1,551 )          |
| Allowance for loan losses                                     | (411 )                | (397 )            |
|   | \$ 93,348             | \$ 94,951         |



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The allowance for loan losses is developed at the loan level and allocated to specific individual loans or to impaired loans. A range of probable losses is calculated after giving consideration to, among other things, the loan characteristics, and historical loss experience. The Company then makes a determination of the best estimate within the range of loan losses. The allowance for loan losses reflects the Company's judgment of the probable loss exposure on its loans held for investment portfolio.

As of the date of the Palm Harbor acquisition ("Acquisition Date"), the Company determined the excess of the loan pool's scheduled contractual principal and interest payments over all cash flows expected as an amount that includes interest that cannot be accreted into interest income (the non-accretable difference). The cash flow expected to be collected in excess of the carrying value of the acquired loans includes interest that 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 revenue.

|  | September 29,<br>2018 | March 31,<br>2018 |
|--|-----------------------|-------------------|
|  | (in thousands)        |                   |
| Consumer loans receivable held for investment – contractual amount | \$ 110,136            | \$ 120,096        |
| Purchase discount  |                       |                   |
| Accretable   | (40,937 )             | (44,481 )         |
| Non-accretable   | (21,138 )             | (23,711 )         |
| Less consumer loans receivable reclassified as other assets        | (113 )                | (106 )            |
| Total acquired consumer loans receivable held for investment, net  | \$ 47,948             | \$ 51,798         |

Over the life of the acquired loans, the Company estimates cash flows expected to be collected to determine if an allowance for loan loss related to loans acquired subsequent to the Acquisition Date is required. The weighted averages of assumptions used in the calculation of expected cash flows to be collected were as follows:

|                 | September 29, 2018 |   | March 31, 2018 |   |
|-----------------|--------------------|---|----------------|---|
| Prepayment rate | 16.2               | % | 16.0           | % |
| Default rate    | 1.2                | % | 1.2            | % |

Assuming there was a 1% unfavorable variation from the expected level, for each key assumption, the expected cash flows for the life of the portfolio, as of September 29, 2018, would decrease by approximately \$1.1 million and \$3.2 million for the expected prepayment rate and expected default rate, respectively.

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

|   | Three Months Ended<br>September 29,<br>2018 |           | Six Months Ended<br>September 29,<br>2018 |           |
|---|---|-----------|---|-----------|
| Balance at the beginning of the period              | \$ 42,873                                   | \$ 54,912 | \$ 44,481                                 | \$ 56,686 |
| Accretion   | (1,968 )                                    | (2,163 )  | (3,867 )                                  | (4,373 )  |
| Reclassifications from (to) non-accretable discount | 32  | (1,569 )  | 323                                       | (1,133 )  |
| Balance at the end of the period                    | \$ 40,937                                   | \$ 51,180 | \$ 40,937                                 | \$ 51,180 |

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Consumer loans held for investment had the following characteristics:

|  | September 29, 2018 |   | March 31, 2018 |   |
|--|--------------------|---|----------------|---|
| Weighted average contractual interest rate | 8.49               | % | 8.57           | % |
| Weighted average effective interest rate   | 9.03               | % | 9.34           | % |
| Weighted average months to maturity        | 167                |   | 168            |   |

The following table disaggregates the Company's gross consumer loans receivable for each class by portfolio segment and credit quality indicator as of the time of origination (in thousands):

| Asset Class                            | September 29, 2018                 |                  |               |                       |                              |          |
|--|------------------------------------|------------------|---------------|-----------------------|------------------------------|----------|
|  | Consumer Loans Held for Investment |                  | Unsecuritized | Construction Advances | Consumer Loans Held For Sale | Total    |
| Credit Quality Indicator (FICO® score) | Securitized 2005                   | Securitized 2007 |               |                       |                              |          |
| <b>Chattel loans</b>                   |                                    |                  |               |                       |                              |          |
| 0-619                                  | \$427                              | \$ 263           | \$ 317        | \$ —                  | \$ —                         | \$1,007  |
| 620-719                                | 9,202                              | 6,584            | 10,228        | —                     | —                            | 26,014   |
| 720+                                   | 9,850                              | 5,872            | 11,305        | —                     | 133                          | 27,160   |
| Other                                  | 48                                 | —                | 479           | —                     | —                            | 527      |
| Subtotal                               | 19,527                             | 12,719           | 22,329        | —                     | 133                          | 54,708   |
| <b>Conforming mortgages</b>            |                                    |                  |               |                       |                              |          |
| 0-619                                  | —                                  | —                | 154           | 26                    | —                            | 180      |
| 620-719                                | —                                  | —                | 2,244         | 6,291                 | 8,527                        | 17,062   |
| 720+                                   | —                                  | —                | 464           | 4,684                 | 4,598                        | 9,746    |
| Other                                  | —                                  | —                | 116           | —                     | —                            | 116      |
| Subtotal                               | —                                  | —                | 2,978         | 11,001                | 13,125                       | 27,104   |
| <b>Non-conforming mortgages</b>        |                                    |                  |               |                       |                              |          |
| 0-619                                  | 80                                 | 356              | 1,020         | —                     | —                            | 1,456    |
| 620-719                                | 1,050                              | 4,111            | 2,981         | —                     | —                            | 8,142    |
| 720+                                   | 1,266                              | 2,394            | 375           | —                     | —                            | 4,035    |
| Other                                  | —                                  | —                | 221           | —                     | —                            | 221      |
| Subtotal                               | 2,396                              | 6,861            | 4,597         | —                     | —                            | 13,854   |
| Other loans                            | —                                  | —                | 10            | —                     | —                            | 10       |
|  | \$21,923                           | \$ 19,580        | \$ 29,914     | \$ 11,001             | \$ 13,258                    | \$95,676 |

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| March 31, 2018                         |                  |                  |               |                       |                              |          |
|--|------------------|------------------|---------------|-----------------------|------------------------------|----------|
| Consumer Loans Held for Investment     |                  |                  |               |                       |                              |          |
| Asset Class                            | Securitized 2005 | Securitized 2007 | Unsecuritized | Construction Advances | Consumer Loans Held For Sale | Total    |
| Credit Quality Indicator (FICO® score) |                  |                  |               |                       |                              |          |
| <b>Chattel loans</b>                   |                  |                  |               |                       |                              |          |
| 0-619                                  | \$465            | \$ 354           | \$ 330        | \$ —                  | \$ —                         | \$1,149  |
| 620-719                                | 10,102           | 7,107            | 8,587         | —                     | 245                          | 26,041   |
| 720+                                   | 10,594           | 6,410            | 11,285        | —                     | 155                          | 28,444   |
| Other                                  | 49               | —                | 403           | —                     | —                            | 452      |
| Subtotal                               | 21,210           | 13,871           | 20,605        | —                     | 400                          | 56,086   |
| <b>Conforming mortgages</b>            |                  |                  |               |                       |                              |          |
| 0-619                                  | —                | —                | 156           | 141                   | 179                          | 476      |
| 620-719                                | —                | —                | 2,137         | 6,428                 | 6,479                        | 15,044   |
| 720+                                   | —                | —                | 199           | 4,519                 | 5,663                        | 10,381   |
| Subtotal                               | —                | —                | 2,608         | 11,088                | 12,430                       | 26,126   |
| <b>Non-conforming mortgages</b>        |                  |                  |               |                       |                              |          |
| 0-619                                  | 82               | 405              | 1,047         | —                     | —                            | 1,534    |
| 620-719                                | 1,120            | 4,378            | 3,093         | —                     | —                            | 8,591    |
| 720+                                   | 1,348            | 2,526            | 395           | —                     | —                            | 4,269    |
| Other                                  | —                | —                | 282           | —                     | —                            | 282      |
| Subtotal                               | 2,550            | 7,309            | 4,817         | —                     | —                            | 14,676   |
| Other loans                            | —                | —                | 11            | —                     | —                            | 11       |
|  | \$23,760         | \$ 21,180        | \$ 28,041     | \$ 11,088             | \$ 12,830                    | \$96,899 |

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. As of September 29, 2018, 44.7% of the outstanding principal balance of the consumer loans receivable portfolio is concentrated in Texas and 10.6% is concentrated in Florida. As of March 31, 2018, 44.2% of the outstanding principal balance of the consumer loans receivable portfolio was concentrated in Texas and 11.0% was concentrated in Florida. Other than Texas and Florida, no other state had concentrations in excess of 10% of the principal balance of the consumer loans receivable as of September 29, 2018 or March 31, 2018.

Collateral for repossessed loans is acquired through foreclosure or similar proceedings and is recorded at the estimated fair value of the home, less the costs to sell. At repossession, the fair value of the collateral is computed based on the historical recovery rates of previously charged-off loans; the loan is charged off and the loss is recorded to allowance for loan losses. On a monthly basis, the fair value of the collateral is adjusted to the lower of the amount recorded at repossession or the estimated sales price less estimated costs to sell, based on current information. Repossessed homes totaled approximately \$1.9 million and \$1.5 million as of September 29, 2018 and March 31, 2018, respectively, and are included in Prepaid expenses and other current assets in the Consolidated Balance Sheet. Foreclosure or similar proceedings in progress totaled approximately \$1.4 million and \$1.1 million as of September 29, 2018 and March 31, 2018, respectively.



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## 7. Commercial Loans Receivable and Allowance for Loan Losses

The Company's commercial loans receivable balance consists of two classes: (i) direct financing arrangements for the home product needs of our independent retailers, communities and developers; and (ii) amounts loaned by the Company under participation financing programs.

Under the terms of the direct programs, the Company provides funds for independent retailers, communities and developers' financed home purchases. Notes are secured by the homes as collateral and, in some instances, other security depending on the circumstances. The other terms of direct arrangements vary depending on the needs of the borrower and the opportunity for the Company.

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

Commercial loans receivable, net, consisted of the following by class of financing notes receivable (in thousands):

|                                | September 29, March 31, |           |
|--------------------------------|-------------------------|-----------|
|                                | 2018                    | 2018      |
| Direct loans receivable        | \$ 33,606               | \$ 16,368 |
| Participation loans receivable | 513                     | 275       |
| Allowance for loan losses      | (135 )                  | (42 )     |
| Deferred financing fees, net   | (155 )                  | —         |
|                                | \$ 33,829               | \$ 16,601 |

The commercial loans receivable balance had the following characteristics:

|  | September 29, March 31, |   |      |   |
|--|-------------------------|---|------|---|
|  | 2018                    |   | 2018 |   |
| Weighted average contractual interest rate | 5.9                     | % | 4.6  | % |
| Weighted average months to maturity        | 5                       |   | 6    |   |

The Company evaluates the potential for loss from its participation loan programs based on each independent lender's overall financial stability, as well as historical experience, and has determined that an allowance for loan losses was not needed at September 29, 2018 or March 31, 2018.

With respect to direct programs with communities and developers, borrower activity is monitored on a regular basis and contractual arrangements are in place to provide adequate loss mitigation in the event of a default. For direct programs with independent retailers, the risk of loss is spread over numerous borrowers. Borrower activity is 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 losses. The Company recorded an allowance for loan losses of \$135,000 and \$242,000 at September 29, 2018 and September 30, 2017, respectively.

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The following table represents changes in the estimated allowance for loan losses, including related additions and deductions to the allowance for loan losses applicable to the direct programs (in thousands):

|   | Three Months Ended |                    | Six Months Ended |                    |
|---|--------------------|--------------------|------------------|--------------------|
|   | September 2018     | September 30, 2017 | September 2018   | September 30, 2017 |
| Balance at beginning of period                | \$ 113             | \$ 222             | \$ 42            | \$ 210             |
| Provision for inventory finance credit losses | 22                 | 20                 | 93               | 32                 |
| Loans charged off, net of recoveries          | —                  | —                  | —                | —                  |
| Balance at end of period                      | \$ 135             | \$ 242             | \$ 135           | \$ 242             |

The following table disaggregates commercial loans receivable and the estimated allowance for loan losses for each class of financing receivable by evaluation methodology (in thousands):

|                                       | Direct Commercial Loans |                | Participation Commercial Loans |                |
|---------------------------------------|-------------------------|----------------|--------------------------------|----------------|
|                                       | September 2018          | March 31, 2018 | September 2018                 | March 31, 2018 |
| Inventory finance notes receivable:   |                         |                |                                |                |
| Collectively evaluated for impairment | \$ 13,415               | \$ 4,193       | \$ —                           | \$ —           |
| Individually evaluated for impairment | 20,191                  | 12,175         | 513                            | 275            |
|                                       | \$ 33,606               | \$ 16,368      | \$ 513                         | \$ 275         |
| Allowance for loan losses:            |                         |                |                                |                |
| Collectively evaluated for impairment | \$(135 )                | \$(42 )        | \$ —                           | \$ —           |
| Individually evaluated for impairment | —                       | —              | —                              | —              |
|                                       | \$(135 )                | \$(42 )        | \$ —                           | \$ —           |

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. The Company will resume accrual of interest once these factors have been remedied. At September 29, 2018, there are no commercial loans that are 90 days or more past due that are still accruing interest. Payments received on nonaccrual loans are recorded on a cash basis, first to interest and then to principal. At September 29, 2018, the Company was not aware of any potential problem loans that would have a material effect on the commercial loans receivable balance. Charge-offs occur when it becomes probable that outstanding amounts will not be recovered.

The following table disaggregates the Company's inventory finance receivables by class and credit quality indicator (in thousands):

|   | Direct Commercial Loans |                | Participation Commercial Loans |                |
|---|-------------------------|----------------|--------------------------------|----------------|
|   | September 2018          | March 31, 2018 | September 2018                 | March 31, 2018 |
| Risk profile based on payment activity: |                         |                |                                |                |
| Performing                              | \$ 33,606               | \$ 16,368      | \$ 513                         | \$ 275         |
| Watch list                              | —                       | —              | —                              | —              |
| Nonperforming                           | —                       | —              | —                              | —              |
|   | \$ 33,606               | \$ 16,368      | \$ 513                         | \$ 275         |

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The Company has concentrations of commercial loans receivable related to factory-built homes in excess of 10% located in the following states, measured as a percentage of commercial loans receivables principal balance outstanding:

|            | September 29, 2018 |   | March 31, 2018 |   |
|------------|--------------------|---|----------------|---|
| California | 22.1               | % | 14.4           | % |
| Arizona    | 13.0               | % | 16.7           | % |
| Texas      | 10.7               | % | 9.0            | % |
| Oregon     | 10.0               | % | 14.7           | % |

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 commercial loans receivables in any other states as of September 29, 2018 or March 31, 2018.

As of September 29, 2018 and March 31, 2018, the Company had concentrations with one independent third-party that equaled 18.4% and 37.4% of the principal balance outstanding, respectively, all of which was secured.

#### 8. Property, Plant and Equipment

Property, plant and equipment, net, consisted of the following (in thousands):

|   | September 29, 2018 |   | March 31, 2018 |   |
|---|--------------------|---|----------------|---|
| Property, plant and equipment, at cost: |                    |   |                |   |
| Land                                    | \$ 24,131          |   | \$ 24,001      |   |
| Buildings and improvements              | 41,058             |   | 39,613         |   |
| Machinery and equipment                 | 25,713             |   | 24,154         |   |
|   | 90,902             |   | 87,768         |   |
| Accumulated depreciation                | (25,794            | ) | (24,413        | ) |
|   | \$ 65,108          |   | \$ 63,355      |   |

Depreciation expense was \$1.1 million and \$2.1 million for the three and six months ended September 29, 2018, respectively. Depreciation expense of \$884,000 and \$1.8 million was recognized during the three and six months ended September 30, 2017, respectively.

Included in the amounts above are certain assets under capital leases. See Note 9 for additional information.

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## 9. Capital Leases

On April 3, 2017, in connection with the purchase of Lexington Homes, the Company recorded capital leases on manufacturing facilities and land in Lexington, Mississippi. The following amounts were recorded for the leased assets as of September 29, 2018 and March 31, 2018 (in thousands):

|                            | September 29, March 31, |          |
|----------------------------|-------------------------|----------|
|                            | 2018                    | 2018     |
| Land                       | \$ 699                  | \$ 699   |
| Buildings and improvements | 1,050                   | 1,050    |
|                            | 1,749                   | 1,749    |
| Accumulated amortization   | (53 )                   | (35 )    |
| Leased assets, net         | \$ 1,696                | \$ 1,714 |

Future minimum payments under the leases as of September 29, 2018 were as follows (in thousands):

|  |         |
|--|---------|
| FY 2019  | \$68    |
| FY 2020  | 766     |
| FY 2021  | 73      |
| FY 2022  | 73      |
| FY 2023  | 73      |
| Thereafter                                     | 195     |
| Total remaining lease payments                 | 1,248   |
| Less: Amount representing interest             | (134 )  |
| Present value of future minimum lease payments | \$1,114 |

## 10. Goodwill and Other Intangibles

Goodwill and other intangibles, net, consisted of the following (in thousands):

|  | September 29, 2018    |                          |                     | March 31, 2018        |                          |                     |
|--|-----------------------|--------------------------|---------------------|-----------------------|--------------------------|---------------------|
|  | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
| Indefinite-lived:                        |                       |                          |                     |                       |                          |                     |
| Goodwill                                 | \$72,920              | \$ —                     | \$72,920            | \$72,920              | \$ —                     | \$72,920            |
| Trademarks and trade names               | 7,200                 | —                        | 7,200               | 7,200                 | —                        | 7,200               |
| State insurance licenses                 | 1,100                 | —                        | 1,100               | 1,100                 | —                        | 1,100               |
| Total indefinite-lived intangible assets | 81,220                | —                        | 81,220              | 81,220                | —                        | 81,220              |
| Finite lived:                            |                       |                          |                     |                       |                          |                     |
| Customer relationships                   | 7,100                 | (5,863 )                 | 1,237               | 7,100                 | (5,756 )                 | 1,344               |
| Other                                    | 1,384                 | (985 )                   | 399                 | 1,384                 | (928 )                   | 456                 |
|  | \$89,704              | \$ (6,848 )              | \$82,856            | \$89,704              | \$ (6,684 )              | \$83,020            |

Amortization expense recognized on intangible assets was \$80,000 and \$164,000 during the three and six months ended September 29, 2018, respectively. Amortization expense recognized on intangible assets was \$92,000 and \$184,000 during the three and six months ended September 30, 2017, respectively.



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## 11. Accrued Liabilities

Accrued liabilities consisted of the following (in thousands):

|   | September 29, March 31, |            |
|---|-------------------------|------------|
|   | 2018                    | 2018       |
| Salaries, wages and benefits                    | \$ 23,916               | \$ 24,416  |
| Customer deposits                               | 22,277                  | 21,294     |
| Unearned insurance premiums                     | 17,804                  | 17,432     |
| Estimated warranties                            | 16,905                  | 16,638     |
| Accrued volume rebates                          | 10,090                  | 7,778      |
| Insurance loss reserves                         | 6,452                   | 6,157      |
| Company repurchase option on certain loans sold | 5,749                   | 5,637      |
| Accrued insurance                               | 5,204                   | 5,320      |
| Accrued taxes                                   | 2,629                   | 1,986      |
| Reserve for repurchase commitments              | 2,303                   | 2,207      |
| Capital lease obligation                        | 1,114                   | 1,155      |
| Other   | 15,640                  | 16,480     |
|   | \$ 130,083              | \$ 126,500 |

## 12. Warranties

Activity in the liability for estimated warranties was as follows (in thousands):

|                                | Three Months Ended |               | Six Months Ended |               |
|--------------------------------|--------------------|---------------|------------------|---------------|
|                                | September 30,      | September 30, | September 30,    | September 30, |
|                                | 2018               | 2017          | 2018             | 2017          |
| Balance at beginning of period | \$ 16,670          | \$ 16,316     | \$ 16,638        | \$ 15,479     |
| Purchase accounting additions  | —                  | —             | —                | 838           |
| Charged to costs and expenses  | 6,713              | 7,399         | 12,942           | 12,622        |
| Payments and deductions        | (6,478 )           | (7,245 )      | (12,675 )        | (12,469 )     |
| Balance at end of period       | \$ 16,905          | \$ 16,470     | \$ 16,905        | \$ 16,470     |

## 13. Debt Obligations

Debt obligations primarily consist of amounts related to loans sold that did not qualify for loan sale accounting treatment. The following table summarizes debt obligations (in thousands):

|   | September 29,<br>2018 | March 31,<br>2018 |
|---|-----------------------|-------------------|
| Acquired securitized financings (acquired as part of the Palm Harbor transaction) |                       |                   |
| Securitized financing 2005-1  | \$ 19,115             | \$ 20,524         |
| Securitized financing 2007-1  | 20,722                | 22,552            |
| Other secured financings  | 4,825                 | 4,966             |
| Secured credit facilities   | 11,466                | 11,770            |
|   | \$ 56,128             | \$ 59,812         |

Acquired securitized financings were recorded at fair value at the time of acquisition, which resulted in a discount, and subsequently are accounted for in a manner similar to ASC 310-30 to accrete the discount.



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The following table summarizes acquired securitized financings (in thousands):

|   | September 29,<br>2018 | March 31,<br>2018 |
|---|-----------------------|-------------------|
| Securitized financings – contractual amount | \$ 41,671             | \$ 46,591         |
| Purchase discount                           |                       |                   |
| Accretable                                  | (1,834 )              | (3,515 )          |
| Non-accretable (1)                          | —                     | —                 |
| Total acquired securitized financings, net  | \$ 39,837             | \$ 43,076         |

(1) There is no non-accretable difference, as the contractual payments on acquired securitized financing are determined by the cash collections from the underlying loans.

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.

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

|  | Three Months Ended    |                       | Six Months Ended      |                       |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
|  | September 30,<br>2018 | September 30,<br>2017 | September 30,<br>2018 | September 30,<br>2017 |
| Balance at the beginning of the period | \$2,697               | \$ 6,666              | \$3,515               | \$ 7,636              |
| Accretion                              | (774 )                | (846 )                | (1,577 )              | (1,716 )              |
| Adjustment to cash flows               | (89 )                 | (111 )                | (104 )                | (211 )                |
| Balance at the end of the period       | \$1,834               | \$ 5,709              | \$1,834               | \$ 5,709              |

Prior to the Acquisition Date, CountryPlace completed its initial securitization (2005-1), which was structured as a securitized borrowing. At the balance sheet dates of September 29, 2018 and March 31, 2018, only Class A-4, originally totaling \$27.4 million with a coupon rate of 5.20%, remained outstanding, with a call date in January 2019. Additionally, CountryPlace completed its second securitized borrowing (2007-1), of which only Class A-4 originally totaling \$25.1 million with a coupon rate of 5.846% remained outstanding at September 29, 2018 and March 31, 2018, with a call date in July 2019. It is anticipated that the Company will purchase or refinance these outstanding facilities at or prior to their call dates.

CountryPlace's securitized debt is subject to provisions that require certain levels of overcollateralization. Overcollateralization is equal to CountryPlace's equity in the bonds. Failure to satisfy these provisions could cause cash, which would normally be distributed to CountryPlace, to be used for repayment of the principal of the related Class A bonds until the required overcollateralization level is reached. During periods when the overcollateralization is below the specified level, cash collections from the securitized loans in excess of servicing fees payable to CountryPlace and amounts owed to the Class A bondholders, trustee and surety, are applied to reduce the Class A debt until such time overcollateralization reaches the specified level. Therefore, failure to meet the overcollateralization requirement could adversely affect the timing of cash flows received by CountryPlace. However, principal payments of the securitized debt, including accelerated amounts, is payable only from cash collections from the securitized loans and no additional sources of repayment are required or permitted. As of September 29, 2018, the 2005-1 and 2007-1 securitized portfolios were within the required overcollateralization level.

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The Company has entered into secured credit facilities with independent third party banks with draw periods from one to fifteen months and maturity dates of ten years after the expiration of the draw periods. The proceeds are used by the Company to originate and hold consumer home-only loans secured by manufactured homes, which are pledged as collateral to the facilities. Upon completion of the draw down period, the facilities are converted into an amortizing loan based on a 20 or 25 year amortization period with a balloon payment due upon maturity. The maximum advance for loans under this program is 80% of the outstanding collateral principal balance, with the Company providing the remaining funds. As of September 29, 2018, the outstanding balance of the converted loans was \$11.5 million at a weighted average interest rate of 4.9%, with \$5.0 million available to draw. Amounts drawn bear interest at 5.15%. Once converted, the initial annual interest rate of 5.15% will adjust every 5 years beginning in 2024 to Prime plus 0.40%. The per annum interest rate will never be less than 5.00% or greater than 6.00%.

## 14. Reinsurance

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

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

|                               | Three Months Ended    |          |                       |          |
|-------------------------------|-----------------------|----------|-----------------------|----------|
|                               | September 29,<br>2018 |          | September 30,<br>2017 |          |
|                               | Written               | Earned   | Written               | Earned   |
| Direct premiums               | \$3,820               | \$4,249  | \$3,628               | \$4,137  |
| Assumed premiums—nonaffiliate | 6,280                 | 6,350    | 6,210                 | 6,326    |
| Ceded premiums—nonaffiliate   | (3,135 )              | (3,135 ) | (4,309 )              | (4,309 ) |
| Net premiums                  | \$6,965               | \$7,464  | \$5,529               | \$6,154  |
|                               | Six Months Ended      |          |                       |          |
|                               | September 29, 2018    |          | September 30, 2017    |          |
|                               | Written               | Earned   | Written               | Earned   |
| Direct premiums               | \$8,361               | \$8,460  | \$7,994               | \$8,287  |
| Assumed premiums—nonaffiliate | 12,214                | 12,584   | 12,470                | 12,593   |
| Ceded premiums—nonaffiliate   | (5,982 )              | (5,982 ) | (7,257 )              | (7,257 ) |
| Net premiums                  | \$15,593              | \$15,062 | \$13,207              | \$13,623 |

Typical insurance policies written or assumed by Standard Casualty have a maximum coverage of \$300,000 per claim, of which Standard Casualty cedes \$175,000 of the risk of loss per reinsurance. Therefore, Standard Casualty's risk of loss is limited to \$125,000 per claim on typical policies. After this limit, amounts are recoverable by Standard Casualty through reinsurance for catastrophic losses in excess of \$1.5 million per occurrence, up to a maximum of \$43.5 million in the aggregate.

Purchasing reinsurance contracts protects Standard Casualty from frequency and/or severity of losses incurred on insurance policies issued, such as in the case of a catastrophe that generates a large number of serious claims on multiple policies at the same time. Under these agreements, the Company is required to repurchase and reestablish its reinsurance contracts for the remainder of the year to the extent they are utilized.

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## 15. 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 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 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 August 2017, the Company received a notice of examination from the Internal Revenue Service (the "IRS") for the Company's federal income tax return for the fiscal year ended April 2, 2016. In July 2018, the Company received notice from the IRS that its examination was complete and resulted in no changes. In general, the Company is no longer subject to examination by the IRS for years before fiscal year 2015 or state and local income tax examinations by tax authorities for years before fiscal year 2013. 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.

On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (the "Tax Act"). The Tax Act makes broad and complex changes to the U.S. tax code that affect the Company and include, but are not limited to: (1) reducing the U.S. federal corporate tax rate, (2) allowing bonus depreciation for full expensing of qualified property, (3) eliminating the manufacturing deduction and (4) limiting the Company's ability to deduct certain executive compensation. The Tax Act reduces the federal corporate tax rate to 21% for our fiscal year ending March 30, 2019.

In addition, on December 22, 2017, the SEC staff issued Staff Accounting Bulletin No. 118 ("SAB 118") that allows the Company to record provisional amounts during a measurement period not to extend beyond one year of the enactment date. The Company is currently analyzing the impact of the various provisions of the Tax Act. The ultimate impact may differ from the provisional amounts recorded. The Company expects to complete our analysis within the measurement period in accordance with SAB 118.

## 16. Commitments and Contingencies

Repurchase Contingencies. The Company is contingently liable under terms of repurchase agreements with financial institutions providing inventory financing for independent 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 repurchased homes. The maximum amount for which the Company was contingently liable under such agreements approximated \$71.4 million at September 29, 2018, without reduction for the resale value of the homes. The Company applies ASC 460, Guarantees ("ASC 460"), and 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 \$2.3 million and \$2.2 million at September 29, 2018 and March 31, 2018, respectively, related to the commitments pertaining to these agreements.

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Letters of Credit. To secure certain reinsurance contracts, Standard Casualty maintains an irrevocable letter of credit of \$11.0 million to provide assurance that Standard Casualty will fulfill its reinsurance obligations. This letter of credit is secured by certain of the Company's investments. There were no amounts outstanding at either September 29, 2018 or March 31, 2018.

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. Cumulative advances on construction-period mortgages are carried in the Consolidated Balance Sheets at the amount advanced less a valuation allowance, and 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.

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

|  | September 29, March 31,<br>2018                      2018 |           |
|--|---|-----------|
| Construction loan contract amount            | \$ 29,273   | \$ 27,093 |
| Cumulative advances                          | (11,001 )   | (11,088 ) |
| Remaining construction contingent commitment | \$ 18,272   | \$ 16,005 |

Representations and Warranties of Mortgages Sold. CountryPlace sells loans to Government-Sponsored Enterprises ("GSEs") and whole-loan purchasers and finances certain loans with long-term credit facilities secured by the respective loans. In connection with these activities, CountryPlace provides to the GSEs, whole-loan purchasers and lenders, representations and warranties related to the loans sold or financed. 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 \$1.1 million as of September 29, 2018 and \$1.0 million as of March 31, 2018, 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. During the six months ended September 29, 2018, no claim request resulted in execution of an indemnification agreement.

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 270 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 unless the commitment is successfully paired with another loan that may mitigate losses from fallout.

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As of September 29, 2018, CountryPlace had outstanding IRLCs with a notional amount of \$18.6 million and are recorded at fair value in accordance with ASC 815, Derivatives and Hedging ("ASC 815"). ASC 815 clarifies that the expected net future cash flows related to the associated servicing of a loan should be included in the measurement of all written loan commitments that are accounted for at fair value through earnings. The estimated fair values of IRLCs are recorded in Prepaid expenses and other assets in the Consolidated Balance Sheets. The fair value of IRLCs is based on the value of the underlying mortgage loan adjusted for: (i) estimated cost to complete and originate the loan and (ii) the estimated percentage of IRLCs that will result in closed mortgage loans. The initial and subsequent changes in the value of IRLCs are a component of gain (loss) on mortgage loans held for sale. During the three and six months ended September 29, 2018, CountryPlace recognized losses of \$8,000 and gains of \$12,000 on outstanding IRLCs, respectively. During the three and six months ended September 30, 2017, CountryPlace recognized gains of \$10,000 and losses of \$15,000, respectively, on outstanding IRLCs.

**Forward Sales Commitments.** CountryPlace manages the risk profiles of a portion of its outstanding IRLCs and mortgage loans held for sale by entering into forward sales of mortgage-backed securities ("MBS") and whole loan sale commitments. As of September 29, 2018, CountryPlace had \$44.2 million in outstanding notional forward sales of MBSs and forward sales commitments. Commitments to forward sales of whole loans are typically in an amount proportionate with the amount of IRLCs expected to close in particular time frames, assuming no change in mortgage interest rates, for the respective loan products intended for whole loan sale.

The estimated fair values of forward sales of MBS and forward sale commitments are based on quoted market values and are recorded within Prepaid expenses and other current assets in the Consolidated Balance Sheets. During the three and six months ended September 29, 2018, CountryPlace recognized gains of \$237,000 and \$62,000, respectively, on forward sales and whole loan sale commitments. CountryPlace recognized losses of \$227,000 and \$72,000 on forward sales and whole loan sale commitments during the three and six months ended September 30, 2017, respectively.

**Legal Matters.** On August 20, 2018, the Company received a subpoena from the SEC's Division of Enforcement requesting certain documents relating to, among other items, trading in the stock of another public company. On October 1, 2018, the SEC sent a subpoena for documents and testimony to Joseph Stegmayer, the Company's former Chairman, President and Chief Executive Officer, regarding similar issues. At this time, the Company believes that Mr. Stegmayer traded in certain publicly traded stock in his personal accounts as well as in accounts held by the Company at a time when the Company had agreed to refrain from such trading. The Company has initiated an independent investigation and intends to cooperate fully with the SEC's investigation.

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.

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## 17. Stockholders' Equity

The following table represents changes in stockholders' equity for the six months ended September 29, 2018 (dollars in thousands):

|  | Common Stock |        | Additional | Retained  | Accumulated   | Total     |
|--|--------------|--------|------------|-----------|---------------|-----------|
|  | Shares       | Amount | paid-in    | earnings  | other         |           |
|  |              |        | capital    |           | comprehensive |           |
|  |              |        |            |           | income (loss) |           |
| Balance, March 31, 2018                            | 9,044,858    | \$ 90  | \$246,197  | \$209,381 | \$ 1,438      | \$457,106 |
| Net income   | —            | —      | —          | 35,267    | —             | 35,267    |
| Cumulative effect of implementing ASU 2016-01, net | —            | —      | —          | 1,621     | (1,621)       | —         |
| Cumulative effect of implementing ASC 606, net     | —            | —      | —          | 454       | —             | 454       |
| Stock option exercises                             | 52,501       | 1      | (174)      | —         | —             | (173)     |
| Stock-based compensation                           | —            | —      | 2,115      | —         | —             | 2,115     |
| Other comprehensive income, net                    | —            | —      | —          | —         | (21)          | (21)      |
| Balance, September 29, 2018                        | 9,097,359    | \$ 91  | \$248,138  | \$246,723 | \$ (204)      | \$494,748 |

## 18. 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. As of September 29, 2018, the plans, which are shareholder approved, permit the award of up to 1,650,000 shares of the Company's common stock, of which 314,330 shares were still available for grant. When options are exercised, new shares of the Company's 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 typically vest over a one to five year period as determined by the plan administrator (the Compensation Committee of the Board of Directors, which consists of independent directors). The stock incentive plans provide for accelerated vesting of stock options upon a change in control (as defined in the plans).

Stock-based compensation cost charged against income for the three and six months ended September 29, 2018 was \$1.5 million and \$2.1 million, respectively. The Company recorded stock-based compensation expense of \$1.0 million and \$1.5 million for the three and six months ended September 30, 2017, respectively.

As of September 29, 2018, total unrecognized compensation cost related to stock options was approximately \$4.5 million and the related weighted-average period over which the expense is expected to be recognized is approximately 3.62 years.



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The following table summarizes the option activity within the Company's stock-based compensation plans for the six months ended September 29, 2018:

|                                   |                         |
|-----------------------------------|-------------------------|
|                                   | Number<br>of<br>Options |
| Outstanding at March 31, 2018     | 418,205                 |
| Granted                           | 48,750                  |
| Exercised                         | (72,544 )               |
| Canceled or expired               | —                       |
| Outstanding at September 29, 2018 | 394,411                 |
| Exercisable at September 29, 2018 | 189,563                 |

## 19. 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 stock-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 (dollars in thousands, except per share amounts):

|  | Three Months Ended    |                       | Six Months Ended      |                       |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
|  | September 29,<br>2018 | September 30,<br>2017 | September 29,<br>2018 | September 30,<br>2017 |
| Net income                                     | \$15,576              | \$ 6,182              | \$35,267              | \$ 17,935             |
| Weighted average shares outstanding:           |                       |                       |                       |                       |
| Basic  | 9,079,679             | 9,020,834             | 9,064,007             | 9,013,917             |
| Common stock equivalents—treasury stock method | 24,509                | 161,065               | 223,723               | 157,598               |
| Diluted  | 9,304,188             | 9,181,899             | 9,287,730             | 9,171,515             |
| Net income per share:                          |                       |                       |                       |                       |
| Basic  | \$1.72                | \$ 0.69               | \$3.89                | \$ 1.99               |
| Diluted  | \$1.67                | \$ 0.67               | \$3.80                | \$ 1.96               |

Anti-dilutive common stock equivalents excluded from the computation of diluted earnings per share for the three and six months ended September 29, 2018 were 3,751 and 6,682, respectively. There were 4,867 and 8,432 anti-dilutive common stock equivalents excluded for the three and six months ended September 30, 2017, respectively.

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## 20. Fair Value Measurements

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

|   | September 29, 2018 |                      | March 31, 2018 |                      |
|---|--------------------|----------------------|----------------|----------------------|
|   | Book Value         | Estimated Fair Value | Book Value     | Estimated Fair Value |
| Available-for-sale debt securities (1)        | \$14,900           | \$14,900             | \$16,181       | \$16,181             |
| Marketable equity securities (1)              | 12,409             | 12,409               | 10,405         | 10,405               |
| Non-marketable equity investments (2)         | 19,302             | 19,302               | 18,853         | 18,853               |
| Consumer loans receivable (3)                 | 93,348             | 107,833              | 94,951         | 113,277              |
| Interest rate lock commitment derivatives (4) | (1 )               | (1 )                 | (12 )          | (12 )                |
| Forward loan sale commitment derivatives (4)  | (88 )              | (88 )                | 26             | 26                   |
| Commercial loans receivable (5)               | 33,829             | 31,047               | 16,601         | 16,972               |
| Securitized financings and other (6)          | (56,128 )          | (60,159 )            | (59,812 )      | (64,509 )            |
| Mortgage servicing rights (7)                 | 1,519              | 1,519                | 1,410          | 1,410                |

(1) For Level 1 classified securities, the fair value is based on quoted market prices. The fair value of Level 2 securities is based on other inputs, as further described below.

(2) The fair value approximates book value based on the non-marketable nature of the investments.

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.

(3) The fair value of the loans held for sale are estimated based on recent GSE mortgage-backed bond prices. The fair value of the construction advances approximates book value and the sales price of these loans.

(4) The fair values are based on changes in GSE mortgage-backed bond prices and, additionally for IRLCs, pull through rates.

(5) The fair value is estimated using market interest rates of comparable loans.

(6) The fair value is estimated using recent public transactions of similar asset-backed securities.

(7) The fair value of the mortgage servicing rights is based on the present value of expected net cash flows related to servicing these loans.

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 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.

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When the Company uses observable market prices for identical securities that are traded in less active markets, it classifies such securities as Level 2. When observable market prices for identical securities are not available, the Company prices its marketable debt instruments using non-binding market consensus prices that are corroborated with observable market data; quoted market prices for similar instruments; or pricing models, such as a discounted cash flow model, with all significant inputs derived from or corroborated with observable market data. Non-binding market consensus prices are based on the proprietary valuation models of pricing providers or brokers. These valuation models incorporate a number of inputs, including non-binding and binding broker quotes; observable market prices for identical or similar securities; and the internal assumptions of pricing providers or brokers that use observable market inputs and, to a lesser degree, unobservable market inputs.

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

|  | September 29, 2018 |         |         |         |
|--|--------------------|---------|---------|---------|
|  | Total              | Level 1 | Level 2 | Level 3 |
| Securities issued by the U.S Treasury and Government (1)   | \$290              | \$ —    | —\$290  | \$ —    |
| Mortgage-backed securities (1)                             | 7,507              | —       | 7,507   | —       |
| Securities issued by states and political subdivisions (1) | 5,481              | —       | 5,481   | —       |
| Corporate debt securities (1)                              | 1,622              | —       | 1,622   | —       |
| Marketable equity securities (2)                           | 12,409             | 12,409  | —       | —       |
| Interest rate lock commitment derivatives (3)              | (1 )               | —       | —       | (1 )    |
| Forward loan sale commitment derivatives (3)               | (88 )              | —       | —       | (88 )   |
| Mortgage servicing rights (4)                              | 1,519              | —       | —       | 1,519   |

(1) Unrealized gains or losses on investments are recorded in accumulated other comprehensive income (loss) at each measurement date.

(2) Unrealized gains or losses on investments are recorded in earnings at each measurement date.

(3) Gains or losses on derivatives are recognized in current period earnings through cost of sales.

(4) Changes in the fair value of mortgage servicing rights are recognized in the current period earnings through Net revenue.

No transfers between Level 1, Level 2 or Level 3 occurred during the six months ended September 29, 2018. The Company's policy regarding the recording of transfers between levels is to record any such transfers at the end of the reporting period.

Financial instruments 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 29, 2018 |         |           |          |
|-----------------------------------|--------------------|---------|-----------|----------|
|                                   | Total              | Level 1 | Level 2   | Level 3  |
| Loans held for investment         | \$83,139           | \$ —    | —         | \$83,139 |
| Loans held for sale               | 13,693             | —       | —         | 13,693   |
| Loans held—construction advances  | 11,001             | —       | —         | 11,001   |
| Commercial loans receivable       | 31,047             | —       | —         | 31,047   |
| Securitized financings and other  | (60,159 )          | —       | (60,159 ) | —        |
| Non-marketable equity investments | 19,302             | —       | —         | 19,302   |

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No recent sales have been executed in an orderly market of manufactured home loan portfolios with comparable product features, credit characteristics or performance. Therefore, loans held for investment are measured using Level 3 inputs that are calculated using estimated discounted future cash flows from the evaluation of loan credit quality and performance history to determine expected prepayments and defaults on the portfolio, discounted with rates considered to reflect current market conditions. Loans held for sale are measured at the lower of cost or fair value using inputs that consist of quoted market prices for mortgage-backed securities or investor purchase commitments for similar types of loan 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 and changes are largely driven by changes in interest rates or investor yield requirements. The cost of loans held for sale is lower than the fair value as of September 29, 2018. As noted above, activity in the manufactured housing asset-backed securities market is infrequent with no reliable market price information. As such, to determine the fair value of securitized financings, management evaluates the credit quality and performance history of the underlying loan assets to estimate the expected prepayment of the debt and credit spreads, based on market activity for similar rated bonds from other asset classes with similar durations.

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. No impairment charges were recorded during the six months ended September 29, 2018.

**Mortgage Servicing.** Mortgage Servicing Rights ("MSRs") are the rights to receive a portion of the interest coupon and fees collected from the mortgagors for performing specified mortgage servicing activities, which consist of collecting loan payments, remitting principal and interest payments to investors, managing escrow accounts, performing loss mitigation activities on behalf of investors and otherwise administering the loan servicing portfolio. MSRs are initially recorded at fair value. Changes in fair value subsequent to the initial capitalization are recorded in the Company's results of operations. The Company recognizes MSRs on all loans sold to investors that meet the requirements for sale accounting and for which servicing rights are retained.

The Company applies fair value accounting to MSRs, with all changes in fair value recorded to Net revenue in accordance with ASC 860-50, Servicing Assets and Liabilities. The fair value of MSRs is based on the present value of the expected future cash flows related to servicing these loans. The revenue components of the cash flows are servicing fees, interest earned on custodial accounts and other ancillary income. The expense components include operating costs related to servicing the loans (including delinquency and foreclosure costs) and interest expenses on servicer advances that the Company believes are consistent with the assumptions major market participants use in valuing MSRs. The expected cash flows are primarily impacted by prepayment estimates, delinquencies and market discounts. Generally, the value of MSRs is expected to increase when interest rates rise and decrease when interest rates decline, due to the effect those changes in interest rates have on prepayment estimates. Other factors noted above as well as the overall market demand for MSRs may also affect the valuation.

|   | September 29, March 31, |            |   |  |
|---|-------------------------|------------|---|--|
|   | 2018                    | 2018       |   |  |
| Number of loans serviced with MSRs            | 4,456                   | 4,346      |   |  |
| Weighted average servicing fee (basis points) | 31.96                   | 32.03      |   |  |
| Capitalized servicing multiple                | 88.17                   | % 84.76    | % |  |
| Capitalized servicing rate (basis points)     | 28.18                   | 27.15      |   |  |
| Serviced portfolio with MSRs (in thousands)   | \$ 538,920              | \$ 519,167 |   |  |
| Mortgage servicing rights (in thousands)      | \$ 1,519                | \$ 1,410   |   |  |

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## 21. Business Segment Information

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

|                             | Three Months Ended |                    | Six Months Ended |                    |
|-----------------------------|--------------------|--------------------|------------------|--------------------|
|                             | September 2018     | September 30, 2017 | September 2018   | September 30, 2017 |
| Net revenue:                |                    |                    |                  |                    |
| Factory-built housing       | \$227,094          | \$ 187,380         | \$459,856        | \$ 380,262         |
| Financial services          | 14,436             | 13,127             | 28,077           | 27,061             |
|                             | \$241,530          | \$ 200,507         | \$487,933        | \$ 407,323         |
| Income before income taxes: |                    |                    |                  |                    |
| Factory-built housing       | \$16,880           | \$ 8,584           | \$38,488         | \$ 21,754          |
| Financial services          | 2,637              | (85                | ) 5,165          | 2,396              |
|                             | \$19,517           | \$ 8,499           | \$43,653         | \$ 24,150          |

## 22. Subsequent Events

See Part II, Item 5, Other Information, on the Form 10-Q for a disclosure of applicable subsequent events of the Company.

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

Forward-Looking Statements

Statements in this Report on Form 10-Q includes "forward-looking statements," within the meaning of Section 27A of the Securities Act of 1933, Section 21E of the Securities and Exchange Act of 1934 and the Private Securities Litigation Reform Act of 1995. Forward-looking statements are often characterized by the use of words such as "believes," "estimates," "expects," "projects," "may," "will," "intends," "plans," or "anticipates," or by discussions of strategy, plans or intentions. 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.

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. To the extent that our assumptions differ from actual results, our ability to meet such forward-looking statements, including our ability to generate positive cash flow from operations, may be significantly hindered. Factors that could affect our results and cause them to materially differ from those contained in the forward-looking statements include, without limitation, those discussed in Risk Factors described in Part I, Item 1A. Risk Factors in our 2018 Annual Report on Form 10-K ("Form 10-K"), which is incorporated herein. Additional factors include potential financial impact on the Company from the subpoena we received from the Securities and Exchange Commission's Division of Enforcement (the "SEC"); the risk of potential litigation or regulatory action arising from the SEC investigation and its findings; and potential reputational damage that the Company may suffer as a result of the matters under investigation, as well as the results of the Audit Committee of the Board of Directors investigation.

Introduction

The following should be read in conjunction with Cavco Industries, Inc. and its subsidiaries' (collectively, the "Company" or "Cavco") Consolidated Financial Statements and the related Notes that appear in Item 1 of this Report. References to "Note" or "Notes" pertain to the Notes to the Company's Consolidated Financial Statements.

Overview

Headquartered in Phoenix, Arizona, the Company designs and produces factory-built homes primarily distributed through a network of independent and Company-owned retailers. We are one of the largest producers of manufactured homes in the United States, based on reported wholesale shipments, marketed under a variety of brand names, including Cavco Homes, Fleetwood Homes, Palm Harbor Homes, Fairmont Homes, Friendship Homes, Chariot Eagle and Lexington Homes. The Company is also a leading builder of park model RVs, vacation cabins and systems-built commercial structures, as well as modular homes built primarily under the Nationwide Homes brand. Cavco's mortgage subsidiary, CountryPlace Acceptance Corp. ("CountryPlace"), is an approved Federal National Mortgage Association ("FNMA" or "Fannie Mae") and Federal Home Loan Mortgage Corporation ("FHLMC" or "Freddie Mac") seller/servicer, and a Government National Mortgage Association ("GNMA" or "Ginnie Mae") mortgage-backed securities issuer that offers conforming mortgages, non-conforming mortgages and home-only loans to purchasers of factory-built homes. Our insurance subsidiary, Standard Casualty Co. ("Standard Casualty"), provides property and casualty insurance primarily to owners of manufactured homes.

Company Growth

From its inception in 1965, Cavco traditionally served affordable housing markets in the southwestern United States principally through manufactured home production. During the period from 1997 to 2000, Cavco was purchased by and became a wholly-owned subsidiary of Centex Corporation, which operated the Company until 2003, when Cavco became a stand-alone publicly-held Company traded on the NASDAQ Global Select Market under the ticker symbol CVCO.

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Beginning in 2007, the overall housing industry experienced a multi-year decline, which included the manufactured housing industry. Since this downturn, Cavco strategically expanded its factory operations and related business initiatives primarily through the acquisition of industry competitor operations. This development has enabled the Company to more broadly participate in the overall housing industry recovery.

In 2009, the Company acquired certain manufactured housing assets and liabilities of Fleetwood Enterprises, Inc. ("Fleetwood"). The assets purchased included seven operating production facilities as well as idle factories. During fiscal year 2011, the Company acquired certain manufactured housing assets and liabilities of Palm Harbor Homes, Inc., a Florida corporation. The assets purchased included five operating production facilities as well as idle factories, 49 operating retail locations, a manufactured housing finance company and a homeowners insurance company. These acquisitions expanded the Company's presence across the United States.

In 2015, the Company purchased the business and operating assets of Chariot Eagle, a Florida-based manufacturer of park model RVs and manufactured homes, as well as certain assets and liabilities of Fairmont Homes. These transactions provided additional home production capabilities, grew the Company's offering of park model RV product lines and further strengthened our market position in the Southeast, Midwest, the western Great Plains states and several provinces in Canada.

On April 3, 2017, the Company purchased Lexington Homes, which operates one manufacturing facility in Lexington, Mississippi. This transaction was accounted for as a business combination and provides additional home production capabilities and increased distribution into new markets in the Southeast.

The Company operates 20 homebuilding facilities located in Millersburg and Woodburn, Oregon; Nampa, Idaho; Riverside, California; Phoenix and Goodyear, Arizona; Austin, Fort Worth, Seguin and Waco, Texas; Montevideo, Minnesota; Nappanee, Indiana; Lafayette, Tennessee; Lexington, Mississippi; Martinsville and Rocky Mount, Virginia; Douglas, Georgia; and Ocala and Plant City, Florida. The majority of the homes produced are sold to and distributed by independently owned retailers located primarily throughout the United States and Canada. In addition, our homes are sold through 38 Company-owned U.S. retail locations.

**Company Outlook**

We maintain a conservative cost structure in an effort to build added value into our homes. In addition, the Company has worked diligently to maintain a solid financial position. Our balance sheet strength and position in cash and cash equivalents should help us avoid liquidity problems and enable us to act effectively as market opportunities present themselves.

With manufacturing facilities strategically positioned across the United States, 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 and interests. By offering a full range of homes from entry-level models to large custom homes with the ability to engineer designs in-house, we can accommodate virtually any customer request. In addition to homes built in accordance with the National Manufacturing Home Construction and Safety Standards ("HUD code") promulgated by the U.S. Department of Housing and Urban Development ("HUD"), we construct modular homes that conform to state and local codes, park model RVs and cabins and light commercial buildings at many of our manufacturing facilities.

We employ a concerted effort to identify niche market opportunities where our diverse product lines and custom building capabilities provide us with a competitive advantage. Our green building initiatives involve the creation of an energy efficient envelope and higher utilization of renewable materials. These homes provide environmentally-friendly maintenance requirements, typically lower utility costs, specially designed ventilation systems and sustainability. Cavco also builds homes designed to use alternative energy sources, such as solar and wind. 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.

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Based on the relatively low cost associated with manufactured home ownership, our products have traditionally competed with rental housing's monthly payment affordability. Rental housing activity is reported to have continued to increase in recent years. As a result, tenant housing vacancy rates appear to have declined, causing a corresponding rise in associated rental rates. These rental market factors may cause some renters to become interested buyers of affordable-housing alternatives, including manufactured homes.

Further, with respect to the general rise in demand for rental housing, we have realized a larger proportion of orders from developers and community owners for new manufactured homes intended for use as rental housing. The Company is responsive to the unique product and related requirements of these home buyers and values the opportunity to provide homes that are well suited for these purposes.

The backlog of sales orders at September 29, 2018 varied among our 20 factories and in total was approximately \$204 million compared to \$199 million at September 30, 2017. Retailers may cancel orders prior to production without penalty. Accordingly, until the production of a particular home has commenced, we do not consider our backlog to be firm orders. In response to this accelerating demand, we have raised production levels by increasing our workforce size and capabilities. However, the constrained labor market is a key challenge to further increasing production to keep pace with order rates. In addition, we have implemented higher product pricing to offset rising input costs, including labor and material price increases, although large backlogs may cause deferred realization of the full benefits.

The Company participates in certain commercial loan programs with members of the Company's independent wholesale distribution chain. Under these programs, the Company provides a significant amount of the funds that independent financiers then lend to distributors to finance retail inventories of our products. In addition, the Company has entered into direct commercial loan arrangements with distributors, communities and developers under which the Company provides funds for financing homes (see Note 7 to the Consolidated Financial Statements). The Company's involvement in commercial loans has increased the availability of manufactured home financing to distributors and users of our products. We believe that our participation in wholesale financing is helpful to retailers, communities and developers and allows our homes additional opportunities for exposure to potential home buyers. These initiatives support the Company's ongoing efforts to expand our distribution base in all of our markets with existing and new customers. However, the initiatives expose the Company to risks associated with the creditworthiness of certain customers and business partners, including independent retailers, developers, communities and inventory financing partners.

Restrictive underwriting guidelines, irregular appraisal processes, higher interest rates compared to site-built homes, regulatory burdens, a limited number of institutions lending to manufactured home buyers and limited secondary market availability for manufactured home loans have been significant constraints to industry growth. We are working directly with other industry participants to develop manufactured home consumer financing loan portfolios to attract industry financiers interested in furthering or expanding lending opportunities in the industry. Additionally, we continue to invest in community-based lending initiatives that provide home-only financing to new residents of certain manufactured home communities. Our mortgage subsidiary also develops and invests in home-only lending programs to grow sales of homes through traditional distribution points. We believe that growing our participation in home-only lending may provide additional sales growth opportunities for our factory-built housing operations.



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We are also working through industry trade associations to encourage favorable legislative and Government-Sponsored Enterprise ("GSE") action to address the mortgage financing needs of potential buyers of affordable homes. Federal law requires the GSEs to issue a regulation to implement the "Duty to Serve" requirements specified in the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, as amended by the Housing and Economic Recovery Act of 2008. In December 2017, FNMA and FHLMC released their final Underserved Markets Plan that describes, with specificity, the actions they will take over a three-year period to fulfill the "Duty to Serve" obligation. These plans became effective on January 1, 2018. Each of the three-year plans offers an enhanced mortgage loan product through their "MH Advantage" and "MH ChoiceHome" programs, as well as establishes a pilot program to purchase home-only loans. Expansion of the secondary market for lending through the GSEs could provide further demand for housing, as lending options would likely become more available to home buyers. Although some limited progress has been made in the area, meaningful positive impact in the form of increased home orders has yet to be realized.

On January 25, 2018, HUD announced a top-to-bottom review of its manufactured housing rules as part of a broader effort to identify regulations that may be ineffective, overly burdensome, or excessively costly given the critical need for affordable housing. If certain changes are made, the Company may be able to more effectively serve buyers of affordable homes.

The insurance subsidiary is subject to adverse effects from excessive policy claims that may occur during periods of inclement weather, including seasonal spring storms or fall hurricane activity in Texas where most of its policies are underwritten. Where applicable, losses from catastrophic events are somewhat limited by reinsurance contracts in place as part of the Company's loss mitigation structure.

During the second quarter of fiscal 2018, Hurricane Harvey produced the largest recorded rain volume for a single weather event in U.S. history, resulting in historic flooding and widespread property damage, primarily in southeast Texas, causing high homeowners' insurance claim volume. While not as severe, during the second quarter of fiscal year 2019, the insurance subsidiary's results were impacted by a windstorm in Arizona, which resulted in increased homeowners' insurance claims for the period. Also, Hurricanes Florence and Michael caused widespread damage across several regions of the country. While our operations were not impacted by these storms, increased consumer demand for replacement of homes lost as a result of these events may occur. In addition, there may be a need for disaster-relief homes for the Federal Emergency Management Agency. The Company produced a limited number of these homes during the third and fourth quarters of fiscal year 2018 as a result of Hurricane Harvey.

As disclosed in Part I, Item 3, Legal Proceedings, the Company and Joseph Stegmayer received subpoenas from the SEC's Division of Enforcement seeking documents related to trading in stock of another public company (the "Public Company"). The Company expects to incur expenses related to this matter that may materially impact earnings over the next several quarters. Those costs will include, among other items, advancement of expenses for Mr. Stegmayer pursuant to his indemnity arrangements with the Company.

**Industry Overview**

According to data reported by the Manufactured Housing Institute ("MHI"), industry home shipments continue to improve, increasing 9.7% for the first 8 months of calendar year 2018 compared to the same period in the prior year. During calendar year 2017 our industry shipped approximately 93,000 HUD code manufactured homes, an increase of 14.8% over the approximately 81,000 units shipped in 2016. This was preceded by 71,000 homes shipped in 2015, 64,000 in 2014, 60,000 in 2013 and 55,000 in calendar year 2012, which was among the lowest levels since industry shipment statistics began to be recorded in 1959. Annual home shipments from 2009 to 2016 were less than the annual home shipments for each of the 40 years from 1969 to 2008. While industry HUD code manufactured home shipments have improved in recent years, the manufactured housing industry continues to operate at relatively low levels compared to historical shipment statistics.

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We believe that employment rates and underemployment among potential home buyers who favor affordable housing as well as consumer confidence levels are improving. "First-time" and "move-up" buyers of affordable homes are historically among the largest segments of new manufactured home purchasers. Included in this group are lower-income households that were particularly affected by an extended period of persistently low employment rates and underemployment. The process of repairing damaged credit among consumers and efforts to save for a home loan down-payment often require substantial time; however, improving consumer confidence in the U.S. economy is evident among manufactured home buyers interested in our products for seasonal or retirement living. Home buyers, who previously have been concerned about financial stability, now appear to be less hesitant to commit to a new home purchase. We believe sales of our products may continue to increase as employment and consumer confidence levels continue to rise.

The two largest manufactured housing consumer demographics, young adults and those who are 55+ years old, are both growing. The U.S. adult population is estimated to expand by approximately 12.1 million between 2018 and 2023. Young adults born from 1976 to 1995, sometimes referred to as Gen Y, represent a large segment of the population. Late-stage Gen Y is approximately 2.2 million people larger than the next age category born from 1966 to 1975, Gen X, and is considered to be in the peak home-buying years. Gen Y represents prime first-time home buyers who may be attracted by the affordability, diversity of style choices and location flexibility of factory-built homes. 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 energy efficiency and low maintenance requirements of systems-built homes, and by the lifestyle offered by planned communities specifically designed for homeowners in this age group.

## Results of Operations

Three and six months ended September 29, 2018 compared to September 30, 2017

## Net Revenue.

Net revenue consisted of the following for the three and six months ended September 29, 2018 and September 30, 2017, respectively (dollars in thousands):

|   | Three Months Ended |                    | Change   | % Change |
|---|--------------------|--------------------|----------|----------|
|   | September 29, 2018 | September 30, 2017 |          |          |
| Net revenue:                                    |                    |                    |          |          |
| Factory-built housing                           | \$227,094          | \$ 187,380         | \$39,714 | 21.2 %   |
| Financial services                              | 14,436             | 13,127             | 1,309    | 10.0 %   |
|   | \$241,530          | \$ 200,507         | \$41,023 | 20.5 %   |
| <br>  |                    |                    |          |          |
| Total homes sold                                | 3,536              | 3,298              | 238      | 7.2 %    |
| <br>  |                    |                    |          |          |
| Net factory-built housing revenue per home sold | \$64,223           | \$ 56,816          | \$7,407  | 13.0 %   |
|   | Six Months Ended   |                    | Change   | % Change |
|   | September 29, 2018 | September 30, 2017 |          |          |
| Net revenue:                                    |                    |                    |          |          |
| Factory-built housing                           | \$459,856          | \$ 380,262         | \$79,594 | 20.9 %   |
| Financial services                              | 28,077             | 27,061             | 1,016    | 3.8 %    |
|   | \$487,933          | \$ 407,323         | \$80,610 | 19.8 %   |
| <br>  |                    |                    |          |          |
| Total homes sold                                | 7,423              | 6,773              | 650      | 9.6 %    |
| <br>  |                    |                    |          |          |
| Net factory-built housing revenue per home sold | \$61,950           | \$ 56,144          | \$5,806  | 10.3 %   |



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The increase in Net revenue from the factory-built housing segment for the three and six months ended September 29, 2018 compared to the same period last year was from higher home selling prices from input cost inflation, modestly larger home sizes and improved home sales volume. Net revenue for the three and six months ended September 29, 2018 includes subcontracted pass-through services of \$6.2 million and \$12.8 million, respectively, from this fiscal year's required implementation of accounting standards whereby subcontracted pass-through services, such as the preparation of a home site or other home enhancements, are now recognized on a gross basis rather than net of associated costs.

Net factory-built housing revenue per home sold is a volatile metric dependent upon several factors. A primary factor is the price disparity between sales of homes to independent retailers, builders, communities and developers ("Wholesale") and sales of homes to consumers by Company-owned retail centers ("Retail"). Wholesale sales prices are primarily comprised of the home and the cost to ship the home from a homebuilding facility to the home-site. Retail home prices include these items and retail markup, as well as items that are largely subject to home buyer discretion, including, but not limited to, installation, utility connections, site improvements, landscaping and additional services. Changes to the proportion of home sales among these distribution channels between reporting periods impacts the overall Net revenue per home sold. For the six months ended September 29, 2018, the Company sold 6,036 homes Wholesale and 1,387 Retail versus 5,541 homes Wholesale and 1,232 homes Retail in the comparable prior year period. Further, fluctuations in net factory-built housing revenue per home sold are the result of changes in product mix, which results from home buyer tastes and preferences as they select home types/models, as well as optional home upgrades when purchasing the home. These selections vary regularly based on consumer interests, local housing preferences and economic circumstances. Our product prices are also periodically adjusted for the cost and availability of raw materials included in, and labor used to produce, each home. For these reasons, we have experienced, and expect to continue to experience, volatility in overall net factory-built housing revenue per home sold.

Financial services segment revenue increased, resulting from 5.1% more home loan sales period over period and more insurance policies in force in the current year compared to the prior year. In addition, the prior year period revenue contains a reduction in net sales of \$1.4 million for additional premiums that were paid to reinstate reinsurance coverage that was utilized to mitigate losses incident to Hurricane Harvey activity. The overall increase is partially offset by lower interest income earned on securitized loan portfolios that continue to amortize.

**Gross Profit.**

Gross profit consisted of the following for the three and six months ended September 29, 2018 and September 30, 2017, respectively (in thousands):

|                                   | Three Months Ended |                    | September 29, 2018 | September 30, 2017 | \$ | % |
|-----------------------------------|--------------------|--------------------|--------------------|--------------------|----|---|
|                                   | September 29, 2018 | September 30, 2017 |                    |                    |    |   |
| Gross profit:                     |                    |                    |                    |                    |    |   |
| Factory-built housing             | \$41,798           | \$ 29,919          | \$11,879           | 39.7               | %  |   |
| Financial services                | 7,618              | 4,635              | 2,983              | 64.4               | %  |   |
|                                   | \$49,416           | \$ 34,554          | \$14,862           | 43.0               | %  |   |
| Gross profit as % of Net revenue: | 20.5               | % 17.2             | % N/A              | 3.3                | %  |   |

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|                       | Six Months Ended      |                       |              |             |
|-----------------------|-----------------------|-----------------------|--------------|-------------|
|                       | September 29,<br>2018 | September 30,<br>2017 | \$<br>Change | %<br>Change |
| Gross profit:         |                       |                       |              |             |
| Factory-built housing | \$85,684              | \$ 64,419             | \$21,265     | 33.0 %      |
| Financial services    | 15,208                | 12,101                | 3,107        | 25.7 %      |
|                       | \$100,892             | \$ 76,520             | \$24,372     | 31.9 %      |

Gross profit as % of Net revenue: 20.7 % 18.8 % N/A 1.9 %

Factory-built housing gross profit for the three and six months ended September 29, 2018 increased from higher home sales and average home selling prices from input cost inflation, as well as factory efficiencies from improved utilization. In addition, the prior year's second quarter was impacted by Hurricane Harvey, which caused delays in manufacturing and retail sales, as well as new home inventory damage at certain Company-owned retail centers. Financial services gross profit for the three and six months ended September 29, 2018 increased as the prior year's second quarter was impacted by Hurricane Harvey, resulting in significant homeowners' insurance claims. While not as significant, during the second quarter of fiscal year 2019, there were high homeowners' insurance claims related to a windstorm in Arizona. The Company maintains reinsurance for catastrophic losses in excess of \$1.5 million. In addition, the overall increase was partially offset by lower interest income earned on securitized loan portfolios that continue to amortize.

## Selling, General and Administrative Expenses.

Selling, general and administrative expenses consisted of the following for the three and six months ended September 29, 2018 and September 30, 2017, respectively (in thousands):

|   | Three Months Ended    |                       |              |             |
|---|-----------------------|-----------------------|--------------|-------------|
|   | September 29,<br>2018 | September 30,<br>2017 | \$<br>Change | %<br>Change |
| Selling, general and administrative expenses: |                       |                       |              |             |
| Factory-built housing                         | \$25,921              | \$ 22,386             | \$ 3,535     | 15.8 %      |
| Financial services                            | 4,114                 | 3,767                 | 347          | 9.2 %       |
|   | \$30,035              | \$ 26,153             | \$ 3,882     | 14.8 %      |

Selling, general and administrative expenses as % of Net revenue: 12.4 % 13.0 % N/A (0.6 )%

|   | Six Months Ended      |                       |              |             |
|---|-----------------------|-----------------------|--------------|-------------|
|   | September 29,<br>2018 | September 30,<br>2017 | \$<br>Change | %<br>Change |
| Selling, general and administrative expenses: |                       |                       |              |             |
| Factory-built housing                         | \$50,970              | \$ 44,683             | \$ 6,287     | 14.1 %      |
| Financial services                            | 8,278                 | 7,775                 | 503          | 6.5 %       |
|   | \$59,248              | \$ 52,458             | \$ 6,790     | 12.9 %      |

Selling, general and administrative expenses as % of Net revenue: 12.1 % 12.9 % N/A (0.8 )%

Selling, general and administrative expenses related to factory-built housing and financial services increased for the three and six months ended September 29, 2018 primarily from higher salary and incentive compensation expense from improved results.

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As a percentage of Net revenue, Selling, general and administrative expenses decreased modestly from fixed cost efficiencies gained from higher sales volume.

## Interest Expense.

Interest expense was \$941,000 and \$1.0 million for the three months ended September 29, 2018 and September 30, 2017, respectively. For the six months ended September 29, 2018 and September 30, 2017, Interest expense was \$1.9 million and \$2.1 million, respectively. The decrease for the three and six months ended September 29, 2018 compared to the same periods in the prior year is attributable to lower interest expense on securitized portfolios that continue to amortize, partially offset by interest related to secured credit facilities and capital leases of manufacturing facilities and land entered into as part of the Lexington Homes acquisition during fiscal year 2018.

## Other Income, net.

Other income, net was \$1.1 million in each of the three months ended September 29, 2018 and September 30, 2017. For the six months ended September 29, 2018 and September 30, 2017, Other income, net was \$3.9 million and \$2.2 million, respectively. The six months ended September 29, 2018 includes \$1.1 million in unrealized gains on corporate investments from this year's implementation of ASU 2016-01, Financial Instruments (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. Unrealized gains and losses are now required to be reported on the Consolidated Statement of Comprehensive Income instead of recording these amounts in accumulated other comprehensive income on the Consolidated Balance Sheets. In addition, interest income increased by \$805,000 in the six months ended September 29, 2018 versus the comparable period from higher interest rates on larger cash balances.

## Income Before Income Taxes.

Income before income taxes consisted of the following for the three and six months ended September 29, 2018 and September 30, 2017, respectively (in thousands):

|                             | Three Months Ended |                    | Change   | % Change   |
|-----------------------------|--------------------|--------------------|----------|------------|
|                             | September 29, 2018 | September 30, 2017 |          |            |
| Income before income taxes: |                    |                    |          |            |
| Factory-built housing       | \$16,880           | \$ 8,584           | \$8,296  | 96.6 %     |
| Financial services          | 2,637              | (85)               | 2,722    | (3,202.4)% |
|                             | \$19,517           | \$ 8,499           | \$11,018 | 129.6 %    |

|                             | Six Months Ended   |                    | Change   | % Change |
|-----------------------------|--------------------|--------------------|----------|----------|
|                             | September 29, 2018 | September 30, 2017 |          |          |
| Income before income taxes: |                    |                    |          |          |
| Factory-built housing       | \$38,488           | \$ 21,754          | \$16,734 | 76.9 %   |
| Financial services          | 5,165              | 2,396              | 2,769    | 115.6 %  |
|                             | \$43,653           | \$ 24,150          | \$19,503 | 80.8 %   |

## Income tax expense.

Income tax expense was \$3.9 million and \$2.3 million for the three months ended September 29, 2018 and September 30, 2017. For the six months ended September 29, 2018 and September 30, 2017, Income tax expense was \$8.4 million and \$6.2 million, respectively. The effective income tax rate for the second fiscal quarter was 20.2% compared to an effective tax rate of 27.3% for the same period last year. For the six months ended September 29, 2018 and September 30, 2017, the effective income tax rate was 19.2% and 25.7%, respectively.

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The decrease in our effective tax rate for the three and six months ended September 29, 2018 is attributed to the Tax Cuts and Jobs Act (the "Tax Act"), enacted on December 22, 2017, which reduced the federal corporate tax rate to 21% for our fiscal year ending March 30, 2019. Income tax expense also includes a benefit of \$1.1 million and \$2.3 million for the three and six months ended September 29, 2018, respectively, related to excess tax benefits from exercises of stock options, compared to a benefit of \$300,000 and \$1.7 million in the comparable prior year periods, respectively.

**Liquidity and Capital Resources**

We believe that cash and cash equivalents at September 29, 2018, together with cash flow from operations, will be sufficient to fund our operations and provide for growth for the next 12 months and into the foreseeable future. We maintain cash in U.S. Treasury money market funds and money market funds, some of which are in excess of federally insured limits. We expect to continue to evaluate potential acquisitions of, or strategic investments in, businesses that are complementary to our Company. Such transactions may require the use of cash and have other impacts on the Company's liquidity and capital resources in the event of such a transaction. Because of the Company's sufficient cash position, we have not sought external sources of liquidity, with the exception of certain credit facilities for our home-only lending programs. 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.

The following is a summary of our cash flows for the six months ended September 29, 2018 and September 30, 2017, respectively (in thousands):

|   | Six Months Ended   |                    | \$ Change |
|---|--------------------|--------------------|-----------|
|   | September 29, 2018 | September 30, 2017 |           |
| Cash, cash equivalents and restricted cash at beginning of the period | \$ 199,258         | \$ 144,839         | \$ 54,419 |
| Net cash provided by operating activities                             | 17,808             | 8,685              | 9,123     |
| Net cash used in investing activities                                 | (3,170 )           | (2,169 )           | (1,001 )  |
| Net cash used in financing activities                                 | (4,201 )           | (942 )             | (3,259 )  |
| Cash, cash equivalents and restricted cash at end of the period       | \$ 209,695         | \$ 150,413         | \$ 59,282 |

Net cash provided by operating activities increased during the six months ended September 29, 2018, compared to the six months ended September 30, 2017, primarily as a result of cash generated by operating income before non-cash charges from increased home sales volume and profitability compared to the prior year. This increase was partially offset by additional lending to expand the Company's commercial and home-only lending programs. Additionally, loan origination activity in excess of proceeds from the sale of loans and increased accounts receivable resulting from higher home sales offset the cash generated from net income before non-cash charges during the period.

Consumer loan originations decreased by \$1.8 million to \$64.5 million for the six months ended September 29, 2018 from \$66.3 million for the six months ended September 30, 2017. These decreases relate to longer factory backlogs extending the loan closing time frame. Proceeds from sales of consumer loans provided \$62.2 million in cash, compared to \$59.2 million in the previous year. While loan originations were down during the period, there were additional sales from loans held for investment, which include home-only loans originated in prior periods.

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With respect to consumer lending for the purchase of manufactured housing, states may classify manufactured homes for both legal and tax purposes as personal property rather than real estate. As a result, financing for the purchase of manufactured homes is characterized by shorter loan maturities and higher interest rates. Unfavorable changes in these factors and the current lack of availability of financing in the industry may have material negative effects on liquidity. See Item IA, "Risk Factors" in our Form 10-K.

Cavco has entered into programs to provide some of the capital used by inventory lenders to finance wholesale home purchases by retailers. The Company has also entered into direct commercial loan arrangements with distributors, communities and developers under which the Company provides funds for financing homes and has invested in community-based lending initiatives that provide home-only financing to new residents of certain manufactured home communities (see Note 7 to the Consolidated Financial Statements). Further, the Company has invested in and developed home-only loan pools and lending programs to attract third party financier interest and to grow sales of new homes through traditional distribution points as well.

Cash used for investing activities during the six months ended September 29, 2018 increased compared to the same period last year as the Company continues to focus on investing in production capacity and efficiency initiatives, which has led to increased purchases of property, plant and equipment during the current period compared to last year. This increase is partially offset by lower purchases of investments.

Financing activities used \$3.3 million of additional cash during the current period compared to the same period last year, as there were lower proceeds from secured credit facilities, partially offset by lower payments related to stock option exercises.

Financings. As of September 29, 2018, there were two classes of securitized bond debt outstanding: one totaling \$19.1 million with a coupon rate of 5.20% with a call date in January 2019, and one totaling \$20.7 million with a coupon rate of 5.846% with a call date in July 2019. It is anticipated that we will purchase or refinance these facilities at or prior to their call dates.

CountryPlace's securitized debt is subject to provisions that require certain levels of overcollateralization.

Overcollateralization is equal to CountryPlace's equity in the bonds. Failure to satisfy these provisions could cause cash, which would normally be distributed to CountryPlace, to be used for repayment of the principal of the related Class A bonds until the required overcollateralization level is reached. During periods when the overcollateralization is below the specified level, cash collections from the securitized loans in excess of servicing fees payable to CountryPlace and amounts owed to the Class A bondholders, trustee and surety, are applied to reduce the Class A debt until such time overcollateralization reaches the specified level. Therefore, failure to meet the overcollateralization requirement could adversely affect the timing of cash flows received by CountryPlace. However, principal payments of the securitized debt, including accelerated amounts, is payable only from cash collections from the securitized loans and no additional sources of repayment are required or permitted. As of September 29, 2018, the 2005-1 and 2007-1 securitized portfolios were within the required overcollateralization level.

The Company has entered into secured credit facilities with independent third party banks with draw periods from one to fifteen months and maturity dates of ten years after the expiration of the draw periods. The proceeds are used by the Company to originate and hold consumer home-only loans secured by manufactured homes, which are pledged as collateral to the facilities. Upon completion of the draw down period, the facilities are converted into an amortizing loan based on a 20 or 25 year amortization period with a balloon payment due upon maturity. The maximum advance for loans under this program is 80% of the outstanding collateral principal balance, with the Company providing the remaining funds. As of September 29, 2018, the outstanding balance of the converted loans was \$11.5 million at a weighted average interest rate of 4.9%, with \$5.0 million available to draw. Amounts drawn bear interest at 5.15%. Once converted, the initial annual interest rate of 5.15% will adjust every 5 years beginning in 2024 to Prime plus 0.40%. The per annum interest rate shall never be less than 5.00% or greater than 6.00%.



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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.

Recent Accounting Pronouncements

See Note 1 to the Consolidated Financial Statements for a discussion of recently issued and adopted accounting pronouncements.

Off Balance Sheet Arrangements

See Note 16 to the Consolidated Financial Statements for a discussion of our off-balance sheet commitments.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes from the quantitative and qualitative disclosures about market risk previously disclosed in our 2018 Annual Report on Form 10-K.

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 President and Acting Chief Executive Officer and Chief Accounting Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in the Exchange Act Rules 13a-15(e) and 15d-15(e)). Based upon that evaluation, our President and Acting Chief Executive Officer and Chief Accounting Officer concluded that, as of September 29, 2018, our disclosure controls and procedures were effective.

(b) Changes in Internal Control over Financial Reporting

There have been no 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 September 29, 2018, which have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Information regarding reportable legal proceedings is contained in Part I, Item 3, Legal Proceedings, in our 2018 Annual Report on Form 10-K. The following describes legal proceedings, if any, that became reportable during the period ended September 29, 2018, and, if applicable, amends and restates descriptions of previously reported legal proceedings in which there have been material developments during such quarter.

On August 20, 2018, the Company received a subpoena from the SEC's Division of Enforcement requesting certain documents relating to, among other items, trading in the stock of Public Company. On October 1, 2018, the SEC sent a subpoena for documents and testimony to Joseph Stegmayer, the Company's former Chairman, President, and Chief Executive Officer, regarding similar issues. At this time, the Company believes that Mr. Stegmayer traded in certain publicly traded stock in his personal accounts as well as in accounts held by the Company at a time when the Company had agreed to refrain from such trading. The Company has initiated an independent investigation and intends to cooperate fully with the SEC's investigation.

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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, breach of express and implied warranties, construction defect, deceptive trade practices, unfair insurance practices, 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 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 2018 Annual Report on Form 10-K, which could materially affect our business, financial condition or future results. The risks described in this Report and in our Annual Report on 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. These risk factors have not materially changed from the disclosures provided in our 2018 Annual Report on Form 10-K, except for the following:

We may face risks related to the potential outcomes of the SEC subpoena, including potential penalties, expense, the use of significant management time and attention, potential litigation or regulatory action, and potential reputational damage that the Company may suffer as a result of the matters under investigation.

As disclosed in the Legal Proceedings section on page 42, on August 20, 2018 the Company received a subpoena from the SEC requesting certain documents relating to, among other items, trading in the stock of the Public Company. On October 1, 2018, the SEC sent a subpoena for documents and testimony to former Chairman of the Board, President and Chief Executive Officer, Joseph Stegmayer, regarding similar issues. At this time, the Company believes that Mr. Stegmayer traded in certain publicly traded stock in his personal accounts as well as in accounts held by Cavco at a time when the Company had agreed to refrain from such trading. The Company intends to cooperate fully with the SEC's investigation.

Effective November 8, 2018, Mr. Stegmayer stepped down from his position as Chairman, President and Chief Executive Officer of the Company after an internal investigation, conducted by independent legal counsel to the Audit Committee of the Board of Directors, identified certain violations of Company policy related to securities trading activities conducted by Mr. Stegmayer.

We are unable to predict what consequences any investigation by any regulatory agency or by our Audit Committee may have on us. Our cooperation with these investigations could result in significant legal and accounting expenses, has diverted management's attention from other business concerns which could harm our business and could result in reputational damage. Any proceedings commenced against us by a regulatory agency could result in administrative orders against us, the imposition of penalties and/or fines against us, and/or the imposition of sanctions against certain of our current or former officers, directors and/or employees. The investigations, results of the investigations, or remedial actions we have taken or may take as a result of such investigations may adversely affect our business. If we are subject to adverse findings resulting from the SEC investigation, or from our own independent investigation, we could be required to pay damages and/or penalties or have other remedies imposed on us.

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## Item 5. Other Information

As disclosed in the Legal Proceedings section on page 42, on August 20, 2018, the Company received a subpoena from the SEC's Division of Enforcement requesting certain documents relating to, among other items, trading in the stock of Public Company. On October 1, 2018, the SEC sent a subpoena for documents and testimony to former Chairman, President and Chief Executive Officer, Joseph Stegmayer regarding similar issues. At this time, the Company believes that Mr. Stegmayer traded in certain publicly traded stock in his personal accounts as well as in accounts held by Cavco at a time when the Company had agreed to refrain from such trading. The Company intends to cooperate fully with the SEC's investigation.

Effective November 8, 2018, Mr. Stegmayer stepped down as Chairman, President and Chief Executive Officer of the Company after an internal investigation, conducted by independent legal counsel to the Audit Committee of the Board of Directors, identified certain violations of Company policy related to securities trading activities conducted by Mr. Stegmayer. The internal investigation remains ongoing. The Board's decision to transition Mr. Stegmayer to a non-executive role allows the Company to retain access to his deep industry and operational experience, while removing him from an executive role.

At the time of his resignation as a member of the Company's Board of Directors, Mr. Stegmayer had no disagreement with the Company on any matter related to the Company's operations, policies, or practices.

Also on November 8, 2018, the Board of Directors appointed Daniel L. Urness as President and Acting Chief Executive Officer. Joshua J. Barsetti will assume the duties of principal financial officer. Long-time independent board member, William Boor, will serve as non-executive Chairman of the Board of Directors.

Mr. Urness, 50, was previously Cavco's Executive Vice President, Chief Financial Officer and Treasurer from April 2015 until August 2018. Previously, Mr. Urness served as Cavco's Vice President, Chief Financial Officer and Treasurer from January 2006 to April 2015 and as a director and/or officer of certain of Cavco's subsidiaries, including Palm Harbor Homes, Inc., Fleetwood Homes, Inc., CountryPlace Acceptance Corp. and Standard Casualty Company. Mr. Urness was also Cavco's Interim Chief Financial Officer from August 2005 to January 2006, Corporate Controller from May 2005 to August 2005, financial consultant to the Company from June 2002 to May 2005 and Controller from May 1999 to June 2002. Prior to joining Cavco, Mr. Urness served as manager and staff at Deloitte & Touche LLP for approximately six years.

Effective November 8, 2018, Mr. Urness will receive a temporary compensation arrangement consisting of a base annual salary of \$255,000. Mr. Urness will be eligible for a bonus for fiscal year ending March 2019. This bonus will be determined based on what Mr. Urness would have earned as the Company's Chief Financial Officer, prorated for the portion of the fiscal year that he served as the Chief Financial Officer of the Company, plus any other bonuses to be set forth in an employment agreement to be entered into by Mr. Urness and the Company. While serving as the Company's Chief Financial Officer, Mr. Urness was eligible to receive incentive compensation based upon the Company's pre-tax income for the fiscal year ending March 30, 2019. Under the terms of his plan, Mr. Urness was eligible to receive incentive compensation equal to (i) 0.4% of the first \$70 million in pre-tax income of the Company; (ii) 1.2% of pre-tax income between \$70 million and \$80 million; (iii) 2.0% of pre-tax income between \$80 million and \$84 million; and (iv) a performance bonus of \$100,000 determined at the sole discretion of the Compensation Committee of the Board of Directors. Mr. Urness will also be eligible for certain equity awards to be set forth in the employment agreement to be entered into by Mr. Urness and the Company. In the event Mr. Urness is terminated as the result of a termination without cause, and such termination constitutes a separation from service, the Company will pay to Mr. Urness a lump sum termination payment equal to three (3) times his base salary. This employment agreement is also expected to include certain customary non-competition and change of control provisions. The Company expects to enter into the new employment agreement with Mr. Urness within thirty (30) days of his appointment as President and Acting Chief Executive Officer, but in no event later than December 31, 2018.

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Mr. Barsetti, 38, has been Cavco's Chief Accounting Officer since August 31, 2018. Previously, Mr. Barsetti served as the Company's Senior Director of Financial Administration from August 2017 to August 2018 and as the Company's Director of Internal Audit from October 2014 to August 2017. Prior to joining Cavco, he served as the Director of Financial Reporting at Universal Technical Institute ("UTI") from November 2013 to October 2014 and as UTI's Audit Manager and Senior Audit Manager from May 2011 to November 2013. He held various internal audit positions at Viad Corp. from September 2005 to May 2011, most recently as an Internal Audit Manager. Mr. Barsetti holds a Bachelor's degree in Accounting from Northern Arizona University and is a registered Certified Public Accountant. Mr. Barsetti's compensation has not changed at this time. Mr. Barsetti earns a base annual salary of \$155,000 and is eligible to receive a target bonus of \$40,000 based on goals and objectives and additional incentive compensation based on the Company's pre-tax income for the fiscal year ending March 30, 2019 equal to: (i) \$15,000 if pre-tax income falls between \$60 million and \$70 million; (ii) \$5,000 if pre-tax income falls between \$70 million and \$80 million; (iii) \$5,000 if pre-tax income falls between \$80 million and \$85 million; and (iv) \$5,000 if pre-tax income is over \$85 million. Mr. Barsetti is also eligible to participate in the Company's other benefits.

There are no family relationships between Messrs. Urness and Barsetti and any other director or executive officer of the Company. Furthermore, there are no related party transactions between Cavco and Messrs. Urness and Barsetti that require disclosure pursuant to Item 404 of Regulation S-K.

In conjunction with his resignation, the Company's Employment Agreement with Mr. Stegmayer was terminated pursuant to a written transition agreement (the "Transition Agreement"). That Transition Agreement provides for: (i) Mr. Stegmayer's immediate resignation from all positions as an officer or director of the Company and any of its subsidiaries; (ii) waiver of any severance payments that may have otherwise been due under the Employment Agreement; (iii) payment of a pre-existing deferred bonus obligation due to Mr. Stegmayer in the approximate amount of \$1 million, plus interest in two equal annual installments; (iv) payment of a pro rata share of any fiscal year 2019 incentive bonus that Mr. Stegmayer may be eligible to receive through November 7, 2018; (v) a complete release of any claims for other compensation or claims that Mr. Stegmayer may have against the Company, except for rights under the Transition Agreement and his pre-existing indemnity arrangements; (v) an at will employment relationship; (vi) an annual salary of \$150,000 with no defined incentive bonus opportunity; and (vi) no modification to the provisions of any incentive equity compensation arrangements, each of which shall remain subject to the terms of existing grant agreements and the plans pursuant to which they were granted.

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Item 6. Exhibits

Exhibit  
No. Exhibit

|             |   |
|-------------|---|
| <u>10.1</u> | <u>Transition Agreement, dated as of November 8, 2018, by and between Cavco Industries, Inc. and Joseph Stegmayer.</u>  |
| <u>10.2</u> | <u>Employment Arrangement Letter, dated as of November 8, 2018, by and between Daniel L. Urness and Cavco Industries, Inc.</u>  |
| <u>10.3</u> | <u>Indemnification Agreement, dated as of November 8, 2018, by and between Daniel L. Urness and Cavco Industries, Inc.</u>  |
| <u>31.1</u> | <u>Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 - Rule 13a-14(a)/15d-14(a)</u>  |
| <u>31.2</u> | <u>Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 - Rule 13a-14(a)/15d-14(a)</u>  |
| <u>32</u>   | <u>Certification Pursuant to 18 U.S.C. 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>   |
| <u>99.1</u> | <u>Press Release dated November 8, 2018</u>   |
| 101         | The following materials contained in this Quarterly Report on Form 10-Q for the period ended September 29, 2018 were formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Comprehensive Income, (iii) Consolidated Statements of Cash Flows and (iv) Notes to Consolidated Financial Statements |

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

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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

| Signature                                    | Title   | Date             |
|--|---|------------------|
| /s/ Daniel L. Urness<br>Daniel L. Urness     | President and Acting Chief Executive Officer<br>(Principal Executive Officer) | November 8, 2018 |
| /s/ Joshua J. Barsetti<br>Joshua J. Barsetti | Chief Accounting Officer<br>(Principal Financial Officer)                     | November 8, 2018 |