

WINNEBAGO INDUSTRIES INC
Form 10-Q
March 30, 2007
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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

(Mark One)

**Quarterly Report Pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934**

For the Quarterly Period Ended February 24, 2007

or

**Transition Report Pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934**

For the transition period from _____ to _____

Winnebago Industries, Inc.

(Exact Name of Registrant as Specified in its Charter)

Iowa
(State or Other Jurisdiction
of Incorporation or Organization)

001-06403
(Commission File Number)

42-0802678
(IRS Employer
Identification No.)

P.O. Box 152, Forest City, Iowa
(Address of Principal Executive Offices)

50436
(Zip Code)

Registrant's telephone number, including area code: (641) 585-3535

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

0

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The number of shares of common stock, par value \$0.50 per share, outstanding on March 23, 2007 was 31,594,306.

WINNEBAGO INDUSTRIES, INC.

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Winnebago Industries, Inc.

Unaudited Consolidated Statements of Income

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

	Quarter Ended		Six Months Ended	
	February 24, 2007	February 25, 2006	February 24, 2007	February 25, 2006
(In thousands, except per share data)				
Net revenues	\$ 199,014	\$ 206,425	\$ 400,779	\$ 438,680
Cost of goods sold	180,049	186,105	360,430	387,196
Gross profit	18,965	20,320	40,349	51,484
Operating expenses:				
Selling	4,315	4,505	9,042	9,178
General and administrative	5,290	5,284	11,807	10,333
Total operating expenses	9,605	9,789	20,849	19,511
Operating income	9,360	10,531	19,500	31,973
Financial income	1,602	1,314	3,165	2,236
Income before income taxes	10,962	11,845	22,665	34,209

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Provision for taxes	3,430	4,145	7,197	11,939
Net income	\$7,532	\$7,700	\$15,468	\$22,270
Income per common share:				
Basic	\$0.24	\$0.23	\$0.49	\$0.68
Diluted	\$0.24	\$0.23	\$0.49	\$0.67
Weighted average common shares outstanding:				
Basic	31,459	32,806	31,354	32,870
Diluted	31,764	33,147	31,666	33,167
Dividends paid per common share	\$0.10	\$0.09	\$0.20	\$0.18

See unaudited notes to condensed consolidated financial statements.

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Winnebago Industries, Inc.

Unaudited Consolidated Balance Sheets

(In thousands)	February 24, 2007	August 26, 2006
Assets		
Current assets:		
Cash and cash equivalents	\$ 12,446	\$ 24,934
Short-term investments	154,549	129,950
Receivables, less allowance for doubtful accounts (\$185 and \$164, respectively)	23,406	20,859
Inventories	94,389	77,081
Prepaid expenses and other assets	4,853	5,269
Deferred income taxes	11,599	9,067
Total current assets	301,242	267,160
Property and equipment, at cost:		
Land	934	946

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Buildings	59,398	59,378
Machinery and equipment	99,972	99,839
Transportation equipment	9,669	9,561
Total property and equipment, at cost	169,973	169,724
Accumulated depreciation	(115,693)	(112,817)
Total property and equipment, net	54,280	56,907
Investment in life insurance	19,524	20,814
Deferred income taxes	25,708	25,002
Other assets	17,095	14,832
Total assets	\$ 417,849	\$ 384,715

Liabilities and Stockholders Equity

Current liabilities:		
Accounts payable	\$ 37,437	\$ 27,923
Income taxes payable	10,343	7,876
Accrued expenses:		
Accrued compensation	13,047	12,498
Product warranties	10,655	9,523
Self-insurance	8,529	7,842
Promotional	3,445	5,253
Accrued dividends	3,153	3,109
Other	5,314	6,098
Total current liabilities	91,923	80,122
Postretirement health care and deferred compensation benefits, net of current portion	87,494	86,271
Contingent liabilities and commitments		
Stockholders equity:		
Capital stock common, par value \$0.50; authorized 60,000 shares, issued 51,776 shares	25,888	25,888
Additional paid-in capital	26,557	22,268
Retained earnings	489,616	480,446
Treasury stock, at cost (20,190 and 20,633 shares, respectively)	(303,629)	(310,280)
Total stockholders equity	238,432	218,322
Total liabilities and stockholders equity	\$ 417,849	\$ 384,715

See unaudited notes to condensed consolidated financial statements.

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Winnebago Industries, Inc.

Unaudited Consolidated Statements of Cash Flows

	Six Months Ended	
	February 24,	February 25,
(In thousands)	2007	2006

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Operating activities:		
Net income	\$ 15,468	\$ 22,270
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	5,331	5,328
Stock-based compensation	3,609	2,895
Deferred compensation expense	1,075	733
Provision for doubtful accounts	135	27
Deferred income taxes	(3,238)	) 1,538
Excess tax benefit of stock options	(1,587)	) (174)
Increase in cash surrender value of life insurance policies	(390)	) (521)
Postretirement benefit income	(245)	) (95)
(Gain) loss on disposal of property	(83)	) 33
Other	2	45
Change in assets and liabilities:		
Inventories	(17,308)	) 29,767
Receivables and prepaid assets	(2,266)	) 10,986
Accounts payable and accrued expenses	9,149	(10,336)
Income taxes payable	4,065	3,257
Postretirement and deferred compensation benefits	(579)	) (663)
Net cash provided by operating activities	13,138	65,090
Investing activities:		
Purchases of short-term investments	(170,399)	) (110,100)
Proceeds from the sale or maturity of short-term investments	145,800	58,950
Purchases of property and equipment	(2,841)	) (1,968)
Proceeds from the sale of property	216	73
Other	532	201
Net cash used in investing activities	(26,692)	) (52,844)
Financing activities:		
Payments for purchase of common stock		(8,284)
Payments of cash dividends	(6,254)	) (5,922)
Proceeds from exercise of stock options	5,733	1,127
Excess tax benefit of stock options	1,587	174
Net cash provided by (used in) financing activities	1,066	(12,905)
Net decrease in cash and cash equivalents	(12,488)	) (659)
Cash and cash equivalents at beginning of period	24,934	19,484
Cash and cash equivalents at end of period	\$ 12,446	\$ 18,825
Supplemental cash flow disclosure:		
Income taxes paid	\$ 6,154	\$ 7,000

See unaudited notes to condensed consolidated financial statements.

Winnebago Industries, Inc.

Unaudited Notes to Condensed Consolidated

Financial Statements

Forward-Looking Information

This Quarterly Report on Form 10-Q, contains statements which may constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, which involve risks and uncertainties, including, but not limited to, the effect of global tensions, availability and price of fuel, a significant increase in interest rates, a decline in consumer confidence, a slowdown in the economy, availability of chassis and other key component parts, sales order cancellations, slower than anticipated sales of new or existing products, new product introductions by competitors and other factors which may be disclosed throughout this report. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. Undue reliance should not be placed on these forward-looking statements, which speak only as of the date of this report. We undertake no obligation to publicly update or revise any forward-looking statements whether as a result of new information, future events or otherwise, except as required by law or the rules of the New York Stock Exchange.

NOTE 1: Basis of Presentation

The Company, we, our, and us are used interchangeably to refer to Winnebago Industries, Inc. or Winnebago Industries, Inc. and its subsidiaries as appropriate to the context.

In our opinion, the accompanying unaudited condensed consolidated financial statements contain all adjustments, consisting of normal recurring accruals, necessary to present fairly the consolidated financial position as of February 24, 2007 and the consolidated statements of income for the quarter and six months ended February 24, 2007 and February 25, 2006, and consolidated cash flows for the six months ended February 24, 2007 and February 25, 2006. The consolidated statement of income for the six months ended February 24, 2007 is not necessarily indicative of the results to be expected for the full year. The balance sheet data as of August 26, 2006 was derived from audited financial statements, but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. These interim consolidated financial statements should be read in conjunction with the audited financial statements and notes thereto appearing in our Annual Report to Shareholders for the year ended August 26, 2006. Certain prior period information in the unaudited consolidated statements of cash flows has been reclassified to conform to the current year presentation.

NOTE 2: Stock-Based Compensation Plans

We have a 2004 Incentive Compensation Plan, as amended, in place which allows us to grant stock options and other equity compensation to key employees and to nonemployee directors. In prior years, stock-based compensation consisted only of stock options. In Fiscal 2007, we granted restricted stock awards to key employees and directors instead of stock options. The value of the restricted stock awards is determined using the intrinsic value method which, in this case, is based on the number of shares granted and the closing price of our common stock on the date of grant.

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Total stock-based compensation expense included in our statements of income for the quarters ended February 24, 2007 and February 25, 2006 was \$792,000 and \$1.0 million, respectively. The total stock-based compensation for the six months ended February 24, 2007 and February 25, 2006 was \$3.6 million and \$2.9 million, respectively. Of the \$3.6 million, \$2.5 million is related to the October 11, 2006 grant to employees of 99,450 shares and the January 10, 2007 grant to nonemployee directors of 7,000 shares of restricted stock. The remainder is related to the amortization of previously granted employee and nonemployee directors stock options and nonemployee directors stock units issued in lieu of their fees. We will continue to recognize compensation expense over the three-year vesting periods for awards granted prior to adoption of Statement of Financial Accounting Standards (SFAS) No. 123R, but for all awards granted after August 27, 2005, compensation expense will be recognized over the requisite service period of the award or over a period ending with an employee's eligible retirement date, if earlier.

NOTE 3: New Accounting Pronouncements

SFAS 109 has been amended by Financial Accounting Standards Interpretations (FIN) 48, *Accounting for Uncertainty in Income Taxes*. The amendment establishes a consistent threshold for recognizing current and deferred income taxes and results in increased comparability in how companies report income tax assets and liabilities. The effective date of FIN 48 is for fiscal years beginning after December 15, 2006 (our first quarter of Fiscal 2008). We are currently evaluating the impact of this pronouncement on our future consolidated financial statements.

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In September 2006, the Financial Accounting Standards Board (FASB) issued Financing Accounting Standards (FAS) No. 157, *Fair Value Measurements*. This statement provides a definition of fair value and a consistent basis by which to measure fair value. The statement is effective for fiscal years beginning after November 15, 2007 and for interim periods within those fiscal years (our Fiscal Year 2009). We are currently evaluating the impact of this pronouncement on our future consolidated financial statements.

In September 2006, the FASB issued SFAS No. 158, *Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans - an amendment of FASB Statements No. 87, 88, 106, and 132(R)* (SFAS 158). SFAS 158 requires that we recognize the overfunded or underfunded status of our defined benefit and retiree medical plans as an asset or liability in our 2007 year-end balance sheet, with changes in the funded status recognized through comprehensive income in the year in which they occur. SFAS 158 is effective for fiscal years ending after December 15, 2006 (our fourth quarter of Fiscal 2007). We are currently evaluating the impact of adopting SFAS 158 on our consolidated results of operations and financial condition.

NOTE 4: Inventories

Inventories are valued at the lower of cost or market, with cost being determined under the last-in, first-out (LIFO) method and market defined as net realizable value.

Inventories consist of the following (in thousands):

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	February 24, 2007		August 26, 2006	
Finished goods	\$43,315		\$33,420	
Work-in-process	40,949		35,166	
Raw materials	42,750		40,080	
	127,014		108,666	
LIFO reserve	(32,625	)	(31,585)
	\$94,389		\$77,081	

NOTE 5: Warranty

We provide our motor home customers a comprehensive 12-month/15,000-mile warranty on the coach, and a 3-year/36,000-mile warranty on sidewalls and floors. We record a liability based on our estimate of the amounts necessary to settle future and existing claims on products sold as of the balance sheet date. Changes in our product warranty liability are as follows:

	Six Months Ended			
	February 24, 2007	February 25, 2006		
(In thousands)				
Balance at beginning of period	\$9,523	\$12,183		
Provision	6,707	5,579		
Claims paid	(5,575)	(6,478)
Balance at end of period	\$10,655	\$11,284		

In addition to the costs associated with the contractual warranty coverage provided on our motor homes, we also occasionally incur costs as a result of additional service actions not covered by our warranties, including product recalls and customer satisfaction actions. We estimate the cost of these service actions using past claim rate experiences and the estimated cost of repairs. Estimated costs are accrued at the time the service action is implemented and included in cost of sales in our consolidated statements of income and as other accrued expenses in our consolidated balance sheets.

Changes in our reserve for customer service actions are as follows:

	Six Months Ended			
	February 24, 2007	February 25, 2006		
(In thousands)				
Balance at beginning of period	\$505	\$624		
Provision	168	41		
Claims paid	(419)	(269)
Balance at end of period	\$254	\$396		

NOTE 6: Employee and Retiree Benefits

Long-term postretirement health care and deferred compensation benefits are as follows:

(In thousands)	February 24, 2007	August 26, 2006
Postretirement health care benefit cost (1)	\$49,814	\$50,583
Deferred compensation liability (2)	25,138	25,015
Executive share option plan liability	12,542	10,673
Total postretirement health care and deferred compensation benefits	\$87,494	\$86,271

- (1) The current portion of accrued postretirement benefit cost of \$964,000 and \$903,000 as of February 24, 2007 and August 26, 2006, respectively, is included within other accrued expenses.
- (2) The current portion of deferred compensation liability of \$1.5 million and \$1.6 million as of February 24, 2007 and August 26, 2006, respectively, is included within accrued compensation.

Postretirement Health Care Benefits

We provide certain health care and other benefits for retired employees, hired before April 1, 2001, who have fulfilled eligibility requirements of age 55 with 15 years of continuous service. Retirees are required to pay a monthly premium for medical coverage based on years of service at retirement and then current age. Effective September 2004, we amended our postretirement health care benefit by establishing a maximum employer contribution amount which resulted in a \$40.4 million reduction of the accumulated postretirement benefit obligation. This reduction was deferred and is being amortized over the approximate remaining service period of active participants. Net periodic postretirement benefit income consisted of the following components (in thousands):

	Quarter Ended		Six Months Ended	
	February 24, 2007	February 25, 2006	February 24, 2007	February 25, 2006
Interest cost	\$472	\$456	\$944	\$913
Service cost	202	233	404	466
Net amortization and deferral	(796)	(737)	(1,593)	(1,474)
Net periodic postretirement benefit (income)	\$(122)	\$(48)	\$(245)	\$(95)

For accounting purposes, we recognized income from the plan for the first and second quarters of both Fiscal 2007 and Fiscal 2006 due to the amortization of the cost savings from the September 2004 amendment. However, we are still obligated to pay the cost of previously accrued and earned retiree benefits and paid approximately \$293,000 and \$342,000 of such benefits for the quarters ended February 24, 2007 and February 25, 2006, respectively, and \$462,000 and \$560,000 for the six months ended February 24, 2007 and February 25, 2006, respectively.

NOTE 7: Contingent Liabilities and Commitments***Repurchase Commitments***

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Our repurchase agreements provide that, in the event of default by the dealer on the agreement to pay the lending institution, we will repurchase the financed merchandise. The agreements provide that our liability will not exceed 100 percent of the dealer invoice and provide for periodic liability reductions based on the time since the date of the original invoice. Our contingent liability on these repurchase agreements was approximately \$307.5 million and \$278.6 million at February 24, 2007 and August 26, 2006, respectively. Losses under these repurchase agreements for the six months ended February 24, 2007 and February 25, 2006 were \$4,000 and \$0, respectively. Our reserve methodology is used to record an estimated expense and loss reserve in each accounting period based upon our extensive history and experience and known current events with respect to repurchase agreements with the lenders to our dealers. Based on the historical data and known current events, repurchase reserves under our repurchase agreements at February 24, 2007 and August 26, 2006 were not significant. Upon resale of the repurchased units, we do not record the transaction as revenue. The difference between the repurchase price and the net proceeds received from reselling the units is charged against our reserve for losses on repurchases.

Guarantees For Suppliers

During the second quarter of Fiscal 2002, we entered into a five-year services agreement (the Agreement) with an unaffiliated third-party paint Supplier (the Supplier) and the Forest City Economic Development, Inc., (FCED) an Iowa nonprofit corporation, requiring the Supplier to provide paint services on our recreation vehicles. The FCED constructed and debt financed a facility which is leased by the Supplier. In the event of termination of the lease agreement by any of the parties involved before September 1, 2007, the rights and obligations of the Supplier under the lease would be

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transferred to us. As of February 24, 2007, the Supplier is current with its lease payment obligations to the FCED with approximately \$2.8 million (principal and interest) remaining to be paid through August 2012. Under the terms of the Agreement in the event of a default by the Supplier, we would be obligated to purchase from the Supplier equipment installed in the paint facility at net book value of \$370,000 as of February 24, 2007, and we would be obligated to assume payment obligations for approximately \$7,600 in capital equipment leases remaining to be paid at February 24, 2007.

During the second quarter of Fiscal 2004, we entered into a five-year limited guaranty agreement (Guaranty Agreement) with a leasing corporation (Landlord) and the previously discussed Supplier. The Landlord constructed a paint facility through debt financing on land adjoining our Charles City manufacturing plant for the Supplier. The Landlord and the Supplier have signed a ten-year lease agreement which commenced on August 1, 2004. The Guarantee Agreement states that we will guarantee the first 60 monthly lease payments (totaling approximately \$1.6 million of which \$676,000 was remaining as of February 24, 2007). In the event of a default under the lease agreement before August 2009 and the Supplier's failure to correct the default, the Landlord shall give us, the guarantor, written notice of its intent to terminate said lease. At the time of that notification, we will have various options that we must exercise in a timely manner. One option is to purchase the real estate with improvements from the Landlord. The price we would pay would be the outstanding loan owed by the Landlord to construct the paint facility, which was approximately \$1.7 million as of February 24, 2007. As of February 24, 2007, the Supplier is current with its lease payment obligations to the Landlord. As of February 24, 2007, the balance of the guarantee was approximately \$151,000 and presented as other accrued liabilities in the accompanying consolidated balance sheets.

Litigation

We are regularly involved in legal proceedings in the ordinary course of business, some of which are covered in part by insurance. Because of the uncertainties related to the outcome of the litigation and range of loss on certain cases we are generally unable to make a reasonable estimate of the liability that could result from an unfavorable outcome. In other cases, we prepare estimates based on historical experience, the professional judgment of our legal counsel, and other assumptions that we believe to be reasonable. As additional information becomes

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available, we reassess the potential liability related to pending litigation and revise the related estimates. Such revisions and any actual liability that greatly exceed our estimates could materially adversely impact our results of operations and financial condition.

NOTE 8: Dividends Declared

On January 11, 2007, the Board of Directors declared a quarterly cash dividend of \$0.10 per common share, payable April 9, 2007 to shareholders of record on March 9, 2007, which has been recorded as an accrued liability in the accompanying balance sheet as of February 24, 2007.

On March 22, 2007, the Board of Directors declared a quarterly cash dividend of \$0.10 per common share, payable July 9, 2007 to shareholders of record on June 8, 2007.

NOTE 9: Repurchase of Outstanding Stock

On April 12, 2006, the Board of Directors authorized the repurchase of outstanding shares of our common stock, depending on market conditions, for an aggregate consideration of up to \$50 million. There is no time restriction on this authorization. There were no repurchases during the first six months of Fiscal 2007. Repurchases of up to \$22.2 million of our common stock remain available under this authorization.

NOTE 10: Income Per Share

The following table reflects the calculation of basic and diluted income per share for the quarters and six months ended February 24, 2007 and February 25, 2006.

	Quarter Ended		Six Months Ended	
	February	February	February	February
	24,	25,	24,	25,
	2007	2006	2007	2006
(In thousands, except per share data)				
<u>Income per share - basic</u>				
Net income per share - basic	\$7,532	\$7,700	\$15,468	\$22,270
Weighted average shares outstanding	31,459	32,806	31,354	32,870
Net income per share - basic	\$0.24	\$0.23	\$0.49	\$0.68
<u>Income per share - assuming dilution</u>				
Net income	\$7,532	\$7,700	\$15,468	\$22,270
Weighted average shares outstanding	31,459	32,806	31,354	32,870
Dilutive impact of options and awards outstanding	305	341	312	297
Weighted average shares and potential dilutive shares outstanding	31,764	33,147	31,666	33,167
Net income per share - assuming dilution	\$0.24	\$0.23	\$0.49	\$0.67

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For the quarters ended February 24, 2007 and February 25, 2006, there were options outstanding to purchase 255,800 shares and 514,624 shares, respectively, of common stock at an average price of \$32.63 and \$31.35, respectively, which were not included in the computation of diluted income per share because they are considered anti-dilutive under the treasury stock method per SFAS No. 128, *Earnings Per Share* (as amended).

For the six months ended February 24, 2007 and February 25, 2006, there were options outstanding to purchase 281,132 shares and 736,142 shares, respectively, of common stock at an average price of \$32.78 and \$30.43, respectively, which were not included in the computation of diluted income per share because they are considered anti-dilutive under the treasury stock method per SFAS No. 128, *Earnings Per Share* (as amended).

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It is suggested that this Management's Discussion be read in conjunction with the Management's Discussion and Analysis included in our Annual Report to Shareholders for the year ended August 26, 2006.

Executive Overview

Winnebago Industries, Inc. is a leading motor home manufacturer with a proud history of manufacturing recreation vehicles for the last 49 years. Our retail market share per Statistical Surveys, Inc. of Class A and Class C motor homes for the calendar year ended December 31, 2006 compared to calendar year ended December 31, 2005 was 19.0 percent compared to 17.9 percent, respectively, or a 6.1 percent increase. Our strategy is to manufacture quality motor homes in a profitable manner. We measure profitability by using five guidelines: return on assets, return on equity, return on invested capital, operating income as a percent of net revenues and net income as a percent of net revenues. Our primary goal is to be a leader in profitability in the recreation vehicle industry. As a result of our performance, we have returned significant profits back to our shareholders through stock repurchases and dividends. During the six months ended February 24, 2007, we paid out dividends of \$6.3 million to our shareholders.

During the first two quarters of Fiscal 2007, we saw the same trend continue in the motor home market that we saw throughout Fiscal 2006; further volume decline and an overall shift in mix to lower-priced products including Class A gas motor homes. In response to this trend, we introduced new value-priced Class A gas motor homes (Winnebago Vista and Itasca Sunstar) at the National RV Trade Show in Louisville, Kentucky in December 2006 and began stocking the dealer channel with these products during the second quarter. These products are offered at a popular price range in which we had not previously had a presence in the Class A market. We also introduced new Class A motor homes

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(Winnebago Destination and Itasca Latitude) that can be purchased with either a rear gas or diesel engine, providing less engine noise in the front and a more residential look and feel. We will begin stocking the dealer channel with these new Class A products in the third quarter. These additional Class A products should assist Winnebago Industries in the Class A market segments as they begin to enter the retail market in coming months.

Company Outlook

The RV industry is cyclical and susceptible to slowdowns in the general economy. RV industry sales have been characterized by cycles of growth and contraction in consumer demand, reflecting prevailing economic, demographic and political conditions that affect disposable income for leisure-time activities. Some of the factors that contribute to this cyclical nature include fuel availability and cost, interest rate levels, the level of discretionary spending, availability of credit and consumer confidence. The motorized portion of the recreation vehicle industry has experienced a volume decline for two years. An extended continuation of higher fuel costs, higher interest rates, lower discretionary spending and lower consumer confidence would adversely affect our business, results of operations and financial condition. We will continue to adjust our factory schedule as necessary to reflect the demand for our products. Should fuel prices remain lower than the record levels seen in the summer of 2006, interest rates continue to remain stable or decline and RV consumer sentiment begin to rise, the motor home market may improve this spring or summer.

As evidenced in the table below, as of February 24, 2007, our sales order backlog showed an increase of 40.1 percent in the Class A gas segment and 60.8 percent in the Class A diesel segment, while the Class C segment remained fairly flat compared to the sales order backlog reported as of February 25, 2006. The increase in Class A backlog is due primarily to the favorable dealer response to our new Winnebago Destination and Itasca Latitude motor homes now entering the market.

Order backlog for our motor homes was as follows:

	As Of	Product	Product	Increase	%
	Feb. 24, 2007	Mix %	Feb. 25, 2006	(Decrease)	Change
Class A gas	650	34.3	464	186	40.1
Class A diesel	394	20.8	245	149	60.8
Total Class A	1,044	55.1	709	335	47.2
Class C	852	44.9	872	(20)	(2.3)
Total backlog	1,896	100.0	1,581	315	19.9
Total approximate revenue dollars (in millions)	\$ 165.3		\$ 127.8	\$ 37.5	29.3
Dealer inventory (units)	4,924		5,435	(511)	(9.4)

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We include in our backlog all accepted purchase orders from dealers to be shipped within the next six months. Orders in backlog can be canceled or postponed at the option of the purchaser at any time without penalty and, therefore, backlog may not necessarily be an accurate measure of future sales.

Long-term demographics are favorable for our industry as our target market of consumers age 50 and older is expected to substantially increase over the next 30 years due to the aging of the baby boom market. Also, according to a 2005 study conducted by the University of Michigan, the age at which the motor home consumer is purchasing motor homes has broadened. Motor homebuyers are entering the market earlier than in the past, as young as 35, and living active and healthier lives with more buyers remaining in the RV lifestyle over the age of 75. The study also indicates that owners are using their motor homes for more than just traditional camping, having a positive impact on long-term motor home market growth. The study shows that motor homes are used to pursue consumers' many lifestyle passions which may include going to motor sports events or tailgating at sporting events.

Critical Accounting Policies

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States (GAAP). In connection with the preparation of our financial statements, we are required to make assumptions and estimates about future events and apply judgments that affect the reported amounts of assets, liabilities, revenue, expenses and the related disclosures. We base our assumptions, estimates and judgments on historical experience, current trends and other factors that we believe to be relevant at the time our consolidated financial statements are prepared. On a regular basis, we review the accounting policies, assumptions, estimates and judgments to ensure that our financial statements are presented fairly and in accordance with GAAP. However, because future events and their effects cannot be determined with certainty, actual results could differ from our assumptions and estimates and such differences could be material.

We believe that the following accounting estimates and policies are the most critical to aid in fully understanding and evaluating our reported financial results and they require our most difficult, subjective or complex judgments resulting from the need to make estimates about the effect of matters that are inherently uncertain. We have reviewed these critical accounting estimates and related disclosures with the Audit Committee of our Board of Directors.

Revenue Recognition. Generally, revenues for motor homes are recorded when all of the following conditions are met: an order for a product has been received from a dealer; written or verbal approval for payment has been received from the dealer's floorplan financing institution; and the product is delivered to the dealer who placed the order. Most sales are financed under floorplan financing arrangements with banks or finance companies.

Revenues from the sales of our original equipment manufacturing components and motor home-related parts are recorded as the products are shipped from our location. The title of ownership transfers on these products as they leave our location due to the freight terms of F.O.B. - Forest City, Iowa.

Postretirement Benefits Obligations and Costs. We provide certain health care and other benefits for retired employees, hired before April 1, 2001, who have fulfilled eligibility requirements at age 55 with 15 years of continuous service. Postretirement benefit liabilities are determined by actuaries using assumptions about the discount rate and health care cost-trend rates. A significant increase or decrease in interest rates could have a significant impact on our operating results. Further discussion of our postretirement benefit plan and related assumptions is included in Note 6.

Warranty. A comprehensive 12-month/15,000-mile warranty and a 3-year/36,000-mile warranty on sidewalls and floors are provided by us with the purchase of any new motor home. Estimated costs related to product warranty are accrued at the time of sale and are based upon past warranty claims and unit sales history and adjusted as required to reflect actual costs incurred, as information becomes available. A significant increase in dealership labor rates, the cost of parts or the frequency of claims could have a material adverse impact on our operating results for the period or periods in which such claims or additional costs

materialize. We also incur costs as a result of additional service actions not covered by our warranties, including product recalls and customer satisfaction actions. Estimated costs are accrued at the time the service action is implemented and are based upon past claim rate experiences and the estimated cost of the repairs. Further discussion of our warranty costs and associated accruals is included in Note 5.

Repurchase Commitments. Generally, companies in the RV industry enter into repurchase agreements with lending institutions which have provided wholesale floorplan financing to dealers. Our repurchase agreements provide that, in the

event of default by the dealer on the agreement to pay the lending institution, we will repurchase the financed motor homes. The agreements also provide that our liability will not exceed 100 percent of the dealer invoice and provide for periodic liability reductions based on the time since the date of the original invoice. These repurchase obligations generally expire upon the earlier to occur of (i) the dealer's sale of the financed unit or (ii) one year from the date of the original invoice. Our

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obligations under these repurchase agreements are reduced by the proceeds received upon the resale of any repurchased unit. The gross repurchase obligation will vary depending on the season and the level of dealer inventories. Past losses under these agreements have not been significant. Further discussion of our repurchase obligations is included in Note 7.

Stock-Based Compensation. Historically, we have granted stock options to our key employees and nonemployee directors as part of their compensation. In Fiscal 2007, we granted restricted stock awards to key employees and nonemployee directors instead of stock options.

The amount of compensation expense incurred related to stock awards and to be incurred in future periods is dependent upon a number of factors, such as the number of awards, both options and shares granted, the timing of stock option exercises and actual forfeiture rates. We estimate the fair value of all stock option awards as of the date of grant by applying the Black-Scholes option-pricing model. The application of this valuation model involves assumptions, some of which are judgmental and highly sensitive. These assumptions include, among others, our expected stock price volatility and the expected life of our stock options, which are based primarily on our historical experience.

The value of the restricted stock is based on the closing price of our common stock on the date of grant.

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The fair value of each award is amortized on a straight-line basis over the requisite service period or to an employee's eligible retirement date, if earlier. This is because our awards typically vest over three years or upon retirement if earlier; thus, options and restricted stock awards are expensed immediately upon grant for retirement-eligible employees. This feature accelerates expense in the period of grant (typically our first fiscal quarter) and creates an uneven pattern of stock-based compensation that results in relatively higher expense in our first fiscal quarter and relatively lower expense in our second through fourth quarters. The impact of this feature is significant since a majority of our awards are made to retirement-eligible employees. Further discussion of our stock-based compensation is included in Note 2.

Other. We have reserves for other loss exposures, such as litigation, taxes, product liability, worker's compensation, employee medical claims, inventory and accounts receivable. We also have loss exposure on loan guarantees. Establishing loss reserves for these matters requires the use of estimates and judgment in regards to risk exposure and ultimate liability. We estimate losses under the programs using consistent and appropriate methods; however, changes in assumptions could materially affect our recorded liabilities for loss.

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Results of Operations

Current Quarter Compared to the Same Quarter Last Year

The following is an analysis of changes in key items included in the consolidated statements of income for the quarter ended February 24, 2007 compared to the quarter ended February 25, 2006.

(In thousands, except percent and per share data)	Quarter Ended		Feb. 25, 2006	% of Revenues	(Decrease) Increase	% Change
	Feb. 24, 2007	% of Revenues				
Net revenues	\$199,014	100.0	\$206,425	100.0	\$(7,411)	(3.6)
Cost of goods sold	180,049	90.5	186,105	90.2	(6,056)	(3.3)
Gross profit	18,965	9.5	20,320	9.8	(1,355)	(6.7)
Selling	4,315	2.1	4,505	2.2	(190)	(4.2)

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General and administrative	5,290	2.7	5,284	2.5	6	.1
Total operating expenses	9,605	4.8	9,789	4.7	(184)	(1.9)
Operating income	9,360	4.7	10,531	5.1	(1,171)	(11.1)
Financial income	1,602	.8	1,314	.6	288	21.9
Income before income taxes	10,962	5.5	11,845	5.7	(883)	(7.5)
Provision for taxes	3,430	1.7	4,145	2.0	(715)	(17.2)
Net income	\$7,532	3.8	\$7,700	3.7	\$(168)	(2.2)
Diluted income per share	\$0.24		\$0.23		\$0.01	4.3
Fully diluted average shares outstanding	31,764		33,147		(1,383)	(4.2)

Unit deliveries consisted of the following:

	Quarter Ended		Feb. 25, 2006	Product Mix %	Increase (Decrease)	% Change
	Feb. 24, 2007	Product Mix %				
Motor home unit deliveries:	2007	Mix %	2006	Mix %	(Decrease)	Change
Class A gas	886	42.1	658	29.0	228	34.7
Class A diesel	430	20.5	471	20.8	(41)	(8.7)
Total Class A	1,316	62.6	1,129	49.8	187	16.6
Class C	787	37.4				