CAVCO INDUSTRIES INC
Form 10-Q
February 06, 2007

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

(Mark One)

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

For the quarterly period ended December 31, 2006

OR

o **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 incorporation)	(IRS Employer Identification Number)

1001 North Central Avenue, Suite 800, Phoenix, Arizona 85004
(Address of principal executive offices)
(Zip Code)
(602) 256-6263
(Registrant s telephone number, including area code)
(Former name, former address and former fiscal year, if changed since last year)

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

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

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

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

As of February 2, 2007, there were 6,375,562 shares of the registrant s common stock, $.01 par value, issued and outstanding.

CAVCO INDUSTRIES, INC.
FORM 10-Q
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PART I. FINANCIAL INFORMATION

Item 1: Financial Statements

CAVCO INDUSTRIES, INC.
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands)

	December 31, 2006 (Unaudited)	March 31, 2006
ASSETS		
Current assets		
Cash and cash equivalents	$ 9,701	$ 15,122
Short-term investments	49,900	42,900
Restricted cash	191	1,223
Accounts receivable	11,426	11,568
Inventories	13,039	12,733
Prepaid expenses and other current assets	2,582	1,446
Deferred income taxes	4,100	4,040
Total current assets	90,939	89,032
Property, plant and equipment, at cost:		
Land	6,050	6,050
Buildings and improvements	6,857	6,744
Machinery and equipment	7,450	6,752
	20,357	19,546
Accumulated depreciation	(7,721)	(7,202)
	12,636	12,344
Goodwill	67,346	67,346
Total assets	$ 170,921	$ 168,722
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Accounts payable	$ 3,304	$ 6,269
Accrued liabilities	19,296	26,384
Total current liabilities	22,600	32,653
Deferred income taxes	12,290	11,040

Commitments and contingencies			
Stockholders equity			
Preferred Stock, $.01 par value; 1,000,000 shares authorized; No shares issued or outstanding			
Common Stock, $.01 par value; 20,000,000 shares authorized; Outstanding 6,374,480 and 6,352,980 shares, respectively		64	64
Additional paid-in capital		122,566	121,354
Retained earnings		13,401	3,611
Total stockholders equity		136,031	125,029
Total liabilities and stockholders equity	$	170,921	$ 168,722

See accompanying Notes to Consolidated Financial Statements

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CAVCO INDUSTRIES, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(Dollars in thousands, except per share amounts)
(Unaudited)

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2006	2005	2006	2005
Net sales	$ 38,189	$ 45,320	$ 135,302	$ 138,287
Cost of sales	31,871	36,365	110,316	110,086
Gross profit	6,318	8,955	24,986	28,201
Selling, general and administrative expenses	3,765	3,946	11,904	12,265
Income from operations	2,553	5,009	13,082	15,936
Interest income	589	387	1,782	1,033
Income from continuing operations before income taxes	3,142	5,396	14,864	16,969
Income tax expense	1,037	1,874	5,208	6,388
Income from continuing operations	2,105	3,522	9,656	10,581
Income from discontinued retail operations net of income taxes of $66 and $148	134	252	134	252
Net income	$ 2,239	$ 3,774	$ 9,790	$ 10,833
Net income per share (basic):				
Continuing operations	$ 0.33	$ 0.56	$ 1.52	$ 1.68
Discontinued retail operations	$ 0.02	$ 0.04	$ 0.02	$ 0.04
Net income	$ 0.35	$ 0.60	$ 1.54	$ 1.72
Net income per share (diluted):				
Continuing operations	$ 0.32	$ 0.52	$ 1.46	$ 1.57
Discontinued retail operations	$ 0.02	$ 0.04	$ 0.02	$ 0.04
Net income	$ 0.34	$ 0.56	$ 1.48	$ 1.61
Weighted average shares outstanding:				
Basic	6,361,869	6,336,342	6,358,889	6,309,010
Diluted	6,615,263	6,775,614	6,625,725	6,721,977

See accompanying Notes to Consolidated Financial Statements

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

	Nine Months Ended December 31,	
	2006	2005
OPERATING ACTIVITIES		
Net income	$ 9,790	$ 10,833
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	519	696
Deferred income taxes	1,190	1,270
Share-based compensation expense	728	188
Tax benefits from option exercises	223	460
Incremental tax benefits from option exercises	(195)	
Changes in operating assets and liabilities:		
Restricted cash	1,032	(124)
Accounts receivable	142	(396)
Inventories	(306)	(1,751)
Prepaid expenses and other current assets	(1,136)	(773)
Accounts payable and accrued liabilities	(10,053)	(283)
Net cash provided by operating activities	1,934	10,120
INVESTING ACTIVITIES		
Purchases of property, plant and equipment	(811)	(5,212)
Purchases of short-term investments	(346,000)	(67,900)
Proceeds from sale of short-term investments	339,000	28,000
Net cash used in investing activities	(7,811)	(45,112)
FINANCING ACTIVITIES		
Proceeds from exercise of stock options	261	581
Incremental tax benefits from option exercises	195	
Net cash provided by financing activities	456	581
Net decrease in cash and cash equivalents	(5,421)	(34,411)
Cash and cash equivalents at beginning of period	15,122	46,457
Cash and cash equivalents at end of period	$ 9,701	$ 12,046

Supplemental disclosures of cash flow information:

Cash paid during the period for income taxes	$	4,637	$	5,183

See accompanying Notes to Consolidated Financial Statements

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CAVCO INDUSTRIES, INC.
Notes to Consolidated Financial Statements
December 31, 2006
(Dollars in thousands, except per share data)
(Unaudited)

1. Basis of Presentation

The accompanying Consolidated Financial Statements of Cavco Industries, Inc. and its wholly-owned subsidiary, CRG Holdings, LLC (collectively, the Company), have been prepared without audit pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) for Quarterly Reports on Form 10-Q and Article 10 of SEC Regulation S-X. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States of America have been condensed or omitted pursuant to such rules and regulations.

In the opinion of management, these statements include all the normal recurring adjustments necessary to fairly state the Company s Consolidated Financial Statements. Certain previous period amounts in the Consolidated Financial Statements have been reclassified to conform to the current period presentation. The Consolidated Statements of Operations and Statements of Cash Flows for the interim periods are not necessarily indicative of the results or cash flows for the full year. The Company suggests that these Consolidated Financial Statements be read in conjunction with the audited Consolidated Financial Statements and the Notes to Consolidated Financial Statements included in the Company s annual report on Form 10-K filed with the SEC on May 24, 2006 (the Form 10-K).

The Company s deferred tax assets primarily result from financial accruals and its deferred tax liabilities result from excess tax amortization of goodwill.

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

2. Composition of Certain Financial Statement Captions

Inventories consist of the following:

	December 31, 2006	March 31, 2006
Raw materials	$ 5,555	$ 4,903
Work in process	2,785	2,731
Finished goods	4,699	5,099
	$ 13,039	$ 12,733

Accrued liabilities consist of the following:

	December 31, 2006	March 31, 2006
Estimated warranties	$ 6,840	$ 6,850
Salaries, wages and benefits	3,005	4,662
Accrued volume rebates	2,556	3,543
Accrued insurance	1,733	2,015
Reserve for repurchase commitments	1,300	1,500
Customer deposits	991	4,291
Other	2,871	3,523
	$ 19,296	$ 26,384

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3. Revolving Line of Credit

The Company has established a $15 million revolving line of credit facility (RLC) with JPMorgan Chase Bank N.A. which expires on July 31, 2007. As of December 31, 2006, $945 of the line amount is reserved for an outstanding letter of credit issued for the Company s workers compensation program. The Company has not made any draws under the RLC. The outstanding principal amount of borrowings under the RLC bears interest at the Company s election at either the prime rate or the London Interbank Offered Rate plus 1.75%. The RLC contains certain restrictive and financial covenants, which, among other things, limit the Company s ability to pledge assets and incur additional indebtedness, and requires the Company to maintain a certain defined fixed charge coverage ratio.

4. Warranties

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

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2006	2005	2006	2005
Balance at beginning of period	$ 7,165	$ 5,858	$ 6,850	$ 5,576
Charged to costs and expenses	1,564	2,145	5,960	5,893
Deductions	(1,889)	(1,845)	(5,970)	(5,311)
Balance at end of period	$ 6,840	$ 6,158	$ 6,840	$ 6,158

5. Contingencies

Repurchase Contingencies The Company is contingently liable under terms of repurchase agreements with financial institutions providing inventory financing for retailers of its products. These arrangements, which are customary in the industry, provide for the repurchase of products sold to retailers in the event of default by the retailer. The risk of loss under these agreements is spread over numerous retailers. The price the Company is obligated to pay generally declines over the period of the agreement (generally 18 32 months) and is further reduced by the resale value of the homes. The maximum amount for which the Company was contingently liable under such agreements approximated $33,764 at December 31, 2006, without reduction for the resale value of the homes. The Company applies FASB Interpretation No. 45, *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness to Others, an interpretation of FASB Statements No. 5, 57, and 107 and a rescission of FASB Interpretation No. 3* (FIN 45) and SFAS No. 5, *Accounting for Contingencies* (SFAS 5) to account for its liability for repurchase commitments. Under the provisions of FIN 45, the Company records the greater of the estimated fair value of the non-contingent obligation or a contingent liability under the provisions of SFAS 5. The Company recorded an estimated liability of $1,300 at December 31, 2006 related to these commitments.

Additionally, in connection with the repurchase agreement with one financial institution, the Company has provided a guaranty in the amount of $300 to guarantee payment should one of the Company s larger independent dealers default on certain of its obligations in the event of a repurchase by the lender.

Legal Matters The Company is party to certain legal proceedings that arise in the ordinary course and are incidental to its business. Certain of the claims pending against the Company in these proceedings allege, among other things, breach of contract and warranty, product liability and personal injury. Although litigation is inherently uncertain, based on past experience, the information currently available and the possible availability of insurance and/or indemnification, 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.

6. Stock-Based Compensation

The Company maintains stock incentive plans whereby stock option grants or awards of restricted stock may be made to certain of our officers, directors and key employees. The plans, which are shareholder approved, permit the award of up to 1,350,000 shares of the Company s common stock, of which 574,997 shares were still available for grant at December 31, 2006. 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 generally vest over a three-year period, with 25% becoming vested on the grant date and the remainder becoming vested in cumulative 25% increments on each of the first three anniversaries of the grant date. The stock incentive plans provide for accelerated vesting of stock options and removal of restrictions on restricted stock awards upon a change in control (as defined in the plans).

Prior to April 1, 2006, the Company accounted for stock options issued under the above plans in accordance with the recognition and measurement provisions of APB Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25), and its related interpretations, as permitted by FASB Statement No. 123, *Accounting for Stock-Based Compensation* (FAS 123). Under the disclosure-only provisions of FAS 123, as amended by FASB Statement No. 148, *Accounting for Stock Based Compensation-Transition and Disclosure*, no option-based compensation cost was recognized, as all options were granted with an exercise price equal to the fair value of the underlying common stock on the date of grant.

Effective April 1, 2006, the Company adopted the fair value recognition provisions of FASB Statement No. 123 revised 2004, *Share-Based Payment* (FAS 123(R)), and SEC Staff Accounting Bulletin No. 107 (SAB 107), using the modified-prospective transition method. Other than restricted stock awards, no share-based compensation cost had been reflected in net income prior to the adoption of FAS 123(R) and the results for prior periods have not been restated. The recognized compensation costs during the three and nine month periods ended December 31, 2006 under the modified-prospective transition method include (i) compensation cost for all share-based payments granted prior to, but not fully vested as of April 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123 and (ii) compensation cost for all share-based payments granted subsequent to April 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of FAS 123(R).

The adoption of FAS 123(R) decreased income before income taxes for the three and nine months ended December 31, 2006 by approximately $198 and $662, respectively, and decreased net income for the three and nine months ended December 31, 2006 by approximately $133 and $432. Total compensation cost, including costs related to the vesting of restricted stock awards, charged against income for the three and nine months ended December 31, 2006 was approximately $200 and $728, respectively. Had compensation cost for the Company s employee stock-based compensation awards been determined based on the fair value at the grant date for the three and nine month periods ended December 31, 2005, the Company s net income and net income per share would have been reduced to the pro forma amounts indicated below:

	Three Months Ended December 31, 2005		Nine Months Ended December 31, 2005	
Net income, as reported	$	3,774	$	10,833
Less: Stock-based employee compensation determined under fair value based method, net of tax benefits		(51)		(425)
Pro forma net income	$	3,723	$	10,408
Basic net income per share:				
As reported	$	0.60	$	1.72
Pro forma	$	0.59	$	1.65
Diluted net income per share:				
As reported	$	0.56	$	1.61
Pro forma	$	0.55	$	1.55

As of December 31, 2006, total unrecognized compensation cost related to stock options was approximately $573 and the related weighted-average period over which it is expected to be recognized is approximately 1.56 years.

The following table summarizes the option activity within the Company s stock-based compensation plans for the nine months ended December 31, 2006:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at March 31, 2006	697,330	$ 15.40		
Granted	12,500	36.15		
Exercised	(21,500)	12.14		
Canceled or forfeited				
Outstanding at December 31, 2006	688,330	$ 15.88	4.30	$ 13,188
Exercisable at December 31, 2006	592,205	$ 14.22	4.16	$ 12,327

No options were granted during the three months ended December 31, 2006. The weighted-average estimated fair value of employee stock options granted during the three months ended December 31, 2005 was $12.42. The total intrinsic value of options exercised during the three months ended December 31, 2006 and 2005 was approximately $373 and $51, respectively.

The Company uses the Black-Scholes-Merton option-pricing model to determine the fair value of stock options. The determination of the fair value of stock options on the date of grant using an option-pricing model is affected by the Company s stock price as well as assumptions regarding a number of complex and subjective variables. These variables include actual and projected employee stock option exercise behaviors, the Company s expected stock price volatility over the term of the awards, risk-free interest rate, and expected dividends. The fair values of options

granted were estimated at the date of grant using the following weighted average assumptions:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2006	2005	2006	2005
Volatility		26.1%	33.8%	28.6%
Risk-free interest rate		4.3%	4.7%	4.0%
Dividend yield		0.0%	0.0%	0.0%
Expected option life in years		5.00	4.25	5.00

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Expected term - The Company estimates the expected term of options granted by using the simplified method as prescribed by SAB 107.

Expected volatility - The Company estimates the volatility of its common stock taking into consideration its historical stock price movement, the volatility of stock prices of companies of similar size with similar businesses to it and its expected future stock price trends based on known or anticipated events.

Risk-free interest rate - The Company bases the risk-free interest rate that it uses in the option pricing model on U.S. Treasury zero-coupon issues with remaining terms similar to the expected term on the options.

Expected dividend - The Company does not anticipate paying any cash dividends in the foreseeable future and therefore uses an expected dividend yield of zero in the option-pricing model.

Forfeitures - The Company is required to estimate future forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. The Company uses historical data to estimate pre-vesting option forfeitures and records stock-based compensation cost only for those awards that are expected to vest.

Though not required under the adoption provisions of FAS 123(R), the Company has made a policy decision to continue the use of the straight-line attribution method in order to remain consistent with the previous FAS 123 pro forma disclosures.

The Company also grants restricted stock awards to certain employees. Restricted stock awards are valued at the closing market value of the Company s common stock on the date of grant, and the total value of the award is expensed ratably over the service period of the employees receiving the grants. A summary of restricted stock activity within the Company s share-based compensation plans and changes for the nine months ended December 31, 2006 is as follows:

	Shares	Grant-Date Fair Value
Nonvested at March 31, 2006	6,887	$ 9.07
Granted	923	32.49
Vested	(6,887)	9.07
Forfeited		
Nonvested at December 31, 2006	923	$ 32.49

For the nine months ended December 31, 2006, the adoption of FAS 123(R) resulted in a reclassification to reduce net cash provided by operating activities with an offsetting increase in net cash provided by financing activities of $195, related to incremental tax benefits from stock options exercised during the period.

7. Earnings Per Share

Basic earnings per share is computed based on the weighted-average number of shares of common stock outstanding during the period. Diluted earnings per share is computed based on the weighted-average number of shares of common stock outstanding during the period increased by the weighted-average number of dilutive common stock equivalents outstanding during the period, using the treasury stock method. The following table sets forth the computation of basic and diluted earnings per share.

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2006	2005	2006	2005
Net income	$ 2,239	$ 3,774	$ 9,790	$ 10,833
Weighted average shares outstanding:				
Basic	6,361,869	6,336,342	6,358,889	6,309,010
Common stock equivalents - treasury stock method	253,394	439,272	266,836	412,967
Diluted	6,615,263	6,775,614	6,625,725	6,721,977
Net income per share:				
Basic	$ 0.35	$ 0.60	$ 1.54	$ 1.72
Diluted	$ 0.34	$ 0.56	$ 1.48	$ 1.61

Anti-dilutive common stock equivalents excluded from the computation of diluted earnings per share for the three and nine months ended December 31, 2006 were 3,527 and 1,331, respectively. No anti-dilutive common stock equivalents were excluded from the computation of diluted earnings per share for the three and nine months ended December 31, 2005.

8. Discontinued Operations

The Company has plans to dispose of certain of its retail sales centers and these operations are classified as discontinued retail operations. Finished goods inventories to be liquidated in conjunction with the disposal of these retail sales centers approximated $425 at December 31, 2006. Income from discontinued retail operations for the three and nine months ended December 31, 2006 and 2005 resulted from better than anticipated results from liquidating retail inventories at closed locations. Net sales for the retail sales centers to be disposed of were $1,160 and $948 for the three month periods ended December 31, 2006 and 2005, respectively, and $4,229 and $4,520 for the nine month periods ended December 31, 2006 and 2005, respectively.

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9. Business Segment Information

The Company operates in two business segments Manufacturing and Retail. Through its Manufacturing segment, the Company designs and manufactures homes which are sold primarily in the southwestern United States to a network of dealers which includes Company-owned retail locations comprising the Retail segment. The Company s Retail segment derives its revenues from home sales to individuals. The accounting policies of the segments are the same as those described in the Form 10-K. Retail segment results include retail profits from the sale of homes to consumers but do not include any manufacturing segment profits associated with the homes sold. Intercompany transactions between reportable operating segments are eliminated in consolidation. Substantially all depreciation and capital expenditures are related to the Manufacturing segment. Each segment s results include corporate office costs that are directly and exclusively incurred for the segment. The following table summarizes information with respect to the Company s business segments for the periods indicated:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2006	2005	2006	2005
Net sales				
Manufacturing	$ 35,814	$ 44,013	$ 128,758	$ 133,923
Retail	4,078	3,864	11,874	10,211
Less: Intercompany	(1,703)	(2,557)	(5,330)	(5,847)
Total consolidated net sales	$ 38,189	$ 45,320	$ 135,302	$ 138,287
Income from operations				
Manufacturing	$ 3,607	$ 6,349	$ 16,589	$ 20,183
Retail	139	115	265	119
Intercompany profit in inventory	84	(185)	224	(185)
General corporate charges	(1,277)	(1,270)	(3,996)	(4,181)
Total consolidated income from operations	$ 2,553	$ 5,009	$ 13,082	$ 15,936

	As of	
	December 31, 2006	March 31, 2006
Total assets		
Manufacturing	$ 103,739	$ 101,139
Retail	3,397	5,466
Corporate	63,785	62,117
Total consolidated assets	$ 170,921	$ 168,722

Total Corporate assets are comprised primarily of cash and cash equivalents, short-term investments and deferred taxes.

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

Introduction

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

Overview

We are the largest producer of manufactured homes in Arizona and the 10th largest producer of manufactured homes in the United States in terms of wholesale shipments, based on 2005 data published by Manufactured Home Merchandiser. Headquartered in Phoenix, Arizona, the Company designs and produces manufactured homes which are sold to a network of retailers located primarily in the southwestern United States. The Company operates three homebuilding facilities located in Arizona, one manufacturing facility in Texas and seven Company-owned sales centers in three states. The retail segment of the Company operates sales center locations which offer homes produced by the Company and other manufacturers to retail customers.

In recent years, the manufactured housing industry has experienced a significant downturn, and continues to operate at levels that are at a forty plus year low point. The availability of consumer financing remains a key issue to be resolved before marked emergence from these historic lows can occur. Progress has also been impeded by several economic challenges including limited financing availability, increased land costs, and a slowdown in housing demand in general.

These issues are not new to Cavco, and the Company has worked diligently throughout this difficult period to produce strong financial results. Through fiscal year 2006 and the first quarter of fiscal year 2007, the Company s earnings showed consistent improvement. However, beginning in the first quarter of fiscal year 2007 and continuing through the third quarter, the Company s sales activity has dramatically slowed. Shipments to California and Nevada have dropped considerably and Arizona shipments are also down, albeit to a lesser extent. The Company has been operating with a minimal backlog throughout the third quarter of fiscal 2007.

While we cannot determine the particular causes of the slowdown in Cavco s orders, we can identify market shifts that may have contributed to the decline and that also may be affecting our competitors who are generally reporting reduced sales activity as well. A slowdown in the site built housing industry combined with reported substantial increases in existing home inventories has impacted the activity in manufactured housing. Site built home repossessions are also reported to be on the rise. While there are indications that site-built lenders have tightened their credit requirements somewhat, they continue to offer more favorable lending terms than are generally available from manufactured housing finance sources. The growth of site-built resale inventory has had an adverse impact on the contingency contract process, wherein manufactured homebuyers must sell their existing site-built home in order to facilitate the purchase of a manufactured home. In addition, many on-site home builders with high inventory levels are offering attractive incentives to homebuyers, which may create added competition for the manufactured housing industry.

As we experienced a downturn in incoming order rates during the year, we have increased our efforts to identify market expansion opportunities. Companywide, our products are diverse and tailored to the needs and desires of our customers. 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 compliment home styles in the areas in which they are to be located.

In the face of the current housing environment, we remain optimistic about the future because we believe that we are located in attractive geographic markets, we have an excellent and diverse line of products and we maintain a conservative cost structure which enables us to build a great value into our homes.

Results of Operations (Dollars in thousands)

Three and nine months ended December 31, 2006 compared to 2005

Net Sales. Total net sales decreased 15.7% to $38,189 for the three months ended December 31, 2006 compared to $45,320 for the comparable quarter last year. For the nine months ended December 31, 2006, net sales decreased 2.2% to $135,302 compared to $138,287 for the same period last year.

Manufacturing net sales decreased 18.6% to $35,814 for the three months ended December 31, 2006 from $44,013 for the same period last year and decreased 3.9% to $128,758 for the nine month period ended December 31, 2006 from $133,923 for the comparable period last year. The decrease in sales during the current quarter was driven by a decline in the incoming order rates for homes as total homes sold during the current quarter decreased to 898 wholesale shipments versus 1,049 in the same period last year. A larger proportion of homes sold during the third quarter were single-section, causing a 4.9% reduction in the average selling price per home which was $39,882 versus $41,957 for last year s third quarter. The decrease in sales for the nine months ended December 31, 2006 was also driven by a decrease in wholesale shipments to 2,866 versus 3,168 in the same period last year; partially offset by a 6.3% increase in the average selling price per home to $44,926 as compared to $42,274 for the same period in the prior year.

Retail net sales increased $214 to $4,078 for the three months ended December 31, 2006 from $3,864 for the same quarter last year and $1,663 to $11,874 for the nine month period ended December 31, 2006 compared to $10,211 last year. This increase in retail sales was driven by higher average selling prices, offset by a reduction in the overall number of homes sold.

Net Income. Net income decreased 40.7% to $2,239 for the three months ended December 31, 2006 compared to $3,774 for the comparable quarter last year. For the nine months ended December 31, 2006, net income decreased 9.6% to $9,790 compared to $10,833 for the same period last year.

Gross Profit. Gross profit as a percent of sales decreased to 16.5% for the three months ended December 31, 2006 from 19.8% for the same period last year and decreased to 18.5% for the nine months ended December 31, 2006 from 20.4% last year. The gross profit percentage has been challenged by lower production volume, a less favorable product mix, and low margin results from the new Texas plant.

Selling, General and Administrative Expenses. Selling, general and administrative expenses decreased 4.6% or $181 to $3,765 or 9.9% of net sales for the three months ended December 31, 2006 versus $3,946 or 8.7% of net sales for the same period last year. For the nine month period ended December 31, 2006, selling, general and administrative expenses decreased 2.9% or $361 to $11,904 from $12,265 last year. The decrease was primarily the result of reduced costs associated with compensation programs tied to profitability and a decrease in costs influenced by lower sales volume, partially offset by share-based compensation expense due to the implementation of FAS 123(R) at the beginning of fiscal year 2007.

Interest Income. Interest income represents income earned on short-term investments and unrestricted cash and cash equivalents. Interest income is earned on a tax-free basis from a portion of the Company s short-term investments. The increase in interest income for the three and nine month periods ended December 31, 2006, compared to these periods last year, resulted from the Company s larger balance of investable funds and higher short-term interest rates.

Income Taxes. The effective income tax rates for the three and nine months ended December 31, 2006 were approximately 33% and 35% versus approximately 35% and 38%, respectively, for the same periods last year. The lower income tax rates reflect the effects of tax-free interest income noted above, certain state income tax credits, and deductions provided in the American Jobs Creation Act.

Discontinued Retail Operations. The Company has plans to dispose of certain of its retail sales centers and these operations are classified as discontinued retail operations (see Note 8).

Liquidity and Capital Resources

The Company has established a $15 million revolving line of credit facility (RLC) with JPMorgan Chase Bank N.A. which expires on July 31, 2007. As of December 31, 2006, $945 of the line amount is reserved for an

outstanding letter of credit issued for the Company s workers compensation program. The Company has not made any draws under the RLC. The outstanding principal amount of borrowings under the RLC bears interest at the Company s election at either the prime rate or the London Interbank Offered Rate plus 1.75%. The RLC contains certain restrictive and financial covenants, which, among other things, limit the Company s ability to pledge assets and incur additional indebtedness, and requires the Company to maintain a certain defined fixed charge coverage ratio.

The Company believes that cash, cash equivalents and short-term investments on hand at December 31, 2006, together with cash flow from operations, will be sufficient to fund our operations and provide for growth for the next twelve months and into the foreseeable future. In addition, as described above, we have entered into a $15 million credit facility with JPMorgan Chase Bank N.A. that can be used to supplement these sources of liquidity.

Our primary source of liquidity has historically been cash generated from operations. During the nine months ended December 31, 2006, operating activities provided $1,934 of cash as compared to $10,120 during the same period last year. Cash generated by operating activities for the current period was primarily derived from operating income before non-cash charges and the satisfaction of restrictions on restricted cash balances related to retail customer deposits; offset by an increase in prepaid income taxes and a reduction in the Company s accounts payable and accrued liabilities balances including wholesale customer deposits, volume rebate and payroll accruals. Cash generated by operating activities in the prior period was primarily derived from operating income before non-cash charges partially offset by higher inventories necessary to supply increased production and to ensure the availability of raw materials.

Investing activities required the use of $7,811 of cash during the nine months ended December 31, 2006 compared to the use of $45,112 during the same period last year. During the nine months ended December 31, 2006, cash was primarily used to make net purchases of $7,000 of short-term investments in order to enhance yields, combined with $811 in purchases of property, plant and equipment. Cash utilized during the prior period related primarily to net purchases of $39,900 of short-term investments in order to enhance yields, as well as the use of $5,212 related to capital expenditures, including approximately $1,550 for a production facility in Texas and approximately $3,000 for land in Arizona on which the Company may build an additional production facility.

Financing activities provided $456 of cash during the nine months ended December 31, 2006 resulting from proceeds associated with the issuance of common stock and related incremental tax benefits upon exercise of stock options under our stock incentive plans. Financing activities provided $581 of cash during the nine month period ended December 31, 2005 from common stock issued in conjunction with the exercise of stock options.

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

In July 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in financial statements in accordance with Statement of Financial Accounting Standard (SFAS) No. 109, *Accounting for Income Taxes*. This Interpretation prescribes a recognition threshold and measurement attribute of tax positions taken or expected to be taken on a tax return. This Interpretation is effective for the first fiscal year beginning after December 15, 2006. Management is currently evaluating the impact FIN 48 will have on our financial position and results of operations, if any.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB 108). SAB 108 provides interpretive guidance on how the effects of prior-year uncorrected misstatements should be considered when quantifying misstatements in the current year financial statements. SAB 108 requires registrants to quantify misstatements using both an income statement (rollover) and balance sheet (iron curtain) approach and evaluate whether either approach results in a misstatement that, when all relevant quantitative and qualitative

factors are considered, is material. If prior year errors that had been previously considered immaterial now are considered material based on either approach, no restatement is required so long as management properly applied its previous approach and all relevant facts and circumstances were considered. If prior years are not restated, the cumulative effect adjustment is recorded in opening accumulated earnings as of the beginning of the fiscal year of adoption. SAB 108 is effective for fiscal years ending after November 15, 2006. Management does not believe SAB 108 will have a material impact on our results from operations or financial position.

In September 2006, the FASB issued Statement No. 157, *Fair Value Measurements* (SFAS 157), which clarifies that the term fair value is intended to mean a market-based measure, not an entity-specific measure and gives the highest priority to quoted prices in active markets in determining fair value. SFAS 157 requires disclosures about (1) the extent to which companies measure assets and liabilities at fair value, (2) the methods and assumptions used to measure fair value, and (3) the effect of fair value measures on earnings. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. Management is currently evaluating the impact SFAS 157 will have on our financial position and results of operations.

Forward-looking Statements

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

- We have incurred net losses in certain prior periods and there can be no assurance that we will generate income in the future;
- We operate in an industry that is currently experiencing a prolonged and significant downturn;
- Housing demand and geographic concentration;
- A write-off of all or part of our goodwill could adversely affect our operating results and net worth;
- The cyclical and seasonal nature of the manufactured housing industry causes our revenues and operating results to fluctuate, and we expect this cyclicality and seasonality to continue in the future;
- Our liquidity and ability to raise capital may be limited;
- Tightened credit standards and curtailed lending activity by home-only lenders have contributed to a constrained consumer financing market;
- The availability of wholesale financing for industry retailers is limited due to a reduced number of floor plan lenders and reduced lending limits;
- We have contingent repurchase obligations related to wholesale financing provided to industry retailers;
- The manufactured housing industry is highly competitive, and competition may increase the adverse effects of industry conditions;
- If we are unable to establish or maintain relationships with independent retailers who sell our homes, our sales could decline;
- Our results of operations can be adversely affected by labor shortages and the pricing and availability of raw materials;

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

If our new Texas facility does not generate an operating profit;

Increased competition from site-built residential housing, which may reduce our revenues;

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

We have a limited operating history as an independent company;

You may have difficulty evaluating our business, as our historical financial information may not be representative of what our results of operations would have been if we had been an independent company;

We may be required to satisfy certain indemnification obligations to Centex Corporation, our predecessor, or may not be able to collect on indemnification rights from Centex;

We could be responsible for certain tax liabilities if the Internal Revenue Service challenges the tax-free nature of the share distribution that resulted in us becoming an independent company;

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

Volatility of stock price.

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

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

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk is the risk of loss arising from adverse changes in market prices and interest rates. We may from time to time be exposed to interest rate risk inherent in our financial instruments, but are not currently subject to foreign currency or commodity price risk. We manage our exposure to these market risks through our regular operating and financing activities. We are not currently a party to any market risk sensitive instruments that could be reasonably expected to have a material effect on our financial condition or results of operations.

The Company maintains short-term investments. Short-term investments are comprised of auction rate certificates which are adjustable-rate securities with dividend rates that are reset by bidders through periodic Dutch auctions generally conducted every 7 to 35 days by a broker/dealer on behalf of the issuer. The Company believes these securities are highly liquid investments through the related auctions; however, the collateralizing securities have stated terms of up to thirty (30) years. The investment instruments are rated AAA by Standard & Poor s Ratings Group, or equivalent. The Company s investments are intended to establish a high-quality portfolio that preserves principal, meets liquidity needs, and delivers an appropriate yield in relationship to the Company s investment guidelines and market conditions. Given the short-term nature of these investments, and that we have no borrowings outstanding, we do not believe that we are subject to significant interest rate risk.

Item 4. Controls and Procedures

(a) Disclosure Controls and Procedures

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The term disclosure controls and procedures means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Securities Exchange Act of 1934 (the Exchange Act) (15 U.S.C. 78a *et seq.*) is recorded, processed, summarized and reported, within the time periods specified in the SEC s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to a member of company s management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Exchange Act Rule 13a-15(e) and 15d-15(e). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this Quarterly Report on 10-Q, our disclosure controls and procedures are effective in enabling us to record, process, summarize and report information required to be included in our periodic SEC filings within the required time period.

(b) Changes In Internal Control Over Financial Reporting

The term internal control over financial reporting (defined in SEC Rule 13a-15(f)) refers to the process of a company that is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP.

No change in the Company s internal control over financial reporting occurred during the fiscal quarter ended December 31, 2006 that materially affected, or is reasonably likely to materially affect, the Company s 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 Form 10-K. The following describes legal proceedings, if any, that became reportable during the quarter ended December 31, 2006, and, if applicable, amends and restates descriptions of previously reported legal proceedings in which there have been material developments during such quarter.

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

Item 1A. Risk Factors

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

Item 6: Exhibits

See Exhibit Index.

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

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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

February 6, 2007 /s/ Joseph H. Stegmayer

Joseph H. Stegmayer Chairman,
President and
Chief Executive Officer
(Principal Executive Officer)

February 6, 2007 /s/ Daniel L. Urness

Daniel L. Urness
Vice President and
Chief Financial Officer
(Principal Financial and
Accounting Officer)

EXHIBIT INDEX

Exhibit No.	Exhibit
3.1(1)	Restated Certificate of Incorporation
3.2(2)	Certificate of Amendment of Restated Certificate of Incorporation
3.3(3)	Amended and Restated Bylaws
31.1*	Certification of the Principal Executive Officer Pursuant to Rule 13-14(a) under the Securities Exchange Act of 1934
31.2*	Certification of the Principal Financial Officer pursuant to Rule 13-14(a) under the Securities Exchange Act of 1934
32**	Certification of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(1) Incorporated by reference to Exhibit 3.1 of the Annual Report on Form 10-K for the fiscal year ended March 31, 2004

(2) Incorporated by reference to Exhibit 3.1 of the Quarterly Report on Form 10-Q for the quarter ended June 30, 2006

(3) Incorporated by reference to Exhibit 3.2 of the Annual Report on Form 10-K for the fiscal year ended March 31, 2004

* Filed herewith

** Furnished herewith