1999

Realizing

THE AMERICAN DREAM

CLAYTON HOMES, INC.

financial highlights

(dollars in thousands, except per share)

Income Statement Data:	YEAR ENDED JUNE 30, 1999	1998	Percent Change
Revenues	**$1,344,283**	$1,127,779	19%
Income before income taxes	**245,968**	222,100	11%
Net income	**154,968**	137,700	13%
Earnings per share:			
Basic	**1.07**	0.93	15%
Diluted	**1.06**	0.92	15%
Dividends per share	**$.064**	$.064	

Balance Sheet Data:			
Total assets	**$1,417,245**	$1,457,757	–3%
Shareholders' equity	**$ 947,768**	$ 881,019	8%
Return on average shareholders' equity	**16.9%**	16.8%	

Portfolio Data:			
Loans serviced	**$3,473,000**	$2,925,000	19%
Delinquency % (over 30 days):			
Originated contracts	**1.8%**	2.0%	
All contracts	**2.1%**	3.3%	
Net losses as a % of average loans outstanding:			
Originated contracts	**1.0%**	0.8%	
All contracts	**1.4%**	0.8%	

Other Data:			
Total floors sold	**50,325**	45,006	12%
Total homes sold	**35,526**	32,358	10%
National market share	**8.1%**	8.0%	
Manufacturing plants	**19**	18	6%
Independent retailers	**671**	702	–4%
Company-owned retail centers	**306**	273	12%
Communities	**75**	71	6%
Community home sites owned	**19,708**	18,964	4%
Personnel count	**7,292**	6,703	9%

Where appropriate, data in this report has been adjusted for the five-for-four stock split paid December 8, 1998.

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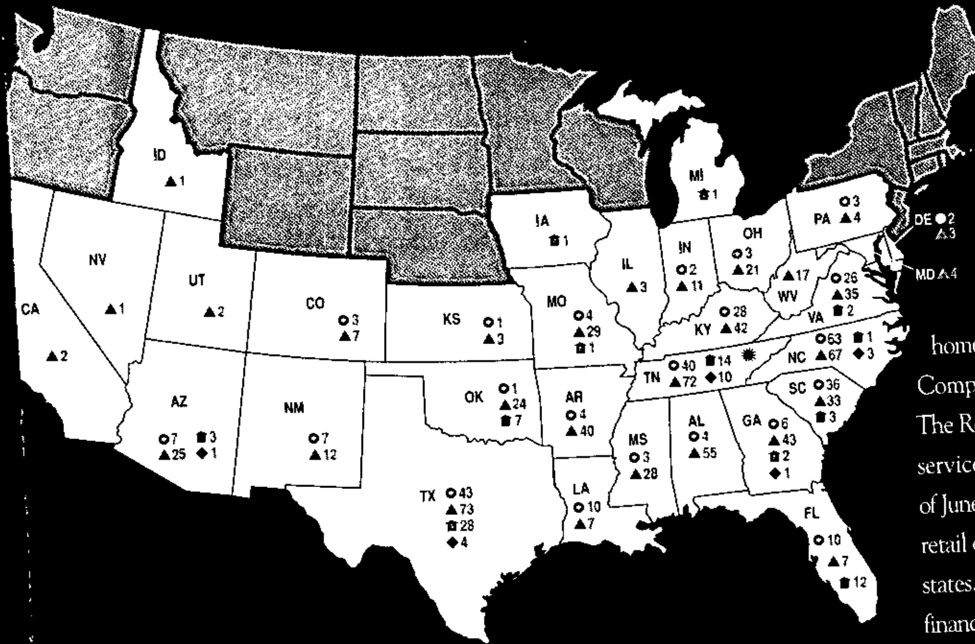
Clayton
Brings The Dream Home

We deliver more than top-quality housing. We create the opportunity for people to afford *The American Dream* –a home of their own–and thus share *The American Dream* with our shareholders and our team members.

Headquartered in Knoxville, Tennessee, employing 7300 people and operating in 31 states, Clayton Homes, Inc. builds, sells, finances and insures manufactured homes, and owns and operates residential manufactured housing communities. The Manufacturing group is a leading producer of manufactured homes with 19 plants supplying homes to 1052 independent and Company-owned retail centers. The Retail group sells, installs and services factory-built homes. As of June 30, 1999, Company-owned retail centers numbered 306 in 22 states. Financial Services provides financing and insurance for home-buyers of Company-owned and selected independent retail sales centers through Vanderbilt Mortgage and Finance, a wholly-owned subsidiary. The Communities group owns and operates 75 manufactured housing communities with 19,708 homesites in 12 states.

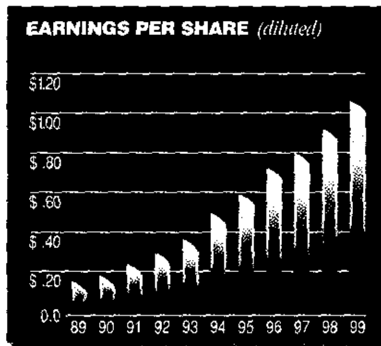


Clayton Headquarters – Knoxville, TN
● Company – Owned Retail Centers
△ Independent Retailers
Manufacturing Plants
Clayton Communities

ABOUT OUR COVER: A new three bedroom multi-sectional home with more than 1800 square feet featuring walk in closets, island kitchen and stacked-stone fireplace.

to our shareholders

'99 This year marks Clayton Homes, Inc.'s 19th consecutive year of record revenues – $1,344,300,000 – and record net income – $154,968,000. Since our initial public offering in June 1983, the Company's net income has increased at an annual compound rate of 27 percent. In January of this year, *Forbes Magazine* named Clayton Homes, Inc. to their Platinum List – a roster of the nation's 400 best performing companies based on growth and profitability.



We appreciate such accolades, but our record of predictable, sustained, strong growth is what truly counts. Behind our favorable numbers has always been a well-planned and thoughtfully executed long-term strategy for Clayton Homes.

Last year we set a number of carefully chosen goals for 1999. The road to achieving them was well mapped. We reached our goals and, in many instances, went beyond them.

WE SET GOALS TO:

◆ *Have 300 Company-owned retail centers in 1999.* We now have 306 stores.

◆ *Prepare for Y2K.* Our computer systems at each of our facilities have been updated, checked, tested and retested to ensure the transition into the new millennium is seamless for our team members, vendors, systems and customers.

◆ *Improve delinquency.* We reduced originated delinquency from 1.98 percent to 1.84 percent, one of the best results in the industry.

◆ *Improve same store sales.* Same store sales growth rose 14 percent in 1999.

◆ *Reduce debt.* We repaid our bridge loan for portfolio acquisitions and reduced debt to capital from 22 percent to 9 percent.

◆ *Expand our presence in the Southwest.* We opened a plant in El Mirage, Arizona, in October of 1998, which was profitable in December.

◆ *Originate $1 billion in mortgages.* We originated $1.08 billion.

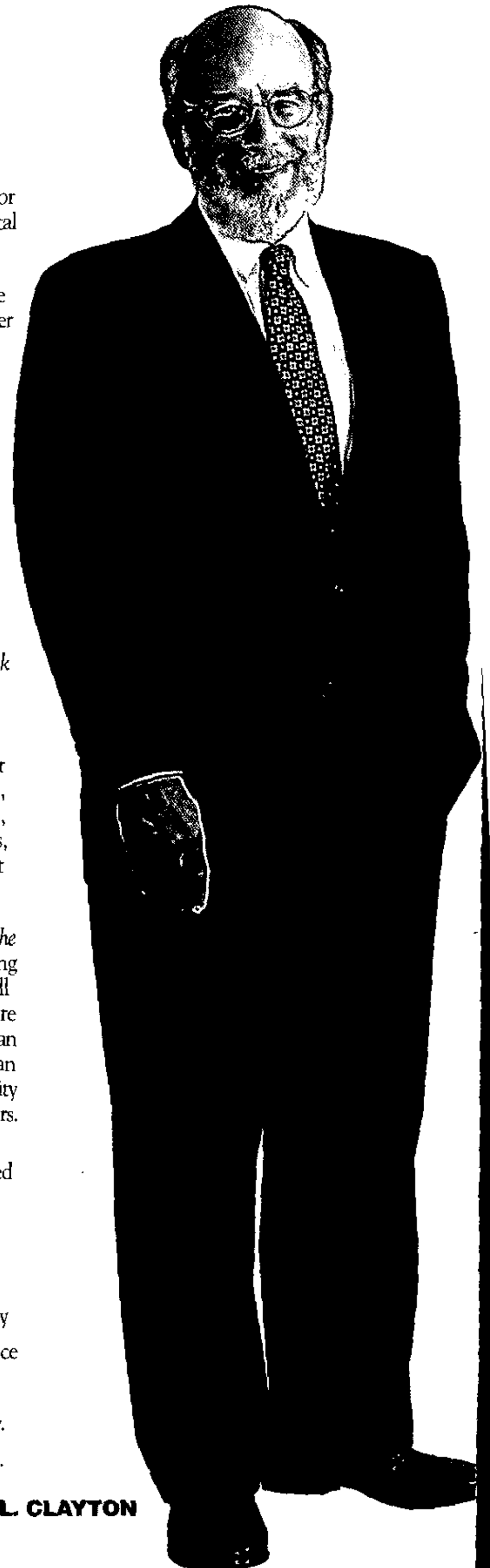
◆ *Develop attractive and profitable communities.* We opened two such communities in 1999 and are in the planning stages for two more.

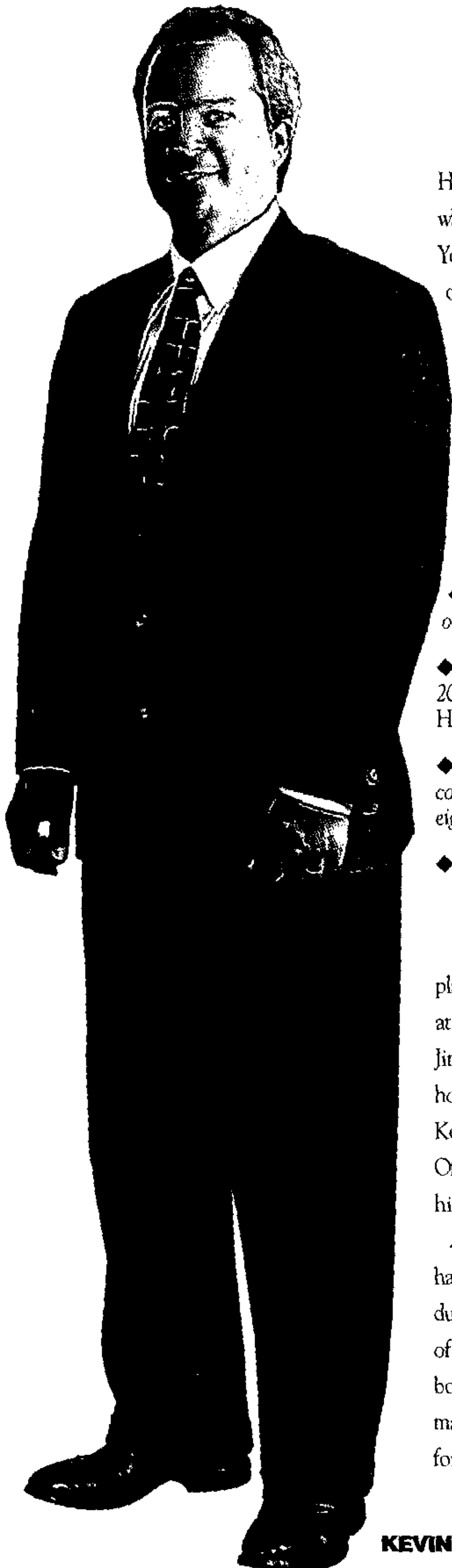
◆ *Develop an interactive Internet wide area network (WAN) communications system.* LINK debuted this summer, providing loan application processing over the Internet – saving time, money and paper. LINK's communication, real-time management information systems, and two-way data exchange will reduce cost and shrinkage and improve training.

◆ *Recruit, retain and develop the best people in the industry.* We built a training center for hosting Clayton sales and leadership academies as well as business retreats. These 11 buildings were manufactured at our plants in Rutledge and Bean Station, Tennessee. Together the buildings can comfortably house 75 guests, and the main facility accommodates meetings of 100 team members.

Now our energy and attention are focused toward FY2000, as we find our industry challenged with excess capacity – where Clayton has historically thrived. Our Company is positioned with a high quality loan portfolio, community sites, and insurance operations that provide a predictable and sustainable base of earnings and cash flow. There will be opportunities for acquisitions.

JAMES L. CLAYTON





KEVIN T. CLAYTON

However, the Company will remain conservative while aggressively seeking opportunistic investments. You can depend on our staying true to our operating philosophy as expressed in our mission statement: "To create and market high value products and services for the benefit of Clayton Stakeholders: our customers, our shareholders and our team members."

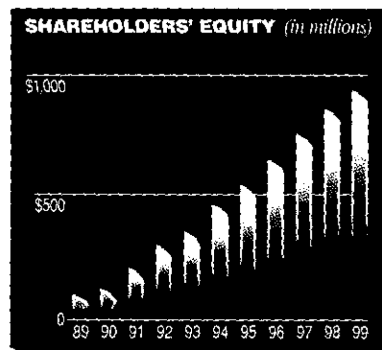
OUR GOALS FOR 2000 INCLUDE:

- *Open 30 Company-owned sales centers.*
- *Begin production at our 20th manufacturing plant in Hodgenville, Kentucky.*
- *Develop two new communities and expand eight others.*
- *Expand our loan servicing to $4 billion.*

Consistent with the Company's succession planning, this year marks a change in leadership at Clayton Homes, Inc. After 43 years of service, Jim Clayton is retiring as Chief Executive Officer; however, he will remain Chairman of the Board. Kevin Clayton, President and Chief Operating Officer, is stepping up to become CEO. He entered his new position officially on July 1, 1999.

As with most events at Clayton, this succession has been well-planned and has evolved seamlessly during the last decade. Kevin has served in each of the Company's four groups, as well as on the board of directors. He was a Retail regional manager, president of the Manufacturing group for three years and president of the Financial Services group for four. He earned an MBA from the University of Tennessee, and Clayton team members have great confidence in Kevin's ability, understanding of the industry and leadership.

Although we were pleased with the performance of the Company this year, we were disappointed with the performance of the stock, which was depressed with all housing stocks. We are making every effort to convey the Clayton record, and we will continue to repurchase stock at these prices.



As always, we thank all Clayton stakeholders for supporting the building of a Company with a solid foundation and a promising future. Our conservarive and methodical approach may not excite everyone, but our consistent success excites the people who count - our shareholders, our customers and our people. Here's to *The American Dream*, and here's to FY2000 at Clayton Homes, Inc.

Sincerely,

James L. Clayton
Chairman of the Board

Kevin T. Clayton
Chief Executive Officer and President

manufacturing
building the american dream

The focus of Clayton Homes Manufacturing group is to build high-quality homes while providing the best possible value to each customer. Improving our processes, executing the basics and maintaining open channels of communication will ensure that we maximize the performance of our plants, team members and retailers.

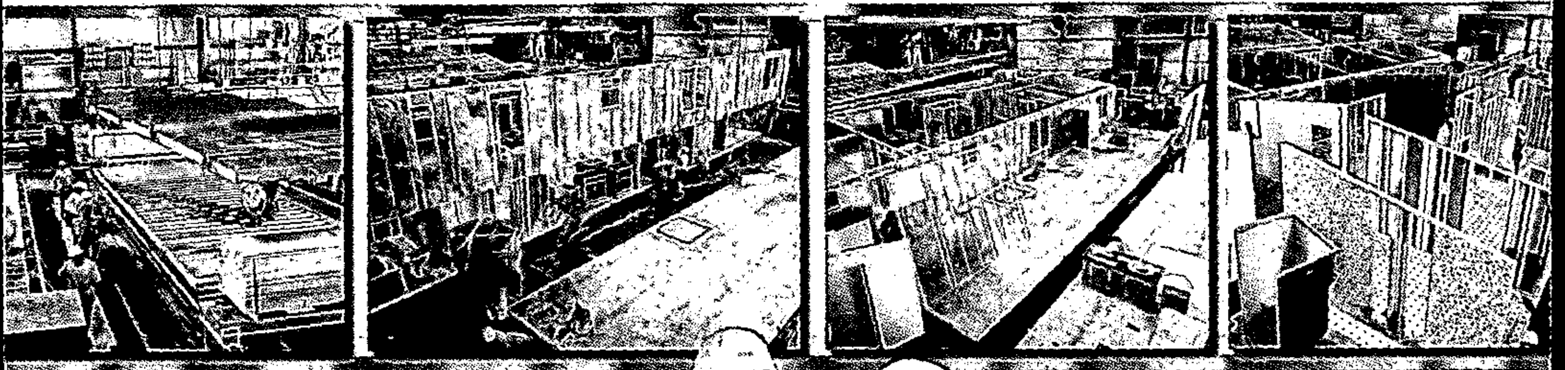
In 1999 our plants produced and sold 28,344 homes representing 42,099 floors – a 6 percent increase over 1998. Product mix was split 48 percent multi-section homes while 52 percent were single-section homes. Manufacturing revenues grew by 9 percent to $654 million in 1999. Eighteen of our 19 plants were profitable, the exception being our Georgia plant, which sustained severe storm-related damage in January. With focused planning and an experienced operations team, our newest plant in El Mirage, Arizona was built in seven months and profitable in the second full month of production.

El Mirage expands our presence in the Southwest, and we are now serving independent retailers as far west as California. The recently announced site for our 20th plant, Hodgenville, Kentucky, will allow expansion in the solid manufactured housing states of Michigan, Indiana and Ohio.

Capital expenditures of $13 million were invested this year to further improve processes, safety, plant efficiency and capacity. In that same spirit, we turned a disaster into an opportunity by upgrading our Georgia facility. The plant was able to resume production in April as a more modern, efficient operation producing highly competitive multi-section homes.

Material cost reductions, achieved through process improvement, component standardization and partnership with our suppliers, remain a key priority. All plants operate with "just-in-time" inventory management, resulting in an average inventory turn of 26 times this year. Our strong national contract purchasing program with key suppliers – GE, Owens Corning, Moen, Weyerhauser, Georgia Pacific, Congoleum and Carriage Carpets to name a few – ensures competitive pricing, unmatched quality, and reliability in every Clayton home.

In 1995 the group implemented a Team Profit Sharing (TPS) Bonus Program. Today team members at 15 of our plants share the operating profits. TPS gives team members the direct ability to affect plant operating

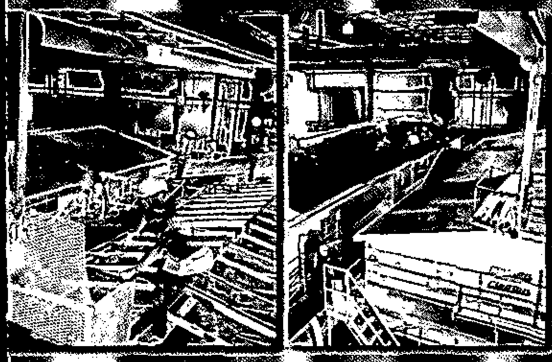


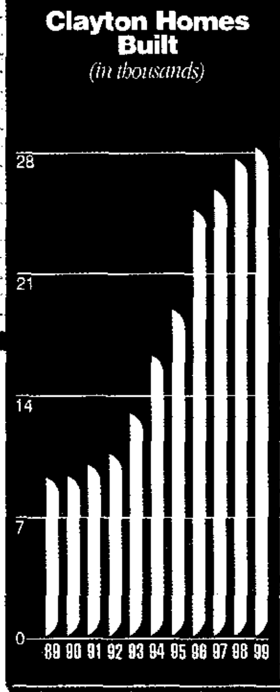
The quality of a Clayton Home is everywhere you look and in many places you can't see. Clayton uses only top quality materials and name brand fixtures and appliances.

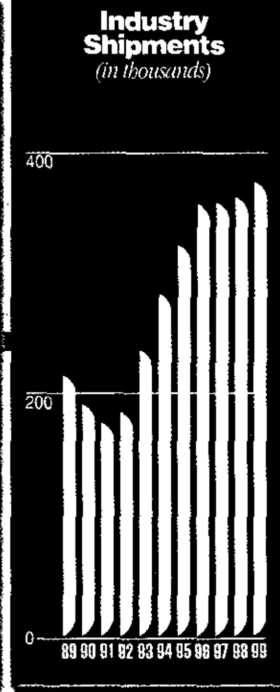
performance as well as their pay. Each person receives a base wage, but overall compensation is determined by actual profits attained – not the production achieved. This requires "open book" reviews of cost areas and monthly profitability with all team members. Results have been improved efficiency, better use of materials, more consistent quality and improved morale.

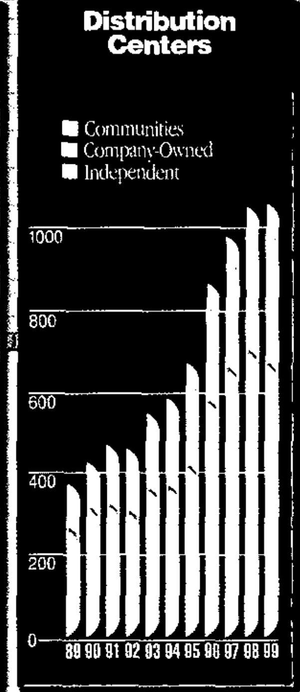
	JUNE 30, 1999	1998	Percent Change
SALES (in millions):			
Independent dealers	$ 333.0	$ 311.9	7%
Intercompany*	320.8	287.4	12%
Total	$ 653.8	$ 599.3	9%
HOMES BUILT (units):			
Single-section	14,663	15,596	-6%
Multi-section	13,681	12,054	13%
Total	28,344	27,650	3%
Intercompany*	(13,364)	(12,922)	3%
Independent retailers	14,980	14,728	2%

**Represents sales to the Company's Retail and Communities operations.*









A constant focus on safety is vital to protecting our team members. Safety improvements such as lowering our houses on the production line to prevent serious falls and knee injuries have proven successful with days lost to injury down 10 percent. Our Oxford, North Carolina plant has achieved a record 434 days without a lost workday accident.

The Clayton Manufacturing Leadership Academy was established during 1999 to teach the basics of leadership and teamwork. Over time, all members of the manufacturing team will attend. The emphasis on developing people skills is preparing our team to successfully compete with an open management style in a diverse production environment.

In Manufacturing, our direct customer is the retailer. We serve 1052 retailers – 671 independent, 306 Company-owned sales centers and 75 Company-owned communities – in 31 states. The supportive and long-term relationships we enjoy with our retailers provide "real world" feedback on ever- changing consumer preferences. This geographically diverse family of retailers guides our rapid response product development and manufacturing teams in providing homes in tune with current market demands.

In fiscal 2000, your Manufacturing group will continue its focus on quality, value, technology and the prudent use of resources. Teaming with our valued retailers and suppliers, we will provide high quality, affordable housing – *The American Dream.*

retail
selling the american dream

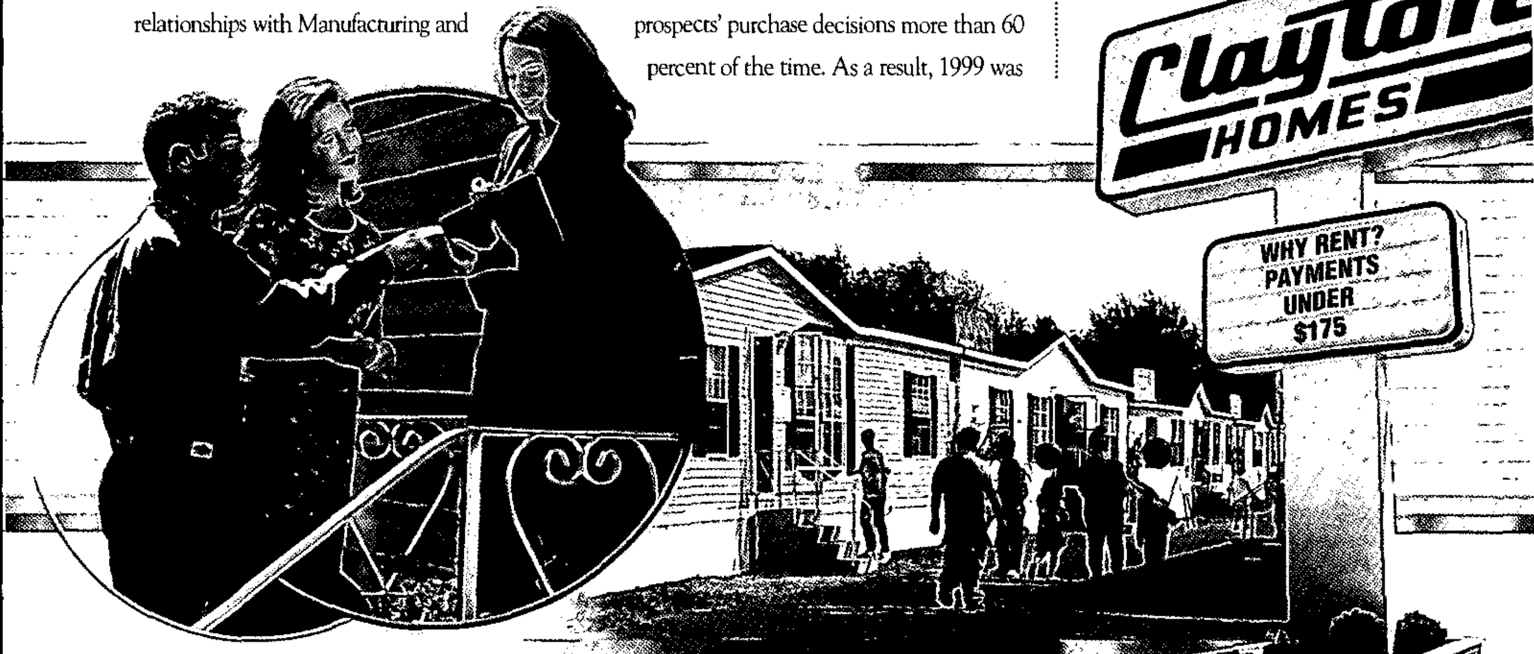
Exceeding homebuyers' expectations and steadily improving the profitability of our sales centers are the primary objectives of the Retail group. Our greatest advantage is the synergy created through Clayton's unique brand of vertical integration. Layers of value are created for shareholders through Retail's solid relationships with Manufacturing and Financial Services, allowing us to more quickly and efficiently serve our homebuyers' desire for quality, affordable housing.

In 1999 the Retail group sold 19,474 homes, generating sales revenues of $673 million. Same store sales increased 14 percent with overall growth at 26 percent.

Success in 1999 can be attributed to a dedicated, well-trained sales team, as well as Retail's restructuring, which began in 1998 and continues into 2000. The group was segmented into four zones and 23 regions, making the number of sales centers that each regional manager oversees 15 or less. With fewer stores assigned, more time can be spent recruiting superior talent, providing comprehensive training for the teams, and assisting customers. New regions will be created to maintain this effective ratio as the Retail group grows.

Industry surveys and our own data confirm that drive-by impressions influence our prospects' purchase decisions more than 60 percent of the time. As a result, 1999 was a year to focus on the curb appeal of our sales centers. We upgraded 178 stores with new signage, paving, landscaping and other visual enhancements designed to make our sales centers more inviting to prospective customers. Our on-going strategic purchasing of sales center real estate permits us to invest in and retain the prime retail location in most of our markets and insulates us from escalating rents.

Today's marketplace demands timely and competitive mortgage financing for homebuyers. Retail's close alliance with Vanderbilt Mortgage and Finance not only benefits our customers but also increases Retail's sales and profitability. Our field representatives keep Vanderbilt informed of customers' needs; in turn, Vanderbilt creates and delivers responsible financing and insurance products.

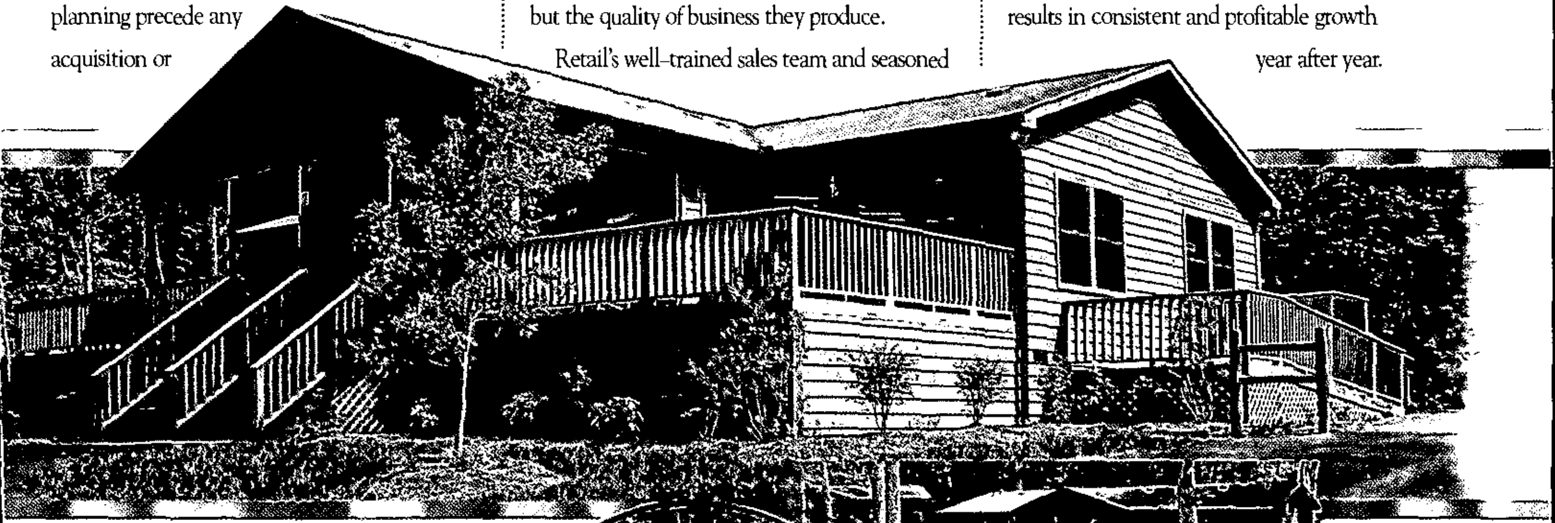


Throughout 1999, Retail and Vanderbilt teamed to develop and market unique programs to capitalize on low interest rates and demands for more flexible payment plans.

In the fourth quarter, Retail introduced LINK, an automated, Internet-based communication system. The Retail sales team will now generate more professional loan applications, and homebuyers will experience faster loan decisions; thereby enhancing the homebuying experience, improving closing ratios and reducing costs.

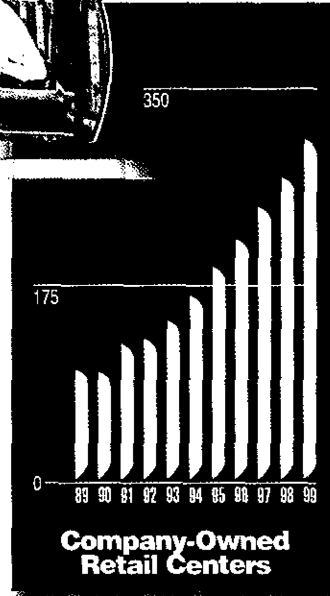
Our record growth continued as we expanded the number of sales centers to serve new markets and provide opportunities for team members. Retail exceeded its goal of 300 operating stores by opening 38 sales centers, closing 5 under-performing locations, and ending the year with 306 stores in 22 states. Careful study and planning precede any acquisition or groundbreaking. New markets are not even targeted for expansion until a successful sales center manager is identified. The most important ingredients in every new sales center are the quality and commitment of the sales team chosen to manage it. For Retail, the measure of success is not the quantity of stores but the quality of business they produce.

Retail's well-trained sales team and seasoned management, coupled with the Company's quality homes and financing, make *The American Dream* a reality. Clayton Homes' often copied but seldom executed, conservative brand of vertical integration developed over 30 years gives your Retail group the edge in the marketplace. This results in consistent and profitable growth year after year.

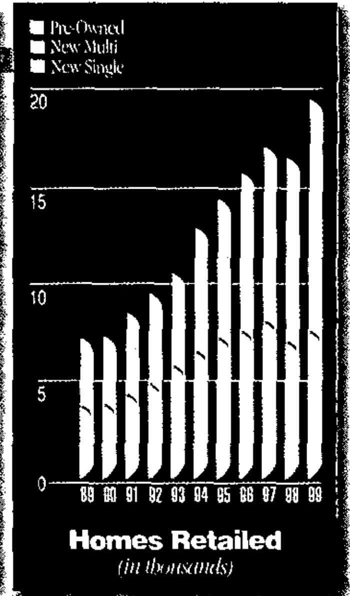


This cost-effective lodge and training center was built adjacent to our headquarters in 1999 to host sales academies, hold retreats and house visiting team members. All 11 buildings were manufactured by Clayton. The conference center reduces training costs while enhancing the experience.

	JUNE 30, 1999	1998	Percent Change
SALES (in millions):			
New homes	$ 613.2	$ 501.7	22%
Used homes	59.4	33.2	79%
Total	$ 672.6	$ 534.9	26%
HOMES SOLD (units):			
New single-section	7,597	7,099	7%
New multi-section	7,297	6,151	19%
Total new	14,894	13,250	12%
Used	4,580	3,287	39%
Total	19,474	16,537	18%



Company-Owned Retail Centers



Homes Retailed
(in thousands)

financial services

making the american dream affordable

Financial Services achieved record results in loan originations, servicing, securitizations and net written insurance premiums for 1999. The group originated and securitized more than $1 billion in mortgages, raising the total serviced portfolio to $3.47 billion – up 19 percent for the year. The increase in loan volume was achieved while further reducing over–30–day delinquency to 1.84 percent, well below industry norms. Net insurance premiums written totaled a record $61 million for the year – up 19 percent.

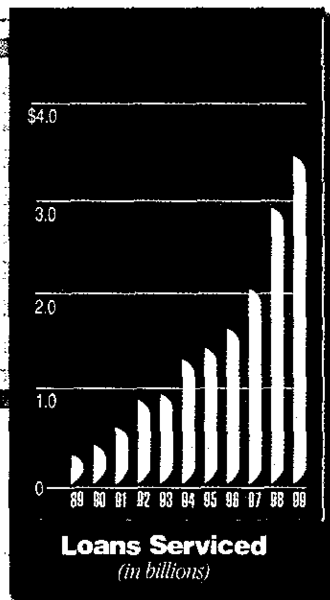
Delinquency on two large portfolios acquired in May 1998 was reduced from 22 percent to 5 percent during the year. Vanderbilt further expanded its purchased loan portfolio in February 1999 with another $94 million loan acquisition. Financial Services' proven track record, the Company's strong balance sheet and synergistic relationships with Retail, Communities and independent retailers uniquely position the group to take advantage of future portfolio investment opportunities.

At least one of our three insurance products, homeowners, family protection, and home buyers protection, is sold with 92% of our financed home sales. Our customers enjoy the luxury of quality, comprehensive coverage backed by a professional and responsive claims organization. Technological advances allow our team to process claims faster while controlling costs.

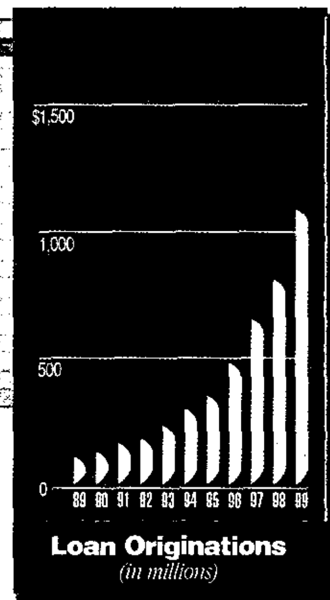
Financial Services continually strives to develop new products to meet our customers' needs.

'99 originated $1 BILLION in mortgages

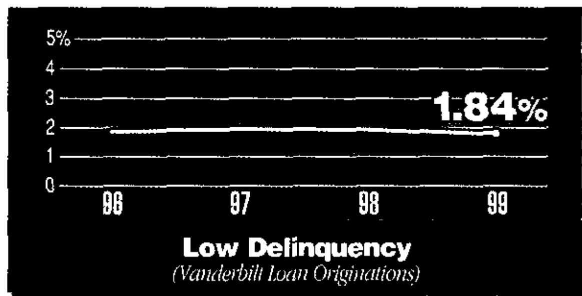
total loans $3.47 BILLION



Loans Serviced
(in billions)



Loan Originations
(in millions)



Low Delinquency
(Vanderbilt Loan Originations)

MBUs

Effective tools for achieving diversification have been our Million Dollar Business Units or MBUs. MBUs are modeled to leverage the group's core competencies and maximize relationship opportunities with Retail, Communities, Manufacturing and independent retailers. MBU originations increased 58 percent to $416 million.

Vanderbilt designed and implemented online training for all account representatives in 1999. This contributed to our reduction in delinquency and improved the quality of our customer relationships.

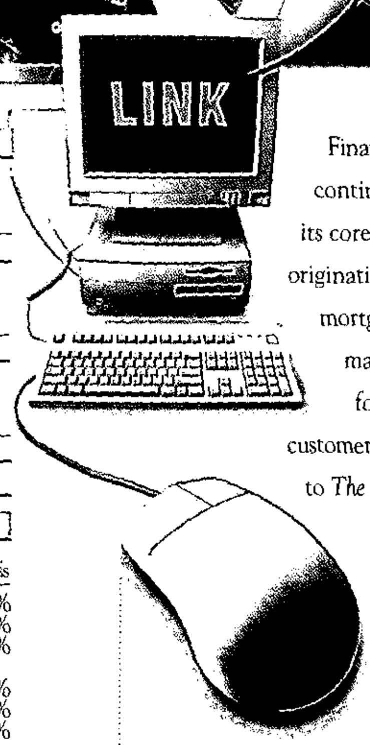
Financial Services' performance would not have been possible without the strategic partnership between Retail and Vanderbilt. Retail sales managets do not control credit decisions, but they do have a vested interest in the life cycle of all Company originated loans. Unlike any other organization in the industry, our Retail managers share in the profit and loss of the loans they originate, thus necessitating a continuing relationship with the homebuyer. This is a significant paradigm shift from the normal commissioned sales mentality of post sale abandonment. It is a challenge to keep the sales team motivated to help service existing customer relationships when they would rather be in front of a new prospect earning a new sales commission. Accountability is further compounded in the mortgage company as the credit manager apptoving the loan is also held responsible for servicing the loan.

vanderbilt mortgage

	JUNE 30, 1999	1998	Percent Change
Loans Serviced (in millions):			
Originated and purchased loans serviced	$3,204	$2,593	24%
Master servicing contracts	269	332	-19%
Total	$3,473	$2,925	19%
Loans Serviced (# of loans in thousands):			
Originated and purchased loans serviced	120	109	10%
Master servicing contracts	15	17	-12%
Total	135	126	7%
Originations (in millions):			
Company-owned	$ 669	$ 539	24%
Independent and other	416	263	58%
Total	$1,085	$ 802	35%
Acquisitions (in millions)	$ 253	$ 516	-51%

	1999		1998	
	*Inc. Access	Exc. Access	*Inc. Access	Exc. Access
Delinquency (% over 30 days — VMF only):				
Contracts originated by VMF	1.8%	1.8%	2.0%	2.0%
Contract portfolios purchased	3.1%	2.1%	8.7%	3.3%
All contracts	2.1%	1.9%	3.3%	2.2%
Net losses as % of average loans outstanding:				
Contracts originated by VMF	1.0%	1.0%	0.8%	0.8%
Contract portfolios purchased	3.7%	3.7%	1.8%	1.7%
Total contracts	1.4%	1.2%	0.8%	0.8%
Number of repossessions on hand:				
Originated by VMF	1,374	1,374	1,229	1,229
Contract portfolios purchased	483	140	453	114
Total repossessions	1,857	1,514	1,682	1,343

Financial Services will continue to build upon its core competencies of originating and servicing mortgages and insuring manufactured homes for our valued customers, affording access to *The American Dream*.



Homebuyers will experience faster mortgage decisions with LINK, an automated Internet-based communication system.

*In May 1998, the Company purchased $245 million in loans from Access Financial Lending Corporation (Access) and contracted to service an additional $267 million for a total of $512 million in servicing.

communities
a place where the american dream comes true

The Communities group capitalizes on every aspect of profitable vertical integration. Residents may choose a quality home from our Manufacturing group, select an attractive home site in our community and secure their mortgage and insurance from our Financial Services group.

In 1999 Communities expanded to 75 with a total of 19,708 homesites. We grew by opening new communities, expanding current ones and acquiring existing properties.

Ground was broken and sales offices opened on two new properties in 1999. Creston Ridge in San Antonio, Texas opened in January with 129 sites available and land for 260 total sites. The Stables in Sevierville, Tennessee held its grand opening in June with 68 sites currently being developed with potential for 486 total sites. Both communities, as with other Clayton-developed properties, will provide residents with desirable amenities such as pools, walking trails and a multi-purpose clubhouse.

The expansion of five existing properties created 248 new home sites,

A new Clayton Community located in Sevierville, Tennessee opened in June with a potential for 486 sites. It will feature a large clubhouse, pool, walking trails and other amenities.

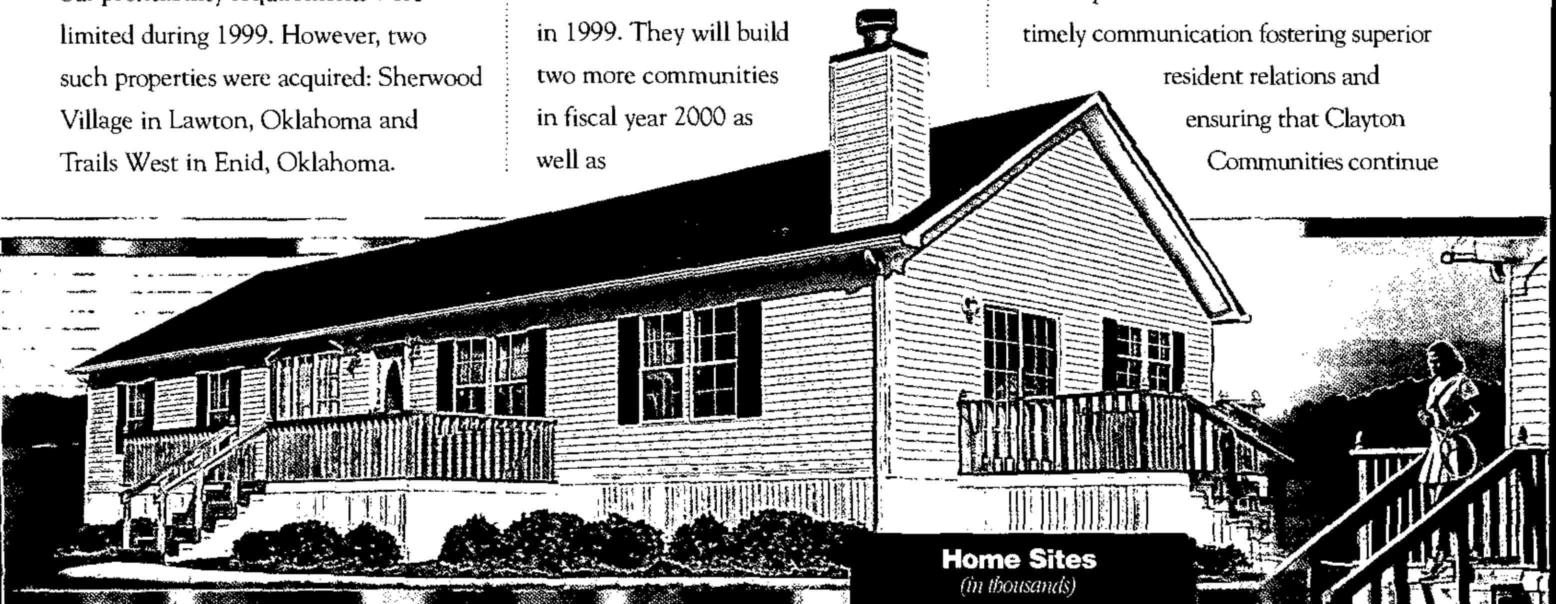
and land adjacent to three Texas communities was purchased during the year. Planning and engineering to enlarge nine other properties are underway.

Acquisition opportunities meeting our profitability requirements were limited during 1999. However, two such properties were acquired: Sherwood Village in Lawton, Oklahoma and Trails West in Enid, Oklahoma.

and long-term appreciation by acquiring under-performing properties and turning them around in an efficient timeframe. Our construction team delivered two communities in 1999. They will build two more communities in fiscal year 2000 as well as

SCOPE

SALES • COLLECTIONS
OCCUPANCY • PEOPLE • EXPENSE



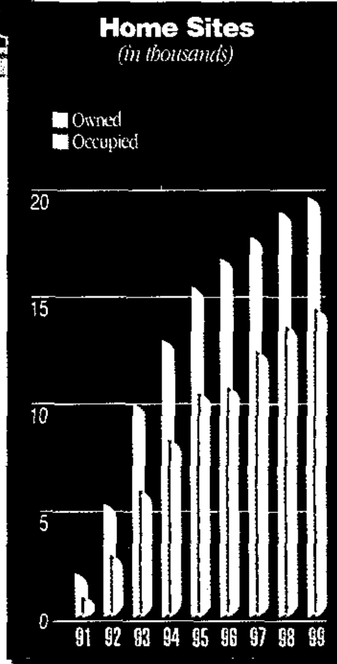
This home built in our Norris Plant features a 7/12 pitch roof, glamour bath, spacious living room, and deluxe GE appliances.

These established communities added an additional 383 homesites.

Communities' overall revenues were up 11.5 percent in 1999. Rental revenues rose 18.8 percent as occupancy was increased to 73.3 percent, and sales increased 2.5 percent. We remain committed to generating superior returns developing expansion projects.

A dual focus on disciplined property management and optimal sales profitability presents challenges for our community managers. Sales, Collections, Occupancy, People and Expense control (SCOPE) provide the benchmarks for measuring successful community operations. The SCOPE model promotes standardization and timely communication fostering superior resident relations and ensuring that Clayton Communities continue as the most attractive place for homeowners to fulfill their desire for quality living.

The Communities group will continue to focus its resources on creating an environment which provides desirable, affordable and secure neighborhoods – where *The American Dream* comes true.



	JUNE 30, 1999	1998
Home sites owned	19,708	18,964
Occupancy rate	73%	72%

eleven year review

(in thousands except per share and other data)	1999	1998	1997	1996	1995	1994	1993	1992	1991	1990	1989
Income Statement Data:											
Revenues:											
Net sales	$1,040,668	$ 880,856	$ 822,906	$762,396	$621,351	$510,153	$384,491	$296,849	$257,557	$219,443	$208,624
Financial services and other income	303,615	246,923	198,797	166,345	136,741	118,083	91,750	74,330	62,392	40,316	33,270
	1,344,283	1,127,779	1,021,703	928,741	758,092	628,236	476,241	371,179	319,949	259,759	241,894
Costs and expenses:											
Cost of sales	705,128	598,589	559,274	521,200	431,826	357,698	267,201	206,049	176,374	153,786	147,982
SG&A	367,430	302,598	270,996	236,188	188,835	153,698	113,695	84,785	76,420	60,220	55,456
Financial services interest	7,981	2,015	2,885	3,649	5,533	8,196	11,819	16,585	18,198	11,595	9,911
Other expenses	12,459	7,976	1,000	0	0	0	0	3,300	3,772	2,213	1,539
	1,092,998	911,178	834,155	761,037	626,194	519,592	392,715	310,719	274,764	227,814	214,888
Operating income	251,285	216,601	187,548	167,704	131,898	108,644	83,526	60,460	45,185	31,945	27,006
Interest income (expense), net/other	(5,317)	5,499	5,152	4,596	3,902	(359)	(170)	(317)	(592)	(575)	(1,042)
Income before income taxes	245,968	222,100	192,700	172,300	135,800	108,285	83,356	60,143	44,593	31,370	25,964
Provision fot income taxes	(91,000)	(84,400)	(73,200)	(65,500)	(48,800)	(39,000)	(29,600)	(20,800)	(16,000)	(11,500)	(9,714)
Income before accounting change	154,968	137,700	119,500	106,800	87,000	69,285	53,756	39,343	28,593	19,870	16,250
Cumulative effect of accounting change	0	0	0	0	0	3,000	0	0	0	0	0
Net income	$ 154,968	$ 137,700	$ 119,500	$106,800	$ 87,000	$ 72,285	$ 53,756	$ 39,343	$ 28,593	$ 19,870	$ 16,250
Net income per share:											
Basic	$1.07	$0.93	$0.81	$0.72	$0.59	$0.51	$0.39	$0.30	$0.27	$0.21	$0.17
Diluted	$1.06	$0.92	$0.80	$0.72	$0.59	$0.49	$0.37	$0.29	$0.24	$0.18	$0.15
Average shares outstanding:											
Basic	145,211	148,463	148,324	148,253	147,020	141,046	136,391	130,103	106,884	94,785	95,639
Diluted	145,931	149,504	149,346	149,183	148,285	149,875	149,106	142,100	126,216	120,217	119,932
Dividends per common share	$.064	$.064	$.061	$.049	$.030	–	–	–	–	–	–
Balance Sheet Data:											
Total assets	$1,417,245	$1,457,757	$1,045,761	$886,350	$761,151	$701,148	$587,032	$554,780	$488,817	$339,099	$294,754
Debt obligations	96,477	247,591	22,806	30,290	48,737	70,680	137,038	192,931	227,444	177,374	163,471
Shareholders' equity	$ 947,768	$ 881,019	$ 754,526	$650,189	$544,187	$462154	$348,630	$292,950	$200,992	$108,334	$ 87,462
Key Financial Ratios:											
As a % of revenue:											
Operating income	18.7%	19.2%	18.4%	18.1%	17.4%	17.3%	17.5%	16.3%	14.1%	12.3%	11.2%
Net income	11.5%	12.2%	11.7%	11.5%	11.5%	11.5%	11.3%	10.6%	8.9%	7.6%	6.7%
Debt as a % of total capital	9.2%	21.9%	2.9%	4.5%	8.2%	13.3%	28.2%	39.7%	53.1%	62.1%	65.1%
Other Data:											
Company-owned retail centers	306	273	245	216	192	165	143	127	123	96	99
Independent retailers	671	702	663	580	421	372	371	312	330	322	269
Manufacturing plants	19	18	17	17	16	13	13	11	10	10	10
Communities	75	71	67	64	55	46	33	20	12	9	7

quarterly results *(unaudited)*

	1999				1998			
(in thousands except per share data)	First Sept. 30	Second Dec. 31	Third Mar. 31	Fourth June 30	First Sept. 30	Second Dec. 31	Third Mar. 31	Fourth June 30
Revenues	$314,686	$319,120	$308,306	$402,171	$262,695	$251,069	$268,375	$345,640
Operating income	53,690	56,841	57,314	83,440	46,745	48,537	49,234	72,085
Net income	33,197	35,013	34,932	51,826	29,679	31,109	31,118	45,794
Earnings per share – Basic	$.23	$.24	$.24	$.36	$.20	$.21	$.21	$.31
– Diluted(a)	$.22	$.24	$.24	$.36	$.20	$.21	$.21	$.31
Price range of stock – High	$16.35	$13.81	$15.19	$13.25	$15.00	$15.55	$17.05	$17.90
– Low	$12.35	$10.80	$10.69	$10.69	$11.40	12.60	13.00	13.65
Dividends per common share	$.016	$.016	$.016	$.016	$.016	$.016	$.016	$.016

(a) Earnings per share is computed independently for each of the quarters presented. Therefore, the sum of the quarterly per share information may not equal the annual earnings per share.

results of operations

The following table reflects the percentage changes in sales by the Company's retail and community sales centers and in wholesale sales to independent retailers. It also shows the percentage changes in the average number of Company-owned retail centers, communities and independent retailers, the average sales per location, and the average price per home sold in each category.

	YEAR ENDED JUNE 30, 1999 vs 1998	1998 vs 1997
RETAIL		
Dollar sales	+25.8%	+7.6%
Number of retail centers	+11.8%	+12.4%
Dollar sales per retail center	+12.5%	–4.2%
Price of home	+6.8%	+10.9%
WHOLESALE		
Dollar sales	+6.8%	+8.3%
Number of independent retailers	+0.6%	+9.8%
Dollar sales per independent retailer	+6.2%	–1.4%
Price of home	+5.0%	+5.7%
COMMUNITIES		
Dollar sales	+2.5%	–10.1%
Number of communities	+5.8%	+5.3%
Dollar sales per community	–3.1%	–14.6%
Price of home	+4.5%	+6.4%

fiscal 1999 compared to fiscal 1998

Total revenues grew 19% on an 18% increase in Manufactured Housing sales and a 23% rise in Financial Services and other income.

Net sales of the Retail group rose 26% to $673 million. This growth was the result of a 12% increase in the average number of Company-owned retail centers, a 7% increase in the average price per home, and an 18% increase in homes sold. Multi-section homes accounted for 49% of total new homes sold versus 46% last year.

During the year, the Company opened 38 retail centers and closed five under-performing retail centers. The Company continually evaluates specific markets and opens, acquires or closes retail centers as conditions warrant. Of the 38 new openings, 15 were acquired and 23 were greenfield start-ups. Ten of the new retail centers were opened in the fourth quarter.

Net sales of the Manufacturing group to independent retailers increased 7% to $333 million, and the number of homes sold rose 2%. The average wholesale price increased 5% principally due to a shift toward multi-section homes. Multi-section homes accounted for 48% of total shipments versus 44% last year.

Net sales of the Communities group increased 3% to $35 million as 2% less homes were sold while the average home selling price increased 5%. Two acquisitions and two greenfield start-ups brought the number of communities to 75 at year end.

Financial Services revenues increased 23% mainly due to VMF, $32 million, and earned insurance premiums and commissions, $8 million. Rental and other income increased 23% on a 19% rise in Communities rental income.

Interest and loan servicing revenues increased 42% to $166 million. The average outstanding balance of receivables owned rose 55% to $600 million with a weighted average interest rate of 10.3%, up from 10.2%. The average outstanding balance of receivables sold rose 35% to $2.5 billion, and the weighted average loan service spread was 3.7% compared to 3.6%.

Financial Services interest expense increased $6 million to $8 million. Debt collateralized by installment contract receivables dropped 28% to an average of $13 million, and the weighted average interest rate increased to 10.4% from 10.1%. Loan covenants preclude prepaying these relatively higher cost obligations.

Gross profit margins increased slightly to 32.2%.

Selling, general and administrative expenses were 35.3% and 34.4% of net sales for the years ended June 30, 1999, and 1998, respectively. Expenses associated with the start-up of 38 new sales centers, four additional communities, one new plant, the reconstruction of the Waycross plant, and costs associated with portfolio acquisitions were primary causes of the increase.

Net losses as a percentage of loans outstanding for fiscal 1999 increased to 1.4% while delinquency rates on all loans decreased to 1.9% (excluding the purchased Access portfolio). Increases in the reserve for credit losses and contingent liabilities were related to purchases of installment contract receivable portfolios. The size, character and rate of change in the credit loss and contingent liability reserves are dependent upon many factors, including, but not limited to, origination volume, portfolio performance and market conditions.

The changes in inventory levels at June 30, 1999, compared to June 30, 1998, are shown below in millions:

	Increase(decrease)
MANUFACTURING	
Raw materials	$ (0.5)
Finished goods	0.4
RETAIL	
Net increase of 33 Company-owned sales centers	14.1
Increase in average inventory levels at 273 Company-owned sales centers	2.0
COMMUNITIES	
Inventory at four manufactured housing communities acquired and developed during the year	0.8
Increase in average inventory levels at 71 manufactured housing communities	0.5
	$ 17.3

fiscal 1998 compared to fiscal 1997

Total revenues grew 10% on a 7% increase in Manufactured Housing sales and a 24% rise in Financial Services and other income.

Net sales of the Retail group rose 8% to $535 million. This growth was the result of a 12% increase in the average number of Company-owned retail centers and an 11% increase in the average price per home offset partially by a 3% decline in homes sold. Multi-section homes accounted for 46% of total new homes sold versus 40% last year.

During the year, the Company opened 33 retail centers and closed five under-performing retail centers. The Company continually evaluates specific markets and opens, acquires or closes retail centers as conditions warrant. Of the 33 new openings, 22 were acquired and 11 were greenfield start-ups. Seven of the new retail centers were opened in the fourth quarter.

Net sales of the Manufacturing group to independent retailers increased 8% to $312 million, and the number of homes sold rose 2%. The average wholesale price increased 6% principally due to a shift toward multi-section homes. Multi-section homes accounted for 44% of total shipments versus 35% last year.

Net sales of the Communities group declined 10% to $34 million as 15% less homes were sold while the average home selling price increased 6%. Four acquisitions brought the number of communities to 71 at year end.

Financial Services revenues increased 28% mainly due to VMF, $34 million, and earned insurance premiums and commissions, $5 million. Rental and other income increased 13% on a 21% rise in Communities rental income.

Interest and loan servicing revenues increased 31% to $117 million. The average outstanding balance of receivables owned rose 72% to $386 million with a weighted average interest rate of 10.2%, down from 12.2%. The average outstanding balance of receivables sold rose 36% to $1.9 billion, and the weighted average loan service spread was 3.6% compared to 3.5%.

Financial Services interest expense decreased $.9 million, or 30%, to $2 million. Debt collateralized by installment contract receivables dropped 29% to an average of $19 million, and the weighted average interest rate declined to 10.1% from 11.1%. Loan covenants preclude prepaying these relatively higher cost obligations.

Gross profit margins remained consistent at 32%.

Selling, general and administrative expenses were 34.4% and 32.9% of sales for the years ended June 30, 1998, and 1997, respectively. Expenses associated with the start-up of 33 new sales centers, acquired communities and initial costs of the Financial Services' MBUs were primary causes of the increase.

Net losses as a percentage of loans outstanding for fiscal 1998 increased to .8% while delinquency rates on all loans increased to 2.2% (excluding the purchased Access portfolio). Increases in the reserve for credit losses and contingent liabilities were related to purchases of installment contract receivable portfolios. The size, character and rate of change in the credit loss and contingent liability reserves are dependent upon many factors, including, but not limited to, origination volume, portfolio performance and market conditions.

The changes in inventoty levels at June 30, 1998, compared to June 30, 1997, are shown below in millions:

	Increase
MANUFACTURING	
Raw materials	$ 3.9
Finished goods	0.6
RETAIL	
Net increase of 28 Company-owned sales centers	16.5
Increase in average inventoty levels at 245 Company-owned sales centers	25.0
COMMUNITIES	
Inventory at four manufactured housing communities acquired during the year	0.1
Increase in average inventoty levels at 67 manufactured housing communities	1.6
	$ 47.7

fourth quarter results

The increase in revenues and net income during the fourth quarters of fiscal 1999 and 1998 are not indicative of future operating trends but rather reflect the seasonality of the manufactured housing industry. In recent years approximately 30–31% of the Company's sales have occurred in the fourth quarter.

liquidity and capital resources

The Company anticipates meeting cash requirements with proceeds from asset securitizations, cash provided from operations, a commercial paper conduit facility, revolving credit lines and long-term debt. A principal strength of the Company is its ability to access global capital markets; continued access to the public and private capital markets is critical to the Company's ability to continue to fund its finance operations. During the year ended June 30, 1999, the Company raised $1.3 billion through asset securitizations.

At June 30, 1999, the Company had short-and long-term debt outstanding of $0 and $96.5 million, respectively. Short-term debt available consists of $150.0 million committed and $56.7 million uncommitted lines of credit for working capital needs. Long-term debt outstanding principally consists of $75.0 million of privately issued senior notes, $11.6 million of installment paper collateralized debt and $9.2 million of tax-exempt bonds.

During fiscal 1999, the Company repurchased 6.5 million shares for a cost of $81.4 million. Under board-approved repurchase programs, all shares may be acquired, at management's discretion, over time on the open market. Shares repurchased will be retired.

During fiscal 1999, the Company originated and acquired approximately $1.3 billion of installment contracts and mortgage loan receivables. Additional investments were made of approximately $10 million to acquire land or existing manufactured housing communities and $5 million in related rental units, $18 million for opening and upgrading of Company-owned retail centers, $13 million for construction and improvement of manufacturing facilities, and $2 million for other fixed assets.

In fiscal 2000, the Company expects to originate approximately $1.1 billion of installment contract and mortgage loan receivables. It will invest approximately $25 million in acquisitions or construction of manufactured housing communities, up to $27 million for opening and upgrading Company-owned retail centers and up to $15 million for construction and improvement of manufacturing facilities.

market risk

The Company is exposed to market risks related to fluctuations in interest rates on its installment paper contract receivables, excess servicing receivable and variable rate debt which principally consists of revolving credit lines. The Company uses intetest rate swaps to manage interest rate risk on certain credit lines, effectively converting these to fixed rate debt. Foreign currency and commodity price risk are not considered to have a material impact on the Company.

As of June 30, 1999, the Company has outstanding long-term debt of $96.5 million. There is no significant exposure to changes in interest rates on debt obligations as the majority of its long-term debt, $86.6 million, carries fixed interest rates. Remaining long-term debt of $9.9 million carries variable interest rates, which reprice frequently. Holding the variable rate debt 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 $58,000, net of tax.

The Company has variable interest rate installment paper contract receivables of $114.5 million on June 30, 1999. Holding the outstanding principal amount constant, each one percentage point increase in interest rates occurring on the first day of the year would result in an increase in interest income for the coming year of approximately $721,000, net of tax.

The Company has outstanding regular REMIC interests with variable interest rates collateralized by fixed installment contract receivables of $241.3 million on June 30, 1999. Holding the outstanding regular interests amount constant, each one percentage point increase in interest rates occurring on the first day of the year would result in a decrease in excess servicing income for the coming year of approximately $1,520,000, net of tax.

new accounting pronouncements

During the year, the AICPA issued Statement of Position 98-1 (SOP 98-1), *Accounting for the Cost of Computer Software Developed or Obtained for Internal Use*, and SOP 98-5, *Reporting on the Costs of Start-Up Activities*. In addition, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 137 (SFAS 137), *Deferral of the Effective Date of SFAS 133*. See Note 1 of Notes to Consolidated Financial Statements for further discussion.

effects of inflation

Inflation has had an insignificant impact on the Company during the past several years.

year 2000

Management believes the majority of the Company's mission critical systems and related software are Year 2000 compliant. The Company has executed a plan to address potential disruptions to normal business activities related to the Year 2000. Areas addressed by the plan include information systems (hardware and software), non-information systems, embedded chips, and supply chain continuance. Currently, the Company has completed its mission critical Year 2000 projects and based on the test results of these systems, management believes the operation of the Company will not be materially impacted by the new millennium. At this point, the Company believes that any problems relating to the Year 2000 will be manifested as minor inconveniences and reasonable precautions have been taken to prevent major disruptions to normal business activities.

Information systems, consisting of hardware and software, have been modified or replaced to ensure Year 2000 compliance. The Company's hardware consists of a mainframe, networks and personal computers. All desktop computers utilized in mission critical functions have been tested and are in compliance. The mainframe computers are compliant with respect to the hardware and operating systems. Many of the Company's critical software systems, such as the general ledger, accounts payable, payroll, human resources, and credit application tracking systems, have been replaced by Year 2000 compliant packages. The Company tested each of these software systems using a standardized testing methodology which includes millennium testing, millennium leap year testing and crossover year testing.

Non-information systems at corporate, such as HVAC, elevator, phone, security, vaults and computer rooms, are Year 2000 compliant as a direct result of building a new Corporate office. Similar equipment at field locations is not dependent on embedded chip technologies and is not considered an area of material exposure.

The Company has completed its survey of major suppliers and vendors of raw materials for Year 2000 compliance. The Company is not directly dependent on electronic data interchange (EDI) for the purchase of raw materials, though some of the Company's suppliers may be. Moreover, the bulk of raw materials (mostly lumber) is readily available from other suppliers. Possible interruptions in the supply chain can be circumvented by purchasing raw materials from an alternate local supplier. Responses from the Company's surveys provide assurance that our critical suppliers, including Financial Services providers, will be compliant.

Through June 30, 1999, the Company has incurred approximately $250,000 in costs associated with Year 2000 compliance. The total costs are not expected to exceed $500,000 or to have a material impact on the Company's financial position, results of operations or cash flows in future periods. Most of the hardware, software and non-information system replacements have been due to growth of the Company, and Year 2000 compliance is a by-product of the replacement systems. The custom written software is addressed by the in-house programming staff and contract programming services. Most costs directly associated with Year 2000 compliance were incurred during fiscal 1999.

Contingency plans, both short-term and long-term, for critical processes for each business unit have been developed. To mitigate any unexpected problems with the Year 2000, plans could include but are not limited to: (1) rapid transitions to alternative suppliers of services and materials, (2) replacement of errant equipment or software, (3) manual ledgers, (4) increased work hours by Company personnel, (5) temporary personnel, (6) outsourcing and (7) routine backup of critical data to different platforms. While contingency plans have been developed, opportunities for refinement and improvements will be incorporated into each business unit's contingency plan throughout 1999. Should the Company be required to execute a long-term contingency plan, an adverse material effect to operations could result.

The failure to correct a material Year 2000 problem could result in an interruption in, or a failure of, certain normal business activities or operations. Such failures could adversely affect the Company's results of operations, liquidity and financial condition. Due to the general uncertainty inherent in the Year 2000 problem, resulting in part from the uncertainty of the Year 2000 readiness of third-party suppliers and customers, the Company is unable to determine at this time whether the consequences of Year 2000 failures could have a material impact on the Company's results of operations, liquidity or financial condition. The Year 2000 project is expected to significantly reduce the Company's level of uncertainty about the Year 2000 problem and, in particular, about the Year 2000 compliance and readiness of its critical suppliers and financial services providers. The Company believes that, with the implementation of new business systems and completion of the project as scheduled, the exposure to significant interruptions of normal operations should be reduced.

forward looking statements

Certain statements in this annual report are forward looking as defined in the Private Securities Litigation Reform Law. These statements involve certain risks and uncertainties that may cause actual results to differ materially from expectations as of the date of this report. These risks fall generally within three broad categories consisting of industry factors, management expertise, and government policy and economic conditions. Industry factors include such matters as potential periodic inventory adjustments by both captive and independent retailers, general or seasonal weather conditions affecting sales and revenues, catastrophic events impacting insurance reserves, cost of labor and/or raw materials, and industry consolidation trends creating fewer but stronger competitors capable of sustaining competitive pricing pressures.

Management expertise is affected by management's overall ability to anticipate and meet consumer preferences, maintain successful marketing programs, continue quality manufacturing output, keep a strong cost management oversight, meet the Year 2000 compliance plan and project stable gain on sale accounting assumptions. Lastly, management has the least control over government policy and economic conditions such as prevailing interest rates, capital market liquidity, government monetary policy, stable regulation of manufacturing standards, consumer confidence, favorable trade policies, and general prevailing economic and employment conditions.

consolidated balance sheets

(in thousands)

	JUNE 30, 1999	1998
Assets		
Cash and cash equivalents	$ 2,680	$ 1,731
Trade receivables	24,998	21,332
Other receivables, principally installment contracts and residual interests, net of reserves for credit losses and unamortized discounts of $9,133 and $30,291, respectively	682,890	815,865
Inventories	184,444	167,113
Securities available-for-sale	19,047	20,361
Restricted cash	100,127	86,176
Property, plant and equipment	291,503	261,549
Deferred income taxes	20,505	11,756
Other assets	91,051	71,874
Total assets	$1,417,245	$1,457,757
Liabilities and Shareholders' Equity		
Accounts payable and accrued liabilities	$ 130,579	$ 138,557
Debt obligations	96,477	247,591
Other liabilities	242,421	190,590
Total liabilities	469,477	576,738
Shareholders' equity		
Preferred stock, $.10 par value, authorized 1,000 shares, none issued	—	—
Common stock, $.10 par value, authorized 200,000 shares, issued 142,373 at June 30, 1999, and 148,520 at June 30, 1998	14,237	14,852
Additional paid-in capital	85,236	162,413
Retained earnings	849,116	703,754
Other comprehensive income	(821)	—
Total shareholders' equity	947,768	881,019
Total liabilities and shareholders' equity	$1,417,245	$1,457,757

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

report of independent accountants

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, of shareholders' equity and of cash flows present fairly, in all material respects, the financial position of Clayton Homes, Inc. and Subsidiaries at June 30, 1999 and 1998, and the results of their operations and their cash flows for each of the three years in the period ended June 30, 1999, in conformity with generally accepted accounting principles. 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 of these statements in accordance with generally accepted auditing standards which 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

PricewaterhouseCoopers LLP
Knoxville, Tennessee
August 5, 1999

consolidated statements of income

(in thousands except per share data)	YEAR ENDED JUNE 30, 1999	1998	1997
Revenues:			
Net sales	$1,040,668	$ 880,856	$ 822,906
Financial services	233,848	190,204	148,515
Rental and other income	69,767	56,719	50,282
	1,344,283	1,127,779	1,021,703
Costs and expenses:			
Cost of sales	705,128	598,589	559,274
Selling, general and administrative	367,430	302,598	270,996
Financial services interest	7,981	2,015	2,885
Provision for credit losses	12,459	7,976	1,000
	1,092,998	911,178	834,155
Operating income	251,285	216,601	187,548
Interest income (expense), net/other	(5,317)	5,499	5,152
Income before income taxes	245,968	222,100	192,700
Provision for income taxes	(91,000)	(84,400)	(73,200)
Net income	$ 154,968	$ 137,700	$ 119,500
Net income per common share:			
Basic	$1.07	$0.93	$0.81
Diluted	$1.06	$0.92	$0.80
Average shares outstanding:			
Basic	145,211	148,463	148,324
Diluted	145,931	149,504	149,346

consolidated statements of shareholders' equity

(in thousands except per share data)	TOTAL SHAREHOLDERS' EQUITY	COMMON STOCK	ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS	OTHER COMPREHENSIVE INCOME
Balance at June 30, 1996	$ 650,189	$ 14,858	$ 169,293	$ 466,038	$ —
Net income	119,500	—	—	119,500	—
Purchase of 1,050 shares of common stock	(11,349)	(105)	(11,244)	—	—
Dividends declared ($.061 per common share)	(9,015)	—	—	(9,015)	—
Issuances related to stock incentive, employee benefit plans and other	5,201	59	5,142	—	—
Balance at June 30, 1997	754,526	14,812	163,191	576,523	—
Net income	137,700	—	—	137,700	—
Purchase of 713 shares of common stock	(9,506)	(71)	(9,435)	—	—
Dividends declared ($.064 per common share)	(10,469)	—	—	(10,469)	—
Issuances related to stock incentive, employee benefit plans and other	8,768	111	8,657	—	—
Balance at June 30, 1998	881,019	14,852	162,413	703,754	—
Comprehensive income					
Net income	154,968	—	—	154,968	—
Unrealized loss on securities available-for-sale	(821)	—	—	—	(821)
Total comprehensive income	154,147				
Purchase of 6,465 shares of common stock	(81,394)	(647)	(80,747)	—	—
Dividends declared ($.064 per common share)	(9,606)	—	—	(9,606)	—
Issuances related to stock incentive, employee benefit plans and other	3,602	32	3,570	—	—
Balance at June 30, 1999	$947,768	$14,237	$ 85,236	$849,116	$ (821)

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

consolidated statements of cash flows

(in thousands)	YEAR ENDED JUNE 30, 1999	1998	1997
Cash Flows from Operating Activities			
Net income	$ 154,968	$ 137,700	$ 119,500
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation and amortization	17,795	14,733	13,058
Gain on sale of installment contract receivables, net of amortization	(15,089)	(31,699)	(21,541)
Provision for credit losses	12,459	7,976	1,000
Deferred income taxes	(8,267)	(25,830)	8,394
Increase in other receivables, net	(103,070)	(25,700)	(27,383)
Decrease (increase) in inventories	(17,331)	(47,679)	4,846
Increase in accounts payable, accrued liabilities and other	24,687	55,429	39,249
Cash provided by operations	66,152	84,930	137,123
Origination of installment contract receivables	(1,085,484)	(801,865)	(646,624)
Proceeds from sales of originated installment contract receivables	1,030,442	705,420	614,588
Principal collected on originated installment contract receivables	80,610	50,260	39,668
Net cash provided by operations	91,720	38,745	144,755
Cash Flows from Investing Activities			
Acquisition of installment contract receivables	(253,625)	(520,912)	(206,937)
Proceeds from sales of acquired installment contract receivables	389,866	230,311	167,138
Principal collected on acquired installment contract receivables	73,200	27,703	3,439
Acquisition of property, plant and equipment	(47,749)	(62,210)	(42,859)
Increase in restricted cash	(13,951)	(15,179)	(594)
Net cash provided by (used in) investing activities	147,741	(340,287)	(79,813)
Cash Flows from Financing Activities			
Dividends	(9,606)	(10,469)	(9,015)
Net borrowings (repayment) on credit facilities	(227,873)	227,873	—
Proceeds from (repayment of) long-term debt	76,759	(3,088)	(7,484)
Issuance of stock for incentive plans and other	3,602	8,768	5,201
Repurchase of common stock	(81,394)	(9,506)	(11,349)
Net cash provided by (used in) financing activities	(238,512)	213,578	(22,647)
Net increase (decrease) in cash and cash equivalents	949	(87,964)	42,295
Cash and cash equivalents at beginning of year	1,731	89,695	47,400
Cash and cash equivalents at end of year	$ 2,680	$ 1,731	$ 89,695
Supplemental disclosures of cash flow information:			
Cash paid during the year for:			
Interest	$ 19,976	$ 4,285	$ 3,912
Income taxes	$ 95,931	$ 93,832	$ 62,269

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

notes to consolidated financial statements

note 1 - summary of significant accounting policies

Consolidated Financial Statements

The consolidated financial statements include the accounts of Clayton Homes, Inc. (CHI) and its wholly and majority-owned subsidiaries. CHI and its subsidiaries are collectively referred to herein as the Company. The Company is a vertically-integrated manufactured housing company headquartered in Knoxville, Tennessee. Employing approximately 7300 people and operating in 31 states, the Company builds, sells, finances and insures manufactured homes, as well as owns and operates residential manufactured housing communities. Significant intercompany accounts and transactions have been eliminated in the financial statements. See Note 10 for information related to the Company's business segments.

Income Recognition

Sales to independent retailers of homes produced by CHI are recognized as revenue upon shipment. Retail sales are recognized when: cash payment is received, or in the case of credit sales, which represent the majority of retail sales, when a down payment is received and the home buyer enters into an installment sales contract; construction of the home is complete; the home buyer has inspected and accepted the home; and title has passed to the retail home buyer. Most of these installment sales contracts, which are normally payable over 84 to 360 months, are financed by Vanderbilt Mortgage and Finance, Inc. (VMF), the Company's financing subsidiary.

The Company acts as agent on physical damage, family protection and home buyer protection plan insurance policies written by unaffiliated insurance companies (ceding companies) for the purchasers of manufactured homes. The insurance policies are in turn reinsured by certain subsidiaries of the Company. Premiums from policies represent short-duration contracts with terms of one to 10 years and are deferred and recognized as revenue over the term of the contracts. Claims expenses are recorded as insured events occur. Expenses are matched to revenue over the terms of the contracts by means of deferral and amortization of policy acquisition costs. Such costs include commissions, premium taxes and ceding fees, which vary with and are directly related to the production of insurance policies and are deferred and amortized over the terms of the related policies.

Installment Contract Receivables and Mortgage Loan Receivables

Installment contract receivables and mortgage loan receivables originated or purchased by VMF are generally sold to investors through an asset backed securities facility, with VMF retaining servicing on the contracts. Certain purchased mortgage loan receivables are sold to financial institutions with servicing released. In 1999, $1.3 billion in installment contract receivables and mortgage loan receivables were securitized with VMF retaining servicing. In May 1998, the Company purchased $245 million in loans from Access Financial Lending Corporation and contracted to service an additional $267 million portfolio. In February 1999, the Company purchased $94 million in loans from United Companies Funding Corporation.

Installment contract receivables held for sale of $467 million and $655 million in 1999 and 1998, respectively, are included in other receivables and are carried at the lower of aggregate cost or market. Certain of the installment contract receivables are purchased in bulk at a discount. The purchase discounts are allocated between unamortized discount and the reserves for credit losses and contingent liabilities based on management's assessment of risks existing in the portfolio. Unamortized discount is amortized over the life of the related portfolio after giving consideration to anticipated prepayments. Adjustments between the reserves for credit losses and contingent liabilities and unamortized discount are made to reflect changes in the estimated collectibility of each portfolio purchased.

VMF provides servicing for investors in installment contract receivables. Total contracts serviced at June 30, 1999, and 1998, including contracts held for investment, were approximately $3.5 billion and $2.9 billion, respectively. Most of the installment contract receivables are with borrowers in the east, south and southwest portions of the United States and are collateralized by manufactured homes. Interest income on installment contract receivables is recognized by a method which approximates the interest method. Service fee income is recognized as the service is performed. The Company accrues for obligations related to cash collections from sold and serviced only loans and remits these collections to investors on a monthly basis. See "Investors payable" in Note 11.

The Company utilizes a financial components approach to transfers and servicing of financial assets, requiring that the carrying amount of the receivables sold be allocated between the assets sold and the assets (liabilities) created, if any, at their fair value at the date of sale. The assets (liabilities) created are: 1) an interest-only strip valued as the discounted present value of the excess (deficiency) interest due the servicer (VMF) during the expected life of the contracts over: i) the stated investor yield; ii) the contractual servicing fee; and iii) estimated credit losses; and 2) servicing asset (liability), representing the discounted present value of the contractual servicing fee over the cost of servicing the contracts. Profit (loss) recorded at the time of the sale is computed as the difference between the allocated carrying amount of the receivables sold and the proceeds realized from the sale. The servicing asset at June 30, 1999, and 1998, is as follows:

(in thousands)	1999	1998
Servicing asset beginning balance	$ 13,043	$ 5,644
Servicing asset recognized	20,718	10,823
Amortization	(6,737)	(3,424)
Servicing asset ending balance	$ 27,024	$ 13,043

The balance represents the estimated fair value of the aggregate servicing assets at June 30, 1999. The estimate of fair value assumes: 1) discount rates which, at the time the asset was created, approximate current market rates; and 2) expected prepayment rates based on loan prepayment experience for similar transactions. The servicing assets are amortized using the effective interest method over the estimated weighted average life of the underlying securities.

The residual interests in the installment receivables sold are classified as trading securities (as defined by SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities)*, and changes in their value are recorded as adjustments to income in the period of change. The Company assesses the fair value of the residual interests periodically. Amortization of the residual interest balances is calculated using the effective interest method over the estimated weighted average life of the underlying securities and is reflected as a reduction of net revenues.

Cash Equivalents

For purposes of the statements of cash flows, all unrestricted highly liquid debt instruments purchased with an original maturity of three months or less are considered to be cash equivalents.

Investment Securities

During the quarter ended March 31, 1999, the Company adopted SFAS No. 134, *Accounting for Mortgage-Backed Securities Retained after the Securitization of Mortgage Loans Held for Sale by a Mortgage Banking Enterprise*. The standard requires that the Company classify mortgage-backed securities and other beneficial interests retained after a securitization in accordance with SFAS No. 115. The effect of the adoption was to reclassify certain manufactured housing contract senior/subordinate pass-thru certificates totaling $20.4 million (aggregate cost) from the held-to-maturity category to the available-for-sale category. Accordingly, these securities are stated at fair value. In accordance with SFAS No. 130, *Reporting Comprehensive Income*, net unrealized holding gains and losses are reported as a separate component of other comprehensive income, net of tax, until realized. The fair value of these securities is estimated based on quoted market prices, when available. If not available, fair value is estimated using quoted market prices for similar financial instruments. These securities can be reasonably expected to mature in 6–10 years.

Inventories

New homes and raw materials are valued at the lower of cost or market, using the last-in, first-out (LIFO) method of inventory valuation. Previously-owned manufactured homes are valued at estimated wholesale prices, which are not in excess of net realizable value.

Property, Plant and Equipment

Land and improvements, buildings, furniture and equipment are valued at cost. Major renewals and improvements are capitalized while replacements, maintenance and repairs, which do not improve or extend the life of the respective assets, are expensed currently. When depreciable assets are sold or retired, the cost and related accumulated depreciation are removed from the accounts, and any gain or loss is included in earnings for the period. Depreciation is computed primarily by the straight-line method over the estimated useful lives of the respective assets ranging from three to 40 years.

The Company follows SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of*, which requires recognition of impairment losses for long-lived assets whenever events or changes in circumstances result in the carrying amount of the assets exceeding the sum of the expected future undiscounted cash flows associated with such assets. The measurement of the impairment losses recognized is based on the difference between the fair values and the carrying amounts of the assets. SFAS 121 also requires that long-lived assets held for sale be reported at the lower of carrying amount or fair value less cost to sell. The Company has not experienced such losses.

Reserves for Credit Losses and Contingent Liabilities

Reserves for credit losses and contingent liabilities are established related to installment contract receivables. Actual credit losses are charged to the reserves when incurred. The reserves established for such losses are determined based on the Company's historical loss experience after adjusting for current economic conditions. Management, in assessing the loss experience and economic conditions, adjusts reserves through periodic provisions. The Company also maintains a reserve for contingent liabilities related to guarantees of installment contract receivables sold with recourse.

Interest Rate Swaps

The Company uses interest rate swaps to assist in managing interest incurred on its short-term variable rate debt. The difference between amounts received and amounts paid under such agreements is recorded as a reduction of, or addition to, interest expense as incurred over the life of the swap.

Restricted Cash

Restricted cash primarily represents reserves required by: 1) trust account cash balances required by certain VMF servicing agreements, and 2) insurance reserves required by escrow or trust agreements.

Management Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Other

Per share and share data have been retroactively adjusted to reflect 5-for-4 stock splits in December 1998 and December 1996. Certain reclassifications have been made to the 1997 and the 1998 financial statements to conform to the 1999 presentation.

New Accounting Pronouncements

In March 1998, the AICPA issued Statement of Position 98-1 (SOP 98-1), *Accounting for the Cost of Computer Software Developed or Obtained for Internal Use*. SOP 98-1 is effective for financial statements for the years beginning after December 15, 1998. SOP 98-1 provides guidance on accounting for computer software developed or obtained for internal use including the requirement to capitalize specified costs and amortization of such costs. The Company will adopt the provisions of SOP 98-1 in its fiscal year ending June 30, 2000, and does not expect such adoption to have a material effect on the Company's reported results of operations, financial position or cash flows.

In April 1998, the AICPA issued SOP 98-5, *Reporting on the Costs of Start-Up Activities*, which is effective for fiscal years beginning after December 15, 1998. SOP 98-5 provides guidance on the financial reporting of start-up and organization costs. It requires start-up activities and organization costs to be expensed as incurred. The adoption of this standard is not expected to have a material impact on the Company's reported results of operations, financial position or cash flows.

In June 1998, the FASB issued SFAS No. 133, *Accounting for Derivatives and Financial Instruments and Hedging Activities*. SFAS 133 establishes accounting and reporting standards of derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. In July 1999, the FASB issued SFAS No. 137, *Deferral of the Effective Date of SFAS 133*, which amends SFAS 133 by deferring the effective date to fiscal years beginning after June 15, 2000. The adoption of SFAS 133 is not expected to have a material impact on the Company's reported results of operations, financial position or cash flows.

note 2 - inventories

Inventories at June 30, 1999, and 1998, are as follows:

(in thousands)	1999	1998
Manufactured homes		
New	$125,456	$114,577
Previously-owned	40,956	33,991
Raw materials	18,032	18,545
	$184,444	$167,113

If the first-in, first-out (FIFO) method of inventory valuation had been used, inventories would have been higher by $20,591,000 and $18,331,000 at June 30, 1999, and 1998, respectively.

note 3 - property, plant and equipment

Property, plant and equipment at June 30, 1999, and 1998, are as follows:

(in thousands)	1999	1998
Land and improvements	$183,449	$166,692
Buildings	147,252	126,085
Furniture and equipment	42,392	34,964
	373,093	327,741
Less: accumulated depreciation and amortization	(81,590)	(66,192)
	$291,503	$261,549

Depreciation charged to operations was $17,795,000, $14,733,000, and $13,058,000 for each of the years ended June 30, 1999, 1998 and 1997, respectively.

note 4 - debt obligations

Debt obligations at June 30, 1999, and 1998, is summarized as follows:

(in thousands)	1999	1998
Lines of credit	$ —	$227,873
Senior notes, 6.25%, due December 2003	75,000	—
Debt collateralized by installment contract receivables, average effective rate 10.19%, due through 2004	11,625	15,557
Tax-exempt bonds, effective rate of 3.75% on June 30, 1999, due through 2028	9,230	4,030
Other notes payable	622	131
	$96,477	$247,591

Annual maturities of long-term debt as of June 30, 1999, are as follows:

(in thousands)			
2000	$ 3,252	2003	$ 2,097
2001	3,144	2004	75,325
2002	3,139	Thereafter	9,520

In December 1998, the Company issued $75.0 million of 6.25% Senior Subordinated Notes due December 2003 (the "6.25% Notes") with interest payable each June and December. The 6.25% Notes are redeemable at the option of the Company, in whole, at 100% of the principal amount plus a make-whole premium at any time prior to December 30, 2003. The 6.25% Notes are not subject to any sinking fund requirements. The net proceeds from this offering were used to repay borrowings under the Company's credit facilities.

In January 1999, the Company entered into a committed one-year $300.0 million commercial paper conduit facility to facilitate interim sales of manufactured housing contracts. Commitment fees are payable quarterly on the unused portion of the facility.

In May 1999, the Company repaid and canceled a one-year committed line of credit for $200.0 million entered into July 1998, primarily to facilitate the purchase and warehousing of manufactured housing loan portfolios.

The Company has a $150.0 million five-year revolving credit facility with its bank group. This line is priced on LIBOR plus rates ranging from .15% to .30%; commitment fees are payable quarterly on the unused portion of the facility.

The Company's tax-exempt manufacturing facilities' bonds carry no sinking fund requirements and bear interest at weekly adjustable rates.

The preceding facilities are governed by various financial covenants which require maintenance of certain financial ratios and are uncollateralized. In addition, the Company has uncommitted lines of credit amounting to $56.7 million with several banks, priced at LIBOR plus rates ranging from .10% to .40%. These lines are subject to periodic review by each bank and may be canceled by the Company at any time.

Under certain interest rate swap agreements, the Company agrees with other parties to exchange the difference between fixed rate and variable rate interest amounts calculated by reference to an agreed upon notional principal amount. At June 30, 1999, the Company's interest rate swap agreements have an aggregate notional amount of $150.0 million and fix the interest rate on the Company's debt to rates ranging from 5.07% to 5.62%. If the Company had terminated all swaps as of June 30, 1999, it would have received a net amount of approximately $390,000 based on quoted market values from the other parties holding the swaps.

note 5 - reserves for credit losses and contingent liabilities

An analysis of the reserves for losses on installment contract receivables and contingent liabilities for the years ended June 30, 1999, 1998, and 1997, are as follows:

(in thousands)	1999	1998	1997
Balance, beginning of year	$ 35,828	$ 8,051	$ 7,766
Provision	12,459	7,976	1,000
Charges, net of recoveries applicable to installment contract receivables			
Purchased	(13,384)	(2,762)	(2,337)
Other	(11,951)	(3,981)	1,622
Reserves transferred from unamortized discounts	(1,981)	2,318	—
Reserves associated with receivables purchased	23,304	24,226	—
Balance, end of year	$ 44,275	$35,828	$ 8,051
Reserves for credit losses	$ 8,541	$29,964	$ 4,917
Reserve for contingencies	35,734	5,864	3,134
	$ 44,275	$35,828	$ 8,051

The reserves for credit losses are netted against receivables and the reserve for contingencies is included in other liabilities on the consolidated balance sheets. The Company is contingently liable as guarantor on installment contract receivables sold with recourse. At June 30, 1999, and 1998, the outstanding principal balances of these receivables totaled approximately $164 million and $188 million, respectively. The associated contingent liability is approximately $22 million and $23 million, respectively. There were no receivables sold with recourse in 1999, 1998 and 1997.

note 6 - shareholders' equity

Stock Option Plan

In 1983, 1985, 1991, and 1997, the Company established Stock Option Plans for a total of 17,021,036 shares of common stock which provide for granting "incentive stock options" or "non-qualified options" and stock appreciation rights to officers and key employees of the Company. In addition, non-management members of the Board of Directors have, with shareholder approval of prices and provisions for exercise, been granted options to purchase shares of common stock. The option prices were established at not less than the fair market value as of the date of grant. Options are exercisable after one or more years and expire no later than 10 years from the date of grant. Activity and price information regarding the plans are as follows:

	Shares	Stock Option Price Range	Weighted Avg Exercise Price	Stock Options Exercisable	Weighted Avg Exercise Price
Balance June 30, 1996	4,155,141	$ 1.10 - $13.70	$ 6.99	1,431,754	$ 5.32
Granted	712,105	$10.32 - $12.80	$11.50		
Exercised	(201,430)	$ 1.10 - $ 8.30	$ 3.50		
Canceled	(248,868)	$ 1.42 - $13.70	$ 9.47		
Balance June 30, 1997	4,416,948	$ 1.10 - $13.70	$ 7.74	1,888,935	$ 6.32
Granted	1,529,856	$ 8.19 - $12.60	$11.61		
Exercised	(1,193,195)	$ 1.10 - $13.70	$ 6.21		
Canceled	(450,571)	$ 1.41 - $13.70	$ 9.90		
Balance June 30, 1998	4,303,038	$ 1.41 - $13.70	$ 9.32	1,187,395	$ 7.29
Granted	1,477,846	$ 8.19 - $15.75	$12.73		
Exercised	(162,002)	$ 1.41 - $13.70	$ 5.03		
Canceled	(757,731)	$ 1.76 - $15.75	$11.55		
Balance June 30, 1999	4,861,151	$ 1.41 - $15.75	$10.15	1,449,866	$ 8.13

Options available for future grant at June 30, 1999, and 1998, were 5,077,035 and 6,118,238, respectively. Options were held by 754 persons at June 30, 1999. The following table summarizes information about the plans' stock options at June 30, 1999:

	Options Outstanding			Options Exercisable	
Range of Exercise Price	Number Outstanding at 6/30/99	Weighted Avg Remaining Contractual Life	Weighted Avg Exercise Price	Number Exercisable at 6/30/99	Weighted Avg Exercise Price
$ 1.41 - $ 2.16	179,016	0.77 years	$ 1.54	101,575	$ 1.58
$ 3.64 - $ 5.05	303,598	2.49 years	$ 4.03	136,809	$ 3.83
$ 7.22 - $10.32	1,807,093	5.41 years	$ 8.25	924,888	$ 7.85
$11.50 - $15.75	2,571,444	8.29 years	$12.81	286,594	$13.38

The Company has elected to continue following Accounting Principles Board Opinion No. 25 (APB 25), *Accounting for Stock Issued to Employees*, and related interpretations in accounting for its stock option plans rather than the alternative fair value accounting provided for under SFAS No. 123, *Accounting for Stock-Based Compensation*. Under APB 25, because the exercise price of the Company's employee and director stock options equals the market price of the underlying stock on the date of grant, no compensation expense is recognized in the accompanying financial statements. Pro forma information regarding net income and net income per common share is required by SFAS No. 123 and has been determined as if the Company has accounted for its stock options under the fair value method of that standard. For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting periods. The pro forma results do not purport to indicate the effects on reported net income for recognizing compensation expense which are expected to occur in future years.

The Company's pro forma information is as follows:

(in thousands except per share data)	1999	JUNE 30, 1998	1997
Net income - as reported	$154,968	$137,700	$119,500
Net income - pro forma	153,610	136,643	118,481
Net income per diluted common share - as reported	$1.06	$0.92	$0.80
Net income per diluted common share - pro forma	1.05	0.91	0.79

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions used for grants issued from 1997 to 1999; dividend yields ranging from 0.41% to 0.78% with a weighted average yield of 0.55%; expected volatility of 0.293%, risk-free interest rates ranging from 5.70% to 5.99% with a weighted average rate of 5.90%; and expected lives ranging from 7.50 to 9.75 years with a weighted average life of 7.74 years. The weighted average grant date fair value of options granted in fiscal years 1999, 1998 and 1997, was $5.66, $5.02 and $4.67 per share, respectively.

note 7 - income taxes

Deferred income taxes reflect the net tax effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The components of deferred tax assets and liabilities at June 30, 1999, and 1998, are as follows:

(in thousands)	1999	1998
Reserves for credit losses and contingencies and discounts	$ 11,618	$ 4,064
Insurance reserves	9,717	9,162
Unearned premiums	8,001	6,355
Residual interest in installment contract receivables	6,607	5,652
Total deferred tax assets	$ 35,943	$ 25,233
Deferred costs	$ (5,931)	$ (4,789)
Other	(9,507)	(8,688)
Total deferred tax liabilities	$ (15,438)	$(13,477)
Net deferred tax asset	$ 20,505	$ 11,756

The provision for income tax is composed of the following:

(in thousands)	1999	1998	1997
Current tax provisions:			
Federal	$92,706	$103,336	$58,591
State	6,561	6,894	6,215
Total current	$99,267	$110,230	$64,806
Deferred tax provision/(benefit)	(8,267)	(25,830)	8,394
Total	$91,000	$ 84,400	$73,200

At June 30, 1999, a deferred tax benefit of $482,000 was allocated directly to shareholders' equity for the unrealized loss on securities available-for-sale.

The provision for income tax reflected in the financial statements differs from income taxes calculated at the statutory federal income tax rate of 35% in 1999, 1998 and 1997, as follows:

(in thousands)	1999	1998	1997
Income taxes at the statutory rate	$86,089	$77,735	$67,451
State income taxes, net of federal benefit	4,265	4,481	4,040
Other, net	646	2,184	1,709
Total	$91,000	$84,400	$73,200

note 8 - employee benefit plans

The Company has a 401(k) profit-sharing plan covering all employees who meet participation requirements. The amount of the Company's contribution is discretionary as determined by the Board of Directors, up to the maximum deduction allowed for federal income tax purposes. Contributions paid and accrued were $3,162,000, $2,488,000 and $2,874,000 for the years ended June 30, 1999, 1998 and 1997, respectively.

note 9 - commitments and contingencies

Certain operating properties are rented under non-cancelable operating leases which expire at various dates through 2009. Total rental expense under operating leases was $5,210,000 in 1999, $4,440,000 in 1998, and $3,705,000 in 1997. The following is a schedule of minimum rental commitments under non-cancelable operating leases, primarily for retail centers, in effect at June 30, 1999:

2000	$4,528,000	2002	$3,006,000	2004	$1,376,000
2001	3,798,000	2003	2,227,000	Thereafter	3,696,000

Institutions financing independent retailer purchases require the Company to execute repurchase agreements. As a result of these agreements, the Company is contingently liable for repurchasing homes in the event of a default by the dealer to the lending institution. These agreements are customary in the manufactured housing industry, and the Company's losses in the past have not been significant. The maximum potential repurchase obligation is approximately $70 million at June 30, 1999, excluding any resale value.

At June 30, 1999, the Company has outstanding letters of credit primarily related to insurance reserves and performance guarantees related to asset backed securitizations of approximately $93 million and $206 million, respectively. The Company believes a significant loss from any such guarantee is remote.

Please see discussion of Guarantor of Installment Contract Receivables at Note 5.

note 10 - business segment information

Effective June 30, 1999, the Company adopted SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*, which supersedes previously issued segment reporting disclosure rules and requires reporting of segment information that is consistent with the way in which management operates the Company. Its adoption did not have any impact on the Company's financial position or the result of operations. The segment disclosures presented for prior years have been restated to conform with the presentation adopted for the current year. The Company has identified four major business segments: Retail, Manufacturing, Financial Services and Communities. The Retail group purchases homes from the Company's manufacturing operations and third party manufacturers to sell to retail customers. The Manufacturing group builds homes for Company-owned and independent retailers. Financial Services provides retail financing of manufactured homes, reinsures risk on family protection, physical damage, and homebuyer protection plan insurance policies, and offers certain specialty finance products. Communities owns and operates manufactured housing communities. Income from operations consists of total revenues less cost of sales and operating expenses. Identifiable assets are used in the operation of each business segment.

Information concerning operations by business segment follows:

(in thousands)	1999	1998	1997
Revenues:			
Retail	$ 737,044	$ 590,256	$ 542,279
Manufacturing	654,471	599,561	540,485
Financial Services	198,527	158,828	125,914
Communities	78,902	70,740	70,244
Intersegment sales	(324,661)	(291,606)	(257,219)
	$1,344,283	$1,127,779	$1,021,703
Income from operations:			
Retail	$ 66,364	$ 59,272	$ 53,102
Manufacturing	72,377	65,437	61,352
Financial Services	117,385	99,685	76,341
Communities	15,850	14,133	14,332
Eliminations/Other	(20,691)	(21,926)	(17,579)
	$ 251,285	$ 216,601	$ 187,548
Interest:			
Interest expense	(11,995)	(2,270)	(1,027)
Interest revenue/Other income	6,678	7,769	6,179
Income before taxes	$ 245,968	$ 222,100	$ 192,700
Identifiable assets:			
Retail	$ 247,009	$ 208,064	$ 152,728
Manufacturing	94,773	80,487	77,133
Financial Services	901,769	1,003,528	610,639
Communities	177,723	166,871	147,815
Eliminations/Other	(4,029)	(1,193)	57,446
	$1,417,245	$1,457,757	$1,045,761
Depreciation and Amoritization:			
Retail	$ 4,684	$ 3,725	$ 2,866
Manufacturing	5,478	5,016	4,427
Financial Services	235	121	—
Communities	6,412	5,418	4,710
Eliminations/Other	986	453	1,055
	$ 17,795	$ 14,733	$ 13,058
Capital expenditures:			
Retail	$ 18,152	$ 15,147	$ 7,389
Manufacturing	12,971	5,721	8,368
Financial Services	576	931	—
Communities	14,703	31,316	21,455
Eliminations/Other	1,347	9,095	5,647
	$ 47,749	$ 62,210	$ 42,859

note 11 - other assets and liabilities

At June 30, 1999, and 1998, other assets and liabilities consisted of:

(in thousands)	1999	1998
Other assets:		
Interest receivable and future servicing rights	$ 56,674	$ 38,157
Deferred policy acquisition costs	16,693	13,180
Prepaid expenses and other	17,684	20,537
	$ 91,051	$ 71,874
Other liabilities:		
Investors payable	$ 89,925	$ 86,804
Reserve for contingencies (Note 5)	35,734	5,864
Escrow deposits	11,378	10,779
Unearned insurance premiums	82,199	65,048
Other	23,185	22,095
	$242,421	$190,590

note 12 - fair value disclosure of financial instruments

SFAS No. 107, *Disclosures About Fair Value of Financial Instruments*, requires that the Company disclose the estimated fair values of its financial instruments. The following methodologies and assumptions were used by the Company to estimate its fair value disclosures for financial instruments.

Fair value estimates are made at a specific point in time, based on relevant market data and information about the financial instrument. The estimates do not reflect any premium or discount that could result from offering for sale in a single transaction the Company's entire holdings of a particular financial instrument. The lack of uniform valuation methodologies introduces a greater degree of subjectivity to these estimated fair values. Comparability to financial instruments between similar companies may not be reasonable because of varying assumptions concerning the estimates of fair value.

Cash and Cash Equivalents

The carrying values for cash and cash equivalents, including those restricted by agreement, approximate the fair value of the assets.

Residual Interests in Installment Contract Receivables

Residual interests in installment contract receivables are calculated using prepayment, default and interest rate assumptions that the Company believes are appropriate at the time of the sale of the installment contract receivables. Projected performance is monitored after the sale. The fair value primarily assumes an appropriate discount rate to be applied to the asset as a whole. The Company used a discount rate and such other assumptions as it believed to be used for similar instruments.

Contracts Held For Sale and as Collateral

Contracts held for sale are generally recent originations or purchased portfolios which will be sold with limited or no recourse during the following year. The Company does not charge fees to originate loans, and, as such, its contracts have origination rates in excess of rates on the securities into which they will be pooled. The Company estimates the fair value of the contracts held for sale using expected future cash flows of the portfolio discounted at the current origination rate.

The carrying values of contracts pledged as collateral to long-term lenders are estimated using discounted cash flow analyses and interest rates being offered for similar contracts. The carrying amount of contracts with a variable rate of interest is estimated to be at fair value. The carrying value of accrued interest adjusted for credit risk equals its fair value.

Debt Collateralized by Installment Contract Receivables

Debt collateralized by installment contract receivables consists primarily of notes collateralized by contracts with maturities that coincide with the underlying contract maturities. The fair value of these financial instruments is based on the current rates offered to the Company for debt of similar maturities using a discounted cash flow calculation. Loan covenants preclude prepayment.

The carrying amounts and estimated fair values of the Company's financial assets and liabilities are as follows:

	JUNE 30,1999		JUNE 30,1998	
(in thousands)	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash and cash equivalents, including restricted cash	$102,807	$102,807	$ 87,907	$ 87,907
Residual interests in installment contract receivables	131,146	131,146	127,705	127,705
Contracts held for sale and as collateral, including accrued interest receivable	486,717	482,881	673,847	661,069
Financial liabilities:				
Senior notes, 6.25%, due December 2003	75,000	72,661	–	–
Debt collateralized by installment contract receivables, average effective rate 10.19%, due through 2004	$ 11,625	$ 12,190	$ 15,557	$ 16,469

note 13 - earnings per share

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

(in thousands except per share data)	1999	1998	1997
Net income	$154,968	$137,700	$119,500
Average shares outstanding:			
Basic	145,211	148,463	148,324
Add: common stock equivalents	720	1,041	1,022
Diluted	145,931	149,504	149,346
Earnings per share – Basic	$1.07	$0.93	$0.81
– Diluted	$1.06	$0.92	$0.80

note 14 - related party transactions

The Company maintains an agreement to purchase certain installment contract receivables originated or acquired by 21st Century Mortgage Corp. in which the Company maintains a 25% ownership interest. The Company acquired approximately $147,000,000, $192,000,000 and $102,000,000 in installment contract receivables and received interest and other related fees totaling approximately $2,038,000, $1,735,000 and $926,000 during fiscal 1999, 1998 and 1997, respectively.

The Company paid approximately $89,000, $196,000, and $87,000, in 1999, 1998 and 1997, respectively, for legal services provided by a law firm, a partner of which serves as a director of the Company.

During 1999, the Company purchased certain real estate properties from the Chairman for $1,450,000, based upon independently obtained appraisals.

expanding
the american dream

As we enter fiscal 2000, we will continue to conservatively utilize resources and further develop *The American Dream* for our customers, shareholders and team members.

directors

JAMES L. CLAYTON
Chairman of the Board, Clayton Homes, Inc.; Director, Dollar General Corporation and Chateau Communities, Inc.; Chairman of the Board, BankFirst

KEVIN T. CLAYTON
Chief Executive Officer and President

THOMAS N. McADAMS(2)
Partner, Bernstein, Stair & McAdams L.L.P.; Director, Rafferty's, Inc.

DAN W. EVINS(1)
Chairman of the Board, Chief Executive Officer, CBRL Group, Inc.

B. JOE CLAYTON
Chief Executive Officer, Clayton Automotive Group; Regional Director, First Tennessee Bank

JOHN J. KALEC(1)
Vice President and Chief Financial Officer, Interactive Pictures Corporation

WILMA H. JORDAN(2)
Chief Executive Officer, The Jordan Edmiston Group, Inc.

C. WARREN NEEL(1)(2)
Dean, College of Business Administration, University of Tennessee; Director, O'Charleys, Inc., Sak's, Inc., Promus Hotel Corporation and American Health Corp., Inc.

(1) Audit Committee
(2) Compensation Committee

Seated: Kevin T. Clayton, and James L. Clayton
Standing (left to right): Thomas N. McAdams, Dan W. Evins, B. Joe Clayton, John J. Kalec, Wilma H. Jordan, C. Warren Neel

officers

James L. Clayton
Chairman of the Board

Kevin T. Clayton
Chief Executive Officer and President

David M. Booth
Executive Vice President
President, Retail

Richard D. Strachan
Executive Vice President
President, Manufacturing

Amber W. Krupacs
Vice President Finance

Greg A. Hamilton
Vice President and Controller

Carl O. Koella, III
Assistant Vice President, Investor Relations and Secretary

stockholder information

Form 10-K
Clayton Homes, Inc. Form 10-K Annual Report to the Securities and Exchange Commission is available without charge to shareholders upon written request to:

Investor Relations
Clayton Homes, Inc.
Box 15169
Knoxville, TN 37901

General Counsel
Bernstein, Stair & McAdams
Knoxville, Tennessee

S.E.C. Counsel
Baker, Donelson, Bearman and Caldwell
Nashville, Tennessee

Independent Accountants
PricewaterhouseCoopers LLP
Knoxville, Tennessee

Stock Exchange Listing
The Company's common shares are listed on the New York Stock Exchange, symbol CMH.

Shareholders
There were approximately 62,000 beneficial holders of common stock on June 30, 1999.

Registrar, Transfer Agent, and Dividend Reinvestment Plan Administrator
American Stock Transfer & Trust Company
40 Wall Street, New York, NY 10005
1.800.278.4353

Annual Meeting
The annual meeting of shareholders will be held on October 27, 1999, at 10:30 a.m. (EST) at the Clayton Homes Headquarters, 5000 Clayton Road, Maryville, TN 37804. Shareholders of record at close of business on September 3, 1999, will be entitled to vote.

CLAYTON HOMES, INC.

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TEL: 423.380.3000 FAX 423.380.3750
(Area code 865 effective after 11/1/99)

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