

**cus•tom•er** (kūs'tə-mər) *n.* One that buys goods or services.

**sat•is•fac•tion** (săt'is-fāk'shən) *n.* 1.a. The gratification of a desire, need, or appetite. b. Pleasure derived from such gratification.

WORDS DEFINE US.



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## 2002 OPERATING HIGHLIGHTS

- Net sales totaled \$627.4 million.
- Net income totaled \$19.4 million.
- Earnings amounted to \$0.85 per share.
- Ended 2002 with \$69.2 million in cash and equivalents.
- Opened a net six retail superstores for a year-end total of 151.

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## WHAT IS PALM HARBOR?

All businesses try to make their strategy a reality. Our fundamental strategy has not changed. We plan to grow our Company by continuing to build an expanded base of satisfied customers. How have we been able to make this strategy a reality? We at Palm Harbor have always understood that "satisfied customers" cannot be defined in dictionary terms. We listen to the feedback from our customers -- those who purchase and live in our homes. Their opinions are what count; their opinions drive other potential customers to our retail superstores and ultimately determine our ability to give our shareholders an above-average, long-term return. In today's vernacular, it's not just talking the talk, but walking the walk. We take pride in being the nation's leading brand of multi-section manufactured homes with a vertically integrated organization, marketing principally through our own retail superstores. We love satisfying our customers, and we welcome this opportunity to relate to you some of the fundamentals that drive our business plan.

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## OPERATING HIGHLIGHTS

*Dollar amounts in thousands, except per share data*

	2001	2002
<b>Income</b>		
Net sales	\$ 650,451	\$ 627,380
Income from operations	41,424	32,853
Net income	19,829*	19,448
Net income per common share	\$ 0.87*	\$ 0.85
Weighted average number of shares	22,772	22,820
<b>Operations</b>		
Number of homes sold	10,829	9,938
Number of manufacturing facilities	15	15
Number of retail sales centers		
Company-owned	145	151
Independent	150	100
<b>Balance Sheet</b>		
Working capital	\$ 80,368	\$ 96,405
Total assets	468,368	475,168
Long-term debt	2,745	2,566
Shareholders' equity	235,652	256,657

*\* Effective April 1, 2000, the Company adjusted its method of recognizing revenue in accordance with Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements." The adjustment reduced net income for the year ended March 30, 2001 by \$2.0 million, or \$0.09 per share. Prior years have not been restated.*

*(Throughout this annual report, 1998, 1999, 2000, 2001 and 2002 are used to refer, respectively, to the Company's fiscal years that ended on the last Friday in March in those calendar periods.)*

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## ANNUAL MEETING

The annual meeting of shareholders of Palm Harbor Homes will be held at 10:00 a.m. (CDT) on June 26, 2002, at the Colonnade Conference Center; Addison, Texas. Shareholders of record as of May 13, 2002, will be entitled to vote at this meeting.

Letter To Shareholders:

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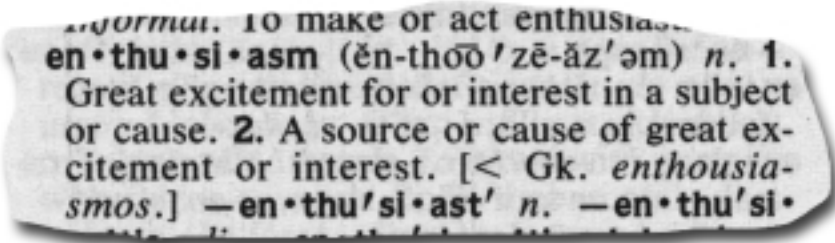
# We work hard

to translate the goals and objectives we have embraced at Palm Harbor into tangible results. Our performance for 2002, which included lower net sales and earnings, is certainly not indicative of the type of positive gains that we are seeking.

Our continued profitability and strong balance sheet may contrast favorably with the results of most other marketers of manufactured homes, but they contradict the long-term record of expansion that we have achieved – and that we expect to attain in the future.

We recognize that the variables that drive stock prices are beyond our

control, but we are still encouraged that our stock price was up 37% at the close of 2002 versus the end of 2001. Fortunately, it is not our job to comment on the relative value of our shares. We would concur, however, with those investors who are looking beyond the financial results of the past two years and seeing bright prospects for Palm Harbor. We



en•thu•si•asm (ĕn-thōō'zē-ăz'əm) n. 1. Great excitement for or interest in a subject or cause. 2. A source or cause of great excitement or interest. [*< Gk. enthousiasmos.*] —en•thu'si•ast' n. —en•thu'si•

*“It is a rarity to be witness to the extreme dedication, professionalism and overall mannerisms, which Josh and Sherif exhibited. These people represent the type of individuals that I recruit for as representatives of my own company.”*

[ Florence, Texas ]

believe that manufactured housing will continue to claim an increasingly important role in meeting the nation's ever-mounting need for new housing. Our principal focus is continuing to build profitable market share. We also plan to use our strong financial position to expand our existing operations and take advantage of other growth opportunities that match our culture and corporate strengths. This letter provides a welcome opportunity to comment on that expansion potential as well as to review the current outlook for our manufactured housing business.

Although we are not pleased with the results for 2002, we knew at the beginning of the year that it was likely to be a tough one for all builders and marketers of manufactured homes. The industry at that time faced well-above normal retail inventories of new and repossessed homes. The industry subsequently had to deal with the negative impact on consumer psychology from what proved to be the formal start of an economic recession, as well as the terrorist attacks of September 2001. Then, just as there were indications that we

**in•no•va•tion** (in'ə-vā'shən) *n.* 1. The act of innovating. 2. Something, such as a method or product, newly introduced.

*"We researched several different manufacturers. Palm Harbor is tops in customer satisfaction and the only one using decking instead of Cresdeck in the floors and 16" centers in both ceiling and walls. The house is wonderful, solid and impressive both in looks and feel. We feel very fortunate for such a quality product at such a fair price."*

[ *Sprague River, Oregon* ]

had reached the bottom in this cycle, we experienced the dual blow of a sharp curtailment in available wholesale financing industry-wide. This developed when some principal lenders exited the manufactured housing sector and legislation in Texas made financing substantially more complicated for many of our customers. These developments during fiscal 2002 combined to intensify the competition for the customers that Palm Harbor has traditionally targeted; namely, more credit-worthy homebuyers.

Those familiar with the manufactured housing market understand the rapid slowdown in sales that developed in early 2000. Easy credit for consumers ended, and the industry found itself with lower retail demand and a record high supply of repossessed homes that, of course, added even more pressure on retail sales. The situation was aggravated further by the ensuing economic recession in 2001, which resulted in at least a 30% contraction in manufacturing capacity and most likely a comparable decline in retail sales centers. Those expecting the path to recovery to be akin to a

cyclical “v” have been disappointed. The industry-wide statistics in the spring of 2002 still do not conform to a clearly visible upward trend. Today, the bottom line is that while there are encouraging indicators about the resiliency and relatively high level of consumer confidence in the United States, our business remains highly competitive, credit driven and difficult to forecast.

Although current conditions do not support a specific forecast for our results over the immediate quarters ahead, we strongly believe that the market now is playing to our strengths more than ever. We continue to manufacture almost entirely only to solid orders, enabling us during 2002 to lower our average receivables and inventories per retail superstore by 9%. We also remain focused on credit-worthy customers who know they are in the driver’s seat these days and want a customized home that meets their specific needs. A management team that has experienced the prior industry-wide slowdowns inherent to the housing business is one of our core assets. We know that our obsession with exceeding our homeowners’

expectations builds market share, especially during periods when other companies are forced to cut back their manufacturing capacity and services. Our vertically integrated business model gives us more control over the entire distribution chain for our homes, including financing and insurance. For 2002, these operations provided 31% of our net income, up from 20% only three years ago. The visibility of that income enhances our financial picture, further reinforcing our ability to use this period to enhance our basic competitive position.

And we are moving ahead. We opened eleven retail superstores during fiscal 2002, while closing five. At fiscal year end, we operated 151 retail superstores -- almost triple the 54 retail superstores we had six years ago. We plan to continue opening retail superstores and taking advantage of opportunities that others are having to forego because of limited access to capital and an infrastructure that will not provide the personnel and systems for expansion. During 2002, we took advantage of continuing to invest in a comprehensive advertising and

**sat • is • fac • tion** (săt'is-făk'shən) *n.* **1.a.** The gratification of a desire, need, or appetite. **b.** Pleasure derived from such gratification.

*"After writing for your brochure, I visited the Plant City factory and saw the quality of your construction. The house was exactly what I ordered and has excellent workmanship with attention to every detail. What an organization you have put together. Please encourage any potential buyers to contact me."*

[ *Plant City, Florida* ]

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*syns: branch, arm, fork, offshoot. in*  
**brand** (bränd) *n.* 1.a. A trademark or distinctive name identifying a product or manufacturer. b. A product line so identified. c. A distinctive kind.

*“Palm Harbor stands for durability and the staying power of its homes. We have always been 100% satisfied with our home and our decision to purchase from Palm Harbor.”*

[ *Sweeny, Texas* ]

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marketing campaign to promote the qualities that distinguish Palm Harbor. In fact, we increased our spending by as much as 25% in certain media to capitalize on the almost absent spending by other brands. We know that having a strong brand matters and that a reputation is really built by “promises made and promises kept.” We see our current results as a temporary pause in our long-term record of growth and know that our efforts to broaden our foundation are going to pay significant dividends for us in the future.

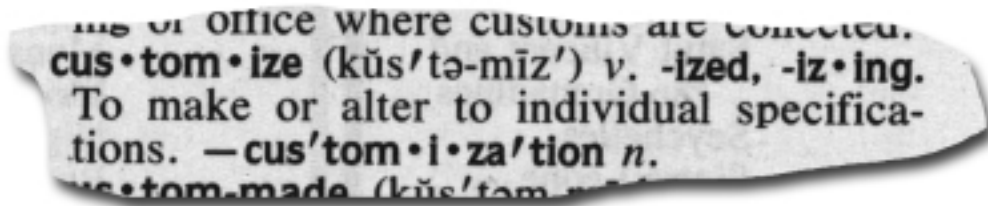
Within our fundamental objective of exceeding our customers’ expectations, we embrace the value of a continuing improvement process and are always seeking to capitalize on ways to enhance our competitiveness. We believe the industry-wide restrictions that have been imposed on financing, including the changes in Texas that are forcing buyers to use more complicated, conventional mortgage financing to purchase homes, provide an opportunity for Palm Harbor to distinguish our brand further. Shortly after the close of fiscal 2002,

we executed a letter of intent to become the sole limited partner of a well-established mortgage banking company. Our goal in this partnership will be to assist our customers in obtaining financing on attractive terms while continuing to build shareholder value.

Although we are confident about the outlook for manufactured housing, we have been considering a number of other opportunities that would add to our earnings. We are seeking acquisitions where we share a similar culture. We seek to develop a “win-win” proposition, affording the

acquisition candidates the capital resources to execute a controlled growth strategy and rewarding Palm Harbor shareholders with an accretive acquisition that will provide a solid return on invested capital. We have always maintained very high criteria for acquisitions and expect incremental gains from any investment or acquisition.

Our goals for 2003 are listed below. They may sound familiar to those who know Palm Harbor, but the reason for that similarity is because our business strategy does not need to be changed. We have the



*“The house Palm Harbor is building for us will be about 3,000 square feet, including a solarium! We’re repeat customers because of the quality of Palm Harbor’s homes. Please remind everyone in your company that a repeat customer is a reality.”*

[ *Dechutes River, Oregon* ]

good fortune to be in an industry that has solid fundamentals, and we have a business model that works. At the risk of being repetitious, here are our objectives for the year ahead:

- *Continue exceeding our customers' expectations.*
- *Continue expanding our network of retail superstores.*
- *Increase inventory turn rates at retail.*
- *Build the prominence of the Palm Harbor brand through targeted advertising.*
- *Continue training our team to strengthen our intellectual capital and marketing prowess.*
- *Successfully integrate any acquisitions into our corporate structure.*
- *Sustain a strong, liquid balance sheet.*
- *Expand financing resources for our customers.*

Expressing goals such as these help shape our actions. The secret to our continuing corporate success, however, is not how we express our intentions but how we execute them. We believe it is important to have a well-stated corporate culture, but the

test is what each member of the Palm Harbor team does each day to build competitive excellence. We get paid for the results we produce; not the work we do. We are enthusiastic about our business and our prospects. We know what we need to do and how to do it.

Sincerely,



Lee Posey  
CHAIRMAN OF THE BOARD



Larry H. Keener  
PRESIDENT AND CHIEF EXECUTIVE OFFICER



Kelly Tacke  
VICE PRESIDENT-FINANCE,  
CHIEF FINANCIAL OFFICER AND  
CORPORATE SECRETARY

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DIRECTORS

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Larry H. Keener  
*President and Chief Executive Officer*  
*Palm Harbor Homes, Inc.*

Lee Posey  
*Chairman of the Board*  
*Palm Harbor Homes, Inc.*

William R. Thomas <sup>(2)</sup>  
*Chairman and President,*  
*Capital Southwest*  
*(venture capital)*

Jerry D. Mallonee <sup>(1)</sup>  
*(private investments)*

Walter D. Rosenberg  
*(private investments)*

John H. Wilson <sup>(1)</sup>  
*President,*  
*U.S. Equity Corporation*  
*(venture capital)*

Frederick R. Meyer <sup>(1)(2)</sup>  
*Chairman of the Board,*  
*Aladdin Industries, Inc.*  
*(a diversified manufacturer)*

A. Gary Shilling <sup>(1)</sup>  
*President,*  
*A. Gary Shilling & Co., Inc.*  
*(economic consulting)*

<sup>(1)</sup> Member of Audit Committee  
<sup>(2)</sup> Member of Compensation Committee

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EXECUTIVE OFFICERS

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Lee Posey  
*Chairman of the Board*

Larry H. Keener  
*President and Chief Executive Officer*

Kelly Tacke  
*Vice President-Finance,*  
*Chief Financial Officer and*  
*Corporate Secretary*

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THE PALM HARBOR TEAM

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John Abel	Austin Cameron	James Gildon	Bill Kotylo	Ted Norris	Joe Stan
Billy Abel	Shawn Chew	Richard Gingrich	Richard Krebs	Steve O'Brien	Edward Steele
Michael Adams	Terry Christian	Mike Glaser	John Kuhn	Richard Peck	George Stevens
Keith Alexander	Jack Coffey	Dan Goodin	Gary Lambert	Gregory Peet	Mark Stocksdale
Brent Alford	David Conway	Bryan Grace	Tim Large	Joe Pequignot	Karen Strickler
Billy Alt	Donny Corum	Jason Grace	Bob Leffew	Tim Pequignot	Rex Swartz
Doug Anderson	John Costanzi	Gary Graham	Kirby Leggett	Felix Petteway	Kelly Tacke
Brian Andrews	Rodney Dalton	Heather Grasseth	John Lyons	Stuart Pikoff	David Thomasson
Stephen Anzaldúa	David Davidson	John Greenleaf	Tim Mace	Joe Poole	Carey Tonovitz
Jim Appelbaum	Nils Dekau	Richard Griffin	Kendall Magruder	Charles Posey	Cristian Trebucq
Craig Austin	Brad Depugh	Michael Gwaltney	Maury Marek	Lee Posey	J. R. Tredway
Brad Babel	Kyesha Diver	David Harris	Russ Martin	Ron Powell	Chris Turturro
Sandi Baker	Rick D'Olimpio	William Heck	John May	Tom Pratt	Tom Underwood
Jamie Baker	Wayne Donnelly	Jerry Helm	Tom McBride	Ken Rarick	Dan Vance
Donna Baker	James Dorris	Scott Hicks	Brent McCarver	Matt Ratliff	Cindy Vann
Jim Barlow	Jim Dortch	Irv Hill	Greg McCullough	Chris Reid	Jeff Violette
Forrest Barnes	Vernal Douglas	Rick Hilpipre	Howard McGirt	Tom Renner	Kenny Wallace
Derek Barnhill	Sean Downing	Steve Hines	Allen McKemie	Jimmy Rodgers	Danny Warrick
Chris Baumeister	Mike Draper	Jane Holcomb	Trey Melchor	Bryan Rogers	Tony Watson
Dennis Beck	Bob Dutton	Peter Huizar	Chad Melin	Colleen Rogers	Jack Weeks
Woody Bell	Ron Elrod	Calvin James	Josh Miller	Leo Roze	Paul Wiest
Jeff Benoist	Frank Emmerich	Kenneth Johnson	Robbie Miller	Ralph Russell	David Witherspoon
Brian Berkenbile	Doug Eudy	Blake Johnson	Dwayne Miller	Gavin Ryan	Mike Wnek
Ted Bernados	David Evans	Michael Johnson	James Mills	Jim Sabol	Bill Wright
John Black	Gene Fahey	Charlie Jourdan	Larry Mitchell	Hazem Sadek	Bob Wright
Joseph Blade	Donald Fancher	Larry Keener	Heather Mitchell	Steve Samford	Marge Wright
Dallas Boggs	Chris Finke	Bobby Kennedy	Emmett Moore	Mike Sanders	Jerry Young
Rick Boles	Kevin Fisher	Bert Kessler	Marvin Moore	Mike Schmitzer	Mark Zeller
H. M. Boswell	Barry Forrest	Joe Kesterson	Brendan Morris	Shawn Sexton	Don Ziebarth
Ralph Brock	Steve Garcia	Tom Kesterson	Carolyn Murdock	Chris Shea	
Howard Broughton	Pat Garrett	Frank Kirsch	Brent Needleman	Reggie Shropshire	
Mike Bueker	Jeff Gelner	Casper Koble	James Newsome	Juanita Smith	
Dean Cade	Steve Gibbs	Marc Kopish	Matt Nino	Carl Smoller	

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CORPORATE INFORMATION

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**Corporate Address**

15303 Dallas Parkway  
Suite 800  
Addison, Texas 75001-4600

Telephone: (972) 991-2422  
Fax: (972) 991-5949

**Internet Address**

<http://www.palmharbor.com>

**Registrar and Transfer Agent**

American Stock Transfer  
46th Floor  
40 Wall Street  
New York, NY 10005

Inquiries regarding stock transfers,  
lost certificates or address changes  
should be directed to the transfer  
agent at the above address.

**Auditors**

Ernst & Young LLP  
Dallas, Texas

**Legal Counsel**

Locke Liddell & Sapp LLP  
Dallas, Texas

**Form 10-K and Quarterly  
Reports/Investor Contact**

The Form 10-K Annual Report of  
Palm Harbor Homes, Inc., as filed  
with the Securities and Exchange  
Commission may be accessed  
electronically on the Internet at  
<http://www.palmharbor.com>. This  
information is also available  
without charge to shareholders  
upon written request. Shareholders  
may also obtain copies of the  
corporate news releases issued in  
conjunction with the Company's  
quarterly results. These requests  
and other investor contacts should  
be directed to Colleen Rogers,  
Investor Relations Manager, at the  
corporate address.

**Nasdaq Symbol**

The Company's common stock is  
traded on The Nasdaq Stock  
Market (National Market) under  
the symbol PHHM.

**Market Prices and Dividend  
Information**

The prices in the table below  
represent the high and low sales  
prices for Palm Harbor Homes,  
Inc. common stock for the past two  
years. No cash dividends have been  
declared, and plans for the  
foreseeable future are to retain  
future earnings to support  
operations and finance the  
Company's expansion. As of  
March 29, 2002, Palm Harbor  
Homes had approximately 3,000  
shareholders based on the number  
of holders of record and an estimate  
of the number of individual  
participants represented by security  
position listings.

2002	High	Low
First Quarter	\$ 24.12	\$ 15.00
Second Quarter	\$ 26.99	\$ 16.90
Third Quarter	\$ 25.00	\$ 18.20
Fourth Quarter	\$ 24.55	\$ 20.44

2001	High	Low
First Quarter	\$ 16.75	\$ 13.25
Second Quarter	\$ 14.81	\$ 13.13
Third Quarter	\$ 17.00	\$ 12.38
Fourth Quarter	\$ 20.56	\$ 14.88

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**SECURITIES AND EXCHANGE COMMISSION**  
Washington, DC 20549

**FORM 10-K**

**FOR ANNUAL AND TRANSITION REPORTS PURSUANT TO SECTIONS 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934**

(Mark One)

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

For the fiscal year ended March 29, 2002

OR

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

For the transition period from \_\_\_\_ to \_\_\_\_

Commission File Number 0-24268

**PALM HARBOR HOMES, INC.**

(Exact name of registrant as specified in our charter)

**Florida**

(State or other jurisdiction of  
incorporation or organization)

**59-1036634**

(I.R.S. Employer identification no.)

**15303 Dallas Parkway, Suite 800, Addison, Texas**

(Address of principal executive offices)

**75001**

(Zip Code)

Registrant's telephone number, including area code: (972) 991-2422

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT: None

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:

**Common Stock, par value \$0.01 per share**

(Title of Class)

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [  ]

The aggregate market value of the registrant's Common Stock held by non-affiliates of the registrant as of May 13, 2002, was \$233,069,447 based on the closing price on that date of the Common Stock as quoted on the Nasdaq National Stock Market.

As of May 13, 2002, 22,949,372 shares of the registrant's Common Stock were issued and outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's Proxy Statement relating to our Annual Meeting of Shareholders to be held June 26, 2002 are incorporated by reference in Part III.

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## **PART I.**

### **Item 1. Business**

#### **General**

Palm Harbor Homes, Inc. is one of the largest producers of multi-section manufactured homes in the United States. Palm Harbor's operations are vertically integrated and encompass manufacturing, marketing, financing and insurance. At March 29, 2002, Palm Harbor operated 15 manufacturing facilities that sell homes in 28 states through 151 Company-owned retail superstores and approximately 100 independent retail sales centers.

At March 29, 2002, the Company-owned retail superstores operated in Alabama, Arizona, Arkansas, Colorado, Florida, Georgia, Indiana, Kentucky, Louisiana, Nevada, New Mexico, North Carolina, Ohio, Oklahoma, Oregon, South Carolina, Tennessee, Texas, Virginia and Washington. With a net increase of six superstores in fiscal 2002, Palm Harbor continued its long-term plan of increasing sales through Company-owned superstores. With this increase in Company-owned superstores, Palm Harbor maintained a high internalization rate – which is the percent of homes manufactured by Palm Harbor and sold through Company-owned retail superstores. Palm Harbor's internalization rate was 83% in both fiscal 2001 and fiscal 2002. Through our subsidiary, CountryPlace Mortgage, Ltd. ("CountryPlace"), Palm Harbor offers installment financing to purchasers of manufactured homes sold by Company-owned retail superstores. Palm Harbor provides property and casualty insurance for owners of manufactured homes through our subsidiary, Standard Casualty Company. Management of Palm Harbor believes that having the internal capability to provide financing and insurance complements our manufacturing and marketing operations and has been additive to earnings.

#### **Products**

Palm Harbor manufactures single and multi-section homes under various brand names including Palm Harbor, Masterpiece, Keystone, CountryPlace, River Bend and Windsor Homes™. Palm Harbor offers over 150 floor plans and approximately 90% of the homes produced by Palm Harbor are structurally or decoratively customized to the home buyer's specifications. Although Palm Harbor produces a wide retail price range of homes, the average retail sales price (excluding land) of Palm Harbor's homes is approximately \$60,000 and approximately 92% of Palm Harbor's homes are multi-section.

A typical home built by Palm Harbor contains two to five bedrooms, a living room, family room, dining room, kitchen, two or three bathrooms and features central heating, a range, refrigerator, carpeting and drapes. In addition, Palm Harbor offers optional amenities, including dishwashers, washers, dryers, furniture packages and specialty cabinets, as well as a wide range of colors, moldings and finishes. Optional features usually associated with site-built homes such as stone fireplaces, computer rooms, skylights, vaulted ceilings and whirlpool baths are also offered. Palm Harbor has a unique package of energy saving construction features referred to as "EnerGmiser™" which includes, among other things, additional insulation to reduce heating and cooling costs, and which exceeds statutorily-mandated energy efficiency levels.

Palm Harbor's homes are designed and copyrighted after extensive field research and consumer feedback. Palm Harbor has developed engineering systems which, through the use of computer-aided technology, permit customization of homes and assist with product development and enhancement.

#### **Manufacturing Operations**

Palm Harbor currently owns or leases 15 facilities located in Alabama, Arizona, Florida, Georgia, North Carolina, Ohio, Oregon and Texas. A typical Palm Harbor manufacturing facility has approximately 100,000 square feet of floor space and employs approximately 190 associates.

Palm Harbor's facilities generally operate on a one shift per day, five days per week basis, and Palm Harbor currently manufactures a typical home in approximately five days. Palm Harbor's facilities have the capacity to produce an aggregate of approximately 142 sections per day. The current rate of production is 53 sections per day.

The following table sets forth the total sections produced and homes sold, as well as the number of manufacturing facilities operated by Palm Harbor, for the fiscal years indicated:

	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>
Homes sold:					
Single-section .....	2,687	3,474	2,862	2,166	1,473
Multi-section.....	<u>11,457</u>	<u>12,154</u>	<u>11,439</u>	<u>8,663</u>	<u>8,465</u>
Total homes sold .....	<u>14,144</u>	<u>15,628</u>	<u>14,301</u>	<u>10,829</u>	<u>9,938</u>
Sections produced .....	26,014	27,380	25,237	19,911	18,951
Operating manufacturing facilities (at end of fiscal year)...	16	16	15	15	15

The finished homes are transported by independent trucking companies to either the retail sales center or the customer's site. The transportation cost is borne by the independent retailer. Retailers or other independent installers are responsible for placing the home on site, making utility hook-ups and, in certain instances, providing installation and finish-out services. The industry practice is to have third parties hired by the retailer provide the installation and finish-out services. Palm Harbor's associates, rather than independent third parties, perform the finish out services on homes sold through Company-owned retail superstores. Palm Harbor believes our finish-out services ensure that Palm Harbor quality is applied during the entire process and increase customer satisfaction, thereby providing Palm Harbor an advantage over many of our competitors.

Palm Harbor's backlog of orders as of May 13, 2002 was approximately \$3.0 million, as compared to approximately \$9.0 million as of May 14, 2001. Since retailers may cancel orders prior to production without penalty, Palm Harbor does not consider our order backlog to be firm orders; however, such cancellations rarely occur. Because of the seasonality of the housing market, the level of backlog generally declines during the winter months.

The principal materials used in the production of Palm Harbor's homes include wood, wood products, gypsum wallboard, steel, fiberglass insulation, carpet, vinyl, fasteners, appliances, electrical items, windows and doors. Palm Harbor believes that the materials used in the production of our homes are readily available at competitive prices from a wide variety of suppliers. The three suppliers which accounted for more than 5% of Palm Harbor's total purchases during the fiscal year ended March 29, 2002, represented only 9.7%, 6.8% and 5.6%, respectively, of our total purchases during fiscal year 2002. Accordingly, Palm Harbor does not believe that the loss of any single supplier would have a material adverse effect on our business.

## Retail Operations

Palm Harbor's homes are sold through a distribution network consisting of superstores owned by Palm Harbor and independent retailers. The following table sets forth the number of homes sold by Palm Harbor through each of these distribution channels, as well as the number of Company-owned retail superstores and independent retail sales centers, during the past three fiscal years:

	<b>March 31, 2000</b>	<b>March 30, 2001</b>	<b>March 29, 2002</b>
Homes sold by:			
Company-owned superstores .....	11,078	9,012	8,298
Independent retailers .....	<u>3,223</u>	<u>1,817</u>	<u>1,640</u>
Total .....	<u>14,301</u>	<u>10,829</u>	<u>9,938</u>
Number of:			
Company-owned superstores .....	133	145	151
Independent retailers .....	<u>200</u>	<u>150</u>	<u>100</u>
Total .....	<u>333</u>	<u>295</u>	<u>251</u>

Palm Harbor first established wholly-owned superstores in 1992, and currently has 151 superstores in Alabama, Arizona, Arkansas, Colorado, Florida, Georgia, Indiana, Kentucky, Louisiana, Nevada, New Mexico, North Carolina, Ohio, Oklahoma, Oregon, South Carolina, Tennessee, Texas, Virginia and Washington. Palm Harbor plans to add additional retail superstores in fiscal 2003.

Palm Harbor's independent retailer network principally consists of local retailers, developers that market land/home packages and developers of retirement lifestyle communities. The decrease in Palm Harbor's independent retailer network over the last two fiscal years is the result of the highly competitive environment in the manufactured housing industry coupled with the increase in Company-owned superstores. No single independent retailer accounted for 5% or more of Palm Harbor's net sales during fiscal 2002. Palm Harbor provides comprehensive sales training to our retail sales associates and brings them to the manufacturing facilities for product training and to view new product designs as they are developed. These training seminars, known as "Palm Harbor University", facilitate the sale of Palm Harbor's homes by increasing the skill and knowledge of the retail sales consultants. In addition, Palm Harbor displays our products in trade shows and supports our retailers through the distribution of floor plan literature, brochures, decor boards, banners and videos.

## Markets Served

Management believes that Palm Harbor's broad geographic presence lessens the impact of adverse economic trends specific to any one region, while at the same time enabling Palm Harbor to capitalize on favorable regional economic trends. During the fiscal year ended March 29, 2002, the percentage of Palm Harbor's revenues by region was as follows:

<b>Region</b>	<b>Primary States</b>	<b>Percentage of Revenue by Region</b>
Southeast	Florida, North Carolina, Alabama, Georgia, South Carolina, Mississippi, Tennessee, Virginia, West Virginia	32 %
Central	Texas, Oklahoma, Arkansas, Louisiana, Kansas	39
West	New Mexico, Arizona, California, Colorado, Oregon, Washington, Montana, Nevada, Utah, Wyoming	21
Midwest	Ohio, Michigan, Indiana, Kentucky, Illinois	<u>8</u>
		<u>100 %</u>

Manufactured housing is a regional business and the primary geographic market for a typical manufacturing facility is within a 250-mile radius. Each of Palm Harbor's manufacturing facilities typically serves 20 to 65 retailers, and the facility sales staff maintains personal contact with each retailer, whether Company-owned or independent. Palm Harbor's decentralized operations allow us to be more responsive in addressing regional customer preferences of product innovation and home design.

### **Consumer Financing**

Historically, Palm Harbor has facilitated retail sales of our homes by maintaining relationships with conventional lenders. Conventional lenders provide two basic types of consumer financing in the manufactured housing industry: chattel or personal property loans for purchasers of a home with no real estate involved and land/home or mortgage loans which finance the land, home and all improvements on the property. There are two types of mortgage loans – conforming and non-conforming. Conforming loans conform to FHA, VA, Freddie Mac and Fannie Mae. Generally, the type of required foundations installed conform to Federal requirements and the borrower must meet certain criteria. Non-conforming loans are financed by a major bank or lending institution which does not require a specific foundation type and have more flexible criteria. Effective January 1, 2002, Texas House Bill 1869 was implemented. This bill requires all manufactured houses in Texas, which are not placed in manufactured home rental communities, to be financed with mortgage loans versus chattel loans. With the introduction of Texas House Bill 1869, Palm Harbor expects to experience a growing shift in financing toward conforming loans.

While Palm Harbor intends to maintain these relationships with conventional lenders, we believe that our ability to provide financing to our customers on competitive terms only improves our responsiveness to the financing needs of prospective purchasers and provides an additional source of earnings for Palm Harbor. Through CountryPlace, Palm Harbor offers customary chattel loans and land/home or mortgage loans to best suit the needs of our retail customers. Financing services by CountryPlace are currently being offered only through Company-owned retail superstores.

Loan applications originate at the Company-owned retail superstore and are forwarded to CountryPlace for final credit approval. CountryPlace then sells the approved loan contracts to one of three national consumer finance companies. CountryPlace and the national consumer finance companies share on a predetermined basis the interest income on all loan contracts. In some cases, CountryPlace shares in losses resulting from defaults or prepayments on loan contracts previously sold. One of the three finance companies is Associates Housing Finance which announced in January 2000 that they would be discontinuing retail and floor plan financing for the manufactured housing industry. Palm Harbor's contract with the Associates expired on March 31, 2002. Consumer loan contracts have been redirected to the remaining financing companies and/or to new finance companies as agreements are negotiated. See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations."

Retail installment loans sold by CountryPlace are serviced and administered by the national consumer finance companies. CountryPlace's share of the interest income is in consideration for the following services provided by CountryPlace: (i) contract origination services, including the training of retailers with respect to the loan evaluation process; (ii) receipt and processing of the retail installment sale contracts; (iii) collection assistance with delinquent accounts, upon the request of the finance company and (iv) repossession assistance.

## Financing

In accordance with manufactured housing industry practice, substantially all retailers finance a portion of their purchases of manufactured homes through wholesale "floor plan" financing arrangements. Under a typical floor plan financing arrangement, a financial institution provides the retailer with a loan for the purchase price of the home and maintains a security interest in the home as collateral. The financial institution which provides financing to the retailer customarily requires Palm Harbor to enter into a separate repurchase agreement with the financial institution under which Palm Harbor is obligated, upon default by the retailer and under certain other circumstances, to repurchase the financed home at declining prices over the term of the repurchase agreement (which generally ranges from 12 to 18 months). The price at which Palm Harbor may be obligated to repurchase a home under these agreements is based upon Palm Harbor's original invoice price plus certain administrative and shipping expenses. Palm Harbor's obligation under these repurchase agreements ceases upon the purchase of the home by the retail customer.

The risk of loss under such repurchase agreements is mitigated by the fact that (i) only 17% of Palm Harbor's homes are sold to independent retailers; (ii) a majority of the homes sold by Palm Harbor to independent retailers are pre-sold to specific retail customers; (iii) Palm Harbor monitors each retailer's inventory position on a regular basis; (iv) sales of Palm Harbor's manufactured homes are spread over a large number of retailers; (v) none of Palm Harbor's independent retailers accounted for more than 5% of Palm Harbor's net sales in fiscal 2002; (vi) the price Palm Harbor is obligated to pay declines over time and (vii) Palm Harbor is, in most cases, able to resell homes repurchased from credit sources in the ordinary course of business without incurring significant losses. Palm Harbor estimates that our potential obligations under such repurchase agreements were approximately \$13.8 million as of March 29, 2002. During the fiscal years ended March 31, 2000, March 30, 2001 and March 29, 2002, net expenses incurred by Palm Harbor under these repurchase agreements totaled \$155,000, \$132,000 and \$212,000, respectively.

Beginning in fiscal 2000, lenient credit standards, which had facilitated increased industry-wide wholesale shipments in previous years, tightened, resulting in declining wholesale shipments, declining margins and lower retail sales levels for most industry participants. At the end of fiscal 2002, additional issues arose in the manufactured housing industry. In March 2002, the largest floor plan lender in the industry, Conseco Finance Servicing Corp. ("Conseco"), announced that they were exiting the wholesale financing, or floor plan lending, business. Our agreement with Conseco, which totals \$15.0 million, will be cancelled on June 30, 2002. In anticipation of such cancellation, we obtained an additional \$30.0 million of floor plan financing during the fourth quarter of fiscal 2002. As of May 9, 2002, Palm Harbor had floor plan borrowings of \$11.4 million with Conseco and we had receivables due from Conseco of approximately \$10.2 million. We believe amounts due from Conseco will be collected in the normal course of business and Palm Harbor will not incur significant losses as the result of doing business with Conseco.

On May 16, 2002, Conseco indicated its commitment to continue to provide retail financing; however, they also began notifying manufacturers and independent retailers that amounts due under floor plan financing agreements were to be paid in full on or prior to July 17, 2002. However, Conseco also indicated in the notification that certain options would be made available to the retailers. Palm Harbor has contacted our independent retailers where we have repurchase obligations regarding the impact of this cancellation on their floor plan financing needs. The majority of these retailers have made other arrangements for their financing needs.

Additionally, the introduction of Texas House Bill 1869 in January 2002 presented another issue to the industry. This bill requires all manufactured houses in Texas, which are not placed in manufactured home rental communities, to be financed with conforming mortgages. Conforming mortgages are subject to higher credit standards than chattel loans and therefore this new regulation may cause certain consumers who would have otherwise qualified for financing under a chattel loan to not qualify under a conforming loan.

## **Competition**

The manufactured housing industry is highly competitive at both the manufacturing and retail levels, with competition based upon several factors, including price, product features, reputation for service and quality, depth of field inventory, promotion, merchandising and the terms of retail customer financing. In addition, manufactured homes compete with new and existing site-built homes, as well as apartments, townhouses and condominiums. Palm Harbor does not view any of our competitors as being dominant in the industry, although some of Palm Harbor's competitors possess substantially greater manufacturing, distribution and marketing resources than Palm Harbor.

## **Government Regulation**

Palm Harbor's manufactured homes are subject to a number of federal, state and local laws, codes and regulations. Construction of manufactured housing is governed by the National Manufactured Housing Construction and Safety Standards Act of 1974, as amended (the "Home Construction Act"). In 1976, the Department of Housing and Urban Development ("HUD") issued regulations under the Home Construction Act establishing comprehensive national construction standards. The HUD regulations, known collectively as the Federal Manufactured Home Construction and Safety Standards, cover all aspects of manufactured home construction, including structural integrity, fire safety, wind loads, thermal protection and ventilation. Such regulations preempt conflicting state and local regulations on such matters, and are subject to continual change. Palm Harbor's manufacturing facilities and the plans and specifications of our manufactured homes have been approved by a HUD-certified inspection agency. Further, an independent HUD-certified third-party inspector regularly reviews Palm Harbor's manufactured homes for compliance with the HUD regulations during construction. Failure to comply with applicable HUD regulations could expose Palm Harbor to a wide variety of sanctions, including mandated closings of Palm Harbor manufacturing facilities. Palm Harbor believes our manufactured homes meet or surpass all present HUD requirements.

Manufactured and site-built homes are all typically built with paneling and other products that contain formaldehyde resins. Since February 1985, HUD has regulated the allowable concentrations of formaldehyde in certain products used in manufactured homes and requires manufacturers to warn purchasers as to formaldehyde-associated risks. The Environmental Protection Agency (the "EPA") and other governmental agencies have in the past evaluated the effects of formaldehyde. Palm Harbor uses materials in our manufactured homes that meet HUD standards for formaldehyde emissions and believes we comply with HUD and other applicable government regulations in this regard.

The transportation of manufactured homes on highways is subject to regulation by various federal, state and local authorities. Such regulations may prescribe size and road use limitations and impose lower than normal speed limits and various other requirements.

Palm Harbor's manufactured homes are subject to local zoning and housing regulations. In certain cities and counties in areas where Palm Harbor's homes are sold, local governmental ordinances and regulations have been enacted which restrict the placement of manufactured homes on privately-owned land or which require the placement of manufactured homes in manufactured home communities. Such ordinances and regulations may adversely affect Palm Harbor's ability to sell homes for installation in communities where they are in effect. A number of states have adopted procedures governing the installation of manufactured homes. Utility connections are subject to state and local regulation and must be complied with by the retailer or other person installing the home.

Certain Palm Harbor warranties may be subject to the Magnuson-Moss Warranty Federal Trade Commission Improvement Act, which regulates the descriptions of warranties on products. The description and substance of Palm Harbor's warranties are also subject to a variety of state laws and regulations. A number of states require manufactured home producers to post bonds to ensure the satisfaction of consumer warranty claims.

A variety of laws affect the financing of the homes manufactured by Palm Harbor. The Federal Consumer Credit Protection Act (Truth-in-Lending) and Regulation Z promulgated thereunder require written disclosure of

information relating to such financing, including the amount of the annual percentage rate and the finance charge. The Federal Fair Credit Reporting Act also requires certain disclosures to potential customers concerning credit information used as a basis to deny credit. The Federal Equal Credit Opportunity Act and Regulation B promulgated thereunder prohibit discrimination against any credit applicant based on certain specified grounds. The Real Estate Settlement Procedures Act and Regulation X promulgated thereunder require certain disclosures regarding the nature and costs of real estate settlements. The Federal Trade Commission has adopted or proposed various Trade Regulation Rules dealing with unfair credit and collection practices and the preservation of consumers' claims and defenses. Installment sales contracts eligible for inclusion in a Government National Mortgage Association program are subject to the credit underwriting requirements of the Federal Housing Association. Manufactured homes in Texas that are not to be placed in a manufactured home rental community are subject to Texas House Bill 1869, which requires them to be financed with a conforming mortgage. A variety of state laws also regulate the form of the installment sale contracts or financing documents and the allowable deposits, finance charge and fees chargeable pursuant to installment sale contracts or financing documents. The sale of insurance products by Palm Harbor is subject to various state insurance laws and regulations which govern allowable charges and other insurance practices.

Palm Harbor's operations are also subject to federal, state and local laws and regulations relating to the generation, storage, handling, emission, transportation and discharge of materials into the environment. Governmental authorities have the power to enforce compliance with their regulations, and violations may result in the payment of fines, the entry of injunctions or both. The requirements of such laws and enforcement policies have generally become more strict in recent years. Accordingly, Palm Harbor is unable to predict the ultimate cost of compliance with environmental laws and enforcement policies. See "Item 3. Legal Proceedings."

#### **Associates**

As of March 29, 2002, Palm Harbor had approximately 4,300 associates. All of Palm Harbor's associates are non-union. Palm Harbor has not experienced any labor-related work stoppages and believes that our relationship with our associates is good.

## Item 2. Properties

Palm Harbor currently owns or leases 15 manufacturing facilities in eight states. Palm Harbor owns substantially all of our machinery and equipment. Palm Harbor believes our facilities are adequately maintained and suitable for the purposes for which they are used. The following table sets forth certain information with respect to Palm Harbor's manufacturing facilities:

<u>State</u>	<u>City</u>	<u>Commencement of Production</u>	<u>Owned/Leased</u>	<u>Approximate Square Feet</u>
Alabama	Boaz	December 1986	Leased	97,683
		January 1993	Leased	75,164
Arizona	Tempe	January 1978	Owned	103,500
	Casa Grande	July 1997	Owned	90,000
Florida	Plant City	September 1981	Owned	93,600
		June 1985	Owned	87,200
Georgia	LaGrange	August 1996	Owned	200,000
North Carolina	Albemarle	January 1994	Owned	112,700
	Siler City	January 1988	Owned	91,200
		July 1996	Leased	40,000
Ohio	Sabina	January 1988	Owned	85,000
Oregon	Millersburg	April 1995	Owned	168,650
Texas	Austin	January 1981	Owned	103,800
		April 1992	Owned	77,000
	Burleson	June 1993	Owned	94,300
	Fort Worth	April 1993	Owned	121,300
	Buda	November 1994	Owned	88,275

In addition to our production facilities, Palm Harbor owns certain properties upon which 42 of our Company-owned retail superstores are located. Palm Harbor also leases approximately 30,000 square feet of office space in Addison, Texas for our corporate headquarters and CountryPlace's office. Palm Harbor's corporate headquarters lease expires in 2003 and the CountryPlace office lease expires in 2002. Effective January 1, 2003, Palm Harbor will obtain an additional 18,000 square feet of office space and CountryPlace will move to the corporate headquarters office space. This lease will expire in 2013.

## Item 3. Legal Proceedings

Palm Harbor is not currently subject to any pending or threatened litigation, other than routine litigation arising in the ordinary course of business, none of which is expected to have a material adverse effect on the business, financial condition or results of operations of Palm Harbor.

In late 1992, Palm Harbor removed an underground storage tank formerly used to store gasoline from the site of our Tempe, Arizona manufacturing facility. Palm Harbor is currently working in cooperation with the Arizona Department of Environmental Quality to assess and respond to gasoline related hydrocarbons detected in soil and groundwater at this site. Under certain circumstances, a state fund may be available to compensate responsible parties for petroleum releases from underground storage tanks. Palm Harbor is evaluating the extent of

the corrective action that may be necessary. Site characterization is complicated by the presence of contaminants associated with the Indian Bend Wash Area Superfund Site described below. At this time, Palm Harbor does not expect that the costs of any corrective action or assessments related to the tank will have a material adverse effect on our results of operations or financial condition.

Palm Harbor's Tempe facility is partially located within a large area that has been identified by the Environmental Protection Agency as the Indian Bend Wash Area Superfund Site. Under federal law, certain persons known as potentially responsible parties ("PRPs") may be held strictly liable on a joint and several basis for all cleanup costs and natural resource damages associated with the release of hazardous substances from a facility. The average cost to clean up a site listed on the National Priorities List is over \$30 million. The Indian Bend Superfund Site is listed on the National Priorities List. Groups of PRPs may include current owners and operators of a facility, owners and operators of a facility at the time of disposal of hazardous substances, transporters of hazardous substance and those who arrange for the treatment or disposal of hazardous substances at a site. No government agency, including the EPA, has indicated that Palm Harbor has been or will be named as a PRP or that we are otherwise responsible for the contamination present at the Indian Bend Superfund Site. In general, although no assurance can be given as to the future actions of either the EPA or PRPs who may incur cleanup costs related to this site, Palm Harbor does not believe that our ownership of property partially located within the Indian Bend Superfund Site will have a material adverse effect on our results of operations or financial condition.

In 1994, Palm Harbor removed two underground storage tanks used to store petroleum substances from property we own in Georgia. In November 2001, Palm Harbor received a letter from the Georgia Department of Natural Resources indicating no further action was necessary with respect to these storage tanks. The letter, however, did not preclude additional action by the State if contaminants were found in adjoining properties. At this time, Palm Harbor does not expect that the costs of future assessment and corrective action related to the tanks will have a material adverse effect on our results of operations or financial condition.

#### **Item 4. Submission of Matters to a Vote of Security Holders**

No matter was submitted during the fourth quarter of the fiscal year covered by this Report to a vote of security holders, through the solicitation of proxies or otherwise.

**PART II.**

**Item 5. Market for Registrant’s Common Equity and Related Stockholder Matters**

Palm Harbor’s Common Stock has been traded on the Nasdaq National Stock Market under the symbol “PHHM” since July 31, 1995, the date on which Palm Harbor completed our initial public offering. The following table sets forth, for the period indicated, the high and low sales information per share of the Common Stock as reported on the Nasdaq National Stock Market.

<u><b>Fiscal 2002</b></u>	<u><b>High</b></u>	<u><b>Low</b></u>
First Quarter .....	\$ 24.12	\$ 15.00
Second Quarter .....	26.99	16.90
Third Quarter .....	25.00	18.20
Fourth Quarter .....	24.55	20.44

<u><b>Fiscal 2001</b></u>	<u><b>High</b></u>	<u><b>Low</b></u>
First Quarter .....	\$ 16.75	\$ 13.25
Second Quarter .....	14.81	13.13
Third Quarter .....	17.00	12.38
Fourth Quarter .....	20.56	14.88

On May 13, 2002, the last reported sale price of Palm Harbor’s Common Stock on the Nasdaq National Stock Market was \$24.34. As of May 13, 2002, there were approximately 840 record holders of the Common Stock, and approximately 3,000 holders of the Common Stock overall based on an estimate of the number of individual participants represented by security position listings.

Palm Harbor has never paid cash dividends on our Common Stock. The Board of Directors intends to retain any future earnings generated by Palm Harbor to support operations and to finance expansion and does not intend to pay cash dividends on our Common Stock for the foreseeable future. The payment of cash dividends in the future will be at the discretion of the Board of Directors and will depend upon a number of factors such as Palm Harbor’s earnings levels, capital requirements, financial condition and other factors deemed relevant by the Board of Directors. Future loan agreements may or may not restrict or prohibit the payment of dividends.

## Item 6. Selected Financial Data

The following table sets forth selected financial information regarding Palm Harbor's financial position and operating results which has been extracted from Palm Harbor's financial statements for the five fiscal years ended March 29, 2002. The information should be read in conjunction with Item 7 – "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Consolidated Financial Statements and accompanying Notes included elsewhere in this report.

	<b>Fiscal Year Ended</b>				
	<b>March 27, 1998</b>	<b>March 26, 1999</b>	<b>March 31, 2000</b>	<b>March 30, 2001</b>	<b>March 29, 2002</b>
	(In thousands of dollars, except per share data)				
<b>Statement of Income:</b>					
Net sales	\$ 637,268	\$ 761,374	\$ 777,471	\$ 650,451	\$ 627,380
Cost of sales	466,494	530,698	530,415	443,131	426,356
Gross profit	170,774	230,676	247,056	207,320	201,024
Selling, general and administrative expenses	117,018	158,916	180,224	165,896	168,171
Income from operations	53,756	71,760	66,832	41,424	32,853
Interest expense	(4,700)	(9,728)	(10,245)	(12,792)	(8,377)
Interest income and other	2,718	4,933	7,034	7,279	6,450
Income before income taxes and cumulative effect of change in accounting principle	51,774	66,965	63,621	35,911	30,926
Income tax expense	19,920	26,788	25,025	14,034	11,478
Income before cumulative effect of change in accounting principle	31,854	40,177	38,596	21,877	19,448
Cumulative effect of change in accounting principle	-	-	-	(2,048)	-
Net income	<u>\$ 31,854</u>	<u>\$ 40,177</u>	<u>\$ 38,596</u>	<u>\$ 19,829</u>	<u>\$ 19,448</u>
Net income per common share - basic and diluted	<u>\$ 1.35</u>	<u>\$ 1.69</u>	<u>\$ 1.66</u>	<u>\$ 0.87</u>	<u>\$ 0.85</u>
Weighted average common shares outstanding - basic	23,589	23,783	23,225	22,760	22,820
Weighted average common shares outstanding - diluted	23,632	23,838	23,255	22,772	22,820
<b>Operating Data:</b>					
Number of homes sold	14,144	15,628	14,301	10,829	9,938
Multi-section homes sold as a percentage of total homes sold	81%	78%	80%	80%	85%
Number of manufacturing facilities <sup>(1)</sup>	16	16	15	15	15
Number of company-owned superstores <sup>(1)</sup>	94	120	133	145	151
<b>Balance Sheet Data:</b>					
Working capital	\$ 22,290	\$ 40,316	\$ 59,452	\$ 80,368	\$ 96,405
Total assets	353,846	427,410	457,174	468,368	475,168
Long-term debt	3,382	3,149	2,906	2,745	2,566
Shareholders' equity	157,056	195,325	217,176	235,652	256,657

<sup>(1)</sup> As of the end of the applicable period.

## **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

Fiscal 2002 continued to be a difficult period for the manufactured housing industry due to three major issues – retail financing availability, repossessions and retail inventory levels. Elevated credit standards, which began in mid-1999, resulted in reduced retail sales levels, declining wholesale shipments and declining margins for most industry participants. Industry-wide multi-section shipments for calendar 2001 were down 18% from a year ago; however, Palm Harbor's shipments declined less than 5% during this same period.

At the end of fiscal 2002, additional issues arose in the manufactured housing industry. In March 2002, the largest floor plan lender in the industry, Conseco Finance Servicing Corp. ("Conseco"), announced that they were exiting the wholesale financing, or floor plan lending, business. Our agreement with Conseco, which totals \$15.0 million, will be cancelled on June 30, 2002. In anticipation of such cancellation, we obtained an additional \$30.0 million of floor plan financing during the fourth quarter of fiscal 2002. As of May 9, 2002, Palm Harbor had floor plan borrowings of \$11.4 million with Conseco and we had receivables due from Conseco of approximately \$10.2 million. We believe amounts due from Conseco will be collected in the normal course of business and Palm Harbor will not incur significant losses as the result of doing business with Conseco.

On May 16, 2002, Conseco indicated its commitment to continue to provide retail financing; however, they also began notifying manufacturers and independent retailers that amounts due under floor plan financing agreements were to be paid in full on or prior to July 17, 2002. However, Conseco also indicated in the notification that certain options would be made available to the retailers. Palm Harbor has contacted our independent retailers where we have repurchase obligations regarding the impact of this cancellation on their floor plan financing needs. The majority of these retailers have made other arrangements for their financing needs.

Additionally, the introduction of Texas House Bill 1869 in January 2002 presented another issue to the industry. This bill requires all manufactured houses in Texas, which are not placed in manufactured home rental communities, to be financed with conforming mortgages. Conforming mortgages are subject to higher credit standards than chattel loans and therefore this new regulation may cause certain consumers who would have otherwise qualified for financing under a chattel loan to not qualify under a conforming loan.

Through CountryPlace Mortgage, Palm Harbor sells approved loan contracts to one of three national finance companies, including Associates Housing Finance. In January 2000, the Associates announced that they would be discontinuing retail and floor plan financing for the manufactured housing industry. Palm Harbor's contract with the Associates expired on March 31, 2002. Consumer loan contracts have been redirected to the remaining finance companies and/or to new finance companies as agreements are negotiated. The Company believes that they will be able to continue to redirect consumer loan contracts, however, no assurances can be made in this regard.

Despite these difficult conditions, both Palm Harbor's business segments were profitable this fiscal year. Additionally, Palm Harbor maintained gross margins, profitably increased market share and reduced inventories, while continuing our controlled growth strategy of opening new retail superstores. During fiscal 2002, the number of Company-owned retail superstores increased by six to 151. The financial services segment, which consists of CountryPlace Mortgage, Palm Harbor's finance subsidiary, and Standard Casualty Company, Palm Harbor's insurance subsidiary, continued to be additive to consolidated sales and net income.

Palm Harbor had cash and cash equivalents of \$69.2 million at March 29, 2002 and virtually no long-term debt. In addition, Palm Harbor's practice of manufacturing only to order coupled with closely monitored retail receivables and stocking levels has enabled us to tightly manage retail receivables and inventory levels. Receivables and inventory per retail superstore have declined 9% since the beginning of the fiscal year. Gross margin remained stable at 32%.

The manufactured housing industry is affected by cyclical downturns and seasonal fluctuations that often make difficult period-to-period comparisons of our revenues and operating results.

The following table sets forth certain items of Palm Harbor's Statement of Income as a percentage of net sales for the periods indicated.

	<b>Fiscal Year Ended</b>		
	<b>March 31, 2000</b>	<b>March 30, 2001</b>	<b>March 29, 2002</b>
Net sales	100.0%	100.0%	100.0%
Cost of sales	68.2	68.1	68.0
Gross profit	31.8	31.9	32.0
Selling, general and administrative expenses	23.2	25.5	26.8
Income from operations	8.6	6.4	5.2
Interest expense	(1.3)	(2.0)	(1.3)
Interest income and other	0.9	1.1	1.0
Income before income taxes and cumulative effect of change in accounting principle	8.2	5.5	4.9
Income tax expense	3.2	2.2	1.8
Income before cumulative effect of change in accounting principle	5.0	3.3	3.1
Cumulative effect of change in accounting principle	-	(0.3)	-
Net income	5.0%	3.0%	3.1%

The following table summarizes certain key sales statistics as of and for the period indicated.

	<b>Fiscal Year Ended</b>		
	<b>March 31, 2000</b>	<b>March 30, 2001</b>	<b>March 29, 2002</b>
Company homes sold through company-owned retail superstores	10,906	8,964	8,268
Total new homes sold	14,301	10,829	9,938
Internalization rate (1)	76%	83%	83%
Average new home price - retail	\$ 58,000	\$ 59,000	\$60,000
Number of retail superstores at end of period	133	145	151
Homes sold to independent retailers	3,223	1,817	1,640

(1) The internalization rate is the percentage of new homes that are manufactured by Palm Harbor and sold through Company-owned retail superstores.

Palm Harbor's fiscal year consists of 52 or 53 weeks, ending on the Friday nearest the last day of March each year. The 2001 and 2002 fiscal years consisted of 52 weeks and the 2000 fiscal year consisted of 53 weeks.

### ***2002 Compared to 2001***

**Net Sales.** Net sales decreased 3.5% to \$627.4 million in 2002 from \$650.5 million in 2001. The decrease in net sales was primarily due to competitive conditions in the manufactured housing industry as indicated by a decrease of 7.9% in the volume of homes sold through Company-owned retail superstores while overall unit volume, which includes sales to independent retailers, declined 8.2% in fiscal 2002. This decline in volume is partially offset by an increase in the average selling price of a new home, which resulted from a continued shift in product mix towards multi-section homes. Of the homes sold by the Company, 85% were multi-section in fiscal 2002 versus 80% in fiscal 2001. The number of Company-owned superstores increased from 145 at the end of fiscal 2001 to 151 at the end of fiscal 2002.

**Gross Profit.** In fiscal 2002, gross profit as a percentage of net sales increased slightly to 32.0% from 31.9% in fiscal 2001. Gross profit decreased 3.0% to \$201.0 million in 2002 compared to \$207.3 million in 2001. Palm Harbor sold 83% of its homes through Company-owned retail superstores in both fiscal 2002 and fiscal 2001.

**Selling, General and Administrative Expenses.** As a percentage of net sales, selling, general and administrative expenses increased, as planned, to 26.8% in 2002 from 25.5% in 2001. Selling, general and administrative expenses increased \$2.3 million, or 1.4%, to \$168.2 million in 2002 from \$165.9 million in 2001, primarily due to Palm Harbor's continued commitment to building brand awareness via advertising, startup expenses associated with the net increase of six retail superstores opened during fiscal 2002 as well as those expected to be opened in fiscal 2003 and training costs associated with people development.

**Interest Expense.** Interest expense decreased 34.5% to \$8.4 million in 2002 from \$12.8 million in 2001. This decrease was primarily due to a decrease in the prime interest rate from 8.0% at the end of fiscal 2001 to 4.75% at the end of fiscal 2002 coupled with a decrease in the floor plan liability.

### **2001 Compared to 2000**

**Net Sales.** Net sales decreased 16.3% to \$650.5 million in 2001 from \$777.5 million in 2000. The decrease in net sales was primarily due to competitive conditions in the manufactured housing industry as indicated by a decrease of 18.7% in the volume of homes sold through Company-owned superstores while overall unit volume, which includes sales to independent retailers, declined 24.3% in fiscal 2001. This decline in volume is partially offset by an increase in the average selling price of a new home, which resulted from a continued shift in product mix towards multi-section homes. During fiscal year 2001, 80% of the homes sold by the Company were multi-section. The number of superstores increased from 133 at the end of fiscal 2000 to 145 at the end of fiscal 2001.

**Gross Profit.** Gross profit margin as a percentage of net sales increased slightly to 31.9% compared to 31.8% in fiscal 2001. Gross profit decreased 16.1% to \$207.3 million in 2001 compared to \$247.1 million in 2000. Palm Harbor sold 83% of its homes through Company-owned retail superstores in fiscal 2001 versus 76% in fiscal 2000.

**Selling, General and Administrative Expenses.** Selling, general and administrative expenses decreased \$14.3 million, or 8.0%, to \$165.9 million in 2001 from \$180.2 million in 2000, primarily due to Palm Harbor's continued focus on reducing fixed expenses company-wide. This decrease was partially offset by the continued commitment to building brand awareness via advertising and expenses associated with the net increase of 12 Company-owned retail superstores. As a percentage of net sales, selling, general and administrative expenses increased, as planned, to 25.5% in 2001 from 23.2% in 2000. This increase is due to the growth in Palm Harbor's retail operations which, generally, have higher selling, general and administrative expenses as a percentage of net sales as compared to wholesale operations.

**Interest Expense.** Interest expense increased 24.9% to \$12.8 million in 2001 from \$10.2 million in 2000. This increase was primarily due to increases in both the average floor plan balance and interest rates from fiscal 2000 to fiscal 2001.

### **Liquidity and Capital Resources**

Cash provided by operating activities totaled \$35.9 million in 2000, compared to \$23.9 million in 2001 and \$34.5 million in 2002. Cash provided by operating activities increased in fiscal 2002 primarily due to decreases in accounts receivable and inventories. Cash provided by operations was adequate to support Palm Harbor's working capital needs, capital expenditures, floor plan payments and investment purchases during fiscal 2002.

Capital expenditures were \$15.9 million, \$14.1 million and \$14.8 million in fiscal 2000, 2001 and 2002, respectively. In 2000, capital expenditures included \$10.1 million for additional retail superstores and approximately \$5.8 million primarily for improvements in mature manufacturing facilities. In 2001, capital expenditures included \$8.2 million for additional retail superstores and approximately \$5.9 million primarily for improvements in mature manufacturing facilities. In 2002, capital expenditures included \$7.2 million for additional retail superstores and approximately \$7.6 million primarily for improvements in mature manufacturing facilities. Palm Harbor expects capital expenditures to approximate \$14 million during 2003 primarily for the purpose of adding retail superstores.

Palm Harbor currently has four floor plan facilities with financial institutions totaling \$155.0 million to finance a major portion of the home inventory at our retail superstores. These facilities are secured by a portion of our home inventory and receivables from financial institutions. The interest rates on the facilities range from prime (4.75% at March 29, 2002) to prime plus 2.0%. One of our facilities totaling \$15.0 million with Conseco (of which \$14.2 million was outstanding at March 29, 2002) will be cancelled on June 30, 2002. In anticipation of such floor plan cancellation, we increased one of our other facilities by \$30.0 million during the fourth quarter of fiscal 2002. Palm Harbor has three facilities totaling \$140.0 million, which require notification six months prior to cancellation. Such notification has not been received by Palm Harbor from any of these three financial institutions. These floor plan facilities contain provisions regarding minimum financial requirements which the Company must maintain in order to borrow against the facilities. Palm Harbor had \$144,747,000 and \$134,977,000 outstanding on these floor plan credit facilities at March 30, 2001 and March 29, 2002, respectively.

Two of Palm Harbor's floor plan financing agreements permit us to earn interest on investments made with the financial institutions, which can be withdrawn without any imposed restrictions. These investments have certain limitations depending upon the amount of floor plan balance outstanding. The interest rate earned on the amounts invested is prime (4.75% at March 29, 2002) minus 0.5%. Palm Harbor had \$16,175,000 and \$14,275,000 invested at March 30, 2001 and March 29, 2002, respectively, and has classified these amounts as Cash and Cash Equivalents in the accompanying Consolidated Balance Sheets.

Palm Harbor has two revolving lines of credit – one \$20.0 million committed and one \$15.0 million uncommitted – from a financial institution for general corporate purposes. The lines of credit bear interest, at the option (under certain conditions) of Palm Harbor, at either the LIBOR rate (1.88% at March 29, 2002) plus 2.0% or the prime rate (4.75% at March 29, 2002) minus 0.25%. The lines of credit contain provisions regarding minimum financial requirements and certain indebtedness limitations which would limit the amount available for future borrowings. Palm Harbor's borrowing capacity on the lines of credit is reduced by letters of credit totaling \$3.6 million. The lines of credit are available through June 26, 2002, and require an annual commitment fee of up to \$50,000. Palm Harbor has received a commitment letter from the financial institution which extends the availability of the lines of credit through June 2003. Palm Harbor had no amounts outstanding on the lines of credit at March 30, 2001 and March 29, 2002.

Through CountryPlace Mortgage, Palm Harbor sells approved loan contracts to one of three national finance companies, including Associates Housing Finance. In January 2000, the Associates announced that they would be discontinuing retail and floor plan financing for the manufactured housing industry. Palm Harbor's contract with the Associates expired on March 31, 2002. Consumer loan contracts have been redirected to the remaining finance companies and/or to new finance companies as agreements are negotiated. The Company believes that they will be able to continue to redirect consumer loan contracts, however, no assurances can be made in this regard.

In July 1999, Palm Harbor's Board of Directors authorized, subject to certain business and market conditions, the use of up to \$20.0 million to repurchase Palm Harbor's common stock. In July 2000, the Board of Directors authorized another \$20.0 million for common stock repurchases. As of May 13, 2002, Palm Harbor had invested \$20.5 million in the common stock buyback program.

Palm Harbor believes that cash flows from operations, together with floor plan financing and our revolving lines of credit, will be adequate to support our working capital, currently planned capital expenditure needs and future share repurchases in the foreseeable future. Palm Harbor may, from time to time, obtain additional floor plan financing for our retail inventories. Such practice is customary in the industry. However, because future cash flows and the availability of financing will depend on a number of factors, including prevailing economic and financial conditions, business and other factors beyond Palm Harbor's control, no assurances can be given in this regard.

### **Contractual Obligations and Commitments** (dollars in thousands)

The following tables summarize Palm Harbor's contractual obligations and contingent commitments at March 29, 2002. For additional information related to these obligations, see the Notes to Consolidated Financial Statements.

	<b>Payments Due by Period</b>				
	<b>Total</b>	<b>Less than 1 year</b>	<b>1-3 years</b>	<b>4-5 years</b>	<b>After 5 years</b>
Long-term debt	\$ 2,742	\$ 176	\$ 394	\$ 2,172	\$ 0
Operating leases	<u>23,825</u>	<u>6,019</u>	<u>6,086</u>	<u>3,445</u>	<u>8,275</u>
Total contractual cash obligations	<u>\$ 26,567</u>	<u>\$ 6,195</u>	<u>\$ 6,480</u>	<u>\$ 5,617</u>	<u>\$ 8,275</u>

	<b>Amount of Commitment Expiration Per Period</b>				
	<b>Total Amounts Committed</b>	<b>Less than 1 year</b>	<b>1-3 years</b>	<b>4-5 years</b>	<b>Over 5 years</b>
Repurchase obligations (1)	\$ 13,758	\$ 12,085	\$ 1,673	\$ 0	\$ 0
Letters of credit (2)	<u>3,632</u>	<u>1,309</u>	<u>2,323</u>	<u>0</u>	<u>0</u>
Total commercial commitments (3)	<u>\$ 17,390</u>	<u>\$ 13,394</u>	<u>\$ 3,996</u>	<u>\$ 0</u>	<u>\$ 0</u>

- (1) Palm Harbor has contingent repurchase obligations outstanding at March 29, 2002 which have a finite life but are replaced as Palm Harbor continues to sell our manufactured homes to dealers under repurchase agreements with financial institutions. The cost of these contingent repurchase obligations to Palm Harbor was \$155,000, \$132,000 and \$212,000 during fiscal 2000, 2001, and 2002, respectively. For additional information on Palm Harbor's repurchase obligations, see critical accounting policies – reserve for repurchase obligations.
- (2) Palm Harbor has provided letters of credit to providers of certain of our insurance policies. While the current letters of credit have a finite life, they are subject to renewal at different amounts based on the requirements of the insurance carriers. Palm Harbor has recorded insurance expense based on anticipated losses related to these policies as is customary in the manufactured housing industry.
- (3) Palm Harbor has contingent obligations related to installment loan contracts sold with recourse. See Note 13 to the financial statements for a discussion of such recourse contingent obligations.

### **Critical Accounting Policies**

Palm Harbor's discussion and analysis of its financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires Palm Harbor to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Management believes the following critical accounting policies, among others, affect its more significant judgments and estimates used in the preparation of its consolidated financial statements.

**Impairment of Intangible Assets.** In assessing the recoverability of Palm Harbor's intangibles, we must make assumptions regarding estimated future cash flows and other factors to determine the fair value of the respective assets. If these estimates or their related assumptions change in the future, Palm Harbor may be required to record impairment charges for these assets. Effective March 31, 2001, Palm Harbor adopted Statement of Financial Standards No. 142, "Goodwill and Other Intangible Assets" and is now required to analyze goodwill for impairment issues on an annual basis. The carrying value of the goodwill was assessed for impairment as of March 31, 2001 and there was no indication of impairment of goodwill and other intangible assets.

**Warranties.** Palm Harbor provides the retail home buyer a one-year limited warranty covering defects in material or workmanship in home structure, plumbing and electrical systems. We record a liability for estimated future warranty costs relating to homes sold, based upon our assessment of historical experience factors. Factors we use in the estimation of the warranty liability include historical warranty experience related to the actual number of calls and the average cost per call. Although we maintain reserves for such claims based on our assessments as described above, which to date have been adequate, there can be no assurance that warranty expense levels will remain at current levels or that such reserves will continue to be adequate. A large number of warranty claims exceeding our current warranty expense levels could have a material effect on Palm Harbor's results of operations.

**Reserve for Repurchase Obligations.** Manufactured housing companies enter into repurchase agreements with financial institutions which have provided wholesale floor plan financing to independent retailers. These agreements generally provide that in the event of a retailer's default Palm Harbor will repurchase the financed home from the lending institution at declining prices over the term of the repurchase agreement (generally 12 –18 months). The risk of loss under such repurchase agreements is mitigated by the fact that (i) only 17% of Palm Harbor's homes are sold to independent retailers; (ii) a majority of the homes sold by Palm Harbor to independent retailers are pre-sold to specific retail customers; (iii) Palm Harbor monitors each retailer's inventory position on a regular basis; (iv) sales of Palm Harbor's manufactured homes are spread over a large number of retailers; (v) none of Palm Harbor's independent retailers accounted for more than 5% of Palm Harbor's net sales in fiscal 2002; (vi) the price Palm Harbor is obligated to pay declines over time and (vii) Palm Harbor is, in most cases, able to resell homes repurchased from credit sources in the ordinary course of business without incurring significant losses. Since mid-1999, the manufactured housing industry has been affected by three major challenges – retail financing availability, repossessions and retail inventory levels. The rapid growth in the number of retailers prior to the deterioration of retail financing has resulted in an imbalance between retail inventory levels and consumer demand. If retail financing was to significantly weaken further, the inventory imbalance could result in even greater price competition, gross margin deterioration and have an overall material adverse effect on Palm Harbor's operating results. While Palm Harbor's practice of manufacturing only to order coupled with closely monitored retail stocking levels has enabled us to continue to tightly manage inventories, we are unable to predict the impact on Palm Harbor's results if industry conditions were to further deteriorate.

**Residual Interests.** CountryPlace Mortgage originates and sells loan contracts to national consumer finance companies and receives cash and/or retains a residual interest in the interest generated by the sold contracts. Since April 1999, substantially all interest income on the sold contracts has been received in cash upon sale of the contracts. Prior to April 1999, a residual interest in the interest generated by the sold contracts was retained and recorded. Residual interests in installment sales contracts sold are recorded at fair value when the Company relinquishes control of the transferred financial assets in accordance with SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" – a replacement of SFAS No. 125 and other related pronouncements. The gain on sale of these contracts is included in revenues net of any estimated recourse obligations, while unrealized gains are included as a component of retained earnings. During the life of the loan, accretion income or expense, as appropriate, is included in revenues and the related receivables on residual interests are marked to fair value at the end of each reporting period through comprehensive income.

The gain or loss on the sale of the installment sales contracts depends in part on the previous carrying amount of the contracts, allocated between the contracts sold and the retained interests based upon their respective fair values at the date of sale. The fair value of the residual interest is determined by discounting the projected cash flows over the expected life of the contracts sold using a number of estimates and assumptions including prepayment, default, and interest rates. Company estimates of prepayment and default rates are determined based upon a model developed by the Company and refined to reflect Company-specific experience and trends. At March 29, 2002, the Company had net receivables of approximately \$8.9 million related to the retained residual interests of loan contracts previously sold by CountryPlace.

**Recourse Obligations.** In some cases, CountryPlace shares in losses resulting from defaults or prepayments of loan contracts previously sold and therefore establishes a reserve for estimated losses at the time the loan contract is sold. At March 29, 2002, the Company had net reserve balances of approximately \$2.9 million for future losses. The reserve for recourse obligation is established based upon historical loss experience, current economic conditions, and industry trends. Management periodically evaluates its reserve for recourse obligations based upon the performance of outstanding receivables remaining in the portfolio in comparison to projected performance when the reserves were established, actual loss history, geographic concentrations, and the estimated value of the underlying collateral.

### ***New Accounting Pronouncements***

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." Effective March 31, 2001, Palm Harbor adopted SFAS No. 144, which supercedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of." The standard retains the previously existing accounting requirements related to the recognition and measurement of the impairment of long-lived assets to be held and used while expanding the measurement requirements of long-lived assets to be disposed of by sale to include discontinued operations. It also expands on the previously existing reporting requirements for discontinued operations to include a component of an entity that either has been disposed of or is classified as held for sale. The adoption of SFAS No. 144 did not have a material effect on Palm Harbor's financial statements.

### ***Forward-Looking Information/Risk Factors***

Certain statements contained in this annual report are forward-looking statements within the safe harbor provisions of the Securities Litigation Reform Act. Forward-looking statements give our current expectations or forecasts of future events and can be identified by the fact that they do not relate strictly to historical or current facts. Investors should be aware that all forward-looking statements are subject to risks and uncertainties and, as a result of certain factors, actual results could differ materially from those expressed in or implied by such statements. These risks include such assumptions, risks, uncertainties and factors associated with the following:

- ***Availability of retail financing.*** Since mid-1999, loans to purchase manufactured houses have been subjected to elevated credit standards, resulting in reduced lending volumes and consequently reduced sales in the manufactured housing industry. A further tightening of credit standards may cause Palm Harbor to experience significant sales declines.
- ***Availability of wholesale financing.*** The largest floor plan lender has chosen to exit the manufactured housing business, thereby reducing the amount of credit available to industry retailers. Further reductions in the availability of floor plan lending may affect Palm Harbor's inventory levels of new homes.
- ***Management's ability to attract and retain executive officers and other key personnel.*** Palm Harbor is dependent on the services and performance of our executive officers, including our Chairman of the Board, Lee Posey and our President and Chief Executive Officer, Larry Keener. The loss of the services of one or more of our executive officers could have a material adverse effect upon the Company's business, financial condition and results of operations.
- ***Control by existing shareholders.*** Approximately 55% of the outstanding Common Stock of Palm Harbor is beneficially owned or controlled by Mr. Posey, Capital Southwest Corporation and its wholly-owned subsidiary, Capital Southwest Venture Corporation and William R. Thomas, President of Capital Southwest Corporation. As a result, these shareholders, acting together, will be able to determine the outcome of elections of Palm Harbor's directors and thereby control the management of Palm Harbor's business.
- ***Impact of Inflation.*** The past several years have shown a relatively moderate rate of inflation which Palm Harbor has been able to offset through increased selling prices. A material increase in inflation in the future could adversely affect Palm Harbor's operating results.

- ***Competitive product advertising, promotional and pricing activity.*** There are numerous manufactured housing companies in the industry and many have their own retail distribution systems and consumer finance operations. In addition to competition within the manufactured housing industry, our products also compete with other forms of lower to moderate-cost housing, including site-built homes, apartments, townhouses and condominiums. If we are unable to address this competition, growth in each segment of our business could be limited.
- ***Cyclical nature of the manufactured housing industry.*** The cyclical and seasonal nature of the industry causes our revenues and operating results to fluctuate and makes it hard for management to forecast sales and profits in uncertain times. As a result of seasonal and cyclical downturns, we may experience fluctuations in our operating results that make difficult period-to-period comparisons.
- ***Volatility in our stock price.*** Our stock is traded on the Nasdaq National Stock Market and is therefore subject to market fluctuations. During fiscal 2002, our stock price ranged from a low of \$15.00 per share to a high of \$26.99 per share.
- ***Terrorist attacks.*** Market disruptions and other effects resulting from the terrorist attacks on September 11, 2001 and actions, including armed conflict by the United States and other governments in reaction thereto.

#### **Item 7A. Quantitative and Qualitative Disclosure About Market Risk**

Palm Harbor is exposed to market risks related to fluctuations in interest rates on our variable rate debt, which consists primarily of our liabilities under retail floor plan financing arrangements. Palm Harbor is not involved in any other market risk sensitive contracts or investments such as interest rate swaps, futures contracts, or other types of derivative financial instruments.

For variable interest rate obligations, changes in interest rates generally do not impact fair market value, but do affect future earnings and cash flows. Assuming Palm Harbor's level of variable rate debt as of March 29, 2002 is held constant, each one percentage point increase in interest rates occurring on the first day of the year would result in an increase in interest expense for the coming year of approximately \$1.3 million.

## **Item 8. Financial Statements and Supplementary Data**

### Report of Independent Auditors

Board of Directors  
Palm Harbor Homes, Inc.

We have audited the accompanying consolidated balance sheets of Palm Harbor Homes, Inc. and Subsidiaries (the “Company”) as of March 30, 2001 and March 29, 2002, and the related consolidated statements of income, shareholders’ equity, and cash flows for each of the three fiscal years in the period ended March 29, 2002. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Palm Harbor Homes, Inc. and Subsidiaries at March 30, 2001 and March 29, 2002, and the consolidated results of their operations and their cash flows for each of the three fiscal years in the period ended March 29, 2002, in conformity with accounting principles generally accepted in the United States.

As discussed in Note 1 to the financial statements, in fiscal 2001 the Company changed its method of accounting for revenue recognition and in fiscal 2002 the Company changed its method of accounting for goodwill.

Dallas, Texas  
May 3, 2002

Ernst & Young LLP

**Palm Harbor Homes, Inc. and Subsidiaries**

**Consolidated Balance Sheets**

(In thousands of dollars)

	<b>March 30, 2001</b>	<b>March 29, 2002</b>
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 61,290	\$ 69,197
Investments	25,132	30,051
Receivables	86,369	80,111
Inventories	125,917	122,048
Prepaid expenses and other assets	8,748	9,046
Total current assets	<u>307,456</u>	<u>310,453</u>
Goodwill, net	52,940	53,109
Other assets, net	17,858	19,106
	<u>70,798</u>	<u>72,215</u>
Property, plant and equipment, at cost:		
Land and improvements	22,949	32,018
Buildings and improvements	62,990	56,990
Machinery and equipment	50,321	55,552
Construction in progress	3,428	8,174
	<u>139,688</u>	<u>152,734</u>
Accumulated depreciation	49,574	60,234
	<u>90,114</u>	<u>92,500</u>
Total assets	<u><u>\$ 468,368</u></u>	<u><u>\$ 475,168</u></u>

**Palm Harbor Homes, Inc. and Subsidiaries**

**Consolidated Balance Sheets**

(In thousands of dollars)

	<b>March 30, 2001</b>	<b>March 29, 2002</b>
	<hr/>	<hr/>
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities		
Accounts payable	\$ 33,766	\$ 28,649
Floor plan payable	144,747	134,977
Accrued liabilities	48,412	50,246
Current portion of long-term debt	163	176
Total current liabilities	<hr/> 227,088	<hr/> 214,048
Long-term debt, less current portion	2,745	2,566
Deferred income taxes	2,883	1,897
Commitments and contingencies		
Shareholders' equity		
Preferred stock, \$.01 par value		
Authorized shares – 2,000,000		
Issued and outstanding shares – none		
Common stock, \$.01 par value		
Authorized shares – 50,000,000		
Issued shares – 23,807,879 at March 30, 2001 and March 29, 2002	239	239
Additional paid-in capital	54,149	54,149
Retained earnings	200,911	220,359
Accumulated other comprehensive income	2,869	1,939
	<hr/> 258,168	<hr/> 276,686
Less treasury shares – 964,590 at March 30, 2001, and 858,507 at March 29, 2002	(16,512)	(14,169)
Unearned compensation	(6,004)	(5,860)
Total shareholders' equity	<hr/> 235,652	<hr/> 256,657
Total liabilities and shareholders' equity	<hr/> <b>\$ 468,368</b>	<hr/> <b>\$ 475,168</b>

*See accompanying notes.*

**Palm Harbor Homes, Inc. and Subsidiaries**

**Consolidated Statements of Income**  
(In thousands of dollars, except per share data)

	<b>Year Ended</b>		
	<b>March 31, 2000</b>	<b>March 30, 2001</b>	<b>March 29, 2002</b>
Net sales	\$ 777,471	\$ 650,451	\$ 627,380
Cost of sales	530,415	443,131	426,356
Selling, general and administrative expenses	180,224	165,896	168,171
Income from operations	66,832	41,424	32,853
Interest expense	(10,245)	(12,792)	(8,377)
Interest income and other	7,034	7,279	6,450
Income before income taxes and cumulative effect of change in accounting principle	63,621	35,911	30,926
Income tax expense	25,025	14,034	11,478
Income before cumulative effect of change in accounting principle	38,596	21,877	19,448
Cumulative effect of change in accounting principle	-	(2,048)	-
Net income	<u>\$ 38,596</u>	<u>\$ 19,829</u>	<u>\$ 19,448</u>
Net income per common share - basic and diluted	<u>\$ 1.66</u>	<u>\$ 0.87</u>	<u>\$ 0.85</u>
Weighted average common shares outstanding - basic	<u>23,225</u>	<u>22,760</u>	<u>22,820</u>
Weighted average common shares outstanding - diluted	<u>23,255</u>	<u>22,772</u>	<u>22,820</u>

*See accompanying notes.*

**Palm Harbor Homes, Inc. and Subsidiaries**

**Consolidated Statements of Shareholders' Equity**  
(In thousands of dollars)

	Common Stock		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Shares		Unearned Compensation	Total
	Shares	Amount				Shares	Amount		
Balance at March 26, 1999	23,807,879	\$ 239	\$ 54,149	\$ 142,486	\$ 1,195	(30,765)	\$ (442)	\$ (2,302)	\$ 195,325
Comprehensive income									
Net income	-	-	-	38,596	-	-	-	-	38,596
Unrealized gain (loss), net	-	-	-	-	(392)	-	-	-	(392)
Total comprehensive income	-	-	-	-	-	-	-	-	38,204
Treasury shares purchased, net	-	-	-	-	-	(737,709)	(12,986)	-	(12,986)
Long-Term Incentive Plan									
Shares purchased	-	-	-	-	-	-	-	(4,468)	(4,468)
Terminations	-	-	-	-	-	(18,565)	(420)	420	-
Provision	-	-	-	-	-	-	-	1,101	1,101
Balance at March 31, 2000	23,807,879	239	54,149	181,082	803	(787,039)	(13,848)	(5,249)	217,176
Comprehensive income									
Net income	-	-	-	19,829	-	-	-	-	19,829
Unrealized gain	-	-	-	-	2,066	-	-	-	2,066
Total comprehensive income	-	-	-	-	-	-	-	-	21,895
Treasury shares purchased, net	-	-	-	-	-	(121,259)	(1,661)	-	(1,661)
Long-Term Incentive Plan									
Shares purchased	-	-	-	-	-	-	-	(3,250)	(3,250)
Terminations	-	-	-	-	-	(56,292)	(1,003)	1,003	-
Provision	-	-	-	-	-	-	-	1,492	1,492
Balance at March 30, 2001	23,807,879	239	54,149	200,911	2,869	(964,590)	(16,512)	(6,004)	235,652
Comprehensive income									
Net income	-	-	-	19,448	-	-	-	-	19,448
Unrealized gain	-	-	-	-	845	-	-	-	845
Realization of gains	-	-	-	-	(1,775)	-	-	-	(1,775)
Total comprehensive income	-	-	-	-	-	-	-	-	18,518
Treasury shares purchased, net	-	-	-	-	-	144,356	2,981	-	2,981
Long-Term Incentive Plan									
Shares purchased	-	-	-	-	-	-	-	(2,987)	(2,987)
Terminations	-	-	-	-	-	(38,273)	(638)	638	-
Provision	-	-	-	-	-	-	-	2,493	2,493
Balance at March 29, 2002	23,807,879	\$ 239	\$ 54,149	\$ 20,359	\$ 1,939	(858,507)	\$ (14,169)	\$ (5,860)	\$ 256,657

*See accompanying notes.*

**Palm Harbor Homes, Inc. and Subsidiaries**

**Consolidated Statements of Cash Flows**  
(In thousands of dollars)

	<b>Year Ended</b>		
	<b>March 31, 2000</b>	<b>March 30, 2001</b>	<b>March 29, 2002</b>
<b>Operating Activities</b>			
Income before cumulative effect of change in accounting principle	\$ 38,596	\$ 21,877	\$ 19,448
Adjustments to reconcile income before cumulative effect of change in accounting principle to net cash provided by operating activities			
Cumulative effect of change in accounting principle	-	(2,048)	-
Depreciation	9,503	10,765	11,993
Amortization	4,053	4,066	94
Deferred income taxes	(1,411)	(1,792)	(1,138)
Gain on sale of loans	(2,253)	-	-
Gain (loss) on disposition of assets	(16)	(16)	329
Purchases of stock for Long-Term Incentive Plan	(4,468)	(3,250)	(2,987)
Provision for Long-Term Incentive Plan	1,101	1,492	2,493
Changes in operating assets and liabilities			
Accounts receivable	(7,077)	5,228	3,497
Inventories	17	(3,272)	3,869
Prepaid expenses and other current assets	342	(1,097)	(146)
Other assets	409	2,708	(1,511)
Accounts payable and accrued expenses	(1,102)	(12,129)	(3,283)
Cash provided by operations	37,694	22,532	32,658
Loans originated	(154,457)	(142,635)	(137,880)
Sale of loans	152,637	143,956	139,711
Net cash provided by operating activities	35,874	23,853	34,489
<b>Investing Activities</b>			
Purchases of property, plant and equipment	(15,933)	(14,147)	(14,773)
Purchases of investments	(10,197)	(11,769)	(13,318)
Sales of investments	3,424	9,702	8,399
Proceeds from disposition of assets	20	276	65
Net cash used in investing activities	(22,686)	(15,938)	(19,627)
<b>Financing Activities</b>			
Net proceeds from (payments on) floor plan payable	9,756	6,139	(9,770)
Principal payments on notes payable and long-term debt	(233)	(241)	(166)
Net purchases of treasury stock	(12,986)	(1,661)	2,981
Net cash provided by (used in) financing activities	(3,463)	4,237	(6,955)
Net increase in cash and cash equivalents	9,725	12,152	7,907
Cash and cash equivalents at beginning of year	39,413	49,138	61,290
Cash and cash equivalents at end of year	<u>\$ 49,138</u>	<u>\$ 61,290</u>	<u>\$ 69,197</u>
Supplemental disclosures of cash flow information:			
Cash paid during the year for:			
Interest	\$ 10,206	\$ 12,670	\$ 8,896
Income taxes	\$ 26,182	\$ 17,874	\$ 15,409

*See accompanying notes.*

# **Palm Harbor Homes, Inc. and Subsidiaries**

## **Notes to Consolidated Financial Statements**

### **1. Summary of Significant Accounting Policies**

#### **Principles of consolidation**

The consolidated financial statements include the accounts of Palm Harbor Homes, Inc. (the "Company") and our wholly-owned subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation. The Company's fiscal year ends on the last Friday in March. Fiscal years 2000, 2001 and 2002 contained 53, 52 and 52 weeks, respectively. Headquartered in Addison, Texas, the Company markets manufactured homes nationwide through vertically integrated operations, encompassing manufacturing, marketing, financing and insurance.

Preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from the estimates and assumptions used by management in preparation of the financial statements.

#### **Revenue recognition**

Effective April 1, 2000, in accordance with Staff Accounting Bulletin No. 101, the Company changed its method of accounting for revenue recognition for retail sales. Historically, the Company recognized revenues for its retail home sales when the home was delivered. Under its new accounting method, adopted in the fourth quarter of 2001 retroactive to April 1, 2000, the Company now recognizes revenue for retail sales when the home is delivered and permanently located at the customer's site. The second and third quarters of 2001 have not been restated for the change because the effect on such quarters is immaterial. Furthermore, the effect of the change on the fourth quarter was immaterial. The cumulative effect of the change on prior years resulted in a charge to net income of \$2,048,000 (after income taxes of \$1,366,000 which is included in results for fiscal 2001). The effect of the change on fiscal 2001 was to increase income before the cumulative effect of the accounting change by \$101,000 and decrease net income by approximately \$2.0 million (\$0.09 per share). For the first quarter of 2001, the Company recognized \$11,535,000 in revenues that are included in the cumulative effect adjustment as of April 1, 2000. Pro-forma amounts (assuming the change is applied retroactively) for periods prior to 2001 are not materially different from reported results and are not presented.

Retail sales including shipping charges are recognized when a down payment is received, the customer enters into a legally binding sales contract, title has transferred and the home is accepted by the customer, delivered and permanently located at the customer's site. Homes sold to independent retailers are recognized when the home is shipped which is when the title passes to the independent retailer. The transportation cost is borne by the independent retailer.

Most of the homes sold to independent retailers are financed through standard industry arrangements which include repurchase agreements (see Note 13). The Company extends credit in the normal course of business under normal trade terms and our receivables are subject to normal industry risk.

#### **Residual interests**

CountryPlace Mortgage, Ltd. ("CountryPlace"), the Company's finance subsidiary, originates and sells loan contracts to national consumer finance companies and receives cash and/or retains a residual interest in the interest generated by the sold contracts. Since April 1, 1999, substantially all interest income on sold contracts has been received in cash upon sale of the contracts. Prior to April 1, 1999, a residual interest in the interest generated by the sold contracts was retained and recorded. The fair value of the residual interest is determined using a number of market based assumptions. The gain on the sale of these contracts is included in revenues net of any estimated recourse obligations while unrealized gains are included as a component of retained earnings. The interest income is shared between CountryPlace and the national consumer finance companies on a predetermined basis for all loan contracts and losses resulting from defaults or prepayments are shared in some cases on loan contracts previously sold.

## **Palm Harbor Homes, Inc. and Subsidiaries**

### **Notes to Consolidated Financial Statements (continued)**

#### **Recourse obligations**

In some cases, CountryPlace shares in losses resulting from defaults or prepayments of loan contracts previously sold and therefore establishes a reserve for estimated losses at the time the loan contract is sold. At March 29, 2002, the Company had net reserve balances of approximately \$2.9 million for future losses. The reserve for recourse obligation is established based upon historical loss experience, current economic conditions, and industry trends. Management periodically evaluates its reserve for recourse obligations based upon the performance of outstanding receivables remaining in the portfolio in comparison to projected performance when the reserves were established, actual loss history, geographic concentrations, and the estimated value of the underlying collateral.

#### **Cash and cash equivalents**

Cash and cash equivalents are all liquid investments with maturities of three months or less when purchased.

#### **Investments**

The Company holds investments as trading and available-for-sale. The trading account assets consist of marketable debt and equity securities and are stated at fair value. Marketable debt and equity securities not classified as trading are classified as available-for-sale. Available-for-sale securities are stated at fair value, with the unrealized gains and losses, net of tax, reported in shareholders' equity.

#### **Inventories**

Raw materials inventories are valued at the lower of cost (first-in, first-out method which approximates actual cost) or market. Finished goods are valued at the lower of cost or market, using the specific identification method.

#### **Property, plant and equipment**

Property, plant and equipment are carried at cost. Depreciation is calculated using the straight-line method over the assets' estimated useful lives. Leasehold improvements are amortized using the straight-line method over the shorter of the lease period or the improvements' useful lives. Estimated useful lives for significant classes of assets are as follows: Land Improvements 10-15 years, Buildings and Improvements 3-15 years, and Machinery and Equipment 2-10 years. Repairs and maintenance are expensed as incurred.

#### **Goodwill**

Goodwill is the excess of cost over fair value of net assets of businesses acquired. Through fiscal 2001, goodwill was amortized on the straight-line method over the expected periods to be benefited – between 10 and 20 years. Commencing in fiscal 2002, goodwill is no longer amortized. The Company tests annually for impairment by reporting unit and expenses an impairment charge when the implied fair value of a reporting unit is less than its carrying value. Substantially all of the Company's goodwill is attributable to its "housing" reporting unit.

#### **Warranties**

Products are warranted against manufacturing defects for a period of one year commencing at the time of sale to the retail customer. Estimated costs relating to product warranties are provided at the date of sale.

#### **Start-up costs**

Costs incurred in connection with the start-up of manufacturing facilities and retail superstores are expensed as incurred.

## **Palm Harbor Homes, Inc. and Subsidiaries**

### **Notes to Consolidated Financial Statements (continued)**

#### **Income taxes**

Deferred income taxes are determined by the liability method and reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

#### **Earnings per share**

In computing both basic and diluted earnings per share, the number of weighted average shares outstanding during the periods presented were used.

#### **Financial concentration**

In March 2002, the largest floor plan lender in the industry, Conseco Finance Servicing Corp. (“Conseco”) announced that they were exiting the wholesale financing, or floor plan lending, business. The Company’s agreement with Conseco, which totals \$15.0 million, will be cancelled on June 30, 2002. In anticipation of such floor plan cancellation, the Company increased one of its other facilities by \$30.0 million during the fourth quarter of fiscal 2002. As of May 9, 2002, the Company had floor plan borrowings of \$11.4 million with Conseco and had receivables due from Conseco of approximately \$10.2 million. The Company believes amounts due from Conseco will be collected in the normal course of business and the Company will not incur significant losses as the result of doing business with Conseco.

On May 16, 2002, Conseco indicated its commitment to continue to provide retail financing; however, they also began notifying manufacturers and independent retailers that amounts due under floor plan financing agreements were to be paid in full on or prior to July 17, 2002. However, Conseco also indicated in the notification that certain options would be made available to the retailers. The Company has contacted its independent retailers where it has repurchase obligations regarding the impact of this cancellation on their floor plan financing needs. The majority of these retailers have made other arrangements for their financing needs.

#### **Reclassifications**

Certain prior period amounts have been reclassified to conform to the current period presentation.

#### **Adoption of financial accounting standard no. 142**

In July 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 142, “Goodwill and Other Intangible Assets.” Effective March 31, 2001, the Company adopted SFAS No. 142, which requires that goodwill not be amortized but instead be tested at least annually for impairment by reporting unit and expensed against earnings when the implied fair value of a reporting unit, including goodwill, is less than its carrying amount. Comparative pro forma results for the fiscal years ended March 31, 2000 and March 30, 2001 would have increased income before cumulative effect of change in accounting principle and net income by \$2.8 million and \$2.5 million, or \$0.12 and \$0.11 per share, to \$1.78 and \$0.98 per share, respectively. The carrying value of the goodwill was assessed for impairment as of March 31, 2001 and there was no indication of impairment of goodwill and other intangible assets.

#### **New accounting pronouncements**

In October 2001, the FASB issued SFAS No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets.” Effective March 31, 2001, the Company adopted SFAS No. 144, which supercedes SFAS No. 121, “Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of.” The standard retains the previously existing accounting requirements related to the recognition and measurement of the impairment of long-lived assets to be held and used while expanding the measurement requirements of long-lived assets to be disposed of by sale to include discontinued operations. It also expands on the previously existing reporting requirements for discontinued operations to include a component of an entity that either has been disposed of or is classified as held for sale. The adoption of SFAS No. 144 did not have a material effect on the Company’s financial statements.

## Palm Harbor Homes, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 2. Inventories

Inventories consist of the following:

	March 30, 2001	March 29, 2002
	<i>(in thousands)</i>	
Raw materials	\$ 7,627	\$ 7,631
Work in process	3,075	3,339
Finished goods - manufacturing	68	659
Finished goods - retail	115,147	110,419
	<u>\$ 125,917</u>	<u>\$ 122,048</u>

#### 3. Investments

The Company's investments totaled \$25,132,000 and \$30,051,000 at March 30, 2001 and March 29, 2002, respectively. The fair value of the available-for-sale securities was \$20,469,000 and \$20,393,000, resulting in net unrealized gains recorded of \$961,000 and \$0 at March 30, 2001 and March 29, 2002, respectively. The majority of the available-for-sale securities consist of U.S. government related obligations and other debt obligations with contractual maturities of generally 2 to 11 years. The remaining of the Company's investments are classified as trading securities.

#### 4. Residual interests in loan contracts sold

Palm Harbor Homes' carrying value (fair value) of retained interest related to the residual interests of loan contracts previously sold by CountryPlace are included in other assets and amounted to approximately \$8.2 million and \$8.9 million, as of March 30, 2001 and March 29, 2002, respectively. The significant economic assumptions used in measuring the retained interest at the date of sale were as follows: prepayment speed (250% MHP model); weighted average life (approximately five years); and residual cash flow discount rate (18.5%). A sensitivity analysis as of March 29, 2002, reflecting a 10% and 20% adverse change in the prepayment speed results in a hypothetical reduction in the carrying value of the residual interests by approximately \$0.4 million and \$0.9 million while a 10% and 20% adverse change in the discount rate results in a hypothetical reduction in the carrying value of the residual interests by approximately \$0.5 million and \$1.0 million. The sensitivity analysis is hypothetical and should be used with caution. For instance, changes in fair value based on a 10% variation in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in fair value may not be linear. In addition, the effect of a variation in a particular assumption on the fair value of the retained interest is calculated without changing any other assumption, when in reality, changes in any one factor may result in changes in another factor.

During the fiscal year ended March 31, 2000, March 30, 2001 and March 29, 2002, the Company recognized approximately \$6.7 million, \$5.0 million and \$3.9 million in gains, respectively. The Company had \$1.1 million, \$1.1 million and \$0.8 million in unrealized gains for the fiscal years ended March 31, 2000, March 30, 2001 and March 29, 2002, respectively.

#### 5. Floor plan payable

The Company currently has four floor plan facilities with financial institutions totaling \$155.0 million to finance a major portion of its home inventory at the Company's retail superstores. These facilities are secured by a portion of the Company's home inventory and receivables from financial institutions. The interest rates on the facilities range from prime (4.75% at March 29, 2002) to prime plus 2.0%. One of the Company's facilities totaling \$15.0 million with Consec (of which \$14.2 million was outstanding at March 29, 2002) will be cancelled on June 30, 2002. In anticipation of such cancellation, the Company increased one of its other facilities by \$30.0 million during the fourth quarter of fiscal 2002. The Company has three facilities totaling \$140.0 million which require notification from the financial institution six months prior to cancellation. Such notification has not been received by the Company from

## Palm Harbor Homes, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

any of these three financial institutions. These floor plan facilities contain provisions regarding minimum financial requirements which the Company must maintain in order to borrow against the facilities. The Company had \$144,747,000 and \$134,977,000 outstanding on these floor plan credit facilities at March 30, 2001 and March 29, 2002, respectively.

Two of the Company's floor plan financing agreements permit the Company to earn interest on investments made with the financial institution, which can be withdrawn without any imposed restrictions. These investments have certain limitations depending upon the amount of floor plan balance outstanding. The interest rate earned on the amounts invested is prime (4.75% at March 29, 2002) minus 0.5%. The Company had \$16,175,000 and \$14,275,000 invested at March 30, 2001 and March 29, 2002, respectively, and has classified these amounts as Cash and Cash Equivalents in the accompanying Consolidated Balance Sheets.

#### 6. Lines of credit

The Company has two revolving lines of credit – one \$20.0 million committed and one \$15.0 million uncommitted – from a financial institution for general corporate purposes. The lines of credit bear interest, at the option (under certain conditions) of the Company, at either the LIBOR rate (1.88% at March 29, 2002) plus 2.0% or the prime rate (4.75% at March 29, 2002) minus 0.25%. The lines of credit contain provisions regarding minimum financial requirements and certain indebtedness limitations which would limit the amount available for future borrowings. The Company's borrowing capacity on the lines of credit is reduced by letters of credit totaling \$3.6 million. The lines of credit are available through June 26, 2002, and require an annual commitment fee of up to \$50,000. The Company has received a commitment letter from the financial institution which extends the availability of the lines of credit through June 2003. The Company had no amounts outstanding on the lines of credit at March 30, 2001 and March 29, 2002.

#### 7. Accrued liabilities

Accrued liabilities consist of the following:

	<b>March 30, 2001</b>	<b>March 29, 2002</b>
	<i>(in thousands)</i>	
Salaries, wages and benefits	\$ 12,953	\$ 13,617
Accrued expenses on homes sold, including warranty	13,268	11,619
Customer deposits	7,508	7,263
Sales incentives	1,904	3,851
Other	12,779	13,896
	<b>\$ 48,412</b>	<b>\$ 50,246</b>

## Palm Harbor Homes, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 8. Long-term debt

Long-term debt consists of the following:

	March 30, 2001	March 29, 2002
	<i>(in thousands)</i>	
Economic development revenue bonds; interest payable monthly at 7.54%; monthly interest and principal payments of \$40,029 through February 2001, \$31,393 through January 2006 with final payment of \$2,002,040 in February 2006	\$ 2,908	\$ 2,742
Less current portion	(163)	(176)
Long-term debt, less current portion	\$ 2,745	\$2,566

The revenue bonds require the maintenance of certain financial statement ratios, prohibit the payment of dividends and are collateralized by certain fixed assets having a carrying value as of March 29, 2002 of \$5,264,000.

Scheduled maturities of long-term debt are as follows (in thousands):

<b>Fiscal Year</b>	<b>Amount</b>
2003	\$ 176
2004	189
2005	205
2006	<u>2,172</u>
	<u>\$ 2,742</u>

The carrying value of the Company's long-term debt approximates its fair value.

#### 9. Income taxes

Income tax expense for fiscal years 2000, 2001 and 2002 is as follows:

	March 31, 2000	March 30, 2001	March 29, 2002
	<i>(in thousands)</i>		
Current			
Federal	\$ 24,616	\$14,687	\$ 11,566
State	2,381	1,440	911
Deferred	(1,972)	(2,093)	(999)
Total income taxes	\$ 25,025	\$14,034	\$ 11,478

## Palm Harbor Homes, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

Significant components of deferred tax assets and liabilities are as follows:

	<b>March 30, 2001</b>	<b>March 29, 2002</b>
	<i>(in thousands)</i>	
Current deferred tax assets		
Warranty reserves	\$ 1,837	\$ 985
Accrued liabilities	3,219	4,901
Inventory	319	1,813
Other	2,613	1,186
	7,988	8,885
Non-current deferred tax assets		
Unrecognized income	3,253	2,564
Total deferred tax assets	11,241	11,449
Deferred tax liabilities		
Tax benefits purchased	2,266	1,834
Property and equipment	(1,583)	(2,489)
Other	2,200	2,552
Total deferred tax liabilities	2,883	1,897
Net deferred income tax assets	\$ 8,358	\$ 9,552

Tax benefits purchased are investments in Safe Harbor lease agreements that are carried net of tax benefits realized. The balance will be amortized over the remaining term of the related lease. Current and non-current deferred tax assets are classified in prepaid expenses and other assets and other assets, net, respectively, in the Consolidated Balance Sheets.

Income tax expense for fiscal year 2001 does not include approximately \$1,366,000 in income tax benefit provided for the cumulative effect of a change in accounting principle.

The effective income tax rate on pretax earnings differed from the U.S. federal statutory rate for the following reasons:

	<b>March 31, 2000</b>	<b>March 30, 2001</b>	<b>March 29, 2002</b>
	<i>(in thousands)</i>		
Tax at statutory rate	\$ 22,268	\$ 12,567	\$ 10,824
Increases (decreases)			
State taxes - net of federal tax benefit	1,547	939	592
Goodwill amortization	1,011	1,016	0
Tax exempt interest	(166)	(162)	(110)
Other	365	(326)	172
Income tax expense	\$ 25,025	\$ 14,034	\$ 11,478
Effective tax rate	39.3%	39.1%	37.1%

## Palm Harbor Homes, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 10. Shareholders' equity

The Board of Directors may, without further action by the Company's shareholders, from time to time, authorize the issuance of shares of preferred stock in series and may, at the time of issuance, determine the powers, rights, preferences and limitations, including the dividend rate, conversion rights, voting rights, redemption price and liquidation preference, and the number of shares to be included in any such series. Any preferred stock so issued may rank senior to the common stock with respect to the payment of dividends or amounts upon liquidation, dissolution or winding up, or both. In addition, any such shares of preferred stock may have class or series voting rights.

#### 11. Long-Term Incentive Plan

Effective March 29, 1999, the Board of Directors approved the Fiscal Year 2000 Long-Term Incentive Plan (the "Plan") whereby certain key associates received awards of restricted common stock. The Company's Chairman and President/CEO do not participate in the plan. Shares awarded under the Plan are purchased by the Company in the open market. These restricted stock awards give the associate the right to receive a specific number of shares of common stock contingent upon remaining an associate of the Company for a specified period. Effective April 3, 2000, April 2, 2001 and April 1, 2002, the Board of Directors approved the Fiscal Year 2001 Long-Term Incentive Plan (the "2001 Plan"), the Fiscal Year 2002 Long-Term Incentive Plan (the "2002 Plan") and the Fiscal Year 2003 Long-Term Incentive Plan (the "2003 Plan"), respectively. The 2001 Plan, 2002 Plan and the 2003 Plan have substantially the same terms as the Plan.

The unamortized cost of the common stock acquired by the Company for the participants in the plans is reflected as "Unearned Compensation" in the accompanying Consolidated Balance Sheets. The plans are administered by a committee authorized by the Board of Directors.

#### 12. Employee plan

The Company sponsors an employee savings plan (the "401k Plan") that is intended to provide participating employees with additional income upon retirement. Employees may contribute between 1% and 15% of eligible compensation to the 401k Plan. The Company matches 50% of the first 6% deferred by employees. Employees are immediately eligible to participate and employer contributions, which begin one year after employment, are vested at the rate of 20% per year and are fully vested after five years of employment. Contribution expense was \$1,226,000, \$1,387,000 and \$1,627,000 in fiscal years 2000, 2001 and 2002, respectively.

#### 13. Commitments and contingencies

Future minimum lease payments for all noncancelable operating leases having a remaining term in excess of one year at March 29, 2002, are as follows (in thousands):

<u>Fiscal Year</u>	<u>Amount</u>
2003	\$ 6,019
2004	3,571
2005	2,515
2006	1,992
2007 and thereafter	9,728
	<u>\$ 23,825</u>

Rent expense (net of sublease income) was \$9,047,000, \$8,991,000 and \$8,617,000 for fiscal years 2000, 2001 and 2002, respectively.

## **Palm Harbor Homes, Inc. and Subsidiaries**

### **Notes to Consolidated Financial Statements (continued)**

The Company is contingently liable under the terms of repurchase agreements covering independent retailers' floor plan financing. Under such agreements, the Company agrees to repurchase homes at declining prices over the term of the agreement, generally 12 to 18 months.

On May 16, 2002, Consec indicated its commitment to continue to provide retail financing; however, they also began notifying manufacturers and independent retailers that amounts due under floor plan financing agreements were to be paid in full on or prior to July 17, 2002. However, Consec also indicated in the notification that certain options would be made available to the retailers. The Company has contacted its independent retailers where it has repurchase obligations regarding the impact of this cancellation on their floor plan financing needs. The majority of these retailers have made other arrangements for their financing needs.

At March 29, 2002, the Company estimates that its potential obligations under all repurchase agreements were approximately \$13.8 million. However, it is management's opinion that no material loss will occur from the repurchase agreements. During fiscal years 2000, 2001 and 2002, net expenses incurred by the Company under these repurchase agreements totaled \$155,000, \$132,000 and \$212,000, respectively.

With respect to certain installment contracts sold prior to April 1, 1999, the Company is contingently liable, as guarantor, for up to 50% of any losses. At March 29, 2002, the outstanding principal balance of these contracts sold with partial recourse was \$35.0 million. With respect to the installment contracts sold after April 1, 1999, the Company's contingent liability is limited to a loss of up to \$5,000 per contract. At March 29, 2002, the number of these outstanding contracts sold with partial recourse was 2,944. Management has consistently provided for its estimated recourse obligation exposure and has recorded a reserve of \$2.9 million at March 29, 2002.

The Company is subject to various legal proceedings and claims that arise in the ordinary course of business. In the opinion of management, the amount of ultimate liability with respect to these actions will not materially affect the financial position or results of operations of the Company.

#### **14. Interest income and other**

During fiscal years 2000, 2001 and 2002, the Company recorded interest income of \$4,419,000, \$5,247,000 and \$3,823,000, respectively and other income, primarily income earned on a real estate investment, of \$2,615,000, \$2,032,000 and \$2,627,000, respectively.

## Palm Harbor Homes, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 15. Business segment information

During the past three fiscal years, the Company has reported three business segments in its annual reports – retail, manufacturing and financial services. However, the Company has experienced a significant increase in the internalization rate, thereby bringing the retail and manufacturing segments together. The Company’s internalization rate reflects the percentage of homes manufactured by the Company and sold through its Company-owned retail stores. The Company’s internalization rate was 83% in fiscal year 2002 versus 63% in fiscal year 1999. The high volume of transactions occurring between the two divisions results in the majority of the manufacturing divisions’ sales being eliminated in consolidation. The manufacturing division is dependent upon the retail division to place orders for sales. Based on these facts, the Company will now report a total of two segments – a “housing” segment which combines the retail and manufacturing operations and a financial services segment which combines the insurance and finance operations. The following table summarizes information with respect to the Company’s business segments for the periods indicated (in thousands):

	Year Ended		
	March 31, 2000	March 30, 2001	March 29, 2002
Net sales			
Housing	\$ 752,782	\$ 626,831	\$ 604,298
Financial services	24,689	23,620	23,082
	\$ 777,471	\$ 650,451	\$ 627,380
Income from operations			
Housing	\$ 71,869	\$ 48,010	\$ 38,342
Financial services	13,554	11,861	10,844
General corporate expenses	(18,591)	(18,447)	(16,333)
	\$ 66,832	\$ 41,424	\$ 32,853
Interest expense	\$ (10,245)	\$ (12,792)	\$ (8,377)
Interest income and other	7,034	7,279	6,450
Income before income taxes and cumulative effect of change in accounting principle	\$ 63,621	\$ 35,911	\$ 30,926
Identifiable assets			
Housing	\$ 407,515	\$ 417,339	\$ 425,645
Financial services	40,213	40,268	37,150
Other	9,446	10,761	12,373
	\$ 457,174	\$ 468,368	\$ 475,168
Depreciation and amortization			
Housing	\$ 13,009	\$ 14,145	\$ 11,437
Financial services	191	164	135
Other	356	522	515
	\$ 13,556	\$ 14,831	\$ 12,087
Capital expenditures			
Housing	\$ 15,538	\$ 14,045	\$ 13,819
Financial services	88	16	138
Other	307	86	816
	\$ 15,933	\$ 14,147	\$ 14,773

## Palm Harbor Homes, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 16. Quarterly financial data (unaudited)

The following table sets forth certain unaudited quarterly financial information for the fiscal years 2001 and 2002.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
	<i>(in thousands, except per share data)</i>				
<b>Fiscal Year Ended</b>					
<b>March 30, 2001</b>					
Net sales	\$ 190,885	\$ 175,813	\$ 145,934	\$ 137,819	\$ 650,451
Gross profit	59,391	57,052	45,531	45,346	207,320
Income from operations	14,365	13,016	7,280	6,763	41,424
Income before cumulative effect of change in accounting principle	7,653	7,667	3,167	3,390	21,877
Cumulative effect of change in accounting principle	(2,048)	-	-	-	(2,048)
Net income	5,605	7,667	3,167	3,390	19,829
Earnings per share	\$ 0.24	\$ 0.34	\$ 0.14	\$ 0.15	\$ 0.87
<b>Fiscal Year Ended</b>					
<b>March 29, 2002</b>					
Net sales	\$ 172,560	\$ 173,378	\$ 158,787	\$ 122,655	\$ 627,380
Gross profit	51,939	55,560	49,803	43,722	201,024
Income from operations	11,010	11,617	8,195	2,031	32,853
Net income	5,777	6,676	5,173	1,822	19,448
Earnings per share	\$ 0.25	\$ 0.29	\$ 0.23	\$ 0.08	\$ 0.85

Quarterly data for the first quarter of fiscal year 2001 has been restated to comply with Staff Accounting Bulletin No. 101. The effect of the change on the first quarter of fiscal year 2001 was to increase income before the cumulative effect of the accounting change by approximately \$2.0 million (\$0.09 per share). The effect of the change on the second, third and fourth quarters was immaterial.

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

None.

**PART III.**

**Item 10. Directors and Executive Officers of the Registrant**

(a) Information with respect to the Company's Board of Directors and executive officers is incorporated by reference from pages 3 through 6 of the Company's definitive Proxy Statement filed with the SEC on May 24, 2002 in connection with the Annual Meeting of Shareholders to be held June 26, 2002.

(b) Based solely upon a review of Forms 3 and 4 and amendments thereto furnished to the Company pursuant to Rule 16a-3(e) promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), during the Company's most recent fiscal year and Form 5 and amendments thereto furnished to the Company with respect to our most recent fiscal year, no person who, at any time during the most recent fiscal year was a director, officer, beneficial owner of more than 10% of any class of equity securities of the Company registered pursuant to Section 12 of the Exchange Act, or any other person subject to Section 16 of the Exchange Act failed to file on a timely basis, reports required by Section 16(a) of the Exchange Act during the most recent fiscal year.

**Item 11. Executive Compensation**

Information with respect to executive compensation is incorporated by reference from pages 10 through 12 of The Company's definitive Proxy Statement filed with the SEC on May 24, 2002 in connection with the Annual Meeting of Shareholders to be held June 26, 2002.

**Item 12. Security Ownership of Certain Beneficial Owners and Management**

Information with respect to security ownership of certain beneficial owners and management is incorporated by reference from pages 7 and 8 of the Company's definitive Proxy Statement filed with the SEC on May 24, 2002 in connection with the Annual Meeting of Shareholders to be held June 26, 2002.

**Item 13. Certain Relationships and Related Transactions**

None.

**PART IV.**

**Item 14. Exhibits, Financial Statement, Schedules and Reports on Form 8-K**

- (a) (1) Financial Statements

The Company's Consolidated Financial Statements for the year ended March 29, 2002 are included on pages 21 through 36 of this report.

- (2) Financial Statement Schedules  
None

(3) Index to Exhibits

<u>Exhibit No.</u>	<u>Description</u>
3.1	Amended and Restated Articles of Incorporation (Incorporated by reference to Exhibit 3.1 to the Registrant's Registration Statement on Form S-1, Registration No. 33-79164).
3.2	Articles of Amendment (Incorporated by reference to Exhibit 3.2 to the Registrant's Registration Statement on Form S-1, Registration No. 33-79164).
3.3	Restated Bylaws (Incorporated by reference to Exhibit 3.3 to the Registrant's Registration Statement on Form S-1, Registration No. 33-79164).
4.1	Form of Common Stock Certificate (Incorporated by reference to Exhibit 4.1 to the Registrant's Registration Statement on Form S-1, Registration No. 33-79164).
10.1	Associate Stock Purchase Plan (Incorporated by reference to Exhibit 10.2 to the Registrant's Registration Statement on Form S-1, Registration No. 33-97676).
10.2	Form of Indemnification Agreement between the Company and each of our directors and certain officers (Incorporated by reference to Exhibit 10.4 to the Registrant's Registration Statement on Form S-1, Registration No. 33-79164).
10.3	Compensation Agreement between the Company and Lee Posey (Incorporated by reference to Exhibit 10.7 to the Registrant's Registration Statement on Form S-1, Registration No. 33-79164).
10.4	Amendment to Compensation Agreement between the Company and Lee Posey (Incorporated by reference to Exhibit 10.6 to the Registrant's Registration Statement on Form S-1, Registration No. 33-97676).
*21.1	List of Subsidiaries.
*23.1	Consent of Ernst & Young LLP.
24.1	Power of Attorney (included on the signature page of the Report).

\* Filed herewith

- (b) None.
- (c) See Item 14(a)(3) above.
- (d) None.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on our behalf by the undersigned, thereunto duly authorized on May 24, 2002.

PALM HARBOR HOMES, INC.

/s/ Lee Posey  
Lee Posey, Chairman of the Board

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

KNOW ALL MEN BY THESE PRESENTS, that the undersigned do hereby constitute and appoint Lee Posey and Kelly Tacke, and each of them, each with full power to act without the other, his true and lawful attorneys-in-fact and agents, each with full power of substitution and resubstitution, for him and in his name, place and stead, in any and all capacities, to sign any and all amendments to the annual report on Form 10-K for the year ended March 29, 2002 of Palm Harbor Homes, Inc., and to file the same, with any and all exhibits thereto, and all other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, full power and authority to do and perform each and every act and thing requisite and necessary to be done as fully to all intents and purposes as the undersigned might or could do in person, hereby ratifying and confirming all of each of said attorneys-in-fact and agents or any of them may lawfully do or cause to be done by virtue thereof.

<u>Signatures</u>	<u>Title</u>	<u>Date</u>
<u>/s/ Lee Posey</u> Lee Posey	Chairman of the Board and Director (Principal Executive Officer)	May 24, 2002
<u>/s/ Larry Keener</u> Larry Keener	Chief Executive Officer, President and Director	May 24, 2002
<u>/s/ Kelly Tacke</u> Kelly Tacke	Vice President-Finance, Chief Financial Officer and Secretary (Principal Financial and Accounting Officer)	May 24, 2002
<u>/s/ William R. Thomas</u> William R. Thomas	Director	May 24, 2002
<u>/s/ Walter D. Rosenberg, Jr.</u> Walter D. Rosenberg, Jr.	Director	May 24, 2002
<u>/s/ Frederick R. Meyer</u> Frederick R. Meyer	Director	May 24, 2002
<u>/s/ John H. Wilson</u> John H. Wilson	Director	May 24, 2002
<u>/s/ A. Gary Shilling</u> A. Gary Shilling	Director	May 24, 2002
<u>/s/ Jerry Mallonee</u> Jerry Mallonee	Director	May 24, 2002

## INDEX TO EXHIBITS

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Exhibit 21.1

Subsidiaries

<u>Name</u>	<u>Jurisdiction of Organization</u>
Palm Harbor Finance Corporation	Texas
Palm Harbor G.P., Inc.	Nevada
Standard Casualty Company	Texas
Better Homes Systems, Inc.	Washington
Palm Harbor Investments, Inc.	Nevada
Palm Harbor Holding, Inc.	Nevada
Standard Insurance Agency, Inc.	Texas
CountryPlace Mortgage, Ltd.	Texas
Palm Harbor Homes I, L.P.	Texas
First Home Mortgage Corporation	Georgia
Palm Harbor Insurance Agency, Inc.	New Mexico
Magic Living, Inc.	Nevada
Palm Harbor Marketing, Inc.	Nevada
Palm Harbor Manufacutring, L.P.	Texas
Palm Harbor GenPar, L.L.C.	Nevada
Palm Harbor Insurance Agency of Florida, Inc.	Florida
Palm Harbor Insurance Agency of Alabama, Inc.	Alabama
Palm Harbor Insurance Agency of Tennessee, Inc.	Tennessee
Palm Harbor Insurance Agency of Delaware, Inc.	Delaware
Palm Harbor Insurance Agency of Texas, Inc.	Texas

Exhibit 23.1

Consent of Ernst & Young LLP

We consent to the incorporation by reference in the Registration Statement (Form S-3 No. 333-24135) pertaining to the Palm Harbor Homes, Inc. Employee Savings Plan, and in the Registration Statement (Form S-3 No. 333-52535) and in the related Prospectus of Palm Harbor Homes, Inc. and subsidiaries, of our report dated May 3, 2002, with respect to the consolidated financial statements of Palm Harbor Homes, Inc. and subsidiaries included in this Annual Report (Form 10-K) for the year ended March 29, 2002.

May 24, 2002  
Dallas, Texas



PALM HARBOR HOMES  
15303 DALLAS PARKWAY • SUITE 800  
ADDISON, TEXAS 75001-4600