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New Rec: Thor Industries	(THO: \$46.75)	November 4, 2007
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Position: Sell **Target: \$30.40**

	Oct-07	Jan-08	Apr-08	Jul-08	F2008e	F2009e
\$MM	F1Q08e	F2Q08e	F3Q08e	F4Q08e	F2008e	F2009e
Revenue	765.8	619.4	763.5	690.6	2,839.2	2,859.2
EPS	0.65	0.43	0.48	0.56	2.12	2.17
Y/Y Gro	18%	31%	-25%	-37%	-12%	3%
PE	n/a	n/a	n/a	n/a	n/a	n/a
PSR	n/a	n/a	n/a	n/a	0.9	0.9
Consen	0.69	0.52	0.86	0.88	2.92	3.25

Shares Out: 56M

Market Cap: \$2.6B

FYE: Oct

Summary: Thor Industries (THO) is the largest manufacturer of towable recreational vehicles (trailers and fifth wheels) in the US. It manufactures the top-

of-the-line Airstream brand, along with brands such as CrossRoads, Dutchmen, Breckenridge, and Keystone. Towables were 66% of sales and 79% of operating income in F2007. The company also manufactures motorized coaches (20% of sales, 12% of operating income), and small/mid-size buses (14% of sales, 9% of operating income). Shares trade at 16x F2008 earnings despite the fact that earnings were down 16% in F2007, or down 22% excluding a one time tax benefit. This is a premium to valuations in mid-2006 when shares traded at about 13x forward earnings. Bulls believe that the worst is over for THO, and expect 17% EPS growth in F2008 and 7% in F2009.

Continued optimism for THO's prospects, despite exposure to weak consumer spending trends, high gas prices, and rising credit worries, is based on strong backlogs reported for the quarter ending in July, and recent industry shipment data suggesting that retail unit sales are growing despite continued (though slowing) declines in wholesale shipments. Bulls attribute this mismatch to dealer inventory reductions, which, they assume, should eventually lead to more orders. As we discuss, we think current trends showing growth in retail registrations despite declining wholesale shipments may be an after-effect of hurricanes Dennis, Katrina, and Rita rather than a signal that towable demand is growing.

Our research suggests that THO and other RV manufacturers may face continued weakness for years to come, much as many observers have come to expect for home builders. RV manufacturers appear to have benefited from an extremely favorable financing environment that encouraged RV buyers to take out large, 10-20 year loans for expensive RVs, very often for 100% and up to 130% of the retail price of the units, allowing dealers to offer loans that cover their profit as well as allowing the buyer to pay off some or all of the money owed on the old vehicle being traded in. Of course, the minute the new RV unit leaves the lot, the value immediately depreciates. Clearly, then, many RV buyers are "upside down" in these loans, owing well more than the financed RVs are worth, and with liberal payment schedules that mean they will never catch up. This will make it difficult for them to trade in their units for another vehicle without incurring still more debt, something increasingly fewer will be able to afford.

As an example, suppose a buyer bought an RV towable unit for \$20,000 five years ago with a 15 year, 7% loan of \$17,000 (100% of invoice) and \$3,000 down. Now he wants to trade this unit in for a new one, but still owes \$13,160 on the old unit, which has lost 50% of its invoice value, and is now worth \$8,500 as a trade. He is "upside down" by the \$4,660 difference between his unit's value and the remaining loan balance. Assuming prices increase 3% per year, a comparable unit would cost \$23,185, so the buyer and will have to come up with \$27,845 to get a

new unit comparable to his original one. If he again borrows 100% of invoice (\$19,715), he will have to come up with \$8,129 for a down payment. As we now detail, he may even be able to borrow the full \$27,845 if he is accepted for even more financing, making it more likely the transaction will get done.

We have seen terms sheets dated as recently as September 2007 showing the following terms: Bank of America (130% on units up to \$25K, declining to 120% on units up to \$200K, all with zero down payment); USBank (125% on units invoiced at less than \$150K for up to 15 years, 115% on units invoiced at over \$150K and/or for more than 15 years); and Bank of the West (120% of invoice, zero down payment up to \$100K). Industry insiders warn that these terms put the buyer even more deeply upside down, since at trade-in time the value of their unit is an even smaller fraction of the loan's outstanding balance. One dealer told us he has seen deals done for as much as 160% of manufacturer's invoice. As long as a borrower's credit is good, he says, banks are not pushing back on these large, under-collateralized loans. However, industry observers understand well the implications for the RV industry. It is getting ever more difficult for buyers to trade up to the next new RV.

While it is difficult to quantify the full extent of this problem, clearly a high percentage of RVs are financed. A survey conducted by RVtravel.com of over 1,500 RV owners in March 2007 found that 53% financed their units through banks or their RV dealers. Another 39% paid cash, though an undisclosed (and likely substantial) number of these cash purchases were made by consumers taking out home equity loans. Thus, we think it is safe to estimate that at least 60%, and probably more, of RV purchases are financed, either with direct loans or with home equity. Anecdotally, dealers tell us that 70% or 80% of units are financed at their locations.

The problems created by this easy financing should become evident with time and with weaker economic conditions and with tighter credit. Industry insiders tell us that the average ownership period for an RV is now about 2.2 years, much shorter than the 3-5 year average seen about five years ago. Thus, RV customers have rapidly churned their vehicles in an easy credit environment. If ownership periods begin to extend in this new world of recession worries and tight credit, the impact should soon be apparent. With so much money owed on their RVs, customers will find themselves unable to purchase their next new unit, depressing sales of new units. Dealers who counted on sales of trade-ins as the profit on new sales may find themselves with too much used inventory, forcing them to cut prices and depressing the values of new and used units. In the worst case scenario, dealers with significant inventory on "floor plan" (financed by

banks) may default on their loans. Banks finding themselves holding RV inventory may be forced to sell at fire sale prices to liquidate the loans.

A significant problem, in our view, is that banks are treating RVs as homes, offering consumers 10-20 year loans on assets that lose half their value in five years. These buyers owe far more principal after five years than the units are worth. Indeed, while many of these RVs do qualify for home-like tax treatment if they contain kitchens and toilets, allowing consumers to write off interest on the loan as they would for a second home, if they finance 100% or more of the unit, they owe far more than the market value of the unit the moment they drive it off the lot. We think that homes retain much more of their initial value subsequent to the owner moving in than do RVs, so the problems of RV buyers upside down is far worse than that of home owners. As we have seen in the housing market, this may prompt underwater buyers to default on their loans rather than continue to make payments on an asset of diminished value. Should this occur, the inventory of used units would grow, further pressuring new unit prices and volumes.

The increased understanding of the problems caused by upside down buyers in the residential market should cause buyers and lenders and dealers alike to turn more cautious. Indeed, industry observers and participants with whom we have spoken are very concerned about the impact of this problem on the RV industry.

Recent data cited by the “street” showing travel trailer (TT) retail unit registrations suggest that the TT market began expanding in February 2007 after being flat-to-down from March 2006-January 2007. Retail registrations for TTs have increased 4% YTD through August. This has excited bulls, who suggest growth is coming from consumers shifting away from motor homes and more expensive fifth wheel units to TTs. The increase has yet to show up in wholesale shipments, however, which are down 14% YTD through September. Bulls suggest this is because dealers are drawing down inventories, and that wholesale units shipped will pick up once dealers work through their excess and get more comfortable that growth is sustainable.

However, putting together recent news reports about FEMA trailers sales and the registration data suggests another explanation for the up tick. After the hurricanes in 2005, FEMA hurriedly purchased about 145,000 TT units from dealers and manufacturers around the country to house those who lost their homes. None of these units were registered. Now FEMA is beginning to sell these units to individuals, but also to dealers. Once the dealers refurbish them and sell them as used units to consumers, they are registered, and inflate the retail registration total. Given that about 13,000-17,000 TTs are registered each month, it would not take many FEMA trailers to move the needle and create the impression of growth. For

example, just 1,007 FEMA trailers would be the difference between no y-y change in registrations versus the 7% growth reported in August 2007.

THO faces a number of other problems that we think should make investors wary. First, it is losing share in its primary towables market to Forest River (owned by Berkshire Hathaway) and Jayco (privately held). Second, its bus business has been growing nicely, but is dependent on federal, state, and local budgets for much of its revenue. If government budgets tighten, sales will likely slow. Finally, it has had two COOs in the past nine months (the newest COO is the son-in-law of the CEO), and has found fraud at its Dutchmen division. An SEC investigation is ongoing.

Despite what appears to be a gathering storm for THO, analysts are very optimistic about F2008. The “street” expects sales to grow 10% in F2008 to \$3,128M, and 4% in 2009 to \$3,249M. EPS is expected to increase 21% in to F2008 to \$2.92, and 11% in F2009 to \$3.25 on expanding operating margins. Given the problems we see developing, we think the market and THO’s revenue will continue to contract in F2008 and estimate sales of \$2.839B in 2008 and \$2.859B in 2009. We think operating margins will remain depressed due to price competition and low product volumes, and so project EPS of \$2.12 in F2008 and \$2.17 in F2009.

THO: “Street” vs. OWS Expectations F2008-F2009

	F2007a	“Street” F2008e	“Street” F2009e	OWS F2008e	OWS F2009e
Towable Sales	\$1,890	\$2,068	n/a	\$1,822	\$1,786
Motorized Sales	\$565	\$578	n/a	\$577	\$588
Buses	\$401	\$482	n/a	\$441	\$485
Total Sales	\$2,856	\$3,128	\$3,246	\$2,839	\$2,859
EBIT	\$185	\$236	\$259	\$174	\$178
Operating Margin	6.5%	7.5%	8.0%	6.1%	6.2%
EPS	\$2.41*	\$2.92	\$3.25	\$2.12	\$2.17

*includes a \$0.16 benefit from a one-time tax settlement

	F2007a	“Street” F2008e	“Street” F2009e	OWS F2008e	OWS F2009e
Towable Sales	-13%	9%	n/a	-4%	-2%
Motorized Sales	-2%	2%	n/a	2%	2%
Buses	27%	20%	n/a	10%	10%
Total Sales	-7%	10%	4%	-1%	1%
EBIT	-25%	28%	10%	-6%	2%
EPS	-16%	21%	11%	-12%	3%

Our target of \$30.40 is 14x our F2009 EPS estimate. This multiple is comparable to that of peers such as WGO, HOG, and PII. This valuation may prove generous if investors perceive a longer downward trend in THO's business.

Background

THO is the largest manufacturer of towable trailers in the US. Towables represented 66% of its sales and 79% of operating income in F2007. The segment includes travel trailers (33% of total sales), which are non-motorized units designed to be towed by cars, pickup trucks, SUVs or vans. Typically, units sell for about \$25,000, but can cost as much as \$65,000. Also included are fifth wheel trailers (31% of total sales) which are towed by long bed (8'+) pickup trucks, and are constructed with a raised forward section that sits over the truck bed and are attached to a hitch installed in the truck bed. They typically sell for about \$45,000, but can cost as much as \$100,000. The company also has a small park model line designed to be parked only, which represents about 3% of sales.

According to the Recreational Vehicle Association (RVIA) and Statistical Surveys, Inc. (SSI), the company has 25% unit market share in the TT business. Other competitors include Forest River, owned by Berkshire Hathaway (15%), privately held Jayco (12%), Fleetwood (6%), Monaco (5%), and smaller competitors (37%). In fifth wheels, THO has a 35% share, followed by Forest River (20%), Jayco (8%), Monaco (4%), KZ (4%), and other smaller players (29%). Its TT brands include Airstream, Keystone, CrossRoads, and Komfort.

The company also has a line of motor homes, which represented 20% of sales and 12% of operating income in F2007. According to RVIA and SSI, the company has a 14% unit market share in the motor home business. Other competitors include Winnebago (19%), Fleetwood (17%), Monaco (11%), Coachman (6%), and other smaller players (33%).

Bus sales represented about 14% of sales and 9% of operating income in F2007. These units are primarily small/medium sized buses used as airport shuttles, mass transit, and tourist uses. The company has a 38% share of the medium bus market.

THO assembles its units from many finished components purchased from suppliers (e.g., microwaves, beds, stoves). Raw materials used to construct the unit include aluminum, steel, plywood, plastic, and fiberglass. Since it is primarily an assembler, the company has little investment in PP&E, with just \$65M in gross machinery/equipment on the books at the end of F2007. Capex spending in F2007 was about \$14M.

The company sells its products through about 1,500 dealers in the US and Canada. Press releases made after the big annual dealer show in November tout new dealer sign-ups of 350-400, but industry sources tell us the company is including the addition of new product lines by existing dealers in its “new dealer” count.

According to a 2004 survey by Harris Interactive, the average RV owner is about 46 years old. Sixty-one percent have an income below \$75,000 per year, and 68% have some college education. The industry has been trying to expand its demographic with a “Go RVing” campaign designed to bring in younger buyers with families (35-55 year olds). One industry insider with whom we spoke worried that expanding sales to this group could become problematic, since “these are the people who get hurt first” in a recession.

Discussion:

1. RVs are heavily financed

According to the RVIA, the average RV costs about \$37,726. This is a significant sum of money for a leisure purchase, especially since most RV buyers make less than \$75,000 per year. The easy credit of the past few years has made RV ownership and trade-ups more accessible. Many dealers offer zero down payment terms on 10-20 year loans, meaning low monthly payments for buyers. For example, the monthly payment on a \$37,000 15 year loan at 7% is \$332.57.

RV buyers have taken advantage of this financing climate. Dealers with whom we have spoken tell us that 55%-80% of their customers finance their purchases, usually for 100% or more of the purchase price. Our interview findings are consistent with a March 2007 survey conducted by RVtravel.com of over 1,500 RV owners found that 53% financed their units through banks or RV dealers. Another 39% paid cash, though this includes those who took out home equity loans to pay for their units. This could be substantial, and likely pushes the percentage of buyers using credit to well over 60%.

Dealers consistently tell us that they are easily able to arrange financing for more than the unit’s purchase price. One dealer told us he could arrange financing for 140% of new unit’s NADA book value. As an example, a customer purchasing a unit for \$25,000 with an NADA value of \$22,000 could borrow \$30,800.

2. Rapid depreciation and long loans make trade ins difficult

While getting buyers into RVs with easy credit has benefited the industry, it has saddled the average RV owner with a significant amount of debt, which may constrain his ability to trade in his new unit. Purchases accompanied by a trade in are an important part of the RV market, with dealers telling us that 80%-90% of buyers come in with an old unit. One industry source with whom we spoke told us that the average period of RV ownership is now 2.2 years versus 3-5 years about five years ago.

Increasingly, however, many buyers are “upside down” in their old units, owing more than they are worth. This is because they have financed 100% or more of the unit purchase price with a 10-20 year loan, but the unit loses 50% of its value in five years.

One particularly bearish industry insider with whom we spoke described the current state of financing in the RV industry as “a disgrace,” saying that the huge amounts owed on RVs was leading to a record number of abandonments/ repossessions. He characterized this as quite a change for an industry whose loans had historically been seen as the safest around. We spoke with an RV repo specialist in Iowa who confirmed that his repos are up versus last year. He commented that when cash is short, the RV loan bill is the last one paid, with priority going to the house and the car.

3. Credit issues at the consumer level could move up the selling chain to impact the dealer and manufacturer level.

Problems at the consumer level are likely to grow in a weakening economy, and impact the selling chain. If banks begin to see RV loans as more risky, they will tighten terms, financing less of the RV’s value and/or higher interest rates. Some industry sources told us that terms are already tightening, with banks demanding better credit scores for high levels of financing.

Banks may also begin to tighten credit at the dealer level. Dealers typically finance their new vehicle inventory with “floor plan” loans backed by the value of the inventory. Terms on these loans become more expensive as the inventory ages, so weak dealers unable to move units may foreclose, leaving the bank with RV inventory it may sell at fire sale prices. This would pressure prices at surrounding dealers. One dealer we visited at a dealership in the South, with no customers in sight on a beautiful sunny weekend, told us his inventory was full of still new 2006 units, for which he was now offering a \$3,000 discount. One has to wonder how long he will finance the loans on this inventory. Perhaps he is waiting for the next hurricane to hit.

All of this, of course, would eventually impact manufacturers like THO. The crisis may already be occurring, with THO's towable sales down 13% in F2007. Bulls blame it on a tough comparison to a 25% increase in 2006, and predict a return to growth, but we think the economic environment for THO's customers is only getting worse.

The potential impact of tightening credit and higher gas prices could be quite dramatic. In the recessionary period of the early 1980s, when very high interest rates coincided with rising gas prices, units shipped declined from 389,900 in 1978 to 107,200 in 1980, and did not return to 1978 levels until 2006.

Historical RV Shipments: 1978-1982 and 2006

Year	RV Units Shipped (000)	Y-Y chng
1978	389.9	(5.8%)
1979	199.2	(48.9%)
1980	107.2	(46.2%)
1981	133.6	24.6%
1982	140.6	5.2%
2006	390.9	1.6%

Source: RVIA

4. Travel trailer retail data cited by bulls is misleading

THO bulls point to improving retail registration data as evidence that the towables market is much stronger than THO's F2007 sales would suggest. We think retail registrations may be benefiting significantly from registration of units FEMA is selling to dealers and individuals from inventories it purchased after the hurricanes of 2005, as we discuss below. But first, here is a look at the data that has the "street" excited.

Data from SSI cited by sell-side analysts and many companies in the RV industry shows that the number of TTs registered nationwide has increased for the past six months, and was up 7% y-y in July and August, and up 4% YTD through August.

Towables Monthly Retail Registrations (number of units)

	Jan-07	Feb-07	Mar-07	Apr-07	May-07	Jun-07	Jul-07	Aug-07
Travel Trailer	6,892	9,628	15,664	16,451	19,366	20,315	18,266	15,387
Fifth Wheel	3,814	4,657	7,128	6,999	8,032	7,795	6,759	6,113
Total	10,706	14,285	22,792	23,450	27,398	28,110	25,025	21,500

Source: SSI

Y-Y change	Jan-07	Feb-07	Mar-07	Apr-07	May-07	Jun-07	Jul-07	Aug-07
Travel Trailer	-16%	-1%	8%	2%	9%	4%	7%	7%
Fifth Wheel	-23%	-13%	-3%	-11%	0%	-5%	-5%	-6%
Total	-19%	-5%	4%	-2%	6%	1%	3%	3%

This does not match up well with wholesale delivery data, which shows TT units delivered were down 8% in August, down 1% in September, and down 14% YTD.

Wholesale Deliveries

	1/07	2/07	3/07	4/07	5/07	6/07	7/07	8/07	9/07
TT	13.2	15.0	18.7	17.9	17.5	17.4	14.8	15.7	13.8
5 th Wheel	6.6	7.2	8.5	7.5	7.1	7.7	5.9	7.1	6.4
Total	19.8	22.2	27.2	25.40	24.6	25.1	20.7	22.8	19.8

Source: RVIA

	1/07	2/07	3/07	4/07	5/07	6/07	7/07	8/07	9/07
TT	-30.2%	-16.7%	-18.7%	-11.4%	-15.5%	-11.2%	-7.5%	-7.6%	-1.4%
5 th Wheel	-13.2%	0.0%	-14.1%	-10.7%	-21.1%	-8.3%	-13.2%	-7.8%	0.0%
Total	-25.3%	-11.9%	-17.3%	-11.2%	-17.2%	-10.4%	-9.2%	-7.7%	-1.0%

Bulls suggest that the TT market is growing, and the retail/wholesale mismatch is a temporary one caused by dealer inventory reductions. They also point to continued weakness in motor home sales, and argue that TTs are gaining share as buyers shy away from the more expensive, gas guzzling motorized RVs. Once dealers get comfortable that growth in TTs is sustainable, bulls argue, growth in wholesale deliveries will follow.

We think the data may be showing growth based on the resale and registration of units purchased by FEMA in late 2005. FEMA bought 145,000 units after the hurricanes. Initially, it bought up retail quality inventory from manufacturers and dealers in a mad rush to house those impacted by the storms. Later, it purchased stripped down units without markings or RV-type toilets, stoves, or heating. A dealer in Florida with whom we spoke said she has many more used units in inventory than this time last year because she is buying the retail-quality units from FEMA for resale. Many of her buyers are families living in coastal Florida who are buying in anticipation of the next big storm so they do not have to depend on motels or FEMA for housing. These buyers are not active RVers, so we think they are unlikely to become the type of repeat buyers the industry needs to keep growing.

Importantly, FEMA never registered the units it purchased for its storm relief program. Thus, the units now appearing on the market from dealers like the one in Florida are units actually manufactured in 2005 or earlier that are now just being registered. This skews the data, and creates the appearance of growth.

Given that 13,000-17,000 TTs are registered each month, it would not take many FEMA trailers to move the needle and create the impression of growth. For example, just 1,007 FEMA trailers would be the difference between no y-y change in registrations versus the 7% growth reported in August 2007.

The RV industry is well aware of the threat posed by a flood of used FEMA units onto the RV market. According to an article in the *Washington Post* in March 2007, industry groups said that FEMA's potential for-sale inventory represented 30% of the industry's sales in 2006. FEMA responded to industry concerns by agreeing to auction trailers in batches of 300 at a time, feeding them slowly into the market to minimize disruptions. Of course, the degree of disruption caused by these FEMA trailers depends on the underlying demand for RVs. If demand softens in a weak economy, any additional units introduced into the market by FEMA would have an outsized impact.

5. Compared to two years ago (pre-Katrina), wholesale unit volumes are about flat

The 2005 hurricanes and their aftermath have made evaluation of wholesale deliveries on a y-y basis difficult to interpret. It appears that the hurricanes increased towable sales from October 2005 through at least September 2006, as demand from displaced residents, FEMA, and contractor housing soaked up available units.

To attempt to remove this impact, we compare industry shipments from the nine months pre-Katrina (Dec 2005-October 2005) to the period December 2006-August 2007. It appears that shipments have been about flat on average over that time. This suggests that the underlying demand for RVs has held fairly constant from 2005-2007, which would make sense given the relatively healthy consumer environment in place during that time. A weakening economy could mean the end of flat unit demand, however. We note that shipments in August 2007 were down 9% versus August 2005, perhaps signaling the beginning of weakness in the towables industry.

Towable wholesale deliveries: 12/04-8/05 vs. 12/06-8/07

	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Total
12/04-8/05	17.5	20.7	21.8	26.2	25.5	21.9	23.6	20.5	25.0	202.7
12/06-8/07	16.4	19.8	22.2	27.2	25.40	24.6	25.1	20.7	22.8	204.2
Y-Y chng	-6%	-4%	2%	4%	0%	12%	6%	1%	-9%	1%

Source: RVIA

6. THO is losing market share

Combining the RVIA wholesale shipment data with THO's reported shipment data, we can get a view of THO's market share trends over time. It has lost 5 share points from the quarter ended July 2006 to that ended July 2007. It lost 4 share points y-y the prior quarter as well. These share losses came even as the company increased its allowance and discounts on towables. In 1Q07, it offered \$9.4M more y-y in discounts and allowances for towables, decreasing sales by 1.7%, but keeping its share of shipments steady. In 2Q07, it offered \$5M in discounts and allowances for towables, decreasing sales by 1.3%, but share slipped to 33%. The company did not offer increased allowances/discounts during the rest of F2007, which may be partly responsible for its declining share.

Towable RV Deliveries: Industry vs. THO

	Apr-05 3Q05	Jul-05 4Q05	Oct-05 1Q06	Jan-06 2Q06	Apr-06 3Q06	Jul-06 4Q06	Oct-06 1Q07	Jan-07 2Q07	Apr-07 3Q07	Jul-07 4Q07
Indust whsle deliveries	73.5	66.0	74.7	73.0	86.7	80.5	65.1	53.4	74.8	70.4
THO Shipments	25.2	21.9	27.5	24	31.7	28.8	23.5	17.4	24.5	22.1
THO Mkt share	34%	33%	37%	33%	37%	36%	36%	33%	33%	31%
Share bp change					3	300	(100)	--	(400)	(500)

	Apr-05 3Q05	Jul-05 4Q05	Oct-05 1Q06	Jan-06 2Q06	Apr-06 3Q06	Jul-06 4Q06	Oct-06 1Q07	Jan-07 2Q07	Apr-07 3Q07	Jul-07 4Q07
Indust whsle deliveries	n/a	n/a	n/a	n/a	18%	22%	-13%	-27%	-14%	-13%
THO Shipments	n/a	n/a	n/a	n/a	26%	32%	-15%	-28%	-23%	-23%

Sources: RVIA, THO filings

THO appears to be losing share to Forest River (owned by Berkshire Hathaway) and privately held Jayco. We wonder if these competitors, with no need to publicly disclose financial results, are offering dealers better terms to win share.

7. Backlogs strong, but have not been predictive of future growth

Bulls have been cheered by the strong backlog number THO reported at the end of 4Q07. Towable backlogs were up 20% y-y versus three previous quarters of declines, bolstering hopes that dealers are beginning to rebuild depleted inventories. We observe, however, that backlogs have not been particularly helpful in predicting the next quarter's sales. For example, a 14% y-y increase in towables backlog in F4Q06 was followed by a 6% y-y decline in sales the following quarter. Backlog as a percent of the next quarter's sales also varies widely, from 32% of next quarter's sales in F1Q07 to 65% of next quarter's sales in F3Q06.

	Oct-05 1Q06a	Jan-06 2Q06a	Apr-06 3Q06a	Jul-06 4Q06a	Oct-06 1Q07a	Jan-07 2Q07a	Apr-07 3Q07a	Jul-07 4Q07a
Backlog Towable \$	252.3	376.1	369.0	229.8	120.6	238.7	267.0	276.1
Y-Y chng	91%	98%	102%	14%	-52%	-37%	-28%	20%
Next qtr chng in sales	25%	24%	29%	-6%	-18%	-14.8%	-13%	n/a
% next qtr sales	55%	61%	65%	46%	32%	46%	54%	n/a

Source: THO filings

8. F4Q07 margins strong, but do not appear to be sustainable

Bulls liked THO's F4Q07 EPS of \$0.90, which beat expectations of \$0.67 largely due to a \$0.14 one time tax benefit. Gross margins in the quarter were also unusually strong, driven mostly by higher margins in the towables segment (16.6% versus 15.5% a year ago). Since the company does not have conference calls, there was no way for the "street" to drill down on an issue analysts clearly found puzzling.

We think these margins will come under pressure as THO fights to regain share with higher allowance/discounts to dealers and/or its volumes drop in a weak selling environment. Therefore, we expect the company's operating margins to decline from 6.5% in F2007 to 6.1% in F2008 and 6.2% in F2009. In contrast, the "street" expects operating margins to expand to 7.5% in F2008 and 8% in F2009.

9. Floor plan notes at the country's largest RV dealer were down in C2Q07

According to Fitch, dealers adjust floor plan loans and their underlying inventory to reflect their expectations about future sales and seasonal selling patterns. Fitch also says that dealers have been reducing their floor plan borrowing because their margins are being squeezed and they want to save on financing costs.

Lazy Days, the largest single site RV dealer in the US, has been reducing its floor plan notes over the past few quarters. As shown below, it reduced its floor plan notes by 5% in C2Q07. The cause does not seem to be an effort to reduce financing costs (even though Lazy Days new vehicle margins fell from 9% in C2Q07 to 7% in C2Q07), since floor plan notes payable have been 14.4%-15.5% of new vehicle sales from 2004-2006. Instead, the reduction in floor plan borrowing may signal this dealer's negative expectations about future RV sales trends.

Lazy Days Floor Plan Notes Payable

	C4Q05	C1Q06	C2Q06	C3Q06	C4Q06	C1Q07	C2Q07
Floor Plan Notes Payable	74.6	47.6	43.0	55.6	67.0	53.9	40.8
Y-Y chng	7%	-14%	-7%	-3%	-10%	13%	-5%

Source: Lazy Days SEC filings

We note that Fitch reports that thus far there are no suggestions of problems in floor plan asset backed securities for non-auto inventories. However, this segment includes farm equipment, which is no doubt very good given the recent strength in the US agriculture sector.

10. Bus business could be at risk if federal/state/local governments cut budgets

THO's bus sales have been very strong, with revenue up 27% y-y in F2007. This strength is related to healthy traffic at US airports, which use THO buses to shuttle passengers between terminals and to rental car lots, and to strong spending by federal, state and local governments who used THO buses for mass transit. Such strong growth could be difficult to maintain as state and local governments feel the pinch of lower property and general tax revenue in a weaker economy.

11. Recent accounting issues, insider sales, management changes and nepotism could be red flags

In January 2007, THO announced that the Audit Committee of its Board of Directors was independently investigating accounting irregularities at its Dutchmen division. In April, the company announced that due to "misconduct" by the Vice President of Finance of Dutchmen, cost of goods sold had been understated from F2004 through F2Q07, resulting in an overstatement of Dutchmen's pre-tax income of \$26M. This misconduct occurred even though management certified in F2006 that it had appropriate internal procedures and controls in place to avoid such problems. An SEC investigation of the misconduct is continuing.

Interestingly, just one month before the accounting investigation was announced, the company's CEO and a director (who subsequently became COO for a very brief time) sold 299,400 and 150,559 shares, respectively, of the company's stock at about \$44 a share. On news of the investigation a month later, shares traded down from \$45 to \$42, and drifted down to \$39 over the next two months.

In October 2007, THO appointed the CEO's son-in-law as COO. While we have no reason to think that this young man is not qualified for the job, we think it is worth noting.

12. Special dividend

Investors have liked THO shares because they have paid out special dividends of \$1.00 per share in F2006 and \$2.00 per share in F2007. If the consumer market and THO's sales sour as we expect, that dividend will not longer be there to support THO's share price.

13. Valuation

THO shares currently trade at 16 times the "street" F2008 EPS estimate, or 15x C2008. Peer such as WGO, HOG, and PII currently trade at 13x-14x C2008 EPS.

P/E Valuations of THO and Peers

Company	Current Share Price	C2008 EPS	P/E
THO	\$46.75	\$3.06	15
PII	\$47.51	\$3.43	14
HOG	\$49.46	\$3.91	13
WGO	\$24.10	\$1.84	13

Our target of \$30.40 is 14x our F2009 EPS estimate. We note that THO traded at 13x forward earnings in mid-2006, so our multiple may be generous if investors perceive a longer downward trend in THO's business.

THO currently trades at an EV/EBITDA of 12, well above historical levels. At our target, the EV/EBITDA multiple would be a much more reasonable 7x at the end of F2008, even assuming FCF of \$118M. At our target, the FCF yield is 7% versus 5% today.

14. Balance sheet analysis

\$M	
Current debt	--
Current equity	766
Current tangible book value	440*
Current market value	2,618
Current cash	250*
Current DSO	21
Current DIO	24

\$M	2007a	2008e	2009e
EBIT (excluding nonrecurring items)	185	\$174	\$178
EBITDA (excl stock-based comp)	199	188	192
Surplus FCF (net income+D&A-capex)	135	118	120
Capex	14	14	14
EV/EBITDA	12	7**	6**
EV/(EBITDA-capex)	13	8**	7**

*Gives effect to \$116M special dividend paid 10/07

**At our target of \$30.40

15. Financials

\$MM	2006a	2007a	2008e	2009e
Towable RVs	2,173.5	1,890.1	1,821.7	1,786.0
Motorized RVs	577.0	565.5	576.8	588.4
RV Sales	2,750.5	2,455.6	2,398.5	2,374.4
Bus Sales	315.8	400.7	440.8	484.8
Total Revenue	3,066.3	2,856.3	2,839.2	2,859.2
Cost of Products	2,634.8	2,493.0	2,483.4	2,498.5
Sell./Gen./Admin.	183.9	177.7	181.0	183.0
Amortization	1.0	0.9	1.0	-
Total Operating Expense	2,819.7	2,671.6	2,665.4	2,681.5
Op Income	246.6	184.7	173.9	177.7
Interest Income	9.0	11.4	10.3	10.0
Interest Expense	(1.3)	(0.8)	(0.8)	(0.8)
Other, Net	1.8	1.6	0.9	0.9
Pretax Income	256.1	196.9	184.2	187.8
Taxes	92.7	62.1	66.3	67.6
Net Income After Taxes	163.4	134.8	117.9	120.2
EPS	2.87	2.41	2.12	2.17

Y-Y change	2006a	2007a	2008e	2009e
Towable RVs	25%	-13%	-4%	-2%
Motorized RVs	2%	-2.0%	2%	2%
RV Sales	19%	-11%	-2%	-1%
Bus Sales	26%	27%	10%	10%
Total Revenue	20%	-7%	-1%	1%
Cost of Products	19%	-5%	0%	1%
Sell./Gen./Admin.	21%	-3%	2%	1%
Total Operating Expense	19%	-5%	0%	1%
Op Income	35%	-25%	-6%	2%
Interest Income	186%	26%	-10%	-3%
Interest Expense	116%	-38%	9%	0%
Other, Net	-63%	-9%	-45%	0%
Pretax Income	35%	-23%	-6%	2%
Taxes	32%	-33%	7%	2%
Net Income After Taxes	37%	-18%	-13%	2%
EPS	38%	-16%	-12%	3%

% Sales	2006a	2007a	2008e	2009e
Towable RVs	71%	66%	64%	62%
Motorized RVs	19%	20%	20%	21%
RV Sales	90%	86%	84%	83%
Bus Sales	10%	14%	16%	17%
Total Revenue	100%	100%	100%	100%
Cost of Products	86%	87%	87%	87%
Sell./Gen./Admin.	6%	6%	6%	6%
Amortization	0%	0%	0%	0%
Total Operating Expense	92%	94%	94%	94%
Op Income	8%	6%	6%	6%
Interest Income	0%	0%	0%	0%
Interest Expense	0%	0%	0%	0%
Other, Net	0%	0%	0%	0%
Pretax Income	8%	7%	6%	7%
Taxes	3%	2%	2%	2%
Net Income After Taxes	5%	5%	4%	4%

	Oct-07	Jan-08	Apr-08	Jul-08	Oct-08	Jan-09	Apr-09	Jul-09
	1Q08e	2Q08e	3Q08e	4Q08e	1Q09e	2Q09e	3Q09e	4Q09e
Towable RVs	526.1	397.6	484.1	413.8	451.6	409.5	498.6	426.2
Motorized RVs	138.6	119.0	162.8	156.3	141.4	121.4	166.1	159.5
RV Sales	664.8	516.6	646.9	570.1	593.0	531.0	664.7	585.7
Bus Sales	101.0	102.8	116.6	120.4	111.1	113.0	128.2	132.5
Total Revenue	765.8	619.4	763.5	690.6	704.1	644.0	792.9	718.1
Cost of Products	668.2	544.5	672.6	598.1	621.3	567.0	695.0	615.2
Sell./Gen./Admin.	44.0	40.0	52.0	45.0	44.5	40.5	52.5	45.5
Total Op Expense	712.2	584.5	724.6	644.1	665.8	607.5	747.5	660.7
Op Income	53.6	34.9	38.9	46.5	38.4	36.5	45.5	57.5
Interest Income	2.8	2.5	2.5	2.5	2.5	2.5	2.5	2.5
Interest Expense	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)
Other, Net	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Pretax Income	56.4	37.4	41.4	49.0	40.9	39.0	48.0	60.0
Taxes	20.3	13.5	14.9	17.6	14.7	14.0	17.3	21.6
Net Income	36.1	23.9	26.5	31.4	26.2	24.9	30.7	38.4
EPS	0.65	0.43	0.48	0.56	0.47	0.45	0.56	0.70
S/O	55.9	55.8	55.7	55.6	55.5	55.4	55.3	55.2

	Oct-07	Jan-08	Apr-08	Jul-08	Oct-08	Jan-09	Apr-09	Jul-09
Y-Y change	1Q08e	2Q08e	3Q08e	4Q08e	1Q09e	2Q09e	3Q09e	4Q09e
Towable RVs	5%	6%	-8%	-16%	-14%	3%	3%	3%
Motorized RVs	2%	2%	2%	2%	2%	2%	2%	2%
RV Sales	5%	5%	-5%	-12%	-11%	3%	3%	3%
Bus Sales	10%	10%	10%	10%	10%	10%	10%	10%
Total Revenue	5%	6%	-3%	-9%	-8%	4%	4%	4%
Cost of Products	5%	4%	-2%	-7%	-7%	4%	3%	3%
Sell./Gen./Admin.	1%	7%	0%	0%	1%	1%	1%	1%
Total Op Expense	4%	4%	-2%	-7%	-7%	4%	3%	3%
Op Income	17%	47%	-24%	-27%	-28%	5%	17%	24%
Interest Income	-4%	6%	-1%	-31%	-11%	0%	0%	0%
Interest Expense	11%	31%	0%	0%	0%	0%	0%	0%
Other, Net	-60%	-31%	-57%	0%	0%	0%	0%	0%
Pretax Income	15%	42%	-23%	-28%	-28%	4%	16%	22%
Taxes	10%	68%	-19%	2%	-28%	4%	16%	22%
Net Income	18%	31%	-26%	-38%	-28%	4%	16%	22%
EPS	18%	31%	-25%	-37%	-27%	5%	17%	23%

	Oct-07	Jan-08	Apr-08	Jul-08	Oct-08	Jan-09	Apr-09	Jul-09
% Total Sales	1Q08e	2Q08e	3Q08e	4Q08e	1Q09e	2Q09e	3Q09e	4Q09e
Towable RVs	69%	64%	63%	60%	64%	64%	63%	59%
Motorized RVs	18%	19%	21%	23%	20%	19%	21%	22%
RV Sales	87%	83%	85%	83%	84%	82%	84%	82%
Bus Sales	13%	17%	15%	17%	16%	18%	16%	18%
Total Revenue	100%	100%	100%	100%	100%	100%	100%	100%
Cost of Products	87%	88%	88%	87%	88%	88%	88%	86%
Sell./Gen./Admin.	6%	6%	7%	7%	6%	6%	7%	6%
Total Op Expense	93%	94%	95%	93%	95%	94%	94%	92%
Op Income	7%	6%	5%	7%	5%	6%	6%	8%
Interest Income	0%	0%	0%	0%	0%	0%	0%	0%
Interest Expense	0%	0%	0%	0%	0%	0%	0%	0%
Other, Net	0%	0%	0%	0%	0%	0%	0%	0%
Pretax Income	7%	6%	5%	7%	6%	6%	6%	8%
Taxes	3%	2%	2%	3%	2%	2%	2%	3%
Net Income	5%	4%	3%	5%	4%	4%	4%	5%