

CAVCO INDUSTRIES INC  
Form PRE 14A  
June 17, 2013

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

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934  
(Amendment No. \_\_\_\_\_)

Filed by the Registrant  x  
Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
- Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material under Sec. 240.14a-12

Cavco Industries, Inc.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

- No fee required.
- Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:

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(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (Set forth the amount on which the filing fee is calculated and state how it was determined):

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(1) Amount Previously Paid:

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(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

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Phoenix, Arizona 85004  
602-256-6263

June 17, 2013

Dear Stockholders:

It is our pleasure to invite you to attend the Cavco Industries, Inc. (“Cavco” or the “Company”) 2013 Annual Meeting of Stockholders. The meeting will be held on July [\_\_\_], 2013 at 9:00 a.m. (M.S.T.) at Cavco’s offices, 1001 N. Central Avenue, Suite 800, Phoenix, Arizona 85004. The attached Notice of Annual Meeting of Stockholders and Proxy Statement provide information concerning the business to be conducted at the meeting and the nominees for election as a director and are first being mailed to stockholders on or about June \_\_\_, 2013.

At the meeting, stockholders will vote to approve, among other things, the issuance of up to approximately 2,031,193 shares (the “Shares”) of our common stock in consideration for 50% of the outstanding shares of Fleetwood Homes, Inc. (“Fleetwood”) held by Third Avenue Value Fund (“Third Avenue” or “TAVF”) and the Whitman High Conviction Fund (“WHCF” and together with TAVF, the “Sellers”). The Company and the Sellers have entered into a stock purchase agreement (the “Stock Purchase Agreement”) pursuant to which the Company proposes to purchase the outstanding shares of Fleetwood held by the Sellers (the “Fleetwood Shares”). The Company currently already owns 50% of the outstanding shares of Fleetwood. The Company and Sellers are parties to a Shareholder Agreement that is more fully described in the Company’s Forms 10-K filed with the Securities and Exchange Commission on June 12, 2012 and June 11, 2013. Following the closing of the Company’s purchase of the Fleetwood Shares, the Company will own 100% of the outstanding shares of Fleetwood.

Our shares of common stock are listed on the NASDAQ Global Select Market. Pursuant to NASDAQ Marketplace Rule 5635(a), the issuance of our common stock in connection with the Stock Purchase Agreement requires the approval of the Company’s stockholders because the issuance exceeds 20% of the number of shares of Company common stock outstanding prior to the issuance. The Shares will represent up to approximately 22.6% of our common stock following the issuance, based on our outstanding capital stock at May 27, 2013. Pursuant to the NASDAQ Marketplace Rules, the issuance of the Shares requires approval by a majority of the total votes cast at a meeting of stockholders at which a quorum is present.

Your vote is important. Whether or not you plan to attend the meeting, please vote your shares using the Internet, by telephone, or by completing, signing, dating, and returning the accompanying proxy in the enclosed envelope. Your shares will then be represented at the meeting if you are unable to attend. You may, of course, revoke your proxy and vote in person at the meeting if you desire.

Thank you for your support.

Sincerely,

Joseph H. Stegmayer  
Chairman of the Board of Directors,  
President and Chief Executive Officer

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Notice of Annual Meeting of Stockholders  
of Cavco Industries, Inc.

Date: July [\_\_\_], 2013

Time: 9:00 a.m. (M.S.T.)

Place: Cavco Industries, Inc.'s ("Cavco") Offices  
1001 N. Central Avenue  
Suite 800  
Phoenix, Arizona 85004

- Items of Business:
1. To elect one director comprising a class of directors to serve until the Annual Meeting of Stockholders in 2016, or until his successor has been elected and qualified;
  2. To ratify the appointment of Ernst & Young LLP as Cavco's independent registered public accounting firm for fiscal year 2014;
  3. To approve the Company's executive compensation on an advisory basis;  
To approve the issuance of up to approximately 2,031,193 shares of our common stock in consideration for 50% of the outstanding shares of Fleetwood Homes, Inc. held by Third Avenue Value Fund ("TAVF") and the Whitman High Conviction Fund ("WHCF" and together with TAVF, the "Sellers") pursuant to the Stock Purchase Agreement, dated June 14, 2013, by and among us and the Sellers; and
  4. To transact such other business as may properly come before the meeting or any adjournment thereof.
- Annual Report: The 2013 Annual Report to Stockholders, which includes the Annual Report on Form 10 K, is enclosed and may be viewed on Cavco's website at <http://www.cavco.com/investorrelations/annualmeeting>.

Who Can Vote: You can vote if you were a stockholder of record at the close of business on May 27, 2013.

Date of Mailing: This Notice and Proxy Statement are first being mailed to stockholders on or about June , 2013.

By Order of the Board of Directors,

JAMES P. GLEW  
Secretary

To ensure representation of your shares at the annual meeting, you must vote and submit the proxy by telephone, over the Internet or by mail in the manner described in the accompanying proxy. All stockholders are encouraged to review the accompanying proxy statement.

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<u>\$</u>	24,168		
<b>Weighted average common shares outstanding</b>		<b>25,595,954</b>	22,379,626
<b>Basic earnings per common share</b>	<b>\$</b>	<b>0.90</b>	\$ 1.08
<b>Diluted earnings per common share</b>	<b>\$</b>	<b>0.89</b>	\$ 1.08
<b>Cash dividends declared per common share</b>	<b>\$</b>	<b>0.12</b>	\$ 0.12

The Notes to Unaudited Consolidated Financial Statements are an integral part of these statements.





## UNITED FIRE &amp; CASUALTY COMPANY AND SUBSIDIARIES

## UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in Thousands)

	<b>Six months ended June 30,</b>	
	<b>2006</b>	<b>2005</b>
<b>Cash Flows From Operating Activities</b>		
Net income	\$ 36,393	\$ 59,517
Adjustments to reconcile net income to net cash provided by operating activities:		
Net bond premium accretion	\$ 1,302	\$ 435
Depreciation and amortization	1,941	1,831
Realized investment gains	(4,537 )	(3,434 )
Gain on sale of subsidiary	(3,402 )	
Net cash flows from trading investments	(5,061 )	4,194
Deferred income tax expense	4,394	492
Changes in:		
Accrued investment income	3,240	(971 )
Premiums receivable	(26,679 )	(14,833 )
Deferred policy acquisition costs	(5,390 )	(2,911 )
Reinsurance receivables	65,628	(3,437 )
Prepaid reinsurance premiums	(1,431 )	99
Income taxes receivable/payable	32,873	(5,401 )
Other assets	(1,401 )	(2,651 )
Future policy benefits and losses, claims and loss settlement expenses	(82,440 )	14,047
Unearned premiums	24,238	10,909
Accrued expenses and other liabilities	8,942	985
Deferred income taxes	(1,095 )	(548 )
Other, net	512	654
Total adjustments	\$ 11,634	\$ (540 )
Net cash provided by operating activities	\$ 48,027	\$ 58,977
<b>Cash Flows From Investing Activities</b>		
Proceeds from sale of available-for-sale investments	\$ 754	\$ 2,816
Proceeds from call and maturity of held-to-maturity investments	16,543	4,691
Proceeds from call and maturity of available-for-sale investments	112,612	109,024
Proceeds from short-term and other investments	20,627	22,797
Net proceeds from sale of subsidiary	7,767	
Purchase of available-for-sale investments	(134,853 )	(271,234 )
Purchase of short-term and other investments	(37,714 )	(11,272 )
Net purchases and sales of property and equipment	(1,532 )	(905 )
Net cash used in investing activities	\$ (15,796 )	\$ (144,083 )
<b>Cash Flows From Financing Activities</b>		
Policyholders' account balances:		
Deposits to investment and universal life contracts	\$ 86,279	\$ 63,151
Withdrawals from investment and universal life contracts	(126,402 )	(55,458 )
Issuance of common stock	107,608	652
Redemption of preferred stock		(142 )
Payment of cash dividends	(6,148 )	(6,350 )
Net cash provided by financing activities	\$ 61,337	\$ 1,853
<b>Net Change in Cash and Cash Equivalents</b>	<b>\$ 93,568</b>	<b>\$ (83,253 )</b>
<b>Cash and Cash Equivalents at Beginning of Period</b>	<b>162,791</b>	<b>305,575</b>
<b>Cash and Cash Equivalents at End of Period</b>	<b>\$ 256,359</b>	<b>\$ 222,322</b>

The Notes to Unaudited Consolidated Financial Statements are an integral part of these statements.



**UNITED FIRE & CASUALTY COMPANY AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**JUNE 30, 2006**

**Note 1. Significant Accounting Policies**

**Basis of Presentation**

The terms United Fire, we, us, or our refer to United Fire & Casualty Company or United Fire & Casualty Company and its consolidated subsidiaries and affiliate, as the context requires. In the opinion of the management of United Fire, the accompanying unaudited Consolidated Financial Statements contain all adjustments (consisting of normal recurring adjustments) necessary to present fairly the financial position, the results of operations and cash flows for the periods presented. The results for the interim periods are not necessarily indicative of the results of operations that may be expected for the year. The Consolidated Financial Statements contained herein should be read in conjunction with our annual report on Form 10-K for the year ended December 31, 2005. The review report of Ernst & Young LLP as of and for the three- and six-month periods ending June 30, 2006 accompanies the unaudited Consolidated Financial Statements included in Item 1 of Part I.

We maintain our records in conformity with the accounting practices prescribed or permitted by the insurance departments of the states in which we are domiciled. To the extent that certain of these practices differ from U.S. generally accepted accounting principles ( GAAP ), we have made adjustments to present the accompanying Consolidated Financial Statements on the basis of GAAP.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The financial statement categories that are most dependent on management estimates and assumptions include the valuation of investments, the valuation of reserves for losses, claims and loss settlement expenses, the valuation of reserves for future policy benefits, the calculation of the deferred policy acquisition cost asset, and the valuation of pension and post-retirement benefit obligations.

**Contingent Liabilities**

In the aftermath of Hurricane Katrina, our Louisiana property and casualty insurance subsidiary, Lafayette Insurance Company, and many other insurers in the Louisiana market have been named defendants in litigation in Louisiana state and federal courts commenced by policyholders seeking class certification alleging various improprieties in the claims settlement process. This litigation is in the early stages and we can not at this time make a determination that the litigation is or will be material, but we believe we have handled our policyholders' claims consistent with the policy language and the applicable law.

In addition, we are a defendant in other legal actions arising from normal business activities. Management, after consultation with legal counsel, is of the opinion that any liability resulting from these actions will not have a material impact on our financial condition and operating results.

**Cash and Cash Equivalents**

For purposes of reporting cash flows, cash and cash equivalents include cash, money market accounts and non-negotiable certificates of deposit with original maturities of three months or less. We made payments for income taxes of \$4.5 million for the six-month period ended June 30, 2006, compared to \$32.9 million for the six-month period ended June 30, 2005. We have also received tax refunds totaling \$27.8 million through the six-month period ended June 30, 2006, due to an overpayment of a prior year tax and a capital loss carryback. We made no significant payments of interest for the six-month periods ended June 30, 2006 and 2005, other than interest credited to policyholders' accounts.

In the second quarter of 2006, our effective federal income tax rate was 26.1 percent, compared to 31.6 percent for the second quarter of 2005. Our effective tax rate differs from the federal statutory rate of 35.0 percent due principally to the effect of tax-exempt municipal bond interest income, nontaxable dividend income and the reduction in the valuation allowance on our deferred tax assets.



## Recently Issued Accounting Standards

In June 2006, the Financial Accounting Standards Board ( FASB ) issued interpretation of Statement of Financial Accounting Standard ( SFAS ) No. 109, *Accounting for Uncertainty in Income Taxes* ( FIN 48 ). This interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. This interpretation will be effective January 1, 2007. We are currently evaluating the impact that FIN 48 will have on our Consolidated Financial Statements.

## Note 2. Stock Options

We have a nonqualified employee stock option plan that authorizes the issuance of up to 1,000,000 shares of United Fire common stock to employees. The plan is administered by the Board of Directors. The Board has the authority to determine which employees will receive options, when options will be granted, and the terms and conditions of the options. The Board may also take any action it deems necessary and appropriate for the administration of the plan. Pursuant to the plan, the Board may, at its sole discretion, grant options to any employees of United Fire or any of its affiliated companies. These options are granted to buy shares of United Fire s common stock at the market value of the stock on the date of grant. The options vest and are exercisable in installments of 20 percent of the number of shares covered by the option award each year from the grant date. To the extent not exercised, installments shall accumulate and be exercisable by the optionee, in whole or in part, in any subsequent year included in the option period, but not later than 10 years from the grant date. Stock options are generally granted free of charge to the eligible employees of United Fire as designated by the Board of Directors. Since the inception of the plan, we have granted options for 589,042 shares of United Fire common stock pursuant to this plan, of which 113,742 have been exercised and 9,800 have been forfeited. For the six-month period ended June 30, 2006, we have granted options for 127,000 shares of United Fire common stock pursuant to this plan, of which 9,680 have been exercised and 4,100 have been forfeited.

We also have a nonqualified nonemployee director stock option and restricted stock plan that authorizes United Fire to grant restricted stock and nonqualified stock options to purchase up to 150,000 shares of United Fire s common stock. The Board has the authority to determine which directors receive options, when options and restricted stock shall be granted, the option price, the option expiration date, the date of grant, the vesting schedule of options or whether the options shall be immediately vested, the terms and conditions of options and restricted stock, other than those terms and conditions set forth in the plan, and the number of shares of Common Stock to be issued pursuant to an option agreement or restricted stock agreement. The Board may also take any action it deems necessary and appropriate for the administration of the plan. Through June 30, 2006, we have granted 18,000 options pursuant to this plan, none of which have been exercised.

Pursuant to our January 1, 2006 adoption of Statement of Financial Accounting Standards ( SFAS ) No. 123(R) *Share-Based Payment* , we now recognize stock-based compensation expense on options granted under our stock option plans. This expense is based on the fair value of the respective stock award and is recognized ratably over the underlying vesting period. We utilized the modified-prospective method prescribed by SFAS 123(R) in transitioning to this new accounting treatment for stock-based compensation expense. This method requires that stock-based compensation expense be recorded for all stock options granted subsequent to January 1, 2006 and all unvested stock options that exist upon the adoption of SFAS 123(R). As allowed by SFAS 123(R), we have utilized the Black-Scholes option pricing method to establish the fair value of options granted under our stock option plans. Our determination of fair value of stock-based payment awards on the date of grant using this option-pricing model is affected by our stock price, as well as assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to the expected volatility in our stock price and expected dividends to be paid over the term of the awards, the risk-free interest rate, and actual and projected employee stock option exercise activity. Any changes in these assumptions may materially affect the estimated fair value of the equity-based award.

Prior to the adoption of SFAS 123(R), we presented the tax benefit of stock option exercises as an operating cash flow. Upon the adoption of SFAS 123(R), tax benefits resulting from tax deductions in excess of compensation cost recognized for those options are classified as financing cash flows. This change in presentation did not have a material impact on the amounts reported in the accompanying statement of cash flows for the three and six-months ended June 30, 2006.

For the three and six months ended June 30, 2006, we recognized stock-based compensation expense under SFAS 123(R) of \$.2 million and \$.5 million, respectively, which resulted in a \$.01 decrease in our basic and diluted earnings per share for each period. As of June 30, 2006, we have approximately \$3.9 million in stock-based compensation that has yet to be recognized through our results of operations pursuant to SFAS 123(R). This compensation will be reflected through our financial results as the underlying stock options vest. Prior to January 1, 2006, the reporting of pro forma stock-based compensation was limited to disclosure in the notes to the Consolidated Financial Statements. Pro forma net income was \$26.8 million and \$59.3 million for the three- and six-month periods



ended June 30, 2005, respectively, inclusive of \$.1 million for the three-month period ended June 30, 2005 and \$.2 million for the six-month period ended June 30, 2005 in pro forma stock-based compensation expense (net of the related tax effects).

**Note 3. Employee Benefit Plans**

Among the employee benefit plans we offer, the two most significant plans are a noncontributory defined benefit pension plan and an employee/retiree health and dental benefit plan.

All of our employees are eligible to participate in the noncontributory defined benefit pension plan after they have completed one year of service, attained 21 years of age and met the hourly service requirements with the Company. Under our pension plan, retirement benefits are a function of the number of years of service and the level of compensation. Our policy is to fund this plan on a current basis to the extent that the contribution is deductible under existing tax regulations.

All of our eligible employees and retirees are able to participate in our health and dental benefit plan. The plan is composed of two programs: (1) the Self-Funded Retiree Health and Dental Benefit Plan and (2) the Self-Funded Employee Health and Dental Benefit Plan. The plan provides health and dental benefits to our employees and retirees (and covered dependents) who have met the service and participation requirements stipulated by the plan. The plan's contract administrators are responsible for making medical and dental care benefit payments. The plan requires participants to submit claims for reimbursement or payment to the claims administrator within 365 days after the end of the calendar year in which the charges were incurred.

Net periodic pension cost totaled \$.7 million for the second quarters of 2006 and 2005. Net periodic postretirement benefit cost totaled \$.4 million for the second quarters of 2006 and 2005. Net periodic pension cost totaled \$1.3 million for the first six months of 2006 and 2005. Net periodic postretirement benefit cost totaled \$.7 million for the first six months of 2006, compared to \$.4 million in the first six months of 2005. We previously disclosed in our annual report on Form 10-K for the year ended December 31, 2005 that we expected to contribute \$4.0 million to our pension plan in 2006. In the first six months of 2006, we contributed \$1.8 million to the pension plan. We do not anticipate that the total contribution for 2006 will vary significantly from the expected contribution.

**Note 4. Segment Information**

We have two reportable business segments in our operations: property and casualty insurance and life insurance. The property and casualty insurance segment has three domestic locations from which it conducts its business. All offices target a similar customer base, market the same products and use the same marketing strategies, and are therefore aggregated. The life insurance segment operates from our home office in Cedar Rapids, Iowa. Because all of our insurance is sold domestically, we have no revenues allocable to foreign operations. Our management evaluates the two segments both on the basis of statutory accounting practices prescribed by our states of domicile and on the basis of GAAP. We analyze results based on profitability (i.e., loss ratios), expenses, and return on equity. The bases we use to determine and analyze segments and to measure segment profit have not changed from that reported in our annual report on Form 10-K for the year ended December 31, 2005.

In May 2006, we closed on the sale of our subsidiary, American Indemnity Company, a Texas domiciled property and casualty insurance company that is licensed in 26 states and the District of Columbia. The sale involved only American Indemnity Company and did not affect the business of any of our other Texas subsidiaries or operations at our Gulf Coast Regional Office in Galveston, Texas. American Indemnity Company has not written or renewed any policies of insurance since November 2003 and was sold as a shell company with no liabilities and only the capital assets necessary to maintain its licenses. The sale of American Indemnity Company resulted in a realized gain of \$3.4 million, which has been recorded in the results of our property and casualty insurance segment.

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The following analysis has been reconciled to amounts reported in our unaudited Consolidated Financial Statements to adjust for inter-segment eliminations.

(Dollars In Thousands)	Property and Casualty Insurance	Life Insurance	Total
<b><u>Six Months Ended June 30, 2006</u></b>			
Net premiums earned	\$ 225,142	\$ 18,256	\$ 243,398
Investment income, net of investment expenses	18,537	40,934	59,471
Realized investment gains	6,260	1,681	7,941
Other income		345	345
Revenues	\$ 249,939	\$ 61,216	\$ 311,155
Inter-segment Eliminations	(67	) (59	) (126
Total Revenues	\$ 249,872	\$ 61,157	\$ 311,029
Net Income	\$ 30,393	\$ 6,000	\$ 36,393
Assets	\$ 1,263,982	\$ 1,491,535	\$ 2,755,517

<b><u>Six Months Ended June 30, 2005</u></b>			
Net premiums earned	\$ 228,465	\$ 18,859	\$ 247,324
Investment income, net of investment expenses	16,694	41,258	57,952
Realized investment gains	1,909	1,526	3,435
Other income		331	331
Revenues	\$ 247,068	\$ 61,974	\$ 309,042
Inter-segment Eliminations	(67	) 21	(46
Total Revenues	\$ 247,001	\$ 61,995	\$ 308,996
Net Income	\$ 54,815	\$ 4,702	\$ 59,517
Assets	\$ 1,115,776	\$ 1,531,559	\$ 2,647,335

### Note 5. Comprehensive Income

Comprehensive income includes all changes in equity during a period except those resulting from contributions to capital and dividends to shareholders. The major components of our comprehensive income are net income and the change in net unrealized investment gains and losses on available-for-sale securities, as adjusted for amounts that have been reclassified as realized investment gains and losses. Comprehensive income was \$24.2 million and \$53.4 million for the six months ended June 30, 2006 and 2005, respectively. Comprehensive income was \$19.6 million and \$36.6 million for the three months ended June 30, 2006 and 2005, respectively.

### Note 6. Earnings Per Share

We compute earnings per share in accordance with SFAS No. 128, Earnings per Share. Accordingly, we compute basic earnings per share by dividing earnings available to common stockholders (defined as net income or loss, less dividends to preferred stockholders and accretions of preferred stock issuance costs) by the weighted-average number of common shares outstanding during the period. Diluted earnings per share gives effect to all potentially dilutive common shares outstanding during the period. The potentially dilutive shares we consider in our diluted earnings per share calculation relate to our outstanding stock options and our convertible preferred stock, as applicable. During the second quarter of 2005, we redeemed all shares of preferred stock that were not previously converted into shares of common stock. We therefore had no shares of preferred stock outstanding during 2006.

We determine the dilutive effect of our convertible preferred stock using the if-converted method. Under this method, we add to the denominator of the earnings per share calculation a number determined by multiplying the number of convertible preferred shares outstanding by the stated conversion rate. We add to the numerator of the earnings per share equation the amount of preferred stock dividends and accretions to reflect the assumed conversion to common stock of all the convertible preferred stock. If the effect of the if-converted method is anti-dilutive, the effect on diluted earnings per share of our convertible preferred stock is disregarded.

We determine the dilutive effect of our outstanding stock options using the treasury stock method. Under this method, we assume the exercise of all of the outstanding options that have an exercise price less than the weighted average fair market value of our common stock during the reporting period. This method assumes that the proceeds from the hypothetical stock option exercises are used to repurchase shares of common stock at the weighted-average fair market value of the stock during the period. The net of the assumed options exercised and assumed common shares repurchased represents the number of potentially dilutive common shares,





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which we add to the denominator of the earnings per share calculation. The components of basic and diluted earnings per share are displayed in the following tables:

(In Thousands Except Per Share Data)	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Earnings available to common shareholders	\$ 22,942	\$ 24,168	\$ 36,393	\$ 55,411
Weighted-average common shares outstanding	25,596	22,380	24,603	21,274
Basic earnings per share	\$ 0.90	\$ 1.08	\$ 1.48	\$ 2.60

(In Thousands Except Per Share Data)	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Net income	\$ 22,942	\$ 26,917	\$ 36,393	\$ 59,517
Preferred dividends and accretions (1)				(4,106)
Total earnings available to common shareholders (1)	\$ 22,942	\$ 26,917	\$ 36,393	\$ 55,411
Weighted-average common shares outstanding	25,596	22,380	24,603	21,274
Potentially dilutive common shares - convertible preferred stock (1)				2,302
Potentially dilutive common shares - stock options (2)	171	94	63	66
Weighted-average common and potential shares outstanding	25,767	22,474	24,666	23,642
Diluted earnings per share	\$ 0.89	\$ 1.08	\$ 1.48	\$ 2.52

(1)The effect of our preferred stock (\$2,749,000 in preferred dividends and accretions and 1,209,000 potentially dilutive common shares) on our second quarter 2005 earnings per share calculation was disregarded since the effect was anti-dilutive.

(2)For the three- and six-month periods ended June 30, 2006, we had 145,000 and 127,000 anti-dilutive options outstanding, respectively, which were excluded from the computation of diluted earnings per share.

#### Note 7. Common Stock Offering

During the second quarter of 2006, we completed an offering of shares of our common stock priced at \$28.00 per share. Pursuant to this offering, we issued 4.025 million shares of our \$3.33 par value common stock, resulting in proceeds (net of \$5.3 million in underwriting expenses) of \$107.5 million.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and Stockholders of

United Fire & Casualty Company

We have reviewed the consolidated balance sheet of United Fire & Casualty Company as of June 30, 2006, and the related consolidated statements of income for the three-month and six-month periods ended June 30, 2006 and 2005, and the consolidated statements of cash flows for the six-month periods ended June 30, 2006 and 2005. These financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the interim consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of United Fire & Casualty Company as of December 31, 2005, and the related consolidated statements of income, stockholders' equity, and cash flows for the year then ended, not presented herein, and in our report dated February 28, 2006, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2005, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Ernst & Young LLP

Chicago, Illinois

July 31, 2006



## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### FORWARD-LOOKING STATEMENT

This release may contain forward-looking statements about our operations, anticipated performance and other similar matters. The Private Securities Litigation Reform Act of 1995 provides a safe harbor under the Securities Act of 1933 and the Securities Exchange Act of 1934 for forward-looking statements. The forward-looking statements are not historical facts and involve risks and uncertainties that could cause actual results to differ materially from those expected and/or projected. Such forward-looking statements are based on current expectations, estimates, forecasts and projections about our Company, the industry in which we operate, and beliefs and assumptions made by management. Words such as expects, anticipates, intends, plans, believes, continues, seeks, estimates, predicts, should, could, may, will continue, variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve risks, uncertainties and assumptions that are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed in such forward-looking statements. Among the factors that could cause our actual outcomes and results to differ are the following: inherent uncertainties with respect to loss reserving, including the reserves established for Hurricanes Katrina and Rita, which are based on management estimates; the occurrence of catastrophic events or other insured or reinsured events with a frequency or severity exceeding our estimates; the actual amount of new and renewal business and demand for our products and services; the competitive environment in which we operate, including price, product and service competition; developments in domestic and global financial markets that could affect our investment portfolio and financing plans; changes in the cost and availability of reinsurance; impact of regulatory actions on our Consolidated Financial Statements; uncertainties relating to government and regulatory policies; additional government and NASDAQ policies relating to corporate governance, and the cost to comply; legal developments; changing rates of inflation, interest rates and other economic conditions; changes in our financial strength rating; our relationship with our agencies; the valuation of invested assets; the valuation of pension and postretirement benefit obligations; the calculation and recovery of deferred policy acquisition costs; the resolution of legal issues pertaining to the World Trade Center catastrophe; the ability to maintain and/or advance our technological systems and safeguard the security of our data; changes in federal tax law; the resolution of regulatory and legal issues pertaining to Hurricane Katrina; or our relationship with our reinsurers. These are representative of the risks, uncertainties and assumptions that could cause actual outcomes and results to differ materially from what is expressed in forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of their dates. Except as required under the federal securities laws and the rules and regulations of the Securities and Exchange Commission, we do not have any intention or obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

### CRITICAL ACCOUNTING POLICIES

Critical accounting policies are defined as those that are reflective of significant judgments and uncertainties and that potentially may result in materially different results under different assumptions and conditions. Our discussion and analysis of our results of operations and financial condition are based upon our Consolidated Financial Statements, which we have prepared in accordance with GAAP. As we prepare these financial statements, we must make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. We evaluate our estimates on an on-going basis. We base our estimates on historical experience and on other assumptions that we believe to be reasonable under the circumstances. Actual results could differ from those estimates. Our critical accounting policies most sensitive to estimates include the valuation of investments, the valuation of reserves for losses, claims and loss settlement expenses, the valuation of reserves for future policy benefits, the calculation of the deferred policy acquisition cost asset, and the valuation of pension and post-retirement benefit obligations. These critical accounting policies are more fully described in our Management's Discussion and Analysis of Results of Operations and Financial Condition presented in our annual report on Form 10-K for the year ended December 31, 2005.

### OVERVIEW AND OUTLOOK

#### Our Business

We operate property and casualty and life insurance businesses, marketing our products through independent agents. Although we maintain a broad geographic presence that includes most of the United States, more than half of our property and casualty premiums and more than three-fourths of our life insurance premiums are written in five states. Within our property and casualty insurance segment, our primary focus is on our core commercial lines business. Through disciplined underwriting and strong agency relationships, we have traditionally emphasized writing good business at an adequate price, preferring quality to volume. Our goal of consistent profitability is supported by these business strategies.



## Summary Information

We conduct our operations through two distinct segments: property and casualty insurance and life insurance. We manage these segments separately because they generally do not share the same customer base, and they each have different pricing and expense structures. We evaluate segment profit based upon operating and investment results. Segment profit or loss as described in the following sections of the Management Discussion and Analysis is pretax.

## Financial Overview

Our financial results reported during the second quarter of 2006 deteriorated from our financial results reported during the second quarter of 2005. While our loss activity relating to the 2005 hurricane season moderated during the quarter, our catastrophe losses incurred were unfavorably impacted by a number of severe storms which hit the Midwest during the spring storm season. During the quarter, we incurred an additional \$4.2 million from the series of severe storms which struck Missouri in March of this year, bringing our total incurred loss from this catastrophe to approximately \$8.8 million. In addition, we incurred \$3.3 million during the quarter related to the severe storm which struck Iowa City in April. The following table details the impact that catastrophes had on our underwriting results for the second quarter of 2006.

### Catastrophe Losses - Three Months Ending June 30, 2006

(Dollars in Thousands Except Per Share Data)

Catastrophe (1)	Pre-Tax Losses and		After-Tax Earnings	Combined Ratio Impact
	Loss Settlement Expenses, Net of Reinsurance	Per Share Impact		
Hurricane Katrina	\$ 3,415	\$ (0.09)	)	3.0
Hurricane Rita	410	(0.01)	)	0.4
Other	12,229	(0.31)	)	10.7
<b>Total</b>	<b>\$ 16,054</b>	<b>\$ (0.41)</b>	<b>)</b>	<b>14.1</b>

(1) The Insurance Services Office, a supplier of property and casualty statistical data, defines as catastrophes those events that cause \$25.0 million or more in industry-wide direct insured losses to property and that affect a significant number of insureds and insurers. We use this definition, but we also include as catastrophes those events we believe are, or will be, material to our operations, either in amount or in number of claims made. Please see the Statutory and Other Financial Measures on page 20.

We believe that our reserves for losses and costs related to the settlement of Hurricane Katrina claims are adequate. We continue to be discouraged by the pace of restoration to damaged residential and commercial properties in the New Orleans area. We are also discouraged that the resolution of lawsuits arising out of Hurricane Katrina will prolong the final settlement of some claims. These delays make it difficult to evaluate the adequacy of our reserves related to this storm.

During the second quarter of 2006, we received approximately \$5.8 million in reinsurance recoveries in response to Hurricanes Katrina and Rita. At June 30, 2006, we had remaining balances due from reinsurers of \$0.4 million related to Hurricane Katrina and balances due from reinsurers of \$2.6 million related to Hurricane Rita. We believe all reinsurance receivables due from reinsurers are collectable and realizable. For 2006, our catastrophe reinsurance program provides coverage on 95 percent of \$170.0 million in catastrophic policy losses in excess of our \$15.0 million retention.

During the second quarter of 2006, we achieved a 6.2 percent increase in direct property and casualty premiums written as compared to the second quarter of 2005. The increase in net premiums written is attributable to the increased level of business being generated in most branches of our company. The favorable impact of this increased level of business on our net premiums written was partially diminished by the continuation of pricing decreases in several of our lines of business. In aggregate, our premium rates decreased by 5.0 percent or less during the second quarter of 2006.

The life insurance segment had a very strong second quarter from an operational standpoint. Our life premium and annuity deposits increased by approximately 58.0 percent, from \$45.4 million in the second quarter of 2005 to \$71.9 million in the second quarter of 2006.

Our annuity reserves continue to decline primarily a result of annuitants seeking alternative investment opportunities, such as CDs. However, we hope to reverse this trend over the next six months of 2006. To maintain our competitive position in the marketplace, we raised our annuity crediting rates during each month of the second quarter.





During the quarter, we successfully completed an offering of shares of our common stock priced at \$28.00 per share. Pursuant to this offering, we issued 4.025 million shares of common stock, resulting in proceeds (net of underwriting expenses) of approximately \$107.5 million. These proceeds are being used for general corporate purposes and to enhance our capital position.

On May 25, we closed on the sale of our subsidiary, American Indemnity Company, to Catlin, Inc., a subsidiary of the Catlin Group. American Indemnity Company is a Texas domiciled property and casualty insurance company that is licensed in 26 states and the District of Columbia. The sale involved only American Indemnity Company and did not affect the business of any of our other Texas subsidiaries or operations at our Gulf Coast Regional Office in Galveston, Texas. American Indemnity Company has not written or renewed any policies of insurance since November 2003 and was sold as a shell company with no liabilities and only the capital assets necessary to maintain its licenses. The sale of American Indemnity Company resulted in a realized gain of \$3.4 million.

## RESULTS OF OPERATIONS

### Consolidated Financial Highlights

Financial Results (Dollars in Thousands Except Per Share Data)	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Total revenues	\$ 156,887	\$ 155,619	\$ 311,029	\$ 308,996
Net income	\$ 22,942	\$ 26,917	\$ 36,393	\$ 59,517
Book value per common share	\$ 22.67	\$ 23.99	\$ 22.67	\$ 23.99
Basic earnings per common share	\$ 0.90	\$ 1.08	\$ 1.48	\$ 2.60
Diluted earnings per common share	\$ 0.89	\$ 1.08	\$ 1.48	\$ 2.52

Second quarter 2006 net income totaled \$22.9 million, or \$0.90 per share. Net income for the second quarter of 2005 was \$26.9 million, or \$1.08 per share. Second quarter diluted earnings were \$0.89 per share and \$1.08 per share for 2006 and 2005, respectively. The additional shares of common stock we issued pursuant to our stock offering completed in the second quarter of 2006 had a \$0.07 impact on our basic and diluted earnings per share. The deterioration in our quarterly results is attributable to the catastrophe loss experienced during the second quarter of 2006.

Total revenues were \$156.9 million in the second quarter of 2006, an increase of 0.8 percent, from \$155.6 million in the second quarter of 2005. Net premiums earned decreased by 1.5 percent to \$122.7 million in the second quarter of 2006, compared to \$124.5 million in the second quarter of 2005. Investment income increased by 3.5 percent to \$30.3 million in the second quarter of 2006, compared to \$29.3 million in the second quarter of 2005. Net realized investment gains increased to \$3.8 million in the second quarter of 2006, compared to \$1.6 million in the second quarter of 2005. This increase is attributable to the gain recognized on our sale of American Indemnity Company.

For the six months ended June 30, 2006, net income was \$36.4 million, or \$1.48 per share. For the six months ended June 30, 2005, net income was \$59.5 million, or \$2.60 per share (after providing for the dividend and accretion on convertible preferred stock). Diluted earnings for the first half of 2006 were \$1.48 per share. Diluted earnings for the first half of 2005 were \$2.52 per share.

Total revenues were \$311.0 million in the first six months of 2006, compared to \$309.0 million for the first six months of 2005. Net premiums earned decreased to \$243.3 million in the first six months of 2006 from \$247.2 million in the first six months of 2005. Investment income increased to \$59.5 million in the first six months of 2006 from \$58.0 million in the first six months of 2005. Net realized investment gains (before tax) were \$7.9 million for the first six months of 2006, compared to net realized investment gains (before tax) of \$3.4 million for the first six months of 2005.

**Property and Casualty Insurance Segment Results**

<b>Property &amp; Casualty Insurance Financial Results:</b>	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>			
(Dollars in Thousands)	<b>2006</b>	2005	<b>2006</b>	2005		
Net premiums written	<b>\$ 129,215</b>	\$ 126,233	<b>\$ 249,609</b>	\$ 242,663		
Net premiums earned	<b>\$ 113,888</b>	\$ 115,010	<b>\$ 225,142</b>	\$ 228,465		
Losses and loss settlement expenses	<b>(67,525)</b>	(56,923)	<b>(144,488)</b>	(101,799)	)	)
Amortization of deferred policy acquisition costs	<b>(27,678)</b>	(25,595)	<b>(55,503)</b>	(50,025)	)	)
Other underwriting expenses	<b>(4,360)</b>	(6,642)	<b>(9,857)</b>	(15,468)	)	)
Underwriting income	<b>\$ 14,325</b>	\$ 25,850	<b>\$ 15,294</b>	\$ 61,173		
Investment income, net	<b>\$ 9,831</b>	\$ 8,588	<b>\$ 18,472</b>	\$ 16,628		
Realized investment gains	<b>\$ 3,989</b>	\$ 360	<b>\$ 6,258</b>	\$ 1,908		
Income before income taxes	<b>\$ 28,145</b>	\$ 34,798	<b>\$ 40,024</b>	\$ 79,709		
<b>GAAP Ratios:</b>						
Net loss ratio	<b>59.3</b>	% 49.5	% <b>64.2</b>	% 44.6	%	%
Expense ratio	<b>28.1</b>	% 28.0	% <b>29.0</b>	% 28.7	%	%
Combined ratio	<b>87.4</b>	% 77.5	% <b>93.2</b>	% 73.3	%	%
Combined ratio (without catastrophes)	<b>73.3</b>	% 72.6	% <b>69.5</b>	% 70.7	%	%
<b>Personal and commercial* lines underwriting analysis:</b>						
Premiums earned - personal lines	<b>\$ 9,301</b>	\$ 11,211	<b>\$ 18,885</b>	\$ 22,283		
Losses and loss settlement expenses incurred - personal lines	<b>\$ 7,520</b>	\$ 7,459	<b>\$ 19,978</b>	\$ 11,607		
Personal lines net loss ratio	<b>80.9</b>	% 66.5	% <b>105.8</b>	% 52.1	%	%
Premiums earned - commercial lines	<b>\$ 104,587</b>	\$ 103,799	<b>\$ 206,257</b>	\$ 206,182		
Losses and loss settlement expenses incurred - commercial lines	<b>\$ 60,005</b>	\$ 49,464	<b>\$ 124,510</b>	\$ 90,192		
Commercial lines net loss ratio	<b>57.4</b>	% 47.7	% <b>60.4</b>	% 43.7	%	%

\*Commercial lines information includes assumed reinsurance results

In the second quarter of 2006, our property and casualty insurance segment's pre-tax income was \$28.1 million, compared to pre-tax income of \$34.8 million in the second quarter of 2005. The deterioration is primarily attributable to the catastrophe loss experience we encountered during the quarter.

Net premiums written in the second quarter of 2006 were \$129.2 million, compared to \$126.2 million in the second quarter of 2005. The increase in net premiums written is attributable to the increased level of business being generated in most branches of our Company. The favorable impact of this increased level of business on our net premiums written was partially diminished by the continuation of pricing decreases in several of our lines of business. In aggregate, our premium rates decreased by 5.0 percent or less during the second quarter of 2006. Net premiums earned in the second quarter of 2006 were \$113.9 million, compared to \$115.0 million in the second quarter of 2005. The decrease in net premiums earned is attributable to the adverse impact on our premium rates of the increased level of competition experienced in recent quarters within the property and casualty insurance industry.

Losses and loss settlement expenses increased to \$67.5 million in the second quarter of 2006 from \$56.9 million in the second quarter of 2005. Without the impact of the catastrophe loss experience, our quarterly loss experience was similar to that experienced during the second quarter of 2005. The strong non-catastrophe results we achieved during the second quarter were attributable to the continuation of the very low levels of non-catastrophe claims frequency we experienced.

Pre-tax catastrophe losses, net of reinsurance, of \$16.1 million for the second quarter of 2006 added 14.1 points to our combined ratio, resulting in a reduction in after-tax earnings of \$0.41 per share. Comparatively, pre-tax catastrophe losses, net of reinsurance, of \$5.6 million for the second quarter of 2005 added 4.9 points to our combined ratio, resulting in a reduction in after-tax earnings of \$0.16 per share.

We analyze our property and casualty financial results through the review and comparison of financial measures common to the insurance industry, which include the losses and loss settlement expense ratios (collectively referred to as the net loss ratio), the underwriting expense ratio (the expense ratio) and the combined ratio. The ratios used in this discussion have been prepared on the basis of GAAP. The calculation of these ratios is discussed further in the Statutory and Other Financial Measures section of this discussion.



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The combined ratio, a commonly used financial measure of underwriting performance, is the sum of the net loss ratio and the expense ratio. Generally, a combined ratio below 100.0 percent indicates a profitable book of business. Our combined ratio for the second quarter of 2006 was 87.4 percent, compared to 77.5 percent for the second quarter of 2005. We review the net loss ratio to measure our profitability by line. We make pricing and underwriting decisions based upon these results. The table below details our commercial and personal lines loss ratios.

Six-month periods ended June 30, 2006 (Dollars in Thousands)	Losses & Loss Settlement			2005			
	Premiums Earned	Expenses Incurred	Net Loss Ratio	Premiums Earned	Expenses Incurred	Net Loss Ratio	
<b>Commercial lines:</b>							
Fire and allied lines	\$ 60,541	\$ 60,064	99.2	% \$ 64,623	\$ 23,985	37.1	%
Other liability	62,997	18,634	29.6	59,469	24,410	41.0	
Automobile	46,403	23,123	49.8	46,501	21,060	45.3	
Workers compensation	20,479	13,189	64.4	19,769	10,542	53.3	
Fidelity and surety	10,290	3,380	32.8	11,496	5,493	47.8	
Miscellaneous	421	(4	) N/A	394	269	68.3	
Total commercial lines	\$ 201,131	\$ 118,386	58.9	% \$ 202,252	\$ 85,759	42.4	%
<b>Personal lines:</b>							
Automobile	\$ 8,547	\$ 5,188	60.7	% \$ 10,834	\$ 5,701	52.6	%
Fire and allied lines	10,172	14,313	140.7	11,069	4,970	44.9	
Miscellaneous	166	477	N/A	380	936	N/A	
Total personal lines	\$ 18,885	\$ 19,978	105.8	% \$ 22,283	\$ 11,607	52.1	%
Reinsurance assumed	\$ 5,126	\$ 6,124	119.5	% \$ 3,930	\$ 4,433	112.8	%
<b>Total</b>	<b>\$ 225,142</b>	<b>\$ 144,488</b>	<b>64.2</b>	<b>% \$ 228,465</b>	<b>\$ 101,799</b>	<b>44.6</b>	<b>%</b>

The expense ratio was 28.1 percent for the second quarter of 2006, compared to 28.0 percent in the second quarter of 2005.

**Life Insurance Segment Results**

<b>Life Insurance Financial Results:</b> (Dollars in Thousands)	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
<b>Revenues:</b>				
Net premiums written	<b>\$8,085</b>	\$8,025	<b>\$16,474</b>	\$15,551
Net premiums earned	<b>\$8,765</b>	\$9,499	<b>\$18,134</b>	\$18,740
Investment income, net	<b>20,462</b>	20,677	<b>40,997</b>	41,398
Realized investment gains	<b>(174</b>	) 1,246	<b>1,681</b>	1,526
Other income	<b>126</b>	239	<b>345</b>	331
<b>Total Revenues</b>	<b>\$29,179</b>	\$31,661	<b>\$61,157</b>	\$61,995
<b>Benefits, Losses and Expenses:</b>				
Losses and loss settlement expenses	<b>\$3,107</b>	\$4,249	<b>\$8,026</b>	\$9,201
Increase in liability for future policy benefits	<b>4,285</b>	4,330	<b>9,219</b>	8,249
Amortization of deferred policy acquisition costs	<b>2,577</b>	2,646	<b>5,032</b>	5,723
Other underwriting expenses	<b>2,223</b>	1,855	<b>4,154</b>	3,708
Interest on policyholders' accounts	<b>12,591</b>	13,775	<b>25,472</b>	27,860
<b>Total Benefits, Losses and Expenses</b>	<b>\$24,783</b>	\$26,855	<b>\$51,903</b>	\$54,741
<b>Income Before Income Taxes</b>	<b>\$4,396</b>	\$4,806	<b>\$9,254</b>	\$7,254

In the second quarter of 2006, our life insurance segment recorded pre-tax income of \$4.4 million, compared to \$4.8 million for the second quarter of 2005. This deterioration in the segment's second quarter results was attributable to several factors. Total revenues diminished primarily as the result of a \$1.4 million decrease in realized investment gains, a \$.2 million decrease in net investment income and a decrease in premiums earned of \$.7 million. The decrease in premiums earned was primarily due to the continued runoff of our credit life business. This deterioration was accompanied by an increase in other underwriting expense of \$.4 million. Somewhat offsetting this deterioration in the segment's results was a \$1.2 million decrease in the interest on policyholders' accounts. This decline was the result of a larger than normal withdrawal of annuity funds experienced during the second quarter. This increased level of annuity withdrawals is discussed further below. Losses and loss settlement expenses decreased in the second quarter of 2006 to \$3.1 million, compared to \$4.2 million in the second quarter of 2005. The improvement is attributable to the favorable mortality experience encountered during the second quarter of 2006, as compared to the second quarter of 2005.

The principal product of our life insurance segment is the single premium deferred annuity. Pursuant to GAAP, we do not report annuity deposits as net premiums earned. Rather, annuity deposits are recorded as liabilities for future policyholder benefits. Revenues for annuities consist of policy surrender charges and investment income earned on policyholder deposits. In the second quarter of 2006, annuity deposits were \$32.3 million, compared to \$13.0 million in the second quarter of 2005. These deposits were more than offset by annuity surrenders and withdrawals of \$42.8 million in the second quarter of 2006, compared to \$23.0 million in the second quarter of 2005. The increase in surrenders and withdrawals is primarily attributable to our annuitants seeking alternative investment opportunities to a greater extent in 2006 than in 2005.

**Investment Results**

We recorded net investment income (before tax) of \$59.5 million for the six-month period ended June 30, 2006, compared to \$58.0 million for the six-month period ended June 30, 2005. Our invested assets decreased from \$2.09 billion at December 31, 2005 to \$2.08 billion at June 30, 2006.

Net realized investment gains (before tax) for the six-month period ended June 30, 2006 totaled \$7.9 million, compared to \$3.4 million of net realized investment gains (before tax) for the six-month period ended June 30, 2005. This increase is attributable to the gain recognized on our sale of American Indemnity Company. During the first six months of 2006 we recorded \$.2 million in investment write-downs, compared to \$.8 million in the first six months of 2005.

We continually monitor the difference between our cost basis and the estimated fair value of our investments. Our accounting policy for impairment recognition requires other-than-temporary impairment charges to be recorded when we determine that it is more likely than not that we will be unable to collect all amounts due according to the contractual terms of the fixed maturity security or that the anticipated recovery in market value of the equity security will not occur in a reasonable amount of time. Impairment charges on investments are recorded based on the fair value of the investments at the measurement date and are included in net realized gains and losses. Factors considered in evaluating whether a decline in value is other-than-temporary include: the length of time and the extent to which the fair value has been less than cost; the financial conditions and near-term prospects of the issuer; and our intent and ability to retain the investment for a period of time sufficient to allow for any anticipated recovery.



**LIQUIDITY & CAPITAL RESOURCES****Liquidity**

Cash flow and liquidity is derived from three sources: 1) operating activities; 2) investing activities; and 3) financing activities.

Net cash provided by our operating activities was \$48.0 million for the six months ended June 30, 2006, compared to \$59.0 million for the six months ended June 30, 2005. The decrease in cash provided by operating activities was primarily attributable to the significant claim payments made during the first six months of 2006 in response to significant catastrophe loss experienced. This was somewhat offset by the tax refund received in the first six months of 2006 and the reinsurance recoveries received during the year related to Hurricanes Katrina and Rita.

We also have significant cash flows from sales of investments and from scheduled and unscheduled investment security maturities, redemptions, and prepayments. These cash flows totaled \$159.8 million through June 30, 2006 and \$149.6 million through June 30, 2005. We invest in fixed maturities that mature at regular intervals in order to meet our scheduled obligations to pay policy benefits, claims, and claim adjusting expenses. If our operating, investment and financing cash flows are not sufficient to support our operations, we have additional short-term investments that we could utilize for this purpose. At June 30, 2006, our consolidated invested assets included \$54.4 million of short-term investments, which consist primarily of fixed maturities that mature within a year. We may also borrow up to \$50.0 million on our existing bank line of credit, which expires on July 10, 2007. As of June 30, 2006, there were no amounts outstanding under our line of credit, other than letters of credit utilized in our reinsurance operations, which are not material in amount.

Cash provided by financing activities was \$61.3 million and \$1.9 million through the first six months of 2006 and 2005, respectively, an increase of \$59.4 million between periods. This increase is primarily due to the completion of our common stock offering, resulting in proceeds (net of underwriting expenses) of \$107.5 million. Offsetting this is an increase in the amount of surrenders and withdrawals experienced by our life insurance segment's annuity portfolio during the year. This resulted in negative annuity cashflows of \$40.1 million during 2006, compared to positive annuity cashflows of \$7.7 million during the first six months of 2005.

**Capital Resources**

At June 30, 2006 our consolidated total assets were \$2.76 billion, compared to \$2.72 billion at December 31, 2005. Invested assets, primarily comprised of fixed maturity securities, decreased \$15.2 million, or 0.7 percent, from December 31, 2005. The decrease in invested assets we experienced this year is attributable primarily to a decline in the unrealized appreciation recorded on our available-for-sale investments. The primary factor leading to this decline was the impact that increasing interest rates had on the carrying value of our available-for-sale fixed maturity portfolio. Available-for-sale fixed maturities are carried at fair market value, which generally declines as interest rates rise. The net unrealized gain from these investments is reported net of tax as a separate component of stockholders' equity. Somewhat offsetting this decrease in invested assets for the period was the excess of cash outflows to investment purchases over cash inflows from investment sales, calls and maturities. The changes in our total reported balance in unaffiliated invested assets are summarized by the following table:

(Dollars in Thousands)	
Invested Assets at December 31, 2005	\$2,091,630
Purchases	179,098
Sales	(1,296 )
Calls / Maturities	(150,709 )
Realized gains on sale	3,649
Mark to market adjustment (1)	852
Net bond premium accretion	(1,302 )
Change in unrealized gains	(41,125 )
Other (2)	(4,320 )
Change in carrying value of invested assets	(15,153 )
<b>Invested Assets at June 30, 2006</b>	<b>\$2,076,477</b>

(1) Pursuant to GAAP, changes in the fair value of both our portfolio of trading securities and limited liability partnership investments are recognized currently in earnings.

(2) Pursuant to the sale of our subsidiary, American Indemnity Company, we disposed of \$4.3 million in U.S. treasury notes.





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The composition of our investment portfolio at June 30, 2006 is presented in the following table:

(Dollars in Thousands)	<b>Property &amp; Casualty Insurance Segment</b>			<b>Life Insurance Segment</b>			<b>Total</b>		
		Percent of Total	%		Percent of Total	%		Percent of Total	%
Fixed maturities (1)	\$ 515,704	73.5	%	\$ 1,284,101	93.3	%	\$ 1,799,805	86.6	%
Equity securities	160,177	22.9		11,458	0.8		171,635	8.3	
Trading securities	9,921	1.4					9,921	0.5	
Mortgage loans	3,880	0.6		18,850	1.4		22,730	1.1	
Policy loans				8,014	0.6		8,014	0.4	
Other long-term investments	9,958	1.4					9,958	0.5	
Short-term investments	1,300	0.2		53,114	3.9		54,414	2.6	
<b>Total</b>	<b>\$ 700,940</b>	<b>100.0</b>	<b>%</b>	<b>\$ 1,375,537</b>	<b>100.0</b>	<b>%</b>	<b>\$ 2,076,477</b>	<b>100.0</b>	<b>%</b>

(1) Available-for-sale fixed maturities are carried at fair value, while held-to-maturity fixed maturities are carried at amortized cost.

At June 30, 2006, \$1,743.3 million, or 96.3 percent, of our fixed income security portfolio, was classified as available-for-sale, compared to \$1,777.1 million, or 96.1 percent, at December 31, 2005. We classify our remaining fixed maturities as held-to-maturity or trading. Held-to-maturity fixed maturities are reported at amortized cost. Our trading securities consist primarily of convertible redeemable preferred debt securities, which are recorded at fair value, with any changes in fair value recognized in earnings. At June 30, 2006, cash and cash equivalents totaled \$256.4 million compared to \$162.8 million at December 31, 2005. This increase was primarily attributable to the common stock offering completed in May of 2006, the tax refunds received during 2006, the reinsurance recoveries received during the year related to Hurricanes Katrina and Rita, and the decreased level of investment activity experienced during the year. These increases in cash and cash equivalents were somewhat offset by the significant claim payments made during the year in response to catastrophe loss experience and the significant levels of annuity withdrawals we have encountered during the year.

Our consolidated deferred policy acquisition costs increased \$27.8 million, or 23.2 percent, to \$147.7 million at June 30, 2006 from the deferred policy acquisition costs at December 31, 2005. Our property and casualty insurance segment's deferred policy acquisition costs increased \$6.5 million, or 12.3 percent, to \$59.3 million at June 30, 2006 from the deferred policy acquisition costs at December 31, 2005. Our life insurance segment's deferred policy acquisition costs increased \$21.3 million to \$88.4 million at June 30, 2006 from the deferred policy acquisition costs at December 31, 2005. The increase in the life insurance segment's deferred policy acquisition costs resulted primarily from the deferred policy acquisition costs related to its universal life and annuity business, which are affected by the changes in unrealized gains and losses on certain available-for-sale securities. Included as a part of the unrealized gains reported at June 30, 2006, are unrealized losses on available-for-sale securities that support the universal life and annuity business. As a result of increases in these unrealized losses during the six month period ended June 30, 2006 due to rising interest rates, deferred policy acquisition costs increased by \$22.4 million.

Stockholders' equity increased from \$500.2 million at December 31, 2005 to \$626.4 million at June 30, 2006, an increase of 25.2 percent. The increase in stockholders' equity was primarily attributable to net proceeds of \$107.5 million from our common stock offering that occurred in May of 2006. Additionally, net income of \$36.4 million added to our increase. The primary decreases to stockholders' equity were a decrease in net unrealized appreciation, after-tax, of \$12.2 million and stockholder dividends of \$6.2 million. At June 30, 2006, book value was \$22.67 per common share compared to \$21.20 per common share at December 31, 2005.

### Statutory and Other Financial Measures

We believe that disclosure of certain statutory and other financial measures enhances investor understanding of our financial performance. The statutory and other financial measures we utilize in this report include net premiums written, catastrophe losses and statutory combined ratio. Statutory financial information represents information prepared in accordance with statutory accounting rules as prescribed by the National Association of Insurance Commissioners *Accounting Practices and Procedures Manual*, as applied in Iowa, United Fire & Casualty Company's state of domicile.

**Net premiums written:** Net premiums written is a statutory accounting measure representing the amount of premiums charged for policies issued during the period. These premiums are reported as revenue as they are earned over the underlying policy period. Net premiums written applicable to the unexpired term of a policy are recorded as unearned premium. We evaluate net premiums written as a measure of business production for the period under review. The table below sets forth a reconciliation of net premiums written to net premiums earned for the six-months ended June 30, 2006 and 2005.

(Dollars in Thousands)

<b>Second Quarter</b>	Net Premiums Written	Net Change in Unearned Premium		Net Premiums Earned
<b>2006</b>	<b>\$ 137,300</b>	<b>\$ (14,647</b>	)	<b>\$ 122,653</b>
2005	134,258	(9,749	)	124,509
<b>Year to date</b>	Net Premiums Written	Net Change in Unearned Premium		Net Premiums Earned
<b>2006</b>	<b>\$ 266,083</b>	<b>\$ (22,807</b>	)	<b>\$ 243,276</b>
2005	258,214	(11,009	)	247,205

**Catastrophe losses:** A catastrophe loss is a single incident or series of closely related incidents causing severe insured losses. Catastrophes are, by their nature, unpredictable. The frequency and severity of catastrophic losses we experience in any year affect our results of operations and financial position. In analyzing the underwriting performance of our property and casualty insurance segment, we evaluate performance both including and excluding catastrophe losses. The Insurance Services Office (ISO), a supplier of property and casualty statistical data, defines as catastrophes those events that cause \$25.0 million or more in industry-wide direct insured losses to property and that affect a significant number of insureds and insurers' ISO losses. We use this definition, but we also include as catastrophes those events we believe are, or will be, material to our operations, either in amount or in number of claims made. For the quarter ending June 30, 2006, losses from non-ISO losses totaled \$.1 million, compared to \$.4 million for the quarter ended June 30, 2005. For the six-month periods ending June 30, 2006 and 2005 non-ISO losses totaled \$.2 million and \$.4 million, respectively. Portions of our catastrophe losses may be recoverable under our catastrophe reinsurance agreements.

**Combined ratio:** The combined ratio is a commonly used financial measure of underwriting performance. Generally, a combined ratio below 100.0 percent indicates a profitable book of business. The combined ratio is the sum of two separately calculated ratios, the net loss and net loss settlement expense ratio (referred to as the net loss ratio) and the underwriting expense ratio (the expense ratio). When prepared in accordance with GAAP, the net loss ratio is calculated by dividing the sum of net losses and net loss settlement expenses by net premium earned. The expense ratio is calculated by dividing nondeferred underwriting expenses and amortization of deferred policy acquisition costs by net premiums earned. When prepared in accordance with statutory accounting principles, the net loss ratio is calculated by dividing the sum of net losses and net loss settlement expenses by net premium earned plus policyholder dividends divided by net premiums earned. The expense ratio is calculated by dividing underwriting expenses by net premiums written.



### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We have exposure to market risk arising from potential losses due to adverse changes in interest rates and market prices. Our primary market risk exposure is changes in interest rates, although we have some exposure to changes in equity prices and limited exposure to foreign currency exchange rates.

Active management of market risk is integral to our operations. Our investment guidelines define the overall framework for managing our market and other investment risks, including accountability and controls. In addition, each of our subsidiaries has specific investment policies that delineate the investment limits and strategies that are appropriate given each entity's liquidity, surplus, product and regulatory requirements. We respond to market risk by rebalancing our existing asset portfolio and by managing the character of future investment purchases.

There have been no material changes in our market risk or market risk factors from that reported in our annual report on Form 10-K for the year ended December 31, 2005.

### **ITEM 4. CONTROLS AND PROCEDURES**

#### **Evaluation of Disclosure Controls and Procedures**

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures as of the end of the period covered by this report were designed and functioning effectively to provide reasonable assurance that the information required to be disclosed by us in reports filed under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms. We believe that a controls system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the controls system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

#### **Changes in Internal Control Over Financial Reporting**

As required by Rule 15d-15(e) under the Securities Exchange Act of 1934, our management, including our Chief Executive Officer and Chief Financial Officer, has evaluated our internal control over financial reporting to determine whether any changes occurred during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Based on this evaluation, no such change in our internal control over financial reporting occurred during the fiscal quarter to which this report relates.

**PART II - OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

The legal proceedings included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005 have not materially changed during the second quarter of 2006.

**ITEM 1A. RISK FACTORS**

*Investing in our common stock involves risks. Before purchasing our common stock, you should carefully consider the risks described below in addition to the other information contained or incorporated by reference in this prospectus supplement, including our Consolidated Financial Statements and related notes. Our business, results of operations and financial condition may be materially and adversely affected due to any of the following risks. The trading price of our common stock could decline due to any of these risks, and you could lose all or part of your investment.*

The risk factors have not materially changed during the second quarter of 2006, from those disclosed in the first quarter 10-Q filed on May 2, 2006.

**ITEM 4. Submission of Matters to a Vote of Security Holders**

At United Fire's Annual Stockholders Meeting on May 17, 2006, the following proposal was adopted by the margins indicated.

Proposal: To elect the following Class C directors for a term of three years or until such time as their respective successors have been elected or appointed.

	Number of Shares VOTED FOR	ABSTAINING
Christopher R. Drahozal	19,947,097	1,962,877
Jack B. Evans	19,929,796	1,980,178
Thomas W. Hanley	19,963,355	2,216,619
George D. Milligan	19,928,207	1,981,767

**ITEM 6. EXHIBITS**

Exhibits

- 3.1 Fourth Restated Articles of Incorporation (incorporated by reference to Exhibit 4.1 of Amendment No. 1 to our Form S-3 Registration Statement filed with the Securities and Exchange Commission on April 4, 2002, SEC File Number 333-83446)
- 3.2 First Amendment to Fourth Restated Articles of Incorporation (incorporated by reference to Exhibit 4.3 of Amendment No. 3 to our Form S-3 Registration Statement filed with the Securities and Exchange Commission as of May 3, 2002, SEC File Number 333-83446)
- 3.3 Second Amendment to the Fourth Restated Articles of Incorporation (incorporated by reference to Exhibit 4.1 of United Fire & Casualty Company's Form 10-Q, Commission File Number 2-39621, filed with the Commission on July 29, 2005)
- 3.4 By-Laws of United Fire & Casualty Company, as amended, incorporated by reference to the Registrant's Form S-8 Registration Statement, filed with the Commission on December 19, 1997
- 10.1 United Fire & Casualty Company Nonqualified Employee Stock Option Plan, incorporated by reference from Registrant's Form S-8 Registration Statement, filed with the Commission on September 9, 1998
- 10.2 United Fire & Casualty Company Employee Stock Purchase Plan, incorporated by reference from Registrant's Form S-8 Registration Statement, filed with the Commission on December 22, 1997

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- 10.3 United-Lafayette 401(k) Profit Sharing Plan, incorporated by reference from Registrant's Form S-8 Registration Statement, filed with the Commission on July 15, 2004
- 10.4 United Fire & Casualty Company Nonqualified Nonemployee Director Stock Option and Restricted Stock Plan, incorporated by reference from Registrant's Form S-8 Registration Statement, filed with the Commission on November 23, 2005
- 15.1 Letter of Acknowledgement from Ernst & Young LLP concerning unaudited interim financial information
- 31.1 Certification of John A. Rife, Pursuant To Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Dianne M. Lyons, Pursuant To Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of John A. Rife, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of Dianne M. Lyons, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

**SIGNATURES**

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

UNITED FIRE & CASUALTY COMPANY

(Registrant)

July 31, 2006

(Date)

/s/ John A. Rife

John A. Rife

President, Chief Executive Officer

/s/ Dianne M. Lyons

Dianne M. Lyons

Vice President, Chief Financial Officer and Principal Accounting Officer

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tration Statement or amendment or supplement thereto in a form to which the Sellers reasonably objects.

(f) The Purchaser shall notify the Sellers in writing of the happening of any event, as promptly as practicable after becoming aware of such event, as a result of which the Registration Statement or the Prospectus includes an untrue statement of a material fact or omission to state a material fact required to be stated therein or necessary to make the statements therein, in the light of the circumstances under which they were made, not misleading and promptly prepare a supplement or amendment to such Registration Statement or Prospectus to correct such untrue statement or omission. In addition, if any stop order or suspension of the Registration Statement or Prospectus is issued, the Purchaser shall immediately notify the Sellers and take all reasonable action to obtain the withdrawal of such order or suspension at the earliest practicable moment.

(g) The Purchaser shall use its best efforts to cause the Issued Shares covered by the Registration Statement to be listed on each securities exchange on which securities of the same class or series issued by the Purchaser are then listed.

(h) The Purchaser shall not identify any Seller as an underwriter without its prior written consent in any public disclosure or filing with the SEC or the Principal Market.

(i) The Purchaser shall enter into such customary agreements for underwritten secondary offerings and take all such other reasonable actions and deliver or cause to be delivered such other document and instruments requested by the

Sellers or the lead underwriter in any secondary underwritten offering in order to expedite or facilitate the disposition of the Cavco Shares.

## ARTICLE II - THE CLOSING

SECTION 2.1 Closing. The closing of the purchase and sale of the Shares (the "Closing") shall occur at the Purchaser's offices, 1001 N. Central Avenue, Suite 800, Phoenix, Arizona 85004, or such other place as the parties may mutually agree as soon as practicable after fulfillment of the conditions set forth in Article V. The date on which closing occurs is herein called the "Closing Date".



SECTION 2.2 Closing Actions of the Sellers. At the Closing, the Sellers shall deliver or cause to be delivered to the Purchaser:

- (a) stock certificates evidencing the Shares duly endorsed in blank, or accompanied by stock powers duly executed in blank;
- (b) a true and complete copy, certified by the Secretary of each of the Sellers, of the resolutions duly and validly adopted by the Board of Directors of each of the Sellers evidencing their authorization of the execution and delivery of this Agreement and the consummation of the transactions contemplated hereby; and
- (c) a certificate of the Sellers certifying as to the matters set forth in

SECTION 2.3 Closing Actions of the Purchaser. At the Closing, the Purchaser shall deliver or cause to be delivered to the Sellers:

- (a) stock certificates evidencing the Issued Shares or instructions to issue the Issued Shares to Sellers;
- (b) a true and complete copy, certified by the Secretary of the Purchaser, of the resolutions duly and validly adopted by the Board of Directors of the Purchaser evidencing its authorization of the execution and delivery of this Agreement and the consummation of the transactions contemplated hereby; and
- (c) a certificate of a duly authorized officer of the Purchaser certifying as to the matters set forth in

SECTION 2.4 Taxes. Notwithstanding any other provision in this Agreement, the Purchaser shall have the right to withhold any and all taxes from any payments to be made hereunder if such withholding is required by United States federal or state law and to collect Forms W-8 or W-9, as applicable, from the Sellers.

### ARTICLE III - REPRESENTATIONS AND WARRANTIES OF SELLERS

Each Seller hereby represents and warrants to Purchaser as follows:

SECTION 3.1 Organization. The Seller is duly organized, validly existing and in good standing under the laws of Delaware.

SECTION 3.2 Authorization. The Seller has the power and authority to execute and deliver this Agreement and the other agreements, documents and instruments of the Seller contemplated hereby and to perform its obligations hereunder and thereunder. The execution, delivery and performance by the Seller of this Agreement and consummation of the transactions contemplated hereby have been duly and validly authorized by all requisite action on the part of the Seller. This

Agreement has been duly executed and delivered by the Seller and constitutes a valid and binding obligation of the Seller in accordance with its terms.

**SECTION 3.3 Consents and Filings.** There is no requirement applicable to the Seller to obtain any consent, approval or authorization of, or to make or effect any declaration, filing or registration on the part of the Seller for or in connection with the valid execution and delivery by Seller of this Agreement, the due performance by it of its obligations hereunder or the lawful consummation by it of the transactions contemplated hereby, except with respect to any filings required under HSR Act.

**SECTION 3.4 Title to Shares.** The Seller has good and valid title to the Shares, free and clear of all Liens, encumbrances, equities, claims, security interests and restrictions of any kind. The execution of this Agreement and any other documents of transfer to be executed and delivered by the Seller to Purchaser are sufficient to convey to Purchaser good and valid title to the Shares, free and clear of all Liens, encumbrances, equities, claims, security interests or restrictions of any kind. The Seller has not granted any option or right, and is not a party to or bound by any agreement that requires or, upon the passage of time, the payment of money or occurrence of any other event, would require the Seller to transfer any of the Shares to anyone other than the Purchaser.

**SECTION 3.5 United States Persons.** Neither Seller is a foreign person within the meaning of Section 1445 of the Internal Revenue Code of 1986, as amended.

#### ARTICLE IV - REPRESENTATIONS AND WARRANTIES OF PURCHASER

Except as otherwise disclosed and readily apparent in Purchaser's Annual Report on Form 10 K for the year ended March 30, 2013 (the "Form 10-K") or any Quarterly Report on Form 10-Q or Current Report on Form 8-K filed by Purchaser with the SEC subsequent to the filing of the Form 10-K and prior to the date of this Agreement (in each case, including any supplements or amendments thereto) (the "Reports"), Purchaser hereby represents and warrants to the Sellers as follows:

**SECTION 4.1 Organization.** Purchaser is duly organized, validly existing and in good standing under the laws of Delaware.

**SECTION 4.2 Authorization; Enforcement.** The execution and performance by Purchaser of this Agreement and consummation of the transactions contemplated hereby have been duly authorized by all requisite action on the part of Purchaser. This Agreement has been duly executed and delivered by Purchaser and constitutes a valid and binding obligation of Purchaser in accordance with its terms. When executed and delivered by Purchaser, this Agreement shall constitute a valid and binding obligation of Purchaser, enforceable against Purchaser in accordance with its terms, except as such enforceability may be limited by applicable bankruptcy, reorganization, moratorium, liquidation, conservatorship, receivership or similar laws relating to, or affecting generally the enforcement of, creditor's rights and remedies or by other equitable principles of general application.

**SECTION 4.3 Governmental Consents and Filings.** There is no requirement applicable to Sellers to obtain any consent, approval or authorization of, or to make or effect any

declaration, filing or registration with, any Governmental Authority for the valid execution and delivery by Sellers of this Agreement, the due performance by it of its obligations hereunder or the lawful consummation by it of the transactions contemplated hereby, except (i) with respect to any filings required under the HSR Act; and (ii) approval of the issuance of the Issued Shares by Purchaser's stockholders pursuant to NASDAQ Marketplace Rule 5635(a).

**SECTION 4.4 No Conflicts.** The execution, delivery and performance of this Agreement by Purchaser, the performance by Purchaser of its obligations hereunder, and the consummation by Purchaser of the transactions contemplated hereby, do not and will not (i) violate or conflict with any provision of Purchaser's Certificate of Incorporation or Bylaws, each as amended to date (ii) conflict with, or constitute a default (or an event which with notice or lapse of time or both would become a default) under, or give to others any rights of termination, amendment, acceleration or cancellation of, any agreement, mortgage, indenture, note, debenture, instrument or obligation to which Purchaser or any of its Subsidiaries is a party or by which Purchaser or any of its Subsidiaries' respective properties or assets are bound, or (iii) result in a violation of any Laws or Orders applicable to Purchaser or any of its Subsidiaries or by which any property or asset of Purchaser or any of its Subsidiaries are bound or affected.

**SECTION 4.5 SEC Documents.** The Common Stock is registered pursuant to Section 12(b) of the Exchange Act, and Purchaser, except as set forth in Schedule 4.5, has timely filed all reports, schedules, forms, statements and other documents required to be filed by it with the SEC pursuant to the reporting requirements of the Exchange Act (all of the foregoing including filings incorporated by reference therein being referred to herein as the "SEC Documents"). Except as set forth on Schedule 4.5, at the times of their respective filings, the Reports complied in all material respects with the requirements of the Exchange Act and the rules and regulations of the SEC promulgated thereunder. The Reports did not, and do not, contain any untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances under which they were made, not misleading.

**SECTION 4.6 Financial Statements.** Except as set forth on Schedule 4.6, as of their respective dates, the financial statements of Purchaser included in the SEC Documents complied as to form in all material respects with Regulation S-X and all other published rules and regulations of the SEC. Such financial statements have been prepared in accordance with generally accepted accounting principles applied on a consistent basis during the periods involved (except (i) as may be otherwise indicated in such financial statements or the notes thereto or (ii) in the case of unaudited interim statements, to the extent they may not include footnotes or may be condensed or summary statements), and fairly present in all material respects the financial position of Purchaser and its consolidated Subsidiaries as of the dates thereof and the results of operations and cash flows for the periods then ended (subject, in the case of unaudited statements, to normal year-end audit adjustments).

**SECTION 4.7 No Material Adverse Change.** Since March 30, 2013, (i) neither Purchaser nor any of its Subsidiaries has experienced or suffered any event or series of events that, individually or in the aggregate, has had or reasonably would be expected to have a Material Adverse Effect; and (ii) no event or circumstance has occurred or exists with respect to Purchaser or its Subsidiaries or their respective businesses, properties, prospects, operations or financial condition,

that, under applicable law, rule or regulation, requires public disclosure or announcement by Purchaser but which has not been so publicly announced or disclosed.

**SECTION 4.8** Litigation. There is no Proceeding pending or, to the knowledge of Purchaser, threatened against Purchaser or any Subsidiary that questions the validity of this Agreement or any of the transactions contemplated hereby or thereby or any action taken or to be taken pursuant hereto or thereto. No Proceeding described in the Reports would, individually or in the aggregate, reasonably be expected, if adversely determined, to have a Material Adverse Effect.

**SECTION 4.9** Compliance with Law. Purchaser and its Subsidiaries have been and are presently conducting their respective businesses in accordance with all applicable Laws and Orders in all material respects.

**SECTION 4.10** Books and Records; Internal Accounting Controls. Purchaser maintains a process of “internal controls over financial reporting” (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act). Purchaser maintains a system of “disclosure controls and procedures” (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act).

**SECTION 4.11** Listing. The Common Stock is listed on the NASDAQ Global Select Market (the “Principal Market”). Purchaser is in compliance in all material respects with the applicable listing and corporate governance rules and regulations of the Principal Market. Purchaser has not, in the preceding twelve (12) months, received notice from the Principal Market to the effect that Purchaser is not in compliance with the listing or maintenance requirements of the Principal Market. Purchaser is, and has no reason to believe that it will not in the foreseeable future continue to be, in compliance with all such listing and maintenance requirements.

## ARTICLE V - CONDITIONS TO CLOSING

**SECTION 5.1** Conditions to Obligations of the Purchaser. The obligations of the Purchaser to consummate the transactions contemplated by this Agreement shall be subject to the fulfillment or written waiver, at or prior to the Closing, of each of the following conditions:

(a) Representations, Warranties and Covenants. (i) The representations and warranties of the Sellers contained in this Agreement (A) that are not qualified as to “materiality” shall be true and correct in all material respects as of the Closing and (B) that are qualified as to “materiality” shall be true and correct as of the Closing, other than such representations and warranties that are made as of another date, in which case such representations and warranties shall be true and correct in all material respects or true and correct, as the case may be, as of such other date, and (ii) the covenants and agreements contained in this Agreement to be complied with by the Sellers at or before the Closing shall have been complied with in all material respects; and

(b) Approvals. (i) The parties shall receive approval of the transactions under the HSR Act and to the fulfillment, prior to or concurrently with the Closing, of the condition that no statute, rule, regulation, order, writ, injunction, judgment or decree shall have been enacted,

promulgated, entered into or enforced by any federal or state court or other Governmental Authority which has the effect of making illegal, impeding or otherwise restraining or prohibiting the transactions contemplated hereby and (ii) the Purchaser shall receive approval of the issuance of the Issued Shares in payment of the purchase price by Purchaser's stockholders pursuant to NASDAQ Marketplace Rule 5635(a).

**SECTION 5.2** Conditions to Obligations of the Sellers. The obligations of the Sellers to consummate the transactions contemplated by this Agreement shall be subject to the fulfillment or written waiver, at or prior to the Closing, of each of the following conditions:

(a) Representations, Warranties and Covenants. (i) the representations and warranties of the Purchaser contained in this Agreement (A) that are not qualified as to "materiality" shall be true and correct in all material respects as of the Closing and (B) that are qualified as to "materiality" shall be true and correct as of the Closing, except to the extent such representations and warranties are made as of another date, in which case such representations and warranties shall be true and correct in all material respects or true and correct, as the case may be, as of such other date, and (ii) the covenants and agreements contained in this Agreement to be complied with by the Purchaser on or before the Closing shall have been complied with in all material respects;

(b) Approvals. The Purchaser shall receive (i) approval of the transactions under the HSR Act and to the fulfillment, prior to or concurrently with the Closing, of the condition that no statute, rule, regulation, order, writ, injunction, judgment or decree shall have been enacted, promulgated, entered into or enforced by any federal or state court or other Governmental Authority which has the effect of making illegal, impeding or otherwise restraining or prohibiting the transactions contemplated hereby and (ii) approval of the issuance of the Issued Shares in payment of the purchase price by Purchaser's stockholders pursuant to NASDAQ Marketplace Rule 5635(a).

(c) No Material Adverse Effect. (i) neither Purchaser nor any of its Subsidiaries has experienced or suffered any event or series of events that, individually or in the aggregate, has had or reasonably would be expected to have a Material Adverse Effect; and (ii) no event or circumstance has occurred or exists with respect to Purchaser or its Subsidiaries or their respective businesses, properties, prospects, operations or financial condition, that, under applicable law, rule or regulation, requires public disclosure or announcement by Purchaser but which has not been so publicly announced or disclosed.

## ARTICLE VI - COVENANTS

**SECTION 6.1** Registration and Listing. During the Standstill Period the Purchaser shall: (i) cause its Common Stock to continue to be registered under Sections 12(b) of the Exchange Act, (ii) comply in all material respects with its reporting and filing obligations under the Exchange Act; (iii) not take any action or file any document (whether or not permitted by the Securities Act or the rules promulgated thereunder) to terminate or suspend such registration or to terminate or suspend its reporting and filing obligations under the Exchange Act or Securities Act even if the rules and regulations thereunder would permit such termination; (iv) use its best efforts to continue the listing or trading of its Common Stock on the Principal Market.

SECTION 6.2 Shareholder Meeting. The Purchaser agrees to file with the SEC a preliminary proxy statement within ten (10) days from the date hereof, and to hold within sixty (60) days from the date hereof Purchaser's 2013 Annual Meeting of Stockholders at which Purchaser's Stockholders will be requested to approve the issuance in full of all Issued Shares in accordance with the rules and regulations of the Principal Market (the "Proposal"). The Purchaser's Board of Directors shall recommend that the Purchaser's stockholders vote in favor of the Proposal, and to the extent requested by the Sellers, will engage a proxy solicitor at Sellers' sole expense, to assist in the solicitation of proxies.

#### ARTICLE VII - INDEMNIFICATION

SECTION 7.1 Survival. All representations, warranties, covenants and agreements contained herein and all related rights to indemnification shall survive the Closing.

SECTION 7.2 Indemnification by Sellers. Sellers shall indemnify and hold harmless the Purchaser and its Representatives for, from and against any and all demands, claims, actions, causes of action, proceedings, assessments, losses, damages, liabilities, settlements, judgments, fines, penalties, interest, costs and expenses (including attorneys' fees) which are asserted against, imposed upon or incurred by any Person as a result of or in connection with the breach or alleged breach by any Seller of any of the Sellers' representations, warranties, covenants, agreements or obligations contained in this Agreement. For the avoidance of doubt, neither Purchaser nor its Representatives shall be entitled to recover from the Sellers any amount in respect of any consequential, indirect or special damages. Without limiting the foregoing, Seller's liability under this Section 7.2 shall in no event exceed the Purchase Price actually received by Sellers from Purchaser. Sellers' liability under this Section 7.2 is intended to be, and shall be, the exclusive monetary remedies of Purchaser after the Closing with respect to any aspect of the transactions contemplated by this Agreement absent a final judicial determination of Seller's fraud by a court of competent jurisdiction. Purchaser hereby releases, waives and discharges, and covenants not to sue or otherwise assert any rights, remedies or recourse with respect to, any cause of action or claim for damages not expressly provided for in this Agreement to the maximum extent permitted by applicable law.

SECTION 7.3 Indemnification by Purchaser. Purchaser shall indemnify and hold harmless the Sellers and each of their Representatives for, from and against any and all demands, claims, actions, causes of action, proceedings, assessments, losses damages, liabilities, settlements, judgments, fines, penalties, interest, costs and expenses (including attorneys' fees) which are asserted against, imposed upon or incurred by any Person as a result of or in connection with (i) the breach or alleged breach by Purchaser of any of the Purchaser's representations, warranties, covenants, agreements or obligations contained in this Agreement or (ii) any untrue statement or alleged untrue statement of a material fact in a Registration Statement, Prospectus or any amendment or supplement thereto or the omission or alleged omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading.

SECTION 7.4 Termination of Indemnification. The obligations to indemnify and hold harmless a party hereto pursuant to (i) Sections 7.2 and 7.3(i) shall terminate upon the termination

of the Standstill Period and (ii) the other clauses of Section 7.3 shall not terminate; provided, however, that as to clause (i) of this sentence such obligations to indemnify and hold harmless shall not terminate with respect to any item as to which the person to be indemnified or the related party thereto shall have, before the expiration of the applicable period, previously made a claim by delivering notice of such claim (stating in reasonable detail the basis of such claim) to the indemnifying party.

#### ARTICLE VIII - TAXES

The parties agree that the payment of the Purchase Price in Issued Shares will not be structured as a tax-free exchange under the Internal Revenue Code of 1986, as amended. Each party hereto acknowledges and agrees that it has had the opportunity to consult with its independent tax advisor to determine the tax consequences of the transaction contemplated under this Agreement and that it is aware of the tax consequences of entering into the transaction.

#### ARTICLE IX - TERMINATION

SECTION 9.1 Termination. At any time prior to Closing, this Agreement may be terminated:

- (a) by mutual written consent of the parties hereto;
- (b) by any of the parties if a federal or state or other Governmental Authority shall have issued an order, writ, injunction, judgment or decree which shall have the effect of making illegal, impeding or otherwise restraining or prohibiting the transaction contemplated by this Agreement and such order, writ, injunction, judgment or decree shall have become final and nonappealable;
- (c) by any of the parties in the event Purchaser does not obtain stockholder approval of the Proposal, in accordance with Section 1.2(b); and
- (d) by any of the parties if any of the conditions in Article V has not been satisfied or waived as of August 31, 2013 or if satisfaction of such a condition is or becomes impossible; provided, however, that the right to terminate this Agreement under this Section 9.1(d) shall not be available to any party whose material breach of a representation, warranty or covenant in this Agreement has been a principal cause of the failure of any of the conditions set forth in Article V to be satisfied by such date or of the failure of any of the conditions set forth in Article V to be capable of being satisfied.

SECTION 9.2 Effect of Termination. In the event of the termination of this Agreement in accordance with Section 9.1(a) or Section 9.1(b), this Agreement shall forthwith become void and of no further force or effect, and there shall be no liability hereunder on the part of any party or its Affiliates, directors, officers, shareholders, agents or other representatives; provided, however, that (i) this Section 9.2, and Sections 13.1, 13.2, 13.5, 13.6, and 13.8 shall survive any termination of this Agreement and (ii) nothing contained herein shall relieve any party from liability for any breach occurring prior to the date of the termination of this Agreement.

## ARTICLE X - VOTING, LOCK-UP AND STANDSTILL PROVISIONS

**SECTION 10.1 Voting.** From and after the Closing and continuing until the termination of the Standstill Period, the Sellers shall vote (including, through the execution of one or more written consents, if applicable) all Issued Shares with respect to which the Sellers have the power to vote in accordance with the recommendations of the board of directors of the Purchaser with respect to any action, proposal or other matter to be voted on by the stockholders of the Purchaser.

**SECTION 10.2 Lock-Up.** Other than in the case of a Permitted Transfer, the Sellers shall not Transfer any of the Issued Shares for the period beginning on the Closing Date and ending one year from the anniversary of the Closing Date (such period, the “Lock-Up Period”). Any Transfer or attempted Transfer of any of the Issued Shares in violation of this Section 10.2 shall, to the fullest extent permitted by law, be null and void ab initio, and the Purchaser shall not, and shall instruct its transfer agent and other third parties not to, record or recognize any such purported Transfer on the share register of the Purchaser.

**SECTION 10.3 Standstill.** During the Standstill Period, the Sellers shall not, directly or indirectly, without the prior written consent of the Purchaser:

- (a) Acquire, agree to acquire or make any public proposal to acquire, directly or indirectly, Beneficial Ownership of common equity securities of the Purchaser or any other securities of the Purchaser entitled to vote generally in the election of directors of the Purchaser (collectively, “Voting Securities”), or securities of the Purchaser that are convertible, exchangeable or exercisable into Voting Securities (other than (i) the acquisition of common stock of the Purchaser or other Voting Securities as a result of any stock splits, stock dividends or other distributions or recapitalizations, reclassifications, reorganizations or similar transactions or offerings made available by the Purchaser to holders of Voting Securities, including rights offerings, and (ii) from an Affiliate of any Seller in a Permitted Transfer);
- (b) Deposit any Voting Securities in a voting trust or similar arrangement or subject any Voting Securities to any voting agreement, pooling arrangement or similar arrangement (other than with another Seller or any direct or indirect subsidiary of the Sellers), or grant any proxy with respect to any Voting Securities (other than (x) to the Purchaser or a person specified by the Purchaser, in a proxy card provided to shareholders of the Purchaser by or on behalf of the Purchaser or (y) to any direct or indirect subsidiary of the Sellers);
- (c) Enter, agree to enter, propose or offer to enter into or facilitate any merger, business combination, tender offer, recapitalization, restructuring, change in control transaction or other similar extraordinary transaction involving the Purchaser or any of its subsidiaries; provided, however, that the Sellers may vote in any such merger, business combination, tender offer, recapitalization, restructuring, change in control transaction or other similar extraordinary transaction in accordance with their reasonable discretion;



- (d) Make, or in any way participate or engage in, any “solicitation” of “proxies” (as such terms are used in the proxy rules of the Securities and Exchange Commission) to vote, or advise or knowingly influence any Person (other than a controlled Affiliate of the Sellers) with respect to the voting of, any voting securities of the Purchaser or any of its subsidiaries;
- (e) Call, or seek to call, a meeting of the shareholders of the Purchaser or initiate any shareholder proposal for action by the shareholders of the Purchaser;
- (f) Form, join or in any way participate in a Group (within the meaning of Section 13(d)(3) of the Exchange Act) (other than with an Affiliate of the Sellers, or any direct or indirect subsidiary, of the Sellers), with respect to any voting securities of the Purchaser;
- (g) Otherwise act, alone or in concert with others, to seek to control or influence the board of directors of the Purchaser, or the management or policies of the Purchaser (including, without limitation, the submission of nominees for election to the board of directors of the Purchaser);
- (h) Publicly disclose any intention, plan or arrangement prohibited by, or inconsistent with, the foregoing;
- (i) Advise or knowingly assist or encourage or enter into any discussions, negotiations, agreements or arrangements with any other Person or Group (within the meaning of Section 13(d)(3) of the Exchange Act) in connection with the foregoing; or
- (j) Knowingly Transfer more than three percent (3%) of the Issued Shares to any one individual or entity.

SECTION 10.4 Non-Disparagement. During the Standstill Period, the Parties agree not to disparage the Purchaser or any officers, directors (including director nominees) or employees of the Purchaser or its affiliates or subsidiaries in any public or quasi-public forum.

#### ARTICLE XI - RIGHT OF FIRST OFFER

##### SECTION 11.1 Right of First Offer.

- (a) At any time and from time to time during the Standstill Period, and subject to the terms and conditions specified in this Section 11.1, the Purchaser shall have a right of first offer if any Seller (the "Offering Seller") proposes to Transfer all or any portion of any shares of common stock of the Purchaser that the Seller owns (the “Offered Stock”) to any independent third party. Each time the Offering Seller proposes to Transfer any Offered Stock (other than Transfers set forth in clauses (i) and (ii) of Permitted Transfers), the Offering Seller shall first make an offering of the Offered Stock to the Purchaser in accordance with the following provisions of this Section 11.1.
- (b) The Offering Seller shall give written notice (the “ROFO Notice”, which may be in the form of an email) to the Purchaser stating its bona fide intention to Transfer the Offered Stock and specifying the number of Offered Stock and the material terms and conditions, including

the price, pursuant to which the Offering Seller proposes to Transfer the Offered Stock. The ROFO Notice shall constitute a Seller's offer to Transfer all of the Offered Stock to the Purchaser in accordance with the provisions of this Section 11.1, which offer shall be irrevocable until the end of the ROFO Purchaser Option Period (defined below), and the consummation of any sale of the Offered Stock to the Purchaser.

(c) The ROFO Notice shall constitute a Seller's offer to Transfer all of the Offered Stock to the Purchaser in accordance with the provisions of this Section 11.1, which offer shall be irrevocable until the end of the Purchaser Option Period, and the consummation of any sale of the Offered Stock to the Purchaser.

(d) By delivering the ROFO Notice, a Seller represents and warrants to the Purchaser that:

(i) Seller has full right, title and interest in and to the Offered Stock described in the ROFO Notice;

(ii) Seller has all the necessary power and authority and has taken all necessary action to Transfer the Offered Stock described in the ROFO Notice as contemplated by this Section 11.1; and

(iii) the Offered Stock described in the ROFO Notice is free and clear of any and all Liens.

#### SECTION 11.2 Exercise of Right of First Offer.

(a) Upon receipt of the ROFO Notice, the Purchaser shall have the right to purchase any or all of the Offered Stock on the terms and at the purchase price set forth in the ROFO Notice and in accordance with the procedures set forth herein.

(b) The initial right of the Purchaser to purchase any Offered Stock shall be exercisable with the delivery of a written notice (the "Purchaser ROFO Exercise Notice", which may be in the form of an email) by the Purchaser to the applicable Seller within one (1) day of the Purchaser's receipt of the ROFO Notice if the amount of the Offered Stock is less than 100,000 shares of common stock of the Purchaser or within five (5) days of the Purchaser's receipt of the ROFO Notice if the amount of the Offered Stock is greater than 100,000 shares of common stock of the Purchaser (the "Purchaser Option Period"), stating the applicable number (including where such number is zero) of shares of Offered Stock the Purchaser elects to purchase on the terms and at the purchase price set forth in the ROFO Notice. The Purchaser ROFO Exercise Notice shall be binding upon delivery and irrevocable by the Purchaser. If the Purchaser fails to deliver the Purchaser ROFO Exercise Notice during the Purchaser Option Period, the Purchaser shall be deemed to have elected not to purchase any of the Offered Stock.

(c) The failure of the Purchaser to deliver a Purchaser ROFO Exercise Notice by the end of the Purchaser Option Period shall constitute a waiver of its rights of first refusal under this

Article XI with respect to the Transfer of the Offered Stock, but shall not affect its rights with respect to any future Transfers.

(d) In the event that the Purchaser shall have exercised its rights to purchase the Offered Stock, then the applicable Seller shall sell such Offered Stock to the Purchaser, and the Purchaser shall purchase such Offered Stock, within thirty (30) days following the expiration of the Purchaser Option Period. Seller shall take all actions as may be reasonably necessary to consummate the sale contemplated by this Article XI including, without limitation, entering into agreements and delivering certificates and instruments and consents as may be deemed necessary or appropriate. At the closing of any sale and purchase pursuant to this Section 11.2(d), Seller shall deliver to the Purchaser certificates (if any) representing the Offered Stock to be sold, free and clear of any Liens or encumbrances, accompanied by evidence of transfer and all necessary transfer taxes paid and stamps affixed, if necessary, against receipt of the purchase price therefor and the amount of any transfer taxes, if any, from the Purchaser by certified or official bank check or by wire transfer of immediately available funds.

(e) In the event that the Purchaser shall not have elected to purchase all of the Offered Stock, then, provided the Seller has also complied with the provisions of Article XI, the Seller may Transfer such shares of such Offered Stock that the Purchaser has elected not to buy, at a price per Share for the Offered Stock not less than that specified in the ROFO Notice and on other terms and conditions which are not materially more favorable in the aggregate to the Prospective Transferee than those specified in the ROFO Notice, but only to the extent that such Transfer occurs within thirty (30) days after expiration of the Purchaser Option Period. Any Offered Stock not Transferred within such thirty (30) day period will be subject to the provisions of this Article XI upon subsequent Transfer.

## ARTICLE XII - DEFINITIONS

As used herein, the terms set forth below shall have the following respective meanings:

“Affiliate” means, with respect to any specified Person, any other Person that directly, or indirectly through one or more intermediaries, controls, is controlled by or is under common control with such specified Person with the terms “control” and “controlled” meaning for purposes of this definition, the power to direct the management and policies of a Person, directly or indirectly, whether through the ownership of voting securities or partnership or other ownership interests, or by contract or otherwise.

“Agreement” shall mean this agreement, as the same may be amended from time to time.

“Beneficially Own” shall have the meaning given to such term in Rule 13d-3 under the Exchange Act.

“Business Day” means a day other than a Saturday, Sunday or other day on which commercial banks in the City of New York are authorized or required to close.

“Common Stock” means the common stock of the Purchaser, par value \$0.01, issued and outstanding immediately prior to the Closing.

“Exchange Act” means The Securities Exchange Act of 1934, as amended.

“Governmental Authority” means any federal, state, local or foreign government or political subdivision thereof, or any agency or instrumentality of such government or political subdivision, or any self-regulated organization or other non-governmental regulatory authority or quasi-governmental authority, or any arbitrator, court or tribunal of competent jurisdiction.

“HSR Act” means the Hart Scott Rodino Antitrust Improvements Act of 1976, as amended.

“Insolvency Event” means an event in which an entity (i) is dissolved (other than pursuant to a consolidation, amalgamation or merger); (ii) becomes insolvent or is unable to pay its debts or admits in writing its inability generally to pay its debts as they become due; (iii) makes a general assignment, arrangement or composition with or for the benefit of its creditors; (iv) (A) institutes a proceeding seeking a judgment of insolvency or bankruptcy or any other relief under any bankruptcy or insolvency law or other similar law affecting creditors’ rights, or a petition is presented for its winding-up or liquidation by it, or (B) has instituted against it a proceeding seeking a judgment of insolvency or bankruptcy or any other relief under any bankruptcy or insolvency law or other similar law affecting creditors’ rights, or a petition is presented for its winding-up or liquidation and such proceeding either (1) results in a judgment of insolvency or bankruptcy or the entry of an order for relief or the making of an order for its winding-up or liquidation or (2) is not dismissed, discharged, stayed or restrained in each case within sixty (60) days of the institution or presentation thereof; (v) passes a resolution for its winding-up or liquidation (other than pursuant to a consolidation, amalgamation or merger); (vi) seeks or becomes subject to the appointment of a receiver, bankruptcy trustee, custodian or other similar official for it or for all or substantially all of its assets; or (vii) has a secured party take possession of all or substantially all of its assets or has a distress, execution, attachment, sequestration or other legal process levied or enforced on or against all or substantially all of its assets; provided, however, that such secured party maintains possession or any such process is not dismissed, discharged, stayed or restrained, in each case within thirty (30) days thereafter.

“Laws” means any statute, law, ordinance, regulation, rule, code, order, constitution, treaty, common law, judgment, decree, other requirement or rule of law of any Governmental Authority.

“Liens” means any security interest, charge, claim, pledge, condition, equitable interest, lien (statutory or other), option, right of first refusal, or restriction of any kind, including any restriction on use, voting, transfer, receipt of income or exercise of any other attribute of ownership.

“Material Adverse Effect” means any material adverse effect on the business, operations, properties, prospects, or condition (financial or otherwise) of the Purchaser and its Subsidiaries taken as a whole and/or any condition, circumstance, or situation that would prohibit in any material respect

the ability of the Purchaser to perform any of its obligations under this Agreement in any material respect.

“Orders” means any order, writ, judgment, injunction, decree, stipulation, determination or award entered by or with any Governmental Authority.

“Permitted Transfers” shall mean, in each case, so long as (x) such Transfer is in accordance with applicable Law and (y) each Seller is in compliance with Article X of this Agreement: (i) any Transfer to an Affiliate of the Sellers, so long as such Person, in connection with such Transfer, executes a joinder to Article X of this Agreement, pursuant to which such Person or Group (within the meaning of Section 13(d)(3) of the Exchange Act) agrees to become a Party to this Agreement and subject to the restrictions applicable to the Sellers and otherwise become a Party for all purposes of this Agreement; provided that no such Transfer(s) shall relieve the transferring Seller from the obligations under this Agreement, (ii) any Transfer solely to tender any of the Issued Shares into a tender or exchange offer commenced by the Purchaser or a third party if the board of directors of the Purchaser has affirmatively publicly recommended to the Purchaser shareholders acceptance of such tender offer or exchange offer pursuant to Rule 14d-9 under the Exchange Act with respect to a third party tender or exchange offer or has determined not to oppose (as evidenced by its filings pursuant to such Rule 14d-9) the tender or exchange offer, (iii) any Transfer if an Insolvency Event with respect to Purchaser shall be imminent or shall have occurred, (iv) any Transfer in the event there occurs any judgment, order, injunction or decree of any Governmental Authority or investigation or threat of investigation by any Governmental Authority against the Purchaser which has had or would be reasonably likely to have a Material Adverse Effect on the Purchaser, and (v) notwithstanding Section 10.3(j), any single Transfer or series of Transfers that in the aggregate is equal to fifteen percent (15%) or less of the Issued Shares.

“Person” means any individual, corporation, limited liability company, partnership (general or limited), syndicate, joint venture, society, association, trust, unincorporated organization or governmental authority, or any trustee, executor, administrator or other legal representative thereof.

“Proceedings” means any claim, action, cause of action, demand, lawsuit, arbitration, inquiry, audit, notice of violation, proceeding, litigation, citation, summons, subpoena or investigation of any nature, civil, criminal, administrative, regulatory or otherwise, whether at law or in equity.

“Prospectus” means the prospectus included in the Registration Statement (including, without limitation, a prospectus that includes any information previously omitted from a prospectus filed as part of an effective registration statement in reliance upon Rule 430A promulgated under the Securities Act), as amended or supplemented by any prospectus supplement, with respect to the terms of the offering of any portion of the Issued Shares covered by the Registration Statement, and all other amendments and supplements to the Prospectus including post-effective amendments, and all material incorporated by reference or deemed to be incorporated by reference in such Prospectus.

“Registration Statement” means each registration statement required to be filed under Section 1.3, including (in each case) the Prospectus, amendments and supplements to such registration statement or Prospectus, including pre- and post-effective amendments, all exhibits thereto, and all

material incorporated by reference or deemed to be incorporated by reference in such registration statement.

“Representatives” means each and every agent, employee, and officer of the relevant entity.

“Securities Act” means the Securities Act of 1933, as amended, and the rules and regulations of the SEC promulgated thereunder.

“Standstill Period” means the period beginning on the Closing Date and ending on the earliest of (i) the fourth anniversary of the Closing Date, or (ii) the third anniversary of the Closing Date if Sellers in the aggregate own less than twelve and one-half percent (12.5%) of the issued and outstanding shares of common stock of the Purchaser. Notwithstanding the foregoing, the Standstill Period shall terminate upon a material breach by Purchaser of any of the Purchaser’s representations, warranties, covenants, agreements or obligations contained in this Agreement, but only if such breach has had, or could reasonably be expected to have, a materially adverse impact on the value of the Issued Shares. Seller must provide written notice to Purchaser of any alleged material breach, after which Purchaser shall have thirty (30) days to either cure or dispute such alleged breach. If Purchaser cures such alleged breach during such thirty (30) day period, the Standstill Period shall remain in effect. If Purchaser disputes the basis of such alleged breach, the Standstill Period shall remain in effect pending resolution of such dispute.

“Subsidiaries” as to any person or entity, means any corporation, partnership, limited liability company, joint venture, trust or estate of or in which more than 50% of (a) the issued and outstanding capital stock having ordinary voting power to elect a majority of the board of directors of such corporation (irrespective of whether at the time capital stock of any other class of such corporation may have voting power upon the happening of a contingency), (b) the interest in the capital or profits of such corporation, partnership, limited liability company, or joint venture or (c) the beneficial interest in such trust or estate is at the time directly or indirectly owned or controlled through one or more intermediaries, or both, by such person or entity. Unless otherwise qualified, all references to a "Subsidiary" or to "Subsidiaries" in this Agreement shall refer to a Subsidiary or Subsidiaries of Purchaser.

“Transfer” means any direct or indirect offer, sale, assignment, encumbrance, pledge, hypothecation, disposition, loan or other transfer (by operation of law or otherwise), either voluntary or involuntary, or entry into any contract, option or other arrangement or understanding with respect to any offer, sale, assignment, encumbrance, pledge, hypothecation, disposition, loan or other transfer (by operation of law or otherwise), of any capital stock (or any security convertible or exchangeable into capital stock) or interest in any capital stock.

All other defined terms shall have the meanings indicated herein.

### ARTICLE XIII - MISCELLANEOUS

SECTION 13.1 Fees and Expenses. Except as expressly provide herein, all fees and expenses incurred by any of the parties hereto in connection with this Agreement or any of the

transactions contemplated hereby or thereby shall be borne and paid solely by the party incurring such fees and expenses.

SECTION 13.2 Notices. All notices, requests, demands, claims and other communications permitted or required to be given hereunder must be in writing and shall be deemed duly given and received (i) if personally delivered, when so delivered, (ii) if mailed, three (3) Business Days after having been sent by registered or certified mail, return receipt requested, postage prepaid and addressed to the intended recipient as set forth below, (iii) if sent by electronic facsimile, once transmitted to the facsimile number specified or referred to below and written confirmation of successful transmission is received by the notifying Party, or (iv) if sent through an overnight delivery service in circumstances to which such service guarantees next day delivery, the day following being so sent:

if to Cavco:

Cavco Industries, Inc.  
Attention: Joseph H. Stegmayer  
1001 North Central Avenue, Suite 800  
Phoenix, Arizona 85004-1935  
Facsimile: (602) 256-6189

if to Third Avenue Value Fund:

Third Avenue Trust,  
on behalf of Third Avenue Value Fund  
Attention: Jim Hall, General Counsel  
622 Third Avenue, 32nd Floor  
New York, NY 10017

if to Whitman High Conviction Fund:

Whitman High Conviction Fund  
Attention: Jim Hall, General Counsel  
622 Third Avenue, 32nd Floor  
New York, NY 10017

SECTION 13.3 Entire Agreement; Modification. This Agreement constitutes the entire agreement between the Parties with respect to the subject matter hereof, and supersedes and replaces all prior agreements, understandings, commitments, communications and representations made between the Parties, whether written or oral, with respect to the subject matter hereof. This Agreement may be amended only by a written agreement of the Parties.

SECTION 13.4 Parties in Interest; Assignment. This Agreement shall be binding upon and inure to the benefit of the parties hereto and their respective successors and assigns (it being understood and agreed that, except as expressly provided herein, nothing contained in this Agreement is intended to confer upon any other Person any rights, benefits or remedies of any kind or character whatsoever under or by reason of this Agreement). No party may assign this Agreement without the prior written consent of each of the other parties hereto. It is expressly understood and agreed that any attempted or purported assignment of this Agreement in violation of this shall be null and void.

SECTION 13.5 Governing Law. Except for federal securities laws (including the Securities Act and the Exchange Act) and any other state securities laws which may be applicable to any issuance, sale or resale of the securities of Fleetwood Homes, Inc., this Agreement shall be governed by and interpreted in accordance with the laws of the State of Delaware, including all matters of construction, validity, performance and enforcement, without giving effect to principles of conflict of laws.

SECTION 13.6 Jurisdiction. The parties hereby irrevocably and unconditionally submit to the exclusive jurisdiction of the courts of the State of Delaware, for the purposes of any suit, action or other proceeding, including any injunctive relief sought in summary proceedings, relating to this Agreement (and each agrees that no such action, suit or proceeding relating to this Agreement shall be brought by it or any of its Representatives except in such courts). Each of the parties further agrees that service of any process, summons, notice or document by mail to such party's respective address set forth above shall be effective service of process for any action, suit or proceeding in Delaware with respect to any matters to which it has submitted to jurisdiction as set forth above in the immediately preceding sentence. Each of the parties irrevocably and unconditionally waives (and agrees not to plead or claim) any objection to the laying of venue of any action, suit or proceeding arising out of this Agreement or the transactions contemplated hereby in the courts of the State of Delaware.

SECTION 13.7 Severability. If any provision of this Agreement, or the application of any such provision to any person, entity or circumstance, is held to be unenforceable or invalid by any court of competent jurisdiction or under any applicable law, the Parties shall negotiate an equitable adjustment to the provisions of this Agreement with the view to effecting, to the greatest extent possible, the original purpose and intent of this Agreement, and in any event, the validity and enforceability of the remaining provisions of this Agreement shall not be affected thereby. Without limiting the foregoing, the covenants and obligations contained in this Agreement shall be construed as separate covenants and obligations, covering their respective subject matters. Each breach of a covenant or obligation set forth in this Agreement shall give rise to a separate and independent cause of action.

SECTION 13.8 Specific Performance; Waiver; Remedies Cumulative. Each Party shall be entitled to enforce its or his rights under this Agreement specifically, to recover damages by reason of any breach of any provision of this Agreement and to exercise all other rights existing in its favor. The Parties hereto agree and acknowledge that money damages may not be an adequate remedy for



any breach of the provisions of this Agreement and that each party may in its or his sole discretion apply to any court of law or equity of competent jurisdiction for specific performance and/or injunctive relief (without posting a bond or other security) in order to enforce or prevent any violation of the provisions of this Agreement. The rights and remedies of the Parties hereunder are cumulative and not alternative. Neither any failure nor any delay by any Party in exercising any right, power or privilege under this Agreement shall operate as a waiver of such right, power or privilege, and no single or partial exercise of any such right, power or privilege shall preclude any other or further exercise of such right, power or privilege or the exercise of any other right, power or privilege.

SECTION 13.9 Public Announcements. The parties will consult with each other before issuing any press release or otherwise making any public statements with respect to this Agreement or the transactions contemplated hereby, and shall not issue any such press release or make any such public statement without the prior written consent of each of the other parties, except as may be required by law or pursuant to any listing agreement, rule or regulation of any national securities exchange or automated system upon which the securities of such party are traded.

SECTION 13.10 Further Assurances. Sellers agree, at any time and from time to time after the date hereof, upon the request of Purchaser, to do, execute, acknowledge and deliver, or to cause to be done, executed, acknowledged and delivered, all such further acts, deeds, assignments, transfers, conveyances, powers of attorney and assurances as may be reasonably required for the better assigning, transferring, conveying, and confirming to Purchaser, or to its successors and assigns, or for the aiding, assisting, collecting and reducing to possession of, any or all of the Shares.

SECTION 13.11 Execution of Agreement. This Agreement may be executed in two or more counterparts, each of which shall be deemed to be an original copy and all of which, when taken together, shall be deemed to constitute one and the same agreement. The exchange of copies of this Agreement and of signature pages by facsimile transmission shall constitute effective execution and delivery of this Agreement as to the Parties and may be used in lieu of the original Agreement for all purposes. Signatures of the Parties transmitted by facsimile shall be deemed to be their original signatures for all purposes.

SECTION 13.12 Construction. The headings of Articles and Sections in this Agreement are provided for convenience only and shall not affect the construction or interpretation of any provision hereof. Any reference herein to an "Article" or "Section" means the corresponding Article or Section of this Agreement. References herein to any gender include the other gender and the neuter, as applicable. This Agreement was negotiated by the Parties with the benefit of legal representation on both sides, and any rule of construction or interpretation otherwise requiring this Agreement to be construed or interpreted against any Party shall not apply to any construction or interpretation hereof.

[SIGNATURES ARE ON THE FOLLOWING PAGE]



IN WITNESS WHEREOF, the parties hereto have executed and delivered this Agreement as of the date first above written.

PURCHASER:

Cavco Industries, Inc., a Delaware corporation

/s/ Joseph H. Stegmayer

By: Joseph H. Stegmayer,  
Chairman, CEO and President

SELLERS:

Third Avenue Trust, a Delaware business  
trust, on behalf of Third Avenue Value Fund

By: Third Avenue Management LLC, its investment adviser

/s/ Vincent J. Dugan

By: Vincent J. Dugan  
Chief Financial Officer

Whitman High Conviction Fund

By: Third Avenue Management LLC, its investment adviser

/s/ Vincent J. Dugan

By: Vincent J. Dugan  
Chief Financial Officer

SCHEDULE 1.2

SCHEDULE 4.5

As disclosed in the Purchaser's periodic reports filed with the United States Securities and Exchange Commission, on July 8, 2011, the Purchaser filed an amendment to its current report on Form 8-K/A, which filing included the consolidated balance sheets of Palm Harbor Homes, Inc., a Florida corporation and its subsidiaries ("Palm Harbor") as of March 26, 2010 and March 27, 2009 and the consolidated statements of operations, shareholders' equity and cash flows for each of the three years in the period ended March 26, 2010, and the notes related thereto. These financial statements were previously audited and included in Palm Harbor's Form 10-K for the year ended March 26, 2010. However, Palm Harbor's auditor was not able to perform its customary procedures to its satisfaction to enable it to consent to the inclusion of its prior audit report in the referenced Form 8-K/A filing due to the untimely and limited cooperation of Palm Harbor and the bankruptcy estate of Palm Harbor towards the completion of those procedures. Accordingly, (i) the Palm Harbor financial statements are considered unaudited, preliminary and subject to change (ii) the Form 8-K/A filing is incomplete and untimely, and (iii) the Palm Harbor financial statements are not presented in accordance with Regulation S-X of the rules and regulations of the United States Securities and Exchange Commission.

As a result, the Company does not satisfy the requirements to provide financial statements in accordance with Regulation S-X, including, but not limited to Rule 3-05, in any filing, registration statement or proxy statement requiring such financial statements, due to the absence of the consent of Palm Harbor's independent registered public accounting firm with respect to Palm Harbor's financial statements.

SCHEDULE 4.6

As disclosed in the Purchaser's periodic reports filed with the United States Securities and Exchange Commission, on July 8, 2011, the Purchaser filed an amendment to its current report on Form 8-K/A, which filing included the consolidated balance sheets of Palm Harbor Homes, Inc., a Florida corporation and its subsidiaries ("Palm Harbor") as of March 26, 2010 and March 27, 2009 and the consolidated statements of operations, shareholders' equity and cash flows for each of the three years in the period ended March 26, 2010, and the notes related thereto. These financial statements were previously audited and included in Palm Harbor's Form 10-K for the year ended March 26, 2010. However, Palm Harbor's auditor was not able to perform its customary procedures to its satisfaction to enable it to consent to the inclusion of its prior audit report in the referenced Form 8-K/A filing due to the untimely and limited cooperation of Palm Harbor and the bankruptcy estate of Palm Harbor towards the completion of those procedures. Accordingly, (i) the Palm Harbor financial statements are considered unaudited, preliminary and subject to change (ii) the Form 8-K/A filing is incomplete and untimely, and (iii) the Palm Harbor financial statements are not presented in accordance with Regulation S-X of the rules and regulations of the United States Securities and Exchange Commission.

As a result, the Company does not satisfy the requirements to provide financial statements in accordance with Regulation S-X, including, but not limited to Rule 3-05, in any filing, registration statement or proxy statement requiring such financial statements, due to the absence of the consent of Palm Harbor's independent registered public accounting firm with respect to Palm Harbor's financial statements.

EXHIBIT A  
REGISTRATION STATEMENT QUESTIONNAIRE

In connection with the Registration Statement, please provide us with the following information regarding the Investor.

1. Please state your organization's name exactly as it should appear in the Registration Statement:  
Except as set forth below, your organization does not hold any equity securities of the Purchaser on behalf of another person or entity. State any exceptions here:

If the Investor is not a natural person, please identify the natural person or persons who will have voting and investment control over the Issued Shares owned by the Seller:

2. Address of your organization:

\_\_\_\_\_  
\_\_\_\_\_

Telephone: \_\_\_\_\_

E-mail: \_\_\_\_\_

Contact Person: \_\_\_\_\_

3. Have you or your organization had any position, office or other material relationship within the past three years with the Purchaser or its affiliates? (Include any relationships involving you or any of your affiliates, officers, directors, or principal equity holders (5% or more) that has held any position or office or has had any other material relationship with the Purchaser (or its predecessors or affiliates) during the past three years.)

\_\_\_\_\_ Yes \_\_\_\_\_ No

If yes, please indicate the nature of any such relationship below:

4. Are you the beneficial owner of any other securities of the Purchaser? (Include any equity securities that you beneficially own or have a right to acquire within sixty (60) days after the date hereof, and as to which you have sole voting power, shared voting power, sole investment power or shared investment power.)

\_\_\_\_\_ Yes \_\_\_\_\_ No

If yes, please describe the nature and amount of such ownership as of a recent date.

5. Except as set forth below, you wish that all of your beneficially owned shares of the Purchaser's common stock acquired pursuant to the Stock Purchase Agreement be offered for your account in the

Registration Statement. (Please note that any shares of the Purchaser's common stock not acquired pursuant to the Stock Purchase Agreement will not be offered for your account in the Registration Statement.)

State any exceptions here:

6. Have you made or are you aware of any arrangements relating to the distribution of the shares of the Purchaser pursuant to the Registration Statement?

\_\_\_\_\_ Yes \_\_\_\_\_ No

If yes, please describe the nature and amount of such arrangements.

7. FINRA Matters

(a) State below whether (i) you or any associate or affiliate of yours are a member of FINRA, a controlling shareholder of a FINRA member, a person associated with a member, a direct or indirect affiliate of a member, or an underwriter or related person with respect to the proposed offering; (ii) you or any associate or affiliate of yours owns any stock or other securities of any FINRA member not purchased in the open market; or (iii) you or any associate or affiliate of yours has made any outstanding subordinated loans to any FINRA member. If you are a general or limited partnership, a "no" answer asserts that no such relationship exists for you as well as for each of your general or limited partners. Italicized terms are defined below.

Yes: \_\_\_\_\_ No: \_\_\_\_\_

If "yes," please identify the FINRA member and describe your relationship, including, in the case of a general or limited partner, the name of the partner:

If you answer "no" to Question 7(a), you need not respond to Question 7(b).

(b) State below whether you or any associate or affiliate of yours has been an underwriter, or a controlling person or member of any investment banking or brokerage firm which has been or might be an underwriter for securities of the Purchaser or any affiliate thereof including, but not limited to, the common stock now being registered.

Yes: \_\_\_\_\_ No: \_\_\_\_\_

If "yes," please identify the FINRA member and describe your relationship, including, in the case of a general or limited partner, the name of the partner.

For purposes of this Question 7:

An affiliate of any person (including a sole proprietorship, partnership, limited liability company, corporation or other legal entity such as a trust or estate) is a person that controls, is controlled by or is under common control with such person. Officers, directors, partners, sole proprietors and branch



managers, or persons of a similar status or performing similar functions, of a person should be presumed to be an affiliate of such person.

An associated person of a member or person associated with a member includes, among others, (1) a natural person who is registered or has applied for registration under the rules of FINRA and (2) a sole proprietor, partner, officer, director, or branch manager of a member, or other natural person occupying a similar status or performing similar functions, or a natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by a member, whether or not any such person is registered or exempt from registration with FINRA under FINRA's By-Laws or the FINRA Rules.

The term control means the following: (i) beneficial ownership of 10% or more of the outstanding common equity of any entity, including any right to receive such securities within 60 days of the member's participation in the public offering; (ii) the right to 10% or more of the distributable profits or losses of an entity that is a partnership, including any right to receive an interest in such distributable profits or losses within 60 days of the member's participation in the public offering; (iii) beneficial ownership of 10% or more of the outstanding subordinated debt of an entity, including any right to receive such subordinated debt within 60 days of the member's participation in the public offering; (iv) beneficial ownership of 10% or more of the outstanding preferred equity of an entity, including any right to receive such preferred equity within 60 days of the member's participation in the public offering; or (v) the power to direct or cause the direction of the management or policies of an entity.

The term immediate family means the parents, mother-in-law, father-in-law, spouse, brother or sister, brother-in-law or sister-in-law, son-in-law or daughter-in-law, and children of an employee or associated person of a member, except any person other than the spouse and children who does not live in the same household as, have a business relationship with, provide material support to, or receive material support from, the employee or associated person of a member. In addition, immediate family includes any other person who either lives in the same household as, provides material support to, or receives material support from, an employee or associated person of a member.

The term member means any broker or dealer admitted to membership in FINRA.

The term participating member means any FINRA member that is participating in a public offering, any associated person of the member, any members of their immediate family and any affiliate of the member.

The term underwriter or related person includes, with respect to the proposed offering, any underwriters and such underwriters' counsel, financial consultants and advisors, finders, participating members, and any other persons related to any participating member.

## ACKNOWLEDGEMENT

The undersigned hereby agrees to notify the Purchaser promptly of any changes in the foregoing information which should be made as a result of any developments, including the passage of time. The undersigned also agrees to provide the Purchaser and the Purchaser's counsel any and all such further information regarding the undersigned reasonably required for the preparation of the Registration Statement promptly upon request in connection with the preparation, filing, amending, and supplementing of the Registration Statement (or any prospectus contained therein). The undersigned hereby consents to the use of all such information in the Registration Statement.

The undersigned understands and acknowledges that the Purchaser will rely on the information set forth herein for purposes of the preparation and filing of the Registration Statement.

The undersigned represents and warrants that all information it provides to the Purchaser and its counsel is currently accurate and complete and will be accurate and complete at the time the Registration Statement becomes effective and at all times subsequent thereto, and agrees, during the effectiveness period and any additional period in which the undersigned is making sales of Issued Shares under and pursuant to the Registration Statement, to notify the Purchaser immediately of any misstatement of a material fact in the Registration Statement or the omission of any material fact necessary to make the statements contained therein not misleading.

Dated:

Name

Signature

Name and Title of Signatory



