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And then there was one...

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Marty's News & Notes

Featuring news about the Factory-Built Housing Industry
Contributing to the industry discussion...

AND THEN THERE WAS ONE...

Rumors continue to circulate that some of the larger, stronger builders are continuing to look to buy other builders who may be struggling, or could bring them assets at bargain basement prices.

TAILING OFF

As the industry has tailed off heavily since the last industry top in 1998 to ever-lower shipments, off a full 69% through 2006, many industry changes have occurred. Most noticeable has been the departure, in many cases through business failure, of most of the industry's lenders, large and small. In fact, the "lack" of lenders continues to be cited as the chief cause of the industry's woes. Now there is a chestnut that deserves a final burial.

But lenders have hardly been the only segment that has been severely impacted and greatly changed. As the most visible face of manufactured housing, there has been great turmoil in the manufacturers/builder ranks. You know, the guys that build the homes. We've seen several bankruptcies, mergers, and sales, all in the name of industry consolidation.

The industry had over many years created a home building capacity from a normal low of about 200,000 homes, annually to a high of 300,000+. As we broke well below the 200,000 shipments pace over 6 years ago, and have stayed there, the home building capacity has been far too great for the demand. The factories themselves were

shuttered, sold, mothballed, or their use changed. The squeeze was on, and continues little abated.

Few Earnings

Most MH companies which report earnings publicly have reported few earnings, and the others were rumored not to be much better off. As companies awaited an increase in activity, 2006 saw another leg down in shipments, after the life raft of 2005 FEMA orders. This year, so far, has failed to even meet the very low 2006 figures. Business, despite our ever-optimistic industry outlook, justified little optimism.

In order to shore up their finances, many builders looked to cut costs as much as they could, but some sought a sale or merger with a stronger rival. Reports of that sale or this merger have circulated almost endlessly for years, some actually happening. For the weak, selling or merger was usually a more attractive option than the other alternative(s).

Meanwhile, the small number of strong industry builders picked up attractive assets to add to their existing lines, often at bargain basement prices. At times they added to their product offerings, or they bought geographic distribution. Some added modular factories, others higher or lower end HUD homebuilders to their existing stable. Many of these assets came on the cheap, few other buyers bidding.

Rumors Abound

Rumors continue to circulate that some of the larger, stronger builders still look at opportunities presented to them to acquire other builders, or they make propositions to others not necessarily for sale. You hear various snippets of these rumors frequently, some with more than a dose of reality. Some of the sources reporting much of this stuff are fully reliable people, little given to fantasy.

The industry builders have broken themselves down clearly to those who would acquire others, those who would be acquired, and all others. In the "all others" category are some who would not be targets and some who do not necessarily want to be targets. If we sit down with the annual "**Top Twenty Five**" list just compiled by the June, 2007 **Manufactured Housing Merchandiser** (Tel (312) 236-3528), we can move the various builders around to surmise additions of the weaker to the stronger. Much of it may be pure guess, but the one element which jumps out is that the acquirers are few and the targets are many. (See also **John Diffendal's June MH report** for his market share breakdown of the Top 25. Tel (615) 340-8284.)

The Acquirers

Not too many are logical acquirers, only a very small handful in that group. In terms of actual acquisitions recently and public statements, **Clayton Homes** and **Champion Home Builders** lead that list. The list of those who could or would be acquired is far larger, although few are running ads to sell themselves. Unknown are those who are not targets themselves, at present, but harbor thoughts they would be acquirers. Surely they exist, but are few in number, and have been quiet about such plans.

The industry is now so small, that only a few players make up a very large percentage of all new HUDCode shipments. I make it that in 2006; **seven** companies built **68.7%**, with just **three** of them building **54.5%** of homes. The builders on the list below number seven hold very small percentages of total industry shipments.

Mature Industry

Recently I spoke with an outside research firm doing a study for investors to ascertain the present state of the industry. He got to me late in his research interviews. One of the questions that arose was his observation to me that the insider industry outlook, which was highly optimistic, clashed severely with actual industry action. I retorted that I had noted the same situation, but have been unable to explain it.

This was followed by the response that **he** viewed MH as a **mature industry** with limited prospects for further growth. The long industry decline over the last 35 years give ample testament to the prospects, barring significant and improbable industry changes. Without a lot of hoopla, once retail lenders stopped making unprofitable loans, overnight MH became a mature industry. We went from great growth in 1998 to mature in just five years. It must be a record.

He further observed that in mature industries a very few companies gobble up their competition, they are quite profitable, and coming into the market by new entrants is difficult. As an example, GM, Ford and Chrysler were the first great survivors of the American auto industry, culminating in the very profitable stretch for them from 1946-1977.

By the late 1970's, their obsolete auto factories, union constraints, fuel shortages, poor build quality, and foreign competition started the next consolidation move we are even now seeing. In the period from 1978 to the present, what were originally small foreign auto companies became the powerful competitors we see today, Toyota, Nissan and Honda nipping at the heels of the past giants, and bidding to overcome them in capacity. They overcame them in profits long ago.

Housing or MH

Note all these companies build motor vehicles. In the MH industry we build housing in a factory. Due to a variety of converging conditions, primarily the enactment of the HUDCode in 1976, coupled with the historic preponderance of chattel financing, what was really nothing more than one more segment of housing, MH became a separate entity, part of housing, but different and separate. It's as though auto manufacturers building diesel cars were built by separate companies, in a separate industry from those building gasoline vehicles, each with separate sales outlets,

separate associations, separate operating styles, and different financing. Essentially since the beginning of the MH industry, it has been separated from the broader category of housing, by its building code and chattel financing.

And the ability to have a separate industry for 50 years in MH, at the longtime level of home shipments before 2001, was entirely fueled by unsustainable retail financing. Once the very accommodative chattel financing was deemed unprofitable by lenders, shipments collapsed and much of the remaining MH industry joined or is in the process of joining the primary housing industry; the site builders and using their conforming financing.

As the industry routs about seeking a return

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to chattel financed homes to the shipments levels of the past, industry conditions evermore move HUDCode housing merely towards the total housing markets, its separate niche evermore difficult to sustain or to justify. Lord knows the shift is being resisted mightily by many in the industry, but it remains to be seen what will be left of it 10 years hence.

Bye-Bye Code

Rumors already abound that the industry's regulators and even Congress are questioning the continued need for the HUDCode as a national building code, as shipments dropped below 150,000 homes, and at present even below the 100,000 shipments level. There is some concern that the size of the HUDCode industry has become so small, that treating it as a separate house building entity is no longer justified. Interesting, eh?

Note that this may not entirely jibe with the beliefs of the industry and its trade associations. After doomsday predictions in the early 1970's against the enactment of the HUDCode, the industry now likes the special treatment it gets. Not that the code isn't under attack at any given point by industry interests, but in the whole I don't think relegating the industry to building with use of the International Residential Code (IRC) would be the preferred option. As strongly as the HUDCode was originally attacked, the same vigor would no doubt champion its continued existence, but changed to suit industry interests, of course.

Makes sense

And in the midst of all of this, the strong builders of which there are only a few, gobble up the weak. Change is happening on a major scale whether the industry desires it or not. Recent rumors had rolled around the industry that one of the "big builders" was negotiating to buy a smaller, but "important builder". Rumors say that for the moment the move has ended, but the deal makes so much sense that it may not be quiescent forever. Frankly, viewed in the cold light of business, once the shock was over, and you thought it out, the deal made a lot of sense for both companies and their stakeholders.

I am very much reminded in this event with the squabble which occurred when **Warren Buffett** made his offer to buy **Clayton Homes**. Many strongly objected. Events since the purchase clearly show that for most stakeholders, the transaction was a very good one. Now Clayton is the acquirer and faces similar obstacles.

With this recent rumored deal, every industry builder has had to decide whether it will try to remain independent or join one of the few "big tents" remaining. You have to think that the events of the next five years, perhaps the next ten, will transform the industry finally into merely housing, and not a subset of

housing. Particularly as the industrial process of the actual home building itself brings each, the site builders and factory builders, into close proximity of process.

This would leave the financing of the “HUDCode” homes to be fully integrated into conforming financing, which clearly continues to be both a trend and a challenge. The industry chafes under being treated differently than site built, all the time refusing to take such actions as it needs to make HUDs perform like site built loans. Absent the same loan performance, HUDCode financing is unlikely to be the exact same as site built. And if it does become its equal, then treating HUD differently makes no sense. Interesting trap for the industry.

Unresolved, but converging

This leaves the chattel-financed home as the truly unresolved orphan of the industry. There, loan performance can be problematic, and only through the protection of high credit capability and strong loan detail verifications can any lender prevail. With these conditions, however, chattel originations are and have been for years strongly curtailed, unable to springboard, the home shipment volume the industry craves. And there is little prospect of rapid improvement, as the industry is hesitant to abandon its longtime chattel model, leaving lenders to continue the constraints necessary to survive. But, as with all things, that which can't be, over time, won't be. And the belief chattel financed homes will again comprise 80+% of all industry sales stretches credulity. At least it does for me.

As an example of the convergence of financing, the new Title I, FHA financing for “home-only loans” may require both conformance with RESPA and that the land-lease tenancy be at least as long as the loan term, or greater. Having been on a number of MHI committees which have explored both these subjects, I have seen first hand the resistance to these types of consumer and lender protections. If incorporated into the law, combined with the present requirement that the Title I loan program be financially sustainable, this program, I predict, will not be the great industry hope many had envisioned. Chattel lend-

ing not much different from this already exists, with moderate volume, at best.

Consolidation

So the move to consolidate the industry home production, which has been happening under our nose, now becomes even more compelling. And having to join the normal site built housing market, the rapid turn the industry desires seems no closer than ever. That is likely to continue to pressure low-profit builders to go into the arms of the few strong builders. I can think of no probable outcome which will stop that process.

So, what are the net impacts of all of this on the industry? The first and most far-reaching conclusion is that almost everything we know and understand about our former industry could change greatly, and already is happening. Consider, as an example, it is quite possible, in fact probable, that two companies by themselves would control 65-70% of the industry shipments (and perhaps more!). I can conjure a fairly quick situation where one of the big builders through just a couple of purchases of other smaller builders, and a continued expansion of its share of the market, could control, by themselves, between 40-45% of home shipments. And assuming the other strong one(s) doesn't want to be irrelevant, we could have another builder with 20-25% of the volume at the same time. You add the numbers. And the faces to this? You know the answer.

Play monopoly

Crazy you say? Sit at your favorite desk, turn off the T.V., take the **Merchandiser's Top Twenty-Five** list and play some monopoly with the builders. Not that hard to connect the dots with companies who have both the ability and desire to make it happen. Hudson, Packard and Nash, folding into American Motors, who folded into Chrysler. Change the names and follow the same trail in HUDville.

For those builders who already lend on MH, the impact of industry consolidation is unknown. We know **Clayton Homes, the Berkshire Hathaway unit**, has active and proficient lending, in-house. Whether the “other” large survivor can match its fire-power in lending is uncertain presently. If MH remains a “separate” industry, lending will be absolutely necessary “in-house” to compete. If lending folds into the far larger site built venue, then the present edge

“in-house” lending might give is far less important in the future. Once you are merely a part of the conforming market world you are awash in mortgage money. You are also awash in competition. Notice how the good always comes sandwiched with the bad?

Dues Money

If you have such home production concentration, in so few companies, do you still have an industry worthy of separate industry representation? If two companies control 70+% of shipments, do they send their dues to MHI/MHARR or to some powerful lobbying firm in Washington? They have to decide at that point whether the “broad-based” association protects them better than the high-powered D.C. lobbyists. Assuming your company sells around 50,000 homes annually, do you send that million dollars in dues to MHI or to your hand-selected lobbyists? Good question, eh?

Yes, the inevitability of far-reaching change seems so powerful, I don't see how it can be

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avoided. At issue will be the entire make-up of the industry, how it operates, and everything we have known in the past.

THE MHL CORP SHIPMENTS CONTEST

Decrease and response

April shipments figures showed an almost 21% decrease over the already low figures of April last year. To be truthful, I got really exorcised over the figure. To me, it confirmed what I have

been continually been saying: there is going to be no bounce back for MH from the sub prime mess. If there is, when does it start?

In response quickly to the frightening shipments figure, which is how I viewed a further 21% decrease. I shot off a bunch of emails to industry leaders. Emotional me, I got carried away. I was reminded by them that many things are going the way MHI wanted. Really?

The sub prime mess would help us, Title I was about to be passed, new MHI Committees were being set up in Washington, D.C. at the Summer Meeting to study the issues, the Home Improvement Act of 2000 was almost ready to work, and.... the shipments in seven states were up!

Well, now, pretty persuasive stuff, all that. My pea brain only saw the 21% decline, not the background chatter above. So I was distressed. I looked more at shipments **decreases** in 37 states, rather than the 7 that were up. I focused more on the 84% empty glass rather than the 16% full one. Stupid me.

See only the good?

To be redundant, as I often am, I do not see it as a badge of honor to try to see what little good there is in an otherwise disaster scenario. I think it better to face facts, not avoid them. Yes, being an alcoholic does have its good points; the great taste as it goes down, life in a bar, your buddies at the table with you, and so on. But the net impact of being an alcoholic is such a disaster, that failing to focus on its bad aspects, as opposed to the few good things, is demented. Telling me that 7 states were up when 37 were down smacks of disconnected.

It is an article of faith that alcoholism cannot be conquered until you **take stock of your condition, accept what you've become, and take serious steps to try to reverse the condition.** In my mind our industry has failed to do exactly that to combat its ailments, therefore is unable to guide any real measures which could change our circumstances. Yah, yah, I know, the HIA 2000 will cure the problems.

As I wrote above, changes are occurring whether we guide them or not. At issue is whether the resulting industry would be larger if we interceded intelligently or whether the final industry without our positive intervention will be the same size in the end. I'm not sure, but I would have tried to intervene, to make

it bigger and better than it otherwise will be.

And the leader...

The shipments pace, based on my work, does not break 100,000 home shipments for 2007. At present it is running at a rate of **93,276** homes. This puts **Scott Slezak**, of **Foremost Insurance** back in the contest lead with his prediction of **93,141**. And the momentum is building towards a finish of under 100,000 shipments for the first time since 1961, when 90,100 homes were shipped, down from the 120,400 of 1959. Nice.

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