

# Mossberg's Investor Digest

## Best Idea Profile

## Palm Harbor Homes (Nasdaq: PHHM)

### DESCRIPTION:

Based in Dallas, 32-year-old Palm Harbor Homes is a leading manufacturer, marketer, financier and insurer of factory-built housing. Its factory-built housing segment operates 9 manufacturing facilities and markets homes through a network of 81 company-owned retail outlets and 150 independent dealers. The financing segment includes CountryPlace Mortgage, and a property and casualty insurance business, Standard Casualty. While, the revenue mix is split 90/10 housing sales/financial services, the financial services arm has consistently delivered results and has been the most profitable piece of the business over the last several years.

### KEY INVESTMENT CONSIDERATIONS:

**Industry Rationalization** – The number of manufactured homes shipped in 2008 was approximately 82,000, the lowest year on record since the data was first tracked in 1959 by the Manufactured Housing Institute. 2009 doesn't appear to be any better with 70,000 homes expected to ship during the year. Over the past 10 years, the number of plants producing homes has fallen by approximately 40%, while the number of homes sold has fallen approximately 75%, which indicates that the remaining plants are only 40% to 50% utilized. Many players won't be able to rationalize their infrastructure and won't survive operating at 40% of capacity. For example, Fleetwood (NYSE: FLE) filed for Chapter 11 bankruptcy in March.

**Keys to survival**– It appears PHHM is making the right moves to survive an extended period of weak demand.

• **Lower operating breakeven** – Management has lowered the quarterly break even revenue level from \$130MM to \$100MM/ quarter, which is still 18% above recent quarterly revenue performance. Additional SG&A cost reductions are expected to lower the breakeven further.

• **Improve the balance sheet** – In June, the company was able to further extend its floor plan credit facility with Textron (a line of credit that allows the company to finance inventory for its dealers) through June 2010. On the 2Q09 conference call, management said they were "confident" they would be able to replace the Textron facility before the facility expires.

• **Maintain high quality loan portfolio** – At the end of the June quarter the company had a loan portfolio worth \$188.9 million. The portfolio has high quality conforming loans, representing some 3,000 loans with an average FICO score of 710 and an average down payment of 16%. There have not been significant charge offs on this portfolio and the percentage of loans past due has been consistently under 1.5%.

**Demand for factory-built homes should improve** - Over the last 30 years; factory-built homes represented 20% of single-family housing starts. However, from 2002 to 2006, low credit standards made it easier to buy site-built homes, and factory-built homes' share of the market declined to 11%. Near term, there is a glut of site-built inventory and home foreclosures to work through, but it appears factory-built homes are regaining market share, accounting for 17% of single family starts last year. A more normalized financing environment should make factory-built homes a more viable alternative for home buyers and help to improve the industry's market share vis-à-vis site-built homes.

**The Housing and Economic Recovery Act of 2008** - This new act creates a duty for Fannie Mae and Freddie Mac to serve the manufactured housing loan market and increase liquidity in the secondary markets for these loans. Prior to this, the market for reselling these loans has been effectively shut down. Increasing liquidity will allow PHHM to make and resell these loans in a liquid market and in the process make it easier to finance new home purchases with competitive loan pricing.

### VALUATION:

It appears the pessimism about PHHM's survival is waning. A slight improvement in economic housing data, PHHM's improved performance and the extension of floor plan facility are likely reasons for the stock's movement from the low point reached in March. With further cost improvements, PHHM should be close to reaching breakeven this year. As survivability concerns are further mitigated, shares should trade closer to tangible book, a level that is 50% higher.

#### (Nasdaq: PHHM)

Investment Data (as of 8/11/09)

<b>Recent Price</b>	<b>\$2.73</b>
52-Week Range	1.42 - 13.15
Fiscal Year End	March
Shares Outstanding	23 MM
Average Trading Volume (3 mos)	86,000
Market Capitalization	62 MM
Cash	22 MM
Long Term Debt	232 MM
Enterprise Value (EV)	273 MM
LT Debt/ Equity	2.40
Tangible BV/ Share	4.26
TTM Revenue	362 MM
P/ Revenue	0.2x
TTM EPS (non-GAAP)	-1.56
P/ EPS	N/A

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