



**SOUTHERN ENERGY HOMES, INC.**  
**First Quarter 2004 Report to Shareholders**  
**April 2, 2004**

SOUTHERN ENERGY HOMES, INC. AND SUBSIDIARIES

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**About This Report**

Effective January 15, 2004, Southern Energy Homes, Inc. no longer has a class of securities registered pursuant to Section 12 of the Securities Exchange Act of 1934 (the “Act”), and the Company is no longer subject to the reporting requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934. Accordingly, this Quarterly Report is not filed with the Securities and Exchange Commission, is not available on the SEC’s EDGAR system, and it does not purport to meet the requirements for companies that are subject to the Act’s reporting requirements. The Company does intend in this Quarterly Report and other reports to provide accurate, high quality financial and other information that is in many ways consistent with the kind of information it has provided in the past, but shareholders and other interested persons are cautioned that this information is not and cannot be deemed the substantial equivalent of the information required of reporting companies under the Act.

This Quarterly Report and other periodic reports to shareholders are available on the Company’s website, [www.SEhomes.com](http://www.SEhomes.com), and at [www.pinksheets.com](http://www.pinksheets.com). Interested persons may also request copies directly from the Company; please direct requests and inquiries to Chief Financial Officer, Southern Energy Homes, Inc., P.O. Box 390, 144 Corporate Way, Addison, Alabama 35540, telephone (256) 747-8589.

**FORWARD LOOKING STATEMENTS:** This Quarterly Report includes forward looking statements. Investors are cautioned that such statements inherently involve risks and uncertainties which could cause actual results to differ materially from those in any forward looking statements, including without limitation: availability of financing for prospective purchasers of the Company's homes and availability of floor plan financing for dealers; availability and pricing of raw materials; the ultimate financial and operational effects of new plant investment being undertaken and discontinued operations; general economic conditions; the cyclical and seasonal nature of housing markets; competitive pricing pressures at both the wholesale and retail levels; changes in market demand; the impact of cost reduction programs and other management initiatives; the Company’s contingent repurchase liabilities with respect to dealer financing and retail buyer financing; the adequacy of accruals for workers’ compensation claims and insurance costs; concentration of the Company’s business in certain regional markets; adverse weather conditions that reduce retail sales; the possibility of plant shutdowns from weather or other causes; availability of labor for the Company to meet operating requirements; the highly competitive nature of the manufactured housing industry; federal, state and local regulation of the Company’s business; the Company’s reliance on independent dealers; and other risks indicated from time to time in the Company’s quarterly and annual reports to its shareholders and other public statements. Southern Energy Homes is not responsible for updating the information contained in this report beyond the published date.

SOUTHERN ENERGY HOMES, INC. AND SUBSIDIARIES  
CONSOLIDATED CONDENSED BALANCE SHEETS

	April 2, 2004	January 2, 2004
<b><u>ASSETS</u></b>		
	(Unaudited)	(Note 1)
<b>Current Assets:</b>		
Cash and cash equivalents	\$ 6,985,000	\$ 10,174,000
Accounts receivable (less allowance for doubtful accounts of \$355,000 and \$362,000, respectively)	9,464,000	4,682,000
Other Receivable	1,103,000	1,526,000
Inventories	10,374,000	8,098,000
Prepayments and other	1,115,000	1,215,000
Current assets of discontinued operations	-	51,000
	29,041,000	25,746,000
<b>Property and equipment:</b>		
Property and equipment, at cost	33,761,000	33,127,000
Less accumulated depreciation	(17,552,000)	(17,204,000)
	16,209,000	15,923,000
<b>Intangibles and other assets:</b>		
Goodwill	3,305,000	3,305,000
Investment in joint ventures	3,548,000	3,694,000
Other assets	156,000	526,000
Non-current assets of discontinued operations	-	50,000
	7,009,000	7,575,000
	\$ 52,259,000	\$ 49,244,000
<b><u>LIABILITIES AND STOCKHOLDERS' EQUITY</u></b>		
<b>Current liabilities:</b>		
Accounts payable	3,776,000	1,120,000
Accrued liabilities	10,101,000	9,969,000
Current liabilities of discontinued operations	-	2,000
	13,877,000	11,091,000
<b>Stockholders' equity:</b>		
Preferred stock, \$.0001 par value, 1,000,000 shares authorized, none outstanding	-	-
Common stock, \$.0001 par value, 40,000,000 shares authorized, 12,143,865 issued and outstanding at April 2, 2004 and at January 2, 2004	1,000	1,000
Treasury stock, at cost, 24,000 shares at April 2, 2004	(84,000)	-
Capital in excess of par	8,337,000	8,341,000
Retained earnings	30,128,000	29,811,000
	38,382,000	38,153,000
	\$ 52,259,000	\$ 49,244,000

The accompanying notes are an integral part of these consolidated condensed financial statements.

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Please see "About this Report" on page 2.*

SOUTHERN ENERGY HOMES, INC. AND SUBSIDIARIES  
CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS  
(Unaudited)

	Thirteen Weeks Ended	
	April 2, 2004	April 4, 2003
Net revenues	\$31,995,000	\$28,044,000
Cost of sales	26,706,000	24,236,000
Gross profit	5,289,000	3,808,000
Operating expenses:		
Selling, general and administrative	4,931,000	5,228,000
Operating income (loss)	358,000	(1,420,000)
Interest expense	(49,000)	(145,000)
Interest income	18,000	18,000
Income (loss) from continuing operations before income taxes	327,000	(1,547,000)
Income taxes	10,000	-
Income (loss) from continuing operations	317,000	(1,547,000)
Income from discontinued operations	-	136,000
Net income ( loss)	\$ 317,000	\$ (1,411,000)
Basic earnings per share:		
Income (loss) from continuing operations	\$ 0.03	\$ (0.13)
Income from discontinued operations	-	0.01
Net income (loss)	\$ 0.03	\$ (0.12)
Diluted earnings per share:		
Income (loss) from continuing operations	\$ 0.02	\$ (0.13)
Income from discontinued operations	-	0.01
Net income (loss)	\$ 0.02	\$ (0.12)
Weighted average number of common shares:		
Basic	12,136,491	12,133,865
Diluted	12,713,557	12,133,865

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SOUTHERN ENERGY HOMES, INC. AND SUBSIDIARIES  
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS  
(Unaudited)

	Thirteen Weeks Ended	
	April 2, 2004	April 4, 2003
<b>Cash flows from operating activities:</b>		
Income (loss) from continuing operations	\$ 317,000	\$ (1,547,000)
Adjustments to reconcile income (loss) from continuing operations to net cash used in operating activities:		
Equity in income of joint ventures	(70,000)	(5,000)
Depreciation of property and equipment	501,000	542,000
Amortization of intangibles	-	13,000
(Gain) loss on sale of property and equipment	(12,000)	28,000
Amortization of debt issuance costs	24,000	92,000
Provision (credit) for doubtful accounts receivable	7,000	(16,000)
Changes in operating assets and liabilities:		
Inventories	(2,276,000)	(1,799,000)
Accounts receivable	(4,298,000)	(1,861,000)
Income taxes, prepayments and other	445,000	(793,000)
Accounts payable	2,656,000	1,808,000
Accrued liabilities	132,000	417,000
Net cash used in operating activities	<u>(2,574,000)</u>	<u>(3,121,000)</u>
<b>Cash flows from investing activities:</b>		
Capital expenditures	(787,000)	(124,000)
Investments in joint ventures	-	(17,000)
Proceeds from joint ventures	146,000	175,000
Proceeds from sale of property and equipment	13,000	-
Net cash (used in) provided by investing activities	<u>(628,000)</u>	<u>34,000</u>
<b>Cash flows from financing activities:</b>		
Purchase of treasury stock	(89,000)	-
Proceeds from exercise of stock options	2,000	-
Net cash used in financing activities	<u>(87,000)</u>	<u>-</u>
Net cash and cash equivalents used in continuing operations	(3,289,000)	(3,087,000)
Net cash and cash equivalents provided by discontinued operations	100,000	776,000
Net decrease in cash and cash equivalents	<u>(3,189,000)</u>	<u>(2,311,000)</u>
Cash and cash equivalents at the beginning of period	10,174,000	6,960,000
Cash and cash equivalents at the end of period	<u>\$ 6,985,000</u>	<u>\$ 4,649,000</u>

The accompanying notes are an integral part of these consolidated condensed financial statements.

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SOUTHERN ENERGY HOMES, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES:

The consolidated condensed balance sheet as of January 2, 2004, which has been derived from audited financial statements, and the unaudited consolidated condensed financial statements as of April 2, 2004, have been prepared by the Company without audit, but in the opinion of management reflect the adjustments necessary (which include only normal recurring adjustments) for the fair presentation of the information set forth therein. Results of operations for the interim 2004 period are not necessarily indicative of results expected for the full year.

STOCK-BASED COMPENSATION

Under fixed stock option plans, stock options may be granted to employees and directors at exercise prices that are equal to, less than, or greater than the fair market value of the Company's stock on the date of grant. Compensation expense, equal to the difference in exercise price and fair market value on the date of grant, is recognized over the vesting period for options granted at less than fair market value.

In accordance with the disclosure provisions of SFAS No. 123, *Accounting for Stock-Based Compensation*, the Company has elected to apply Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations in accounting for its stock based plans. Accordingly, the Company has recognized no compensation expense for these plans during the quarters ended April 2, 2004 and April 4, 2003. Had the Company accounted for its stock-based compensation plans based on the fair value of awards granted consistent with the methodology of SFAS 123, the Company's reported net loss and loss per share for each of the quarters ended April 2, 2004 and April 4, 2003 would have been affected as indicated below. The effects of applying SFAS 123 on a pro forma basis for the quarters ended April 2, 2004 and April 4, 2003, are not likely to be representative of the effects on reported pro forma net income for future years as options vest over several years and as it is anticipated that additional grants will be made in future years.

	Thirteen weeks ended	
	April 2 2004	April 4, 2003
Net income ( loss) - as reported	\$ 317,000	\$ (1,411,000)
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards	(54,000)	(46,000)
Net income (loss) -pro forma	\$ 263,000	\$ (1,457,000)
As reported - net income (loss) per share	\$ 0.02	\$(0.12)
Pro forma- net income (loss) per share	\$ 0.02	\$(0.12)

2. INVENTORIES:

Inventories are valued at first-in, first-out ("FIFO") cost, which is not in excess of market. An analysis of inventories follows:

	April 2, 2004	January 2, 2004
Raw materials	\$ 5,114,000	\$ 4,564,000
Work-in-progress	890,000	703,000
Finished goods	4,370,000	2,831,000
	\$10,374,000	\$8,098,000

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### 3. EARNINGS PER SHARE:

Basic earnings per share ("EPS") excludes dilution and is computed by dividing income available to common stockholders by the weighted average number of shares outstanding during the subject period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock are exercised or converted into common stock or result in the issuance of common stock that will share in the earnings of the Company.

The following reconciliation details the numerators and denominators used to calculate basic and diluted earnings per share for the respective periods:

	Thirteen Weeks Ended	
	April 2, 2004	April 4, 2003
Income (loss) from continuing operations	\$ 317,000	\$(1,547,000)
Income from discontinued operations	-	136,000
Net income (loss)	<u>\$ 317,000</u>	<u>\$(1,411,000)</u>
Average shares outstanding:		
Basic	12,136,491	12,133,865
Add: dilutive effect of options issued	577,066	-
Diluted	<u>12,713,557</u>	<u>12,133,865</u>
Earnings per share – basic:		
Income (loss) from continuing operations	\$ 0.03	\$ (0.13)
Income from discontinued operations	-	0.01
Net income (loss)	<u>\$ 0.03</u>	<u>\$(0.12)</u>
Earnings per share – diluted:		
Income (loss) from continuing operations	\$ 0.02	\$ (0.13)
Income from discontinued operations	-	0.01
Net income (loss)	<u>\$ 0.02</u>	<u>\$(0.12)</u>

At April 2, 2004 and April 4, 2003, 478,029 and 1,448,141 outstanding options were excluded from the weighted average number of common shares, on a diluted basis, because they were antidilutive.

### 4. RECENT ACCOUNTING PRONOUNCEMENTS:

In January 2003, the FASB issued Interpretation No. 46, Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51 (FIN 46). In December 2003, the FASB modified FIN 46 to make certain technical corrections and address certain implementation issues that had arisen. FIN 46 addresses whether business enterprises must consolidate the financial statements of entities known as "variable interest entities". A variable interest entity is defined by FIN 46 to be a business entity that has one or both of the following characteristics: (1) the equity investment at risk is not sufficient to permit the entity to finance its activities without additional support from other parties, which is provided through other interests that will absorb some or all of the expected losses of the entity; and (2) the equity investors lack one or more of the following essential characteristics of a controlling financial interest: (a) direct or indirect ability to make decisions about the entity's activities through voting rights or similar rights, (b) the obligation to absorb the expected losses of the entity if they occur, which makes it possible for the entity to finance its activities, or (c) the right to receive the expected residual returns of the entity if they occur, which is the compensation for risk of absorbing

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expected losses. FIN 46 does not require consolidation by transferors to qualifying special purpose entities. For non-public companies with an interest in an entity that is subject to the interpretation and that is created after December 31, 2003, this interpretation is effective immediately. A non public enterprise must apply this interpretation to all entities that are subject to this interpretation by the beginning of the first annual period beginning after December 15, 2004. FIN 46 did not have an impact on the Company's financial position, results of operations or cash flows.

#### 5. REPURCHASE AGREEMENTS:

Substantially all of the Company's independent dealers finance their purchases through "floor plan" arrangements under which a financial institution provides the dealer with a loan for the purchase price of the home and maintains a security interest in the home as collateral. In connection with a floor plan arrangement, the financial institution that provides the independent dealer financing customarily requires the Company to enter into a separate repurchase agreement with the financial institution, under which the Company is obligated, upon default by the independent dealer, to repurchase the homes at the Company's original invoice price less cost of all damaged/missing items and less certain curtailments, plus certain administrative and shipping expenses. Repurchases under dealer floor plan financing arrangements were \$455,000 and \$466,000 for the quarters ended April 2, 2004 and April 4, 2003, respectively. Losses on homes repurchased under these agreements were \$24,000 and \$129,000 for the quarters ended April 2, 2004 and April 4, 2003, respectively. At April 2, 2004, the Company had a reserve of \$250,000 for losses related to future repurchases. At April 2, 2004, the Company's contingent repurchase liability under floor plan financing arrangements through independent dealers was approximately \$40 million. The Company estimates and records a reserve for probable losses on dealer repurchases based on historical loss experience and the outstanding principal amount of floor plan financing.

Effective August 31, 2003, Wenco 21, LLC, a joint venture in which the Company held a 50% interest, was liquidated with the assets and liabilities of Wenco 21, LLC being transferred into a book entry reserve account held by 21<sup>st</sup> Mortgage Corporation, the other joint venture partner. In exchange for its pro rata distribution of the liquidated assets and liabilities, the Company received an interest (in the form of a revenue sharing agreement) in specified assets and liabilities that were transferred to 21<sup>st</sup> Mortgage Corporation. Under the terms of the revenue sharing agreement, the Company and 21<sup>st</sup> Mortgage Corporation will share equally in the profits and losses derived from the loans that comprised the Wenco 21, LLC portfolio. The Company is also obligated under the revenue sharing agreement to repurchase homes that were financed by Wenco 21, LLC, upon repossession, for 50% to 65% of the outstanding loan balance. At April 2, 2004, the Company had a reserve of \$304,000 for losses related to future repurchases. The Company's contingent repurchase obligation under this commitment is approximately \$11.5 million. Losses on homes repurchased under this obligation were not significant for the quarters ended April 2, 2004 and April 4, 2003. At April 2, 2004, the carrying amount of loans in the Wenco 21 portfolio included in the reserve account was approximately \$19.3 million. These loans collateralize approximately \$18.5 million of the reserve account's obligations. The Company currently adjusts the carrying value of this investment for any income or losses incurred by the portfolio through earnings and its maximum exposure to loss as a result of its continuing involvement with the loan portfolio, assuming that 100% of the loans and underlying collateral becomes worthless, is approximately \$11.6 million.

#### 6. LEGAL PROCEEDINGS:

The Company is a party to various legal proceedings incidental to its business. The Company typically issues a one-year warranty on new manufactured homes. The Company provides for warranty costs at the time of sale in the ordinary course of business based on historical warranty experience. The majority of the Company's outstanding legal proceedings are claims related to warranty on manufactured homes or employment issues such as workers' compensation claims. Management believes that adequate reserves are maintained for such claims. In the opinion of management, after consultation with legal counsel, the ultimate liability, if any, with respect to these proceedings, will not materially affect the financial position or results of operations of the Company. However, the ultimate resolution of these matters, which could occur within one

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year, could result in losses in excess of the amounts reserved. For the quarters ended April 2, 2004 and April 4, 2003, accrued litigation reserves, (in addition to normal warranty and workmens' compensation claims reserves) were \$0.8 million and \$1.0 million, respectively.

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

### **OVERVIEW**

During the first quarter of 2004, Southern Energy's sales and net income rose as a result of increased home shipments, with unit shipments of homes up 8.9% compared with the first quarter of last year. By comparison, industry unit shipment were down 5.5% for this quarter versus the same period in 2003. The Company believes this increase in market share reflects the Company's emphasis on quality products, expanded dealer net work and manufacturing flexibility that allows it to provide a wide range of custom features in homes.

Availability of financing for both dealers and consumers continues to be a critical element in the manufactured housing industry. In late 2003, the outlook for financing improved with the announcement by the Federal National Mortgage Association and lender partners to enter the market with low-cost financing for manufactured homes, though another large lender announced after the end of the first quarter this year that it plans to exit this market. Management expects demand for manufactured housing to improve as credit becomes more available.

The new Southern Estates product line, which produced its first home in August 2003, fills a product gap in our line by including the most popular options with less customization. To provide manufacturing capacity for the new product line, the Company reconfigured certain of its manufacturing operations by combining production of the Lifestyle line into the Southern Energy plant. During the first quarter of 2004, the Company completed its investment of \$1.5 million to expand the Southern Energy plant into adjacent facilities during the first quarter of 2004. The expanded space will be used for improving efficiencies in finishing operations on the Company's higher end homes.

At the end of the first quarter the Company had \$7.0 million in cash and no debt. In addition to completion of the facility expansion during the quarter, the Company also increased inventory investment for the upcoming building season. The restructuring of operations undertaken over the past three years to reduce retail sales centers combined with operational focus to improve costs over the past year had a positive effect on first quarter results. Cost structure has improved and management is optimistic about improved profitability as home sales grow. However, margins may continue to be pressured by increased costs for raw materials that rose in the fourth quarter of 2003 and continued in the first quarter of this year. It is too early to determine if increased demand for housing will result in improved pricing flexibility to offset higher raw material costs.

### CRITICAL ACCOUNTING ESTIMATES

The Company uses accounting policies that it believes are appropriate to accurately and fairly report its results of operations and financial position, and it applies those accounting policies in a consistent manner. The preparation of the Company's financial statements in conformity with generally accepted accounting principles requires that the Company's management make estimates and assumptions that may affect the reported amounts of assets, liabilities, revenues and expenses. These estimates and assumptions are based on historical experience and other factors believed to be reasonable under the circumstances. The Company evaluates these estimates and assumptions on an ongoing basis. Actual results can and frequently will differ from these estimates. It is possible that materially different amounts would be reported under different conditions or using different methods or assumptions.

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The Company believes that the following accounting policies are the most critical ones used in the preparation of its financial statements, because these are the ones that involve the most significant judgments and estimates about the effect of matters that are inherently uncertain.

### **Product Warranties**

The Company warrants its products against certain manufacturing defects for a period of one year commencing at the time of retail sale, and the estimated cost of such warranties is accrued at the time of sale to the independent dealer. The Company's estimates are derived from two main elements: the historical average cost of servicing warranties, and the number of units under warranty, which includes homes in retailer inventories and homes purchased by consumers still within the warranty period. Many factors can cause the actual warranty cost in any period to vary from average historical cost. In addition, the time when a unit is sold at retail affects the average warranty cost estimate in a given time period, both because of the fluctuations in historical average per unit warranty cost over time, and the fact that warranty costs are higher earlier in the warranty period and lower nearer the end of the warranty period. Warranty costs represent a significant expense to the Company, and therefore significant changes in the above factors could have an adverse effect on the Company's financial performance.

### **Litigation**

The Company is a party to various legal proceedings incidental to its business. The Company typically issues a one-year warranty on new manufactured homes. The majority of these legal proceedings are claims related to warranty on manufactured homes or employment issues such as workers' compensation claims. Management believes that adequate reserves are maintained for such claims. In the opinion of management, after consultation with legal counsel, the ultimate liability, if any, with respect to these proceedings will not materially affect the financial position or results of operations of the Company; however, the ultimate resolution of these matters, which could occur within one year, could result in losses in excess of the amounts reserved.

### **Workers' Compensation Claims**

The Company is partially self-insured for workers compensation claims. The Company purchases insurance coverage for all workers compensation claims in excess of stated limits, currently \$350,000 per occurrence. Amounts are accrued currently for the estimated costs of claims incurred, including related expenses. Accrual of liabilities for unsettled claims requires that the Company estimate its ultimate liability for medical costs, lost wages and legal and related expenses. These estimates are primarily based on actuarial information and third-party consultants who provide assessments of medical impairments and related economic consequences. Periodic adjustments to the reserves are made as events occur that indicate changes are necessary. Nonetheless, there is no assurance that the amounts accrued will not vary from the ultimate amounts incurred upon final disposition of all outstanding claims.

### **Repurchase Agreements**

Substantially all of the Company's independent dealers finance their purchases through "floor plan" arrangements under which a financial institution provides the dealer with a loan for the purchase price of the home and maintains a security interest in the home as collateral. In connection with a floor plan arrangement, the financial institution that provides the independent dealer financing customarily requires the Company to enter into a separate repurchase agreement with the financial institution, under which the Company is obligated, upon default by the independent dealer, to repurchase the homes at the Company's original invoice price less cost of all damaged/missing items and less certain curtailments, plus certain administrative and shipping expenses. Repurchases under dealer floor plan financing arrangements were \$455,000 and \$466,000 for the quarter ended April 2, 2004 and April 4, 2003, respectively. Losses on homes repurchased under these agreements were \$24,000 and \$129,000 for the quarters ended April 2, 2004 and April 4, 2003, respectively. At April 2, 2004, the Company had a reserve of \$250,000 for losses related to future repurchases. At April 2, 2004, the Company's contingent repurchase liability under floor plan financing arrangements through independent dealers was approximately \$40 million. The Company estimates and records a reserve for probable losses on dealer repurchases based on historical loss experience and the outstanding principal amount of floor plan financing.

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Effective August 31, 2003, Wenco 21, LLC, a joint venture in which the Company held a 50% interest, was liquidated with the assets and liabilities of Wenco 21, LLC being transferred into a book entry reserve account held by 21<sup>st</sup> Mortgage Corporation, the other joint venture partner. In exchange for its pro rata distribution of the liquidated assets and liabilities, the Company received an interest (in the form of a revenue sharing agreement) in specified assets and liabilities that were transferred to 21<sup>st</sup> Mortgage Corporation. Under the terms of the revenue sharing agreement, the Company and 21<sup>st</sup> Mortgage Corporation will share equally in the profits and losses derived from the loans that comprised the Wenco 21, LLC portfolio. The Company is also obligated under the revenue sharing agreement to repurchase homes that were financed by Wenco 21, LLC, upon repossession, for 50% to 65% of the outstanding loan balance. At April 2, 2004, the Company had a reserve of \$304,000 for losses related to future repurchases. The Company's contingent repurchase obligation under this commitment is approximately \$11.5 million. Losses on homes repurchased under this obligation were not significant for the quarters ended April 2, 2004 and April 4, 2003. At April 2, 2004, the carrying amount of loans in the Wenco 21 portfolio included in the reserve account was approximately \$19.3 million. These loans collateralize approximately \$18.5 million of the reserve account's obligations. The Company currently adjusts the carrying value of this investment for any income or losses incurred by the portfolio through earnings and its maximum exposure to loss as a result of its continuing involvement with the loan portfolio, assuming that 100% of the loans and underlying collateral becomes worthless, is approximately \$11.6 million.

#### **Volume Incentives Payable**

Volume incentive payments to independent dealers who retail the Company's products are accounted for as a reduction to gross sales, and are estimated and accrued when sales of products are made to the dealers. Volume incentive reserves are recorded based on the annualized purchases of independent dealers who purchase the minimum qualifying amount of product from the Company. The potential amount of the payment is accrued by the Company at the time of the sale to the dealer, based upon estimates derived from the historical payout rates. Actual payout rates fluctuate based on dealer compliance and performance, which is affected by a number of variables, including general economic conditions and the quality of individual dealers and their respective sales organizations. Volume incentive costs represent a significant expense to the Company, and therefore significant changes in the above factors could have an adverse effect on the Company's financial performance.

#### **RECENT ACCOUNTING PRONOUNCEMENT**

In March 2004, the FASB issued Exposure Draft, "Share-Based Payment." In this statement, the FASB formally proposed to require companies to recognize the fair value of stock options and other stock-based compensation to employees for future reporting periods. It is probable that the Company will be required to expense options under its current plan in future periods under this Exposure Draft. However, the Company cannot estimate the impact that expensing options will have on the final statements until the FASB completes its exposure draft process and issues its final statement.

## RESULTS OF OPERATIONS

Results of operations for the thirteen weeks ended April 2, 2004 and April 4, 2003 are not necessarily indicative of the results that may be expected for the entire year, due in part, to the cyclical and seasonal nature of the Company's business. Typically, sales are higher in the second and third quarters than in the first and fourth quarters of the year.

### Net Revenues

Total net revenues (consisting of gross sales less volume discounts, dealer interest and returns and allowances) for the thirteen weeks ended April 2, 2004 were \$32.0 million, as compared with \$28.0 million in the prior year period.

Net revenues from wholesale sales of manufactured homes were \$30.8 million (including intersegment revenues of \$0.3 million) for the thirteen weeks ended April 2, 2004, as compared with \$26.6 million (including intersegment revenues of \$0.6 million) for the prior year period, an increase of 15.8%. Total homes shipped for the thirteen weeks ended April 2, 2004 was 916, up from the 841 homes shipped in the prior year period an increase of 8.9% which compares to a 5.5% decrease in industry shipments, according to the Manufacturing Housing Institute. The average wholesale price per home for the thirteen weeks ended April 2, 2004 was \$32,063, as compared with \$30,040 in the prior year period, an increase of 6.7%. The increase in sales and continued gain in market share was due to our increased emphasis on quality products, expanded dealer net work and manufacturing flexibility that allows us to provide a wide range of custom features in our homes.

Following are basic operating facts for the thirteen weeks ended April 2, 2004, and April 4, 2003, respectively:

### Operating facts

	<u>Thirteen Weeks ended</u>	
	<u>April 2, 2004</u>	<u>April 4, 2003</u>
Wholesale units sold:		
External customers	906	825
Intercompany	<u>10</u>	<u>16</u>
	<u>916</u>	<u>841</u>
Average sales price – wholesale	\$32,063	\$30,040
Floor sections produced	1,550	1,483

### Gross Profit

Gross profit consists of net revenues less the cost of sales, which includes labor, materials and overhead. Gross profit for the thirteen weeks ended April 2, 2004 was \$5.3 million, or 16.5% of net revenues, as compared with \$3.8 million, or 13.4% of net revenues, in the prior year period. The improvement in gross profit was due to increased leverage on the higher sales volume, favorable product mix and lower warranty costs compared with the first quarter of 2003. The margin increase since the end of last year was offset by higher material costs with steel and lumber being the commodities with the largest price increases.

### Selling, General and Administrative Expenses

Selling, general and administrative expenses include primarily sales commissions, advertising expenses, freight costs, salaries for support personnel, administrative compensation, executive and management bonuses, insurance costs and professional fees. Selling, general and administrative expenses were \$4.9 million, or 15.4% of net revenues, during the thirteen weeks ended April 2, 2004, as compared with \$5.2 million, or 18.6% of net revenues, for the same period of the prior year. The decline in selling, general and administrative expenses in

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both dollars and percentage of revenue was attributable primarily to higher sales volume, lower insurance expenses, lower legal expenses and lower administrative salaries.

#### Interest Expense

Interest expense for the thirteen weeks ended April 2, 2004 was \$49,000, as compared with \$145,000 in the prior year period. The decline in interest expense was due to lower bank service fees.

#### Income Taxes

Income taxes are provided for based on the tax effect of revenue and expense transactions included in the determination of pre-tax book income. The Company maintains a valuation allowance for its deferred income taxes unless realization is considered more likely than not. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. The Company considers projected future taxable income and tax planning strategies in making this assessment. Due to cumulative losses in recent fiscal years, the Company has established a valuation allowance against the net deferred tax benefits related to net operating loss carryforwards and other net deductible temporary differences between financial and taxable income.

During the first quarter of 2004, the Company recorded a tax benefit associated with the reduction in the valuation allowance of approximately \$125,000. This reduction occurred as a result of the Company's profitability during the quarter. The valuation allowance may continue to be reversed in future periods if the Company continues to be profitable.

At January 2, 2004, the Company had a federal net operating loss carryforward of approximately \$2.9 million that expires in 2023. The Company also has state net operating loss carryforwards amounting to approximately \$20.9 million which are available to offset future taxable income in Alabama and Texas. The state loss carryforwards expire at various dates between 2006 and 2023. The tax benefit of these federal and state loss carryforwards are reserved for through the deferred tax valuation allowance. The tax loss generated in 2002 for federal income tax purposes was carried back under the temporary 5 year net operating loss carry back rules applicable to 2002. Accordingly, the Company filed a carryback refund claim and received a federal income tax refund of \$5.3 million in 2003 with respect to the 2002 net operating loss.

#### LIQUIDITY AND CAPITAL RESOURCES

During the thirteen weeks ended April 2, 2004, cash used in operations was approximately \$3.3 million. Net income includes a non-cash charge for depreciation expense of \$0.5 million. Cash used in operating activities also reflected increased accounts receivable of \$4.3 million, increased inventories of \$2.3 million, partially offset by an increase in accounts payable of \$2.7 million, and an increase in accrued liabilities of \$0.1 million. In addition to cash provided by operating activities, other significant items affecting cash flows from operations included capital expenditures of \$0.8 million, purchase of treasury stock of \$0.1 million and net cash from joint ventures of \$0.1 million.

In accordance with the Company's current revolving credit facility, the Company applies all cash receipts to reduce the line of credit. At April 2, 2004 the balance of the revolving credit facility was zero and the Company's net working capital from operations was \$15.2 million, including \$7.0 million in cash and cash equivalents, as compared with working capital of \$14.7 million at January 2, 2004, including \$10.2 million in cash and cash equivalents. The increase in net working capital was primarily attributable to an increase in accounts receivable of \$4.3 million, and an increase in inventory of \$2.3 million partially offset by a decline in cash and cash equivalents of \$3.2 million, an increase in accounts payable and accrued liabilities of \$2.8.

During the thirteen weeks ended April 4, 2003, cash used in operations was approximately \$3.1 million. Net loss from continuing operations for the thirteen weeks was \$1.5 million. Included in the net loss were amortization expenses of \$0.1 million and depreciation expense of \$0.5 million. Cash used in operating activities also reflected increased accounts receivable of \$2.0 million, increased inventories of \$1.8 million,

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partially offset by an increase in accounts payable of \$1.8 million, and an increase in accrued liabilities of \$0.4 million. In addition to cash provided by operating activities, other significant items affecting cash flows from continuing operations included capital expenditures of \$0.1 million and net cash from joint ventures of \$0.2 million.

At April 4, 2003 the balance of the revolving credit facility was zero and the Company's net working capital from continuing operations was \$13.0 million, including \$4.7 million in cash and cash equivalents, as compared with working capital of \$13.2 million at January 3, 2003, including \$7.0 million in cash and cash equivalents. The decline in net working capital was primarily attributable to a decline in cash and cash equivalents of \$2.3 million, and an increase in accounts payable and accrued liabilities of \$2.2, partially offset by an increase in accounts receivable of \$2.0 million, an increase in inventory of \$1.8 million and an increase in prepayments and other of \$0.7 million.

At April 2, 2004, the Company had a \$10 million secured line of credit. The line of credit matures on March 8, 2005 and bears interest at the prime rate plus 1%, which amounted to 5% at April 2, 2004. At April 2, 2004 the Company's availability on the line of credit (based on an asset base limitation) was \$10 million. The Company's ability to draw upon this line of credit is dependent upon its continued compliance with certain financial ratios and covenants. The Company had no outstanding borrowings at April 2, 2004 and January 2, 2004, respectively.

As of April 2, 2004, the Company does not currently plan to make material capital expenditures during the remainder of the year. However, if business conditions change, the Company could increase its capital expenditures plans for the remainder of 2004.

#### INFLATION

The Company believes that the relatively moderate rate of inflation over the past few years has not had a significant impact on its sales or profitability. Although there can be no assurance that the Company will be able to do so in the future, the Company has in the past been able to pass on most of the increases in its costs by increasing selling prices. There is no assurance that we will be able to continue increasing our selling prices in the future.

#### QUANTITATIVE AND QUALITATIVE DISCLOSURES OF MARKET RISK

Historically the Company has not entered into derivatives contracts to either hedge existing risk or for speculative purposes. The Company also does not and has not entered into contracts involving derivative financial instruments or derivative commodity instruments. To the extent that "financial instruments" may be deemed to include trade accounts receivable, loans and structured notes, the Company does not utilize derivative instruments to manage such risks. The Company's principal credit agreement bears a floating interest rate of 1.0% over prime. Accordingly, the Company is subject to market risk associated with changes in interest rates. At April 2, 2004, nothing was outstanding under the credit agreement. With respect to accounts receivable, most of the Company's sales of manufactured homes are pre-sold, such that orders exist before construction begins. When manufactured homes are sold to dealers as inventory, such homes are generally paid from availability under the dealer's floor plan financing arrangement. In the typical case, funds are wired to the Company from the dealer's floor plan lender within 21 days of delivery to the dealer's lot. Management thus does not perceive that the Company is subject to a material market risk with respect to its non-interest bearing accounts receivable.

#### CONTROLS AND PROCEDURES

The Company has evaluated the effectiveness of its disclosure controls and procedures. The evaluation was performed under the supervision and with the participation of the Company's management. Based on this evaluation, management has concluded that the disclosure controls and procedures are effective in ensuring that all material information disclosed in this quarterly report has been communicated to them in a manner

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appropriate to allow timely decisions regarding disclosure. There have been no significant changes in the Company's internal controls, or in other factors that could significantly affect internal controls, including any corrective actions with regard to significant deficiencies and material weaknesses with regard to the Company's internal controls, subsequent to that evaluation.

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