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Annual Reports ~~DESK~~ STAEK

Thousand Trails, Inc.

1986 Annual Report

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**"America's
Finest
Outdoor
Recreational
Resorts"**

The Company

Thousand Trails, based in Bellevue, Washington, owns, operates, and sells memberships in a network of 43 camp resorts in 16 states and in British Columbia, Canada. Nearly 100,000 families are members of Thousand Trails.

A Thousand Trails resort is a destination for families who love the outdoors and appreciate quality facilities managed by a fine staff of professionals. Each location is distinguished by its natural beauty, surrounding attractions and well-planned amenities including swimming pools; lodges and recreation centers; sports facilities such as tennis, shuffleboard, and horseshoes; trading posts; hiking trails and open space. Individual campsites are developed with special care to ensure privacy and to provide full convenience for members. On-site travel-trailers and cabins are also available to members for a nightly fee.

Memberships are sold by a professional sales staff primarily at the Company's resorts. The marketing department supports the on-site sales effort through direct mail, telemarketing, member referral, and joint marketing programs with other related businesses.

A Thousand Trails member pays an initial membership fee and annual dues entitling the member's family to up to three generations of use of any existing or future locations for an unlimited number of visits of up to two weeks' duration per visit.

Operating Highlights

Year Ended December 31,	1982	1983	1984	1985	1986
Membership Sales	\$56,454,000	\$79,971,000	\$116,983,000	\$127,603,000	\$59,860,000
Total Revenues	70,073,000	100,222,000	148,515,000	173,734,000	113,413,000
Net Earnings (Loss)	7,761,000	12,004,000	19,110,000	1,788,000	(50,422,000)
Earnings (Loss) Per Share*					
Primary	\$.97	\$1.23	\$1.78	\$.17	\$(4.87)
Fully Diluted	\$.89	\$1.21	\$1.76	\$.16	\$(4.87)
Weighted Average Shares* and Equivalents					
(PPrimary)	7,998,000	9,721,000	10,729,000	10,678,000	10,346,000
(Fully Diluted)	8,787,000	10,003,000	10,883,000	11,034,000	10,346,000
Shareholders' Equity Per Share	\$3.68	\$5.91	\$7.59	\$7.63	\$2.76
Number of Shareholders	1,459	1,643	1,991	2,381	2,609
Employees	700	1,100	1,500	2,000	1,100
Family Memberships	38,100	51,100	68,700	85,100	91,000
Resorts	21	28	42	43	43

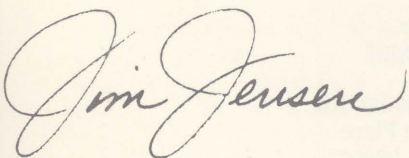
*Adjusted for stock splits in 1984 and 1983.

In last year's annual report, we stated that 1986 would be a year of consolidation as we shifted from a strategy of rapid growth and increased borrowings to one of down-sizing the Company and focusing on cash flow.

Our consolidation efforts included: 1) a 36% decrease in staff at our corporate headquarters and the initiation of a search for a smaller, less expensive corporate headquarters facility; 2) a moratorium on new property acquisitions and a 68% decrease in construction spending; 3) a decrease in membership sales targets to conserve the cash necessary to finance new sales; 4) a decrease in the number of operating sales offices from 27 to 12 by December 31, 1986; and 5) a refocusing of our sales efforts on our most cost-effective selling locations. To further enhance cash flow, we continued incentive programs during 1986 to encourage members to pay their installment contracts prior to maturity. As a result of the actions taken to date, we achieved positive cash flow from operations in the fourth quarter of 1986 and the first quarter of 1987. We also reduced borrowings under the Company's bank line of credit from \$100 million at December 31, 1986 to \$90.3 million at March 31, 1987. In addition, in December 1986, we purchased \$17.9 million principal amount of the Company's 14.625% senior subordinated notes due 1992 at a cost of \$11.5 million. The cash for this purchase came from the sale to Western Savings and Loan Association of certain assets not related to the Company's membership resorts. This purchase will reduce interest costs by \$2.7 million annually beginning in 1987. During the fourth quarter of 1986, we reevaluated the marketing strategy for future membership sales at each of the Company's resorts. This reevaluation was prompted by the lower level of membership sales and higher marketing costs in 1986, the financial constraints on the Company's ability to finance new membership sales, and other relevant market considerations. As a result, we reduced the number of campsites planned for construction in the future at the resorts and made a \$33.3 million (after tax) noncash write-down of resort land and improvements. The adjustment reduced future construction requirements

from \$104 million to \$52 million. **B**ecause of the size of the Company's debt in relation to our down-sized operations, we have begun discussions with the Company's principal lenders to restructure the debt. Our objective is to reduce interest costs and extend amortization schedules. Although there can be no assurance that a restructuring of the Company's debt can be accomplished, we believe there is a reasonable likelihood that we will be able to restructure the debt in a manner that should provide sufficient cash flow to continue our existing level of operations. The opinion of the Company's independent auditors on the financial statements included in this report has been qualified subject to a successful restructuring of the debt. **O**ur challenge in 1987 is to work toward profitable operations by restructuring the Company's debt and maintaining a moderate rate of sales at a reasonable marketing cost. We have recently completed several marketing studies that have brought us new information about the market for our industry. Additionally, we have added to our management team new marketing and sales executives with successful track records in direct leisure time marketing. Although we expect lower sales volume in 1987 than in 1986, we intend to focus on reducing marketing costs as a percentage of sales and positioning our product line for a long-term future. **W**e have confidence in our product and maintain the strong belief that Thousand Trails fulfills a valuable recreational and leisure time need. We appreciate your continued support.

Sincerely,



C. James Jensen
Chairman of the Board and
Chief Executive Officer



Howard P. Behar
President and
Chief Operating Officer

Officers

Jerol E. Andres
Vice President;
President,
Happy Trails Resorts, Inc. and
Outdoor Enterprises, Inc.

Howard P. Behar
President and
Chief Operating Officer

S. Duke Campbell
Senior Vice President, Operations

James E. Claus
Vice President,
Chief Financial Officer
and Treasurer

Kathleen M. Hornsby
Vice President and Corporate Secretary

Walter B. Jaccard
General Counsel

C. James Jensen
Chairman of the Board and
Chief Executive Officer

Robert V. Linderman
Vice President, Resort Services

A. Robert Paltiel
Vice President, Marketing

Ronald M. Tate
Vice President, Sales

Charlene E. Whitener
Vice President, Membership Administration

Directors

Howard P. Behar
Thousand Trails, Inc.

Robert T. Davis
Professor of Business
Stanford University, Oakland, CA

C. James Jensen
Thousand Trails, Inc.

James F. Nordstrom
President
Nordstrom, Inc., Seattle, WA

Edwin M. Stanley
Chairman
Management Compensation Group, Portland, OR

Charles E. Swanson
Encyclopedia Britannica, Inc., retired

J. P. Weyerhaeuser III
Weyerhaeuser Company, retired

Shareholder Information

Annual Meeting
Thursday, July 16, 1987
3 p.m.

Transfer Agent and Registrar
The First Jersey National Bank
One Exchange Place
Jersey City, NJ 07303

Independent Accountants
Touche Ross & Co.
30th Floor
1111 Third Ave.
Seattle, WA 98101

Corporate Headquarters
15325 SE 30th Place
Bellevue, WA 98007

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

Annual Report Pursuant to Section 13 or 15(d) of
The Securities Exchange Act of 1934

For the fiscal year ended December 31, 1987

Commission File Number: 2-65920

THOUSAND TRAILS, INC.

(Exact name of registrant as specified in its charter)

WASHINGTON

91-0851870

(State or other jurisdiction of
incorporation or organization)

U.S. Highway
Identification No.

8200 SE 10TH PLACE

BELLEVUE, WASHINGTON 98007

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code (206) 644-0190

Securities registered pursuant to Section 12(b) of the Act:

Title of each class
None

Name of each exchange on which registered
None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, no par value
(Title of Class)

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

On April 30, 1987, the aggregate number shares of the voting stock held by nonaffiliates of the registrant was 50,945,414.

Number of shares of Common Stock (no par value) of the registrant outstanding as of April 30, 1987: 50,337,369.

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

Annual Report Pursuant to Section 13 or 15(d) of
The Securities Exchange Act of 1934

For the fiscal year ended December 31, 1986

Commission File Number: 2-65020

THOUSAND TRAILS, INC.

(Exact name of registrant as specified in its charter)

WASHINGTON

(State or other jurisdiction of
incorporation or organization)

91-0851850

(I.R.S. Employer
Identification No.)

15325 SE 30TH PLACE,

BELLEVUE, WASHINGTON 98007

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (206) 644-1100

Securities registered pursuant to Section 12(b) of the Act:

Title of each class

None

Name of each exchange on which registered

None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, no par value

(Title of Class)

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

On April 30, 1987, the aggregate market value of the voting stock held by nonaffiliates of the registrant was \$21,015,741.

Number of shares of Common Stock (no par value) of the registrant outstanding as of April 30, 1987: 10,357,869.

THOUSAND TRAILS, INC.

FORM 10-K

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THOUSAND TRAILS, INC.

PART I

ITEM 1. BUSINESS

Thousand Trails, Inc. owns and operates the largest membership-based destination campground resort system in the United States. The Company's resorts are located in scenic areas generally within 100 miles of metropolitan centers. The resorts are operated exclusively for members and feature family-oriented recreational facilities and activities in a carefully developed setting of individual campsites, common facilities, and open space left in a natural state. The campsites and facilities are used by members owning recreational vehicles and members renting Company-owned travel trailers or cabins.

A Thousand Trails member pays an initial membership fee and annual dues, entitling the member's family to use the Company's resorts for an unlimited number of visits. Memberships are marketed principally to families who are interested in using the resorts for vacations and on weekends. There were 91,000 memberships outstanding at December 31, 1986, approximately 51,000 (56%) of which were fully paid and the balance of which are being purchased on an installment basis.

Resort Network

Between 1983 and 1985, the Company rapidly acquired and developed new properties in order to establish a national network of resorts. At December 31, 1986, the Company had 43 resorts located in 16 states and British Columbia, Canada. In addition, the Company had two additional properties which are classified on its balance sheet as investments in real estate. The Company has no plans to develop these properties in 1987, although they are available for development or disposition in subsequent years.

The Company presently has sufficient planned campsite inventory to sell memberships for the next several years without having to acquire any new properties, and the Company does not intend to acquire any new properties during 1987.

During the fourth quarter of 1986, the Company reevaluated the market for future membership sales at each of its resorts and reduced its estimate of the number of memberships it will be able to sell in the future from 183,000 to 99,000. This reevaluation was prompted by the lower level of membership sales achieved by the Company in 1986, the financial constraints on the Company's ability to finance new membership sales, and other relevant market considerations. As a result, the Company reduced the number of campsites planned for construction in the future at its resorts from 16,292 to 7,763 and charged against operations approximately \$63,281,000 of incurred but unamortized land and improvement costs in certain areas to reflect the change in estimated net realizable value resulting from lower levels of membership sales in 1986 and future years. See "Item 7. Management's Discussion and Analysis of Financial Condition and Result of Operations."

For sales and operational purposes, the Company has divided the United States and the province of British Columbia, Canada into geographic areas. Area designations and the location and year of acquisition of each of the 43 operating resorts are indicated on the map located on page 9.

Resort Facilities

The resorts feature campsites with electrical and water connections for recreational vehicles, restroom and shower facilities, rental trailers or cabins, and such facilities as swimming pools, indoor recreation centers, tennis courts, basketball and athletic courts, other outdoor game areas and fields, hiking trails, chapels, trading posts, and other resort facilities. On each resort, the Company employs a recreational staff to organize activities for children, adults, and families, such as barbecues, arts and crafts projects, dances, exercise classes, parties, tournaments, and a broad range of games. The Company also provides a year-round maintenance and security staff at each resort.

The Company owns and maintains fully furnished rental trailers at each operating resort and fully furnished cabins at five resorts. As of December 31, 1986, the Company had a total of 1,739 rental trailers and 90 cabins at its resorts.

Although specific resort facilities vary, the conceptual site plan of the San Benito, California resort located on page 10 is representative of a typical resort. Located on page 11 is a table that presents the facilities available at each resort as of December 31, 1986.

The Company plans facilities at its resorts that can be built in phases over a number of years as use by members dictates. In determining the optimum rate of development for a resort, the Company utilizes historical data regarding use of the resort by members as well as estimates of future membership sales at the resort. Information concerning the development status of the Company's resorts by geographic area, including costs of existing and planned campsites and facilities, is summarized as of December 31, 1986 in the table below.

								Estimated	Cumulative
								Cost of	Costs
								Additional	Expensed
								Planned	to
								Improve-	Membership
Area	Number of Resorts	Average Acreage	Member-ships Sold	Total Planned	Existing	Approved	Existing Resort Land & Improvements	ments	Sales ⁽¹⁾
Operating									
(Dollars in thousands)									
1	8	159	19,880	2,302	2,325	3,367	\$ 16,201	\$ 1,228	\$12,346
2	13	202	44,366	7,017	5,036	7,261	64,896	13,913	46,936
3	7	222	13,011	3,387	1,744	5,300	28,396	9,280	12,540
4	1	268	1,311	1,100	249	1,200	7,750	5,602	1,558
5	4	237	7,339	3,161	916	3,300	22,477	14,140	8,143
6	10	252	5,093	2,006	940	7,462	19,760	7,540	5,991
	43		91,000	18,973	11,210	27,890	\$159,480	\$51,703	\$87,514

(1) Cumulative costs expensed do not include the real estate adjustment of \$63,281,000 discussed above.

In general, the Company has developed its resorts in stages. In the initial start-up phase, core facilities, including the sales office, entry and tour road, and common facilities such as an activity center, swimming pool and cabana complex, athletic courts, and restroom facilities are completed along with an initial number of campsites. As membership sales and usage dictate, additional common facilities and campsites are built until planned maximum capacity is reached. However, the Company is not obligated to continue development of a resort if the additional capacity is not required based on membership sales and usage.

The Company has developed design and construction standards that are utilized on its resorts to promote high quality development and reduce maintenance and replacement costs. Development is seasonal and most construction occurs during the summer months. The Company acts as general contractor for all of its development and engages subcontractors to perform a substantial amount of the construction required on its resorts. The Company also employs construction crews for certain activities. The number of Company construction employees ranged from a peak of approximately 65 persons in the summer of 1986 to 16 at the end of 1986.

Memberships

Prior to 1983, the Company sold only a camping membership designed for owners of recreational vehicles. During 1983, the Company purchased travel trailers, installed them on its resorts for use by members, and began marketing vacation memberships to individuals who do not have a recreational vehicle.

A camping membership entitles the member's family to use an individual campsite without charge in a recreational vehicle provided by the member. A vacation membership entitles the member's family to rent a company-owned travel trailer at a preferential rate ranging from \$18 to \$29 per night, depending on the type of trailer and length of stay. A toll-free reservation system is used for advance booking of rental trailers. A camping member may also rent a Company-owned travel trailer but is charged a higher rental rate ranging from \$21 to \$32 per night, depending on the type of trailer and length of stay. In addition, rentals of Company-owned travel trailers by camping members are subject to use priority for vacation members.

During 1985, the Company combined the camping membership formerly offered to owners of recreational vehicles and the vacation membership formerly offered to individuals who do not have a recreational vehicle. The combined membership, called a resort membership, entitles the member's family to rent a Company-owned travel trailer at the preferential rates available to vacation members or, at the member's option, to use an individual campsite without charge in a recreational vehicle provided by the member. Resort members are also entitled to the same reservation priority for rental trailers available to vacation members.

In 1986, the Company constructed 90 cabins at five resorts to provide nicer accommodations for members than travel trailers. All members may rent the cabins on an equal priority basis at a rate ranging from \$28 to \$39 per night depending on length of stay.

Camping, vacation, and resort memberships are either unlimited or restricted to certain geographic areas. The unlimited membership entitles the member's family to use all existing and future resorts operated by the Company in its entire resort network. The area membership entitles the member's family to use the existing and future resorts within a defined geographic area. There are presently six membership areas which are described on the map on page 9. Members who purchase an area membership have the right to convert it to an unlimited membership at any time for an additional fee. Approximately 84% of the memberships sold in 1986 were unlimited memberships and the balance were area memberships. The unlimited resort membership is currently priced at \$7,495.

All types of memberships permit the member's family to use the Company's resorts but do not convey an ownership interest in the Company or its resorts, the right to use any specific campsite, trailer, or cabin, or the right to control further development or operation of the resorts. Although the Company may develop additional resorts in the future, prospective members are cautioned to base their decision to purchase a membership on the facilities available at the time of purchase. The Company does not contractually obligate itself to provide additional facilities at any future date.

There is no limit on how many times a member may visit each resort during the year. However, to allow all members reasonable access to each resort, a member is permitted to stay at a specific resort for a maximum of up to 14 consecutive days, after which the member may not stay at any resort for the next seven days. The average duration of a member's stay at a resort is three to four days.

Prior to 1986, all memberships sold by the Company could be used for the lifetime of the members and allowable transferee members. During 1986, the Company began marketing term memberships which expire after 3 or 10 years and sell for \$1995 and \$4995, respectively. The term memberships are non-transferrable.

The lifetime memberships currently sold by the Company cannot be transferred during the initial two years after purchase, except to a family member or by operation of law. Thereafter, these memberships may be transferred by sale, gift, or inheritance, but may not be transferred more than twice and only one of these transfers can be by sale. Lifetime memberships expire upon the death of the last allowable transferee. Transfers under the current contract are not permitted at a price higher than the purchase price paid by the original member plus a 10% transfer charge payable to the Company. Transferees are accepted as members and issued membership cards admitting them to the resorts only after the Company has consented to the transfers and the transferees have executed new membership contracts which include annual dues at the current level for new members. The Company does not repurchase memberships or locate purchasers for members who wish to sell their memberships. The number of membership transfers, which has been less than 1.4% of the total memberships outstanding at the end of each year, was 908 in 1984, 1,003 in 1985, and 905 in 1986.

Marketing Strategy and Programs

The Company directs its marketing efforts principally to RV owners and others who have an active interest in family-oriented, outdoor recreational activities. Prospective members receive invitations to tour the Company's resorts primarily through direct mail solicitations, personal referrals, and referrals by other companies with which Thousand Trails has a joint marketing arrangement. A prospective member is offered a gift such as complimentary camping, an electronic appliance, or an item of sporting equipment, as an incentive to travel to one of the resorts, tour the facilities with a salesperson, and attend a sales presentation. The sales presentation emphasizes the location, quality of the amenities, and regularly planned activities at each resort. Approximately 145,000 prospective members toured the Company's resorts in 1986 and approximately 6.8% of these prospective members purchased a membership.

During 1986, approximately 63% of the Company's membership sales were solicited by direct mail. In addition to direct mail solicitation, the Company solicits new members through a member referral program by which current members receive awards for referrals. During 1986, approximately 17% of the Company's membership sales were referrals from existing members, and the Company believes its member referral program will become increasingly important as the number of members grows and direct mail solicitations become less effective. The Company has also entered into joint marketing agreements with a number of companies, such as Fleetwood Industries, Camping World, and U-Haul, which resulted in approximately 3% of the Company's 1986 membership sales. The Company intends to pursue joint marketing arrangements with other companies and believes that such arrangements will become a more significant part of its marketing program in the future.

The Company intends to make increasing use of marketing programs involving more selective targeting of tour recipients and emphasizing referrals of prospective members by existing members and other companies.

The Company believes that such programs may result in lower marketing costs as a percentage of membership sales than direct mail solicitations. Industry experience suggests, however, that continued penetration of a market without variation of marketing techniques to expand the base of potential members will eventually lead to reduced sales volume and reduced profitability. As a result, the Company is exploring alternative membership programs to broaden its appeal within a given market area, such as the introduction of cabins at five of its resorts in 1986.

Membership Sales

Membership sales are made primarily at Company resorts after a tour of the resort. During 1986, the Company conducted sales activities at 27 of its 43 operating resorts. In an effort to reduce marketing costs and make best use of its available resources, the Company has temporarily discontinued marketing at a number of resorts and is concentrating its sales efforts at its most cost effective properties. The Company intends to conduct sales activity at approximately 12 resorts during 1987. At the remaining 31 resorts where the Company does not have a sales organization, a member of the resort services staff will be trained to give sales presentations on a limited basis to referrals from members and others.

The Company's membership sales are concentrated in the six-month period from April through September. The percentages of annual sales occurring during this period were 66% in 1984, 65% in 1985, and 67% in 1986. Although the seasonality of sales has been mitigated somewhat by the addition of resorts in the milder climates of California, the Southwest and the Southeast, the Company expects membership sales to continue to exhibit seasonal patterns.

In 1986, the number of salespersons employed by the Company ranged from a peak of 324 persons in the summer to 130 at year end due to the seasonal nature of the Company's business. Salespersons are compensated on a commission basis. Each salesperson is trained by the Company and must follow detailed guidelines prepared by the Company in making sales presentations. Printed information regarding the Company and its resorts, as well as the rights and obligations of membership, is presented to each prospective member before a membership is sold.

In addition to systematic training of salespersons and utilization of standardized sales presentations, the Company monitors its salespersons by surveying individuals who received a sales presentation but did not purchase a membership. The information received helps the Company identify any problems in sales practices and evaluate both the presentations made by individual salespersons and the general consumer perception of the Company. The Company records, analyzes, and investigates consumer complaints on a continuing basis to provide prompt information to the sales and marketing management, to assure a rapid and proper response to consumers, and to monitor the progress of the Company in eliminating causes of consumer concern.

Membership Profile

Most members own recreational vehicles and have an active interest in camping, boating, fishing, and other family-oriented recreational activities. Each year, the Company conducts a survey of its membership to gather additional information regarding members' use of, and satisfaction with, the resorts and operations, and to develop a current demographic profile of the membership. The most recent survey (1985) was mailed to a random sample of 2,000 camping members (3.6% of total members) and 2,000 vacation members (3.6% of total members), of which 1,110 (56%) and 864 (43%) responded, respectively. Based on this survey, the Company has estimated the profile of its membership to be as follows:

	<u>Camping Member</u>	<u>Vacation Member</u>
Percentage who own a recreational vehicle	79.3%	15.0%
Median family income	\$32,800	\$35,000
Percentage who are homeowners	91.0%	86.5%
Years at present residence	14.6	12.3
Of members not retired, years with present employer	14.2	8.6
Average age of primary wage earner	55.3	51.0
Percentage who are retired	45.0%	30.0%

In addition to providing a membership profile to help increase the effectiveness of the Company's marketing program, the annual survey solicits member ratings of the Company's facilities and services. Responses indicate a high level of member satisfaction.

Resort Operations

At each operational resort, the Company employs a manager, supervisor, and staff to provide recreational programs, security, and maintenance. Usage of resorts by members is greatest during the summer months. A toll-free advance notification system is employed at most resorts for members camping in their own recreational vehicles from May to September and at all resorts for the Memorial Day, Fourth of July, and Labor Day weekends. A toll-free reservation system is used at all resorts for advance booking of rental trailers and cabins. Although substantially all of the resorts operate on a year-round basis, the resort services program is scaled down during the winter months commensurate with member usage. In 1986, the Company's total resort services staff ranged from a peak of 1,101 persons in the summer to 560 at the end of the year.

Annual membership dues and other resort revenues in 1986 were approximately 92% of the cost of resort operations after allocating to marketing expenses certain costs incurred to support membership sales. The Company's objective is for annual membership dues and other resort revenues to provide fully for expenses of resort operations and related general and administrative expenses. The Company currently estimates that the break-even point for resort operations will occur when memberships outstanding reach approximately 50% of total memberships available for sale. Dues are subject to annual increases not greater than the percentage increase in the consumer price index. For memberships sold prior to April 1987, the dues of senior citizen and disabled members, of which there were 26,078 as of December 31, 1986, are not subject to escalation. Dues on all memberships sold after April 1987 will be subject to escalation. Average annual membership dues as of December 31, 1986, were \$232. Annual dues for new members are currently \$330. Total revenue from membership dues was \$18,974,000 in 1986. See Notes A and I of Notes to Consolidated Financial Statements.

Food, sporting equipment, and various sundries are available for sale to members at trading posts operated on 30 resorts and laundry facilities and game machines are available at all resorts. In addition, resort services personnel provide certain services and activities to members for which a fee is charged, such as recreational vehicle storage and food service. The Company also receives revenues from the rental of travel trailers or cabins to members and their guests. Total revenue from all of these sources was \$9,045,000 in 1986.

Membership Receivables Management

Memberships may be purchased for cash or on an installment basis. The down payment on installment sales must be at least 10% of the sales price and averaged approximately \$1,315 in 1986. The outstanding balance is payable in monthly installments over periods ranging from 10 to 84 months, with the unpaid balance bearing interest at rates which averaged 14.8% on contracts executed in 1986 and which vary depending upon the size of the down payment and length of the contract. The average term of installment contracts executed in 1986 was 71 months. Members may use the resorts as soon as the down payment is made. In 1986, 12.5% of the Company's membership sales were made for cash and the balance were installment sales. Of the Company's outstanding memberships at December 31, 1986, approximately 51,000 (56%) were fully paid.

The Company allows new members who do not wish to make the down payment at the time of sale to pay the full down payment over a period of up to four months without interest. Such down payment-financed sales are recorded as sales and membership contracts receivable at such time as sufficient payments have been made to aggregate the minimum down payment; however, in the interim the members are entitled to limited membership privileges. During 1985 and 1986, respectively, 16.6% and 18.1% of the Company's membership sales were down payment-financed.

The Company manages and collects the membership contracts receivable arising from installment sales of memberships. The total contracts receivable portfolio as of December 31, 1986 was approximately \$167,268,000, with an annual yield of 15%. Interest income increased from \$16,067,000 in 1984 to \$25,534,000 in 1986 and, as a percentage of total revenues, from 10.8% in 1984 to 22.5% in 1986. Scheduled contract payments, including principal and interest, due over the next five years for contracts receivable outstanding at December 31, 1986, are as follows:

	1987	1988	1989	1990	1991
	(Dollars in Thousands)				
Scheduled payments (principal and interest)	\$56,266	\$49,983	\$42,821	\$35,858	\$29,069
Percentage of total contracts receivable (principal only)	20.2%	19.3%	17.8%	16.1%	14.3%

The Company has increased its cash flow by developing programs to encourage members to pay their accounts in full prior to maturity. In 1984, 1985, and 1986, these programs generated additional principal payments of approximately \$9,800,000, \$12,735,000, and \$14,413,000, respectively, in excess of scheduled payments.

Before a new contract is recognized as a sale for financial reporting purposes, the contract goes through a thorough verification process. Within seven days after a new member signs a contract, the member is contacted separately by both his salesperson and by an employee in the corporate office to review the contract and verify the member's commitment to his purchase. Approximately 18.4% of new contracts sent from the resorts to the corporate office are cancelled at this time and a full refund of any payment is made. A new contract is recognized as a sale and, if an installment sale, included in the Company's contracts receivable only following the confirmation by the corporate office. Furthermore, all new sales are subject to a provision of approximately 10% of sales for estimated sales cancellations, which are defined as members who do not make two payments on their contracts. In addition to the provision for sales cancellations, the Company provides for contracts that will be written off after two or more payments have been made through its provision for doubtful accounts. See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations."

At the present time, 46.3% of all accounts have monthly payments transferred automatically from the member's bank account to a Company bank account under the Company's pre-authorized payment program. 75% of the installment sales made in 1986 utilized this program. For the remaining accounts, statements are sent to members two weeks prior to a payment's due date. A late notice is mailed seven days after the due date if the payment is not received by that time. The late notice is followed by telephone calls from accounts receivable representatives. Letters or mailgrams are used to confirm payment arrangements made by telephone. By the time an account is 32 days past due, a member will have been contacted by the Company four times. As of the end of each month of the year in 1984, 1985, and 1986, at least 83.6% of the members purchasing on an installment basis were current in their payments and no more than 4.46% were over 32 days past due in their payments.

Accounts more than 90 days overdue are written off and membership privileges are terminated. Once an account is written off, an account recovery representative is assigned to the account. A member may reinstate his membership by satisfying all prior payments, with interest, at which time the receivable will be reinstated. In 1985, a total of \$7,274,000 was written off and \$607,000 of accounts previously written off was recovered through reinstatement of memberships and settlement of accounts. In 1986, a total of \$13,368,000 was written off and \$400,000 of accounts previously written off was recovered through reinstatement of memberships and settlement of accounts.

The following table sets forth information concerning contracts receivable written off during the past three years:

	1984	1985	1986
	(Dollars in Thousands)		
Contracts receivable written off (net)	\$ 1,827	\$ 6,667	\$ 12,354
Average contracts receivable outstanding	\$115,138	\$166,107	\$177,189
Write-offs as a percentage of average contracts receivable	1.6%	4.0%	7.3%

The Company had higher contracts receivable write-offs in 1986 than in 1985 and 1984. Upon analysis, the Company believes the higher contracts receivable write-offs were primarily attributable to three factors: (1) a higher default rate on memberships sold to individuals who do not have a recreational vehicle, who have a tendency to use the Company's resorts less than owners of recreational vehicles, (2) a higher default rate on installment contracts arising from membership sales in Texas (19.9% of the total portfolio), which may be related to economic problems in that state, and (3) the negative publicity arising from the losses incurred by the Company in 1986 and the bankruptcy proceedings involving other companies in the industry in 1986. See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations."

Outdoor Enterprises, Inc.

Since 1984, Outdoor Enterprises, Inc. (formerly ThouServ, Inc.), a wholly owned subsidiary of the Company, has marketed consumer products to members and other persons. These products include VISA cards, automobile club services, insurance for recreational vehicles and automobiles, credit life insurance, and consumer products for recreational vehicle and camping activities. The VISA cards are issued by Western Savings and Loan Association, which operates the VISA card program. See "Item 13. Certain Relationships and Related Transactions."

Employees

The number of Company employees fluctuates with the seasonal nature of the Company's business and is highest in the summer months and lowest in the winter months. At December 31, 1986, the Company had approximately 1,095 full-time employees, of which 281 were executive, clerical, marketing, and administrative personnel employed at the Company's corporate headquarters in Bellevue, Washington. At December 31, 1986, the Company also had approximately 52 part-time employees engaged in sales, operations, and construction activities. During the summer of 1986, the Company had peak employment of approximately 2,154 persons. Between December 31, 1985 and December 31, 1986, the Company reduced staffing at its corporate headquarters by approximately 36% in light of the lower level of membership sales achieved by the Company in 1986 and in an effort to be more cost effective. The Company is not a party to any collective bargaining agreement and believes that its relationship with employees is good.

Competition

Several organizations compete directly with the Company by marketing memberships usable at multiple destination campground locations. There are also other organizations and individuals which own one or a few campgrounds and offer their members reciprocal use of other campground locations through affiliations with other campground operators. The Company believes that it is the largest organization operating a system of campgrounds exclusively for use by its own members. The Company believes that its ability to compete successfully for membership sales is based upon its ability to solicit prospective purchasers and to attract and retain an effective sales force, and upon the attractiveness and location of its resorts.

The Company faces indirect competition from a variety of sources. Recreational campsites are developed and operated as public facilities by federal, state, and local governments without charge or for nominal fees. Private camping clubs also exist which own common recreation facilities and offer individual campsites for sale. Such camping clubs are typically operated at single locations and sell ownership interests at prices significantly higher than the Company's membership prices. The Company also competes indirectly with other types of recreational land developments which do not involve camping.

Governmental Regulation

Development and Operation of Resorts

Development and operation of resorts typically require the Company to obtain and comply with major discretionary permits or approvals issued by local governments. Such requirements may be imposed, for example, by local zoning ordinances or master plans for shoreline use, or by state environmental policy statutes. The Company has obtained such discretionary approvals and permits for its existing operations at each of its 43 operating resorts, although the Company has not yet received permits necessary for all of its planned campsites. See table on page 2.

To construct improvements on its resorts, the Company is also usually required to obtain a number of permits which are typically nondiscretionary and routinely issued. These include building permits and sanitary sewage permits. Problems concerning the issuance of such permits are usually resolved through design, operating, or engineering solutions negotiated with local government officials.

The governmental authorities regulating the Company's activities have broad discretionary powers to enforce and interpret the statutes and regulations which they administer, including the power to enjoin or suspend sales activities, require or restrict construction of additional facilities, and revoke licenses and permits relating to the Company's business activities. Although the Company believes it is in compliance in all material respects with the current requirements of these authorities, it is unable to predict the effect, which could be adverse, of future developments in the laws or regulations administered by federal, state, and local authorities having jurisdiction over its development activities.

Membership Sales

Several states in which the Company does business have enacted legislation within the past three years governing sales activities of the type conducted by the Company. The Company generally supported passage of the legislation and assisted in drafting much of the legislation and accompanying administrative rules. The legislation generally requires comprehensive disclosure to prospective purchasers and a three- to five-day right of rescission. The legislation affects the Company's membership sales in the states of Arizona, California, Indiana, Oregon, Nevada, Virginia, and Washington. Similar legislation has been proposed, and is generally supported by the Company, in certain other states in which it operates.

The Company's activities are also regulated by a variety of consumer protection statutes and regulations. The Company and various governmental agencies sometimes receive complaints from persons solicited for tours and from members who for a variety of reasons desire to rescind their membership contracts. The Company attempts to work directly with individuals and appropriate authorities to resolve any complaints that may be received. See "Item 3. Legal Proceedings." To control practices that might violate consumer protection laws and regulations or give rise to such complaints, the Company monitors its tour solicitation programs, and attempts are made to standardize sales presentations.

The Company's membership contracts may be subject to certain consumer rights and defenses that vary from jurisdiction to jurisdiction. Installment sales of memberships are regulated by state and federal consumer credit laws, including truth-in-lending and similar laws requiring disclosure of finance charges and usury or retail installment sales laws that regulate the amount of permissible finance charges. The Company's membership contracts are revised periodically to include the information required by various disclosure laws. The interest rates currently charged on the unpaid balance of installment contracts is believed by the Company to be within the maximum finance charge permitted in each jurisdiction in which it sells memberships. However, since many states have a floating finance charge limit that fluctuates with prevailing money market interest rates, a general decline in interest rates could reduce the effective interest rate that the Company is permitted to charge on future installment sales in certain jurisdictions.

Direct mail marketing is regulated by certain state and federal laws, including general lottery laws and various types of advertising and promotion laws. Although these laws vary from state to state, the Company believes its direct mail marketing programs are in compliance in all material respects with all applicable federal laws and the laws and regulations of all states in which the Company markets memberships.

Certain states also have laws or regulations that, while not adopted specifically for the purpose of regulating the marketing or sale of campground resort memberships, may be applied to regulate or preclude the sale of memberships by the Company. Since such laws are generally not designed to address the particular characteristics of the membership campground resort industry, compliance with them could make it difficult or prohibitively expensive for the Company to operate in such states. Even if such laws are ultimately changed or determined through litigation not to be applicable to the Company, the delay and uncertainty could have a material adverse effect on the Company.

Under certain circumstances, courts have held that sales of memberships may be rescinded under statutes regulating the sale of securities where the memberships were not registered as securities and were sold on the basis of their investment potential or where members were providing speculative capital for a new and risky venture. The Company has not registered its memberships under such statutes because it believes its memberships are not securities as that term is defined in such statutes and under existing judicial authority. Prospective members are informed in the sales presentation and the membership contract that Thousand Trails memberships are not investments and should be purchased solely for their recreational value. In addition, memberships sold by the Company are subject to restrictions on transferability which prohibit any financial gain on the disposition of a membership.

The Company is unable to predict the effect, which could be adverse, of future developments in the laws or regulations of the states in which it operates. In addition, the governmental authorities regulating the Company's sales and marketing activities have broad discretionary powers to enforce and interpret statutes and regulations, including the power to enjoin or suspend sales activities.

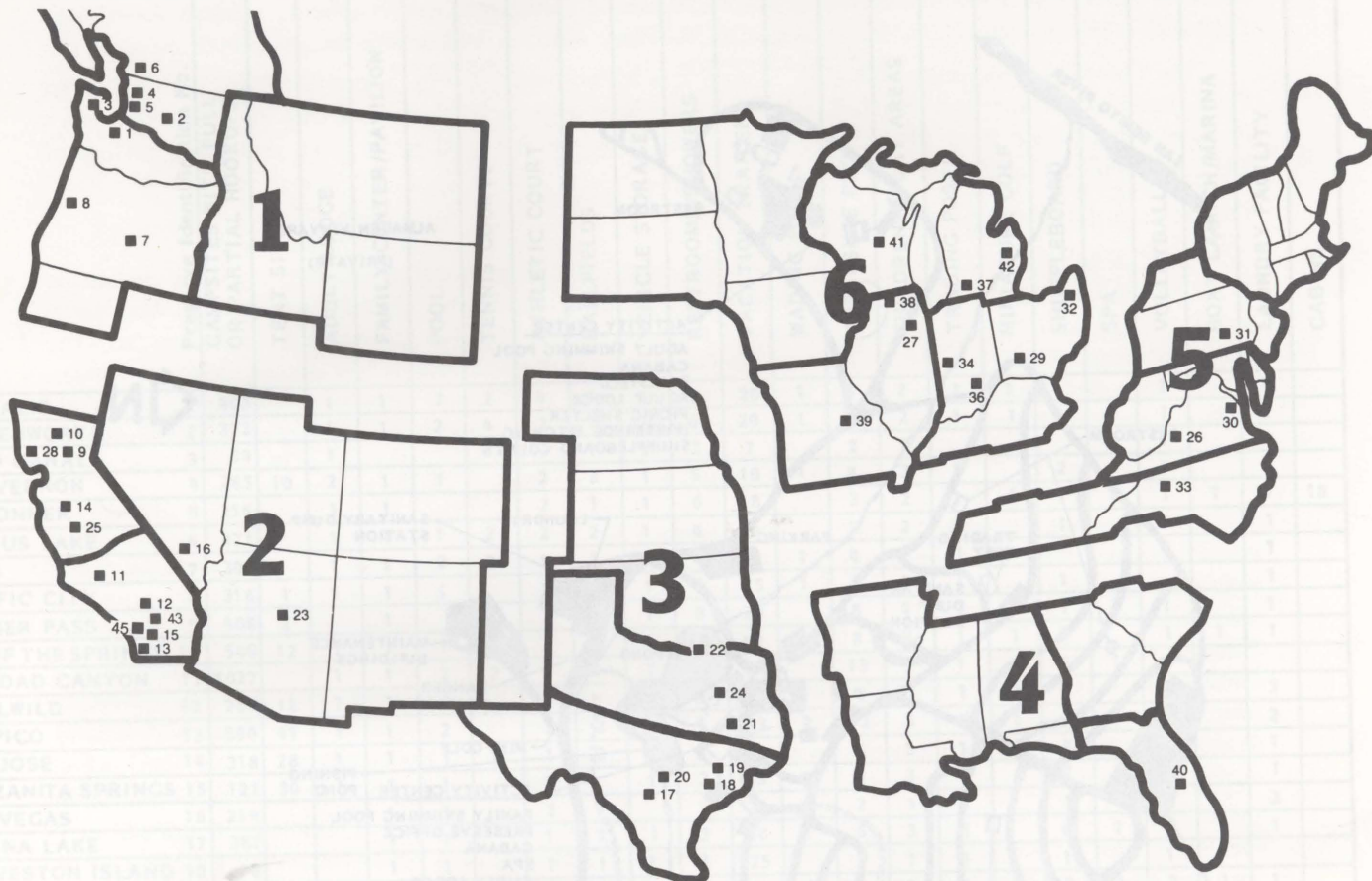
Risk Management

During 1985 and 1986, the Company reduced insurance coverages and selected higher deductibles on its insurance policies in an effort to control increasing insurance costs. Insurance coverages obtained in 1987 are generally comparable to 1986 coverages. There can be no assurance that such coverages will ultimately prove adequate or that the amount or type of the Company's insurance coverages will remain available or that, if available, they will be on a cost-effective basis.

Resort Locations

Set forth on the following page are the locations of the Company's 43 operating resorts, the year of acquisition of each resort, and the geographic boundaries of the Company's membership areas.

Thousand Trails®



AREA 1

- 1972 Chehalis, WA ■1
- 1975 Leavenworth, WA ■2
- 1976 Hood Canal, WA ■3
- 1976 Mount Vernon, WA ■4
- 1978 La Conner, WA ■5
- 1978 Cultus Lake, B.C. ■6
- 1978 Bend, OR ■7
- 1979 Pacific City, OR ■8

AREA 2

- 1979 Donner Pass, CA ■9
- 1979 Lake of the Springs, CA ■10
- 1980 Soledad Canyon, CA ■11
- 1980 Idyllwild, CA ■12
- 1980 Pio Pico, CA ■13
- 1981 San Jose, CA ■14
- 1981 Oakzanita Springs, CA ■15
- 1982 Las Vegas, NV ■16
- 1983 Verde Valley, AZ ■23
- 1983 San Benito, CA ■25
- 1983 Duncans Mills, CA ■28
- 1985 Palm Springs, CA ■43
- 1985 Palomar Valley, CA ■45

AREA 3

- 1982 Medina Lake, TX ■17
- 1982 Galveston Island, TX ■18
- 1982 Lake Conroe, TX ■19
- 1982 Colorado River, TX ■20
- 1982 Lake Whitney, TX ■21
- 1983 Lake Texoma, TX ■22
- 1983 Lake Tawakoni, TX ■24

AREA 4

- 1984 Orlando, FL ■40

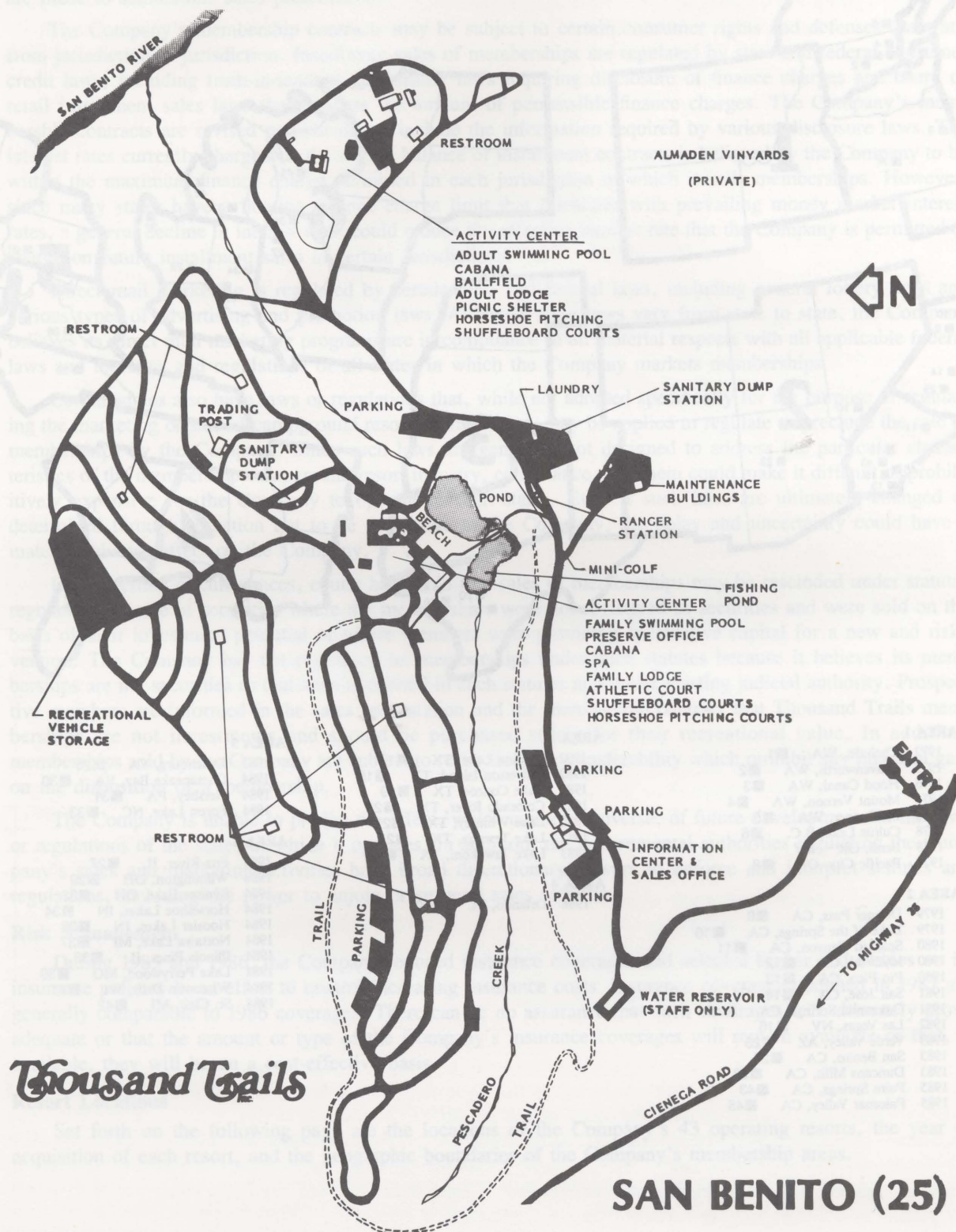
AREA 5

- 1983 Lynchburg, VA ■26
- 1984 Chesapeake Bay, VA ■30
- 1984 Hershey, PA ■31
- 1984 Forest Lake, NC ■33

AREA 6

- 1983 Fox River, IL ■27
- 1984 Wilmington, OH ■29
- 1984 Kenisee Lake, OH ■32
- 1984 Horseshoe Lakes, IN ■34
- 1984 Hoosier Lakes, IN ■36
- 1984 Nottawa Lake, MI ■37
- 1984 Illinois Pines, IL ■38
- 1984 Lake Perrywood, MO ■39
- 1984 Wisconsin Dells, WI ■41
- 1984 St. Clair, MI ■42

Set forth below is a conceptual chart for the Company's San Benito resort in California which identifies the presently planned facilities when the resort is fully developed. The table on page 11 includes information on the facilities which have been completed at San Benito and the Company's other operating resorts as of December 31, 1986. The table on page 2 includes information on the number of actual and planned campsites, the cost of existing property and improvements, and the estimated cost of planned improvements by geographic area for the Company's resorts.



Thousand Trails[®]

Facilities and Amenities

	Preserve Identification No.	CAMPsites WITH FULL OR PARTIAL HOOKUPS	TENT SITES	ADULT LODGE	FAMILY CENTER/PAVILION	POOL	TENNIS COURTS	ATHLETIC COURT	BALLFIELDS	VEHICLE STORAGE	RESTROOMS/SHOWERS	VACATION TRAILERS	WADING POOL	HORSESHOE PITS	CHILDRENS' PLAY AREAS	TRADING POSTS	MINIATURE GOLF	SHUFFLEBOARD	SPA	VOLLEYBALL	BOAT LAUNCH/MARINA	LAUNDRY FACILITY	CABINS
CHEHALIS	1	403		1	1	2	2	4	1	1	8	20	1	7	2	1	1			1		1	
LEAVENWORTH	2	272		1	1	2	4	2	1	1	6	20	1	8	2	1	1	4		1		2	
HOOD CANAL	3	84		1					1	1	2	7		2	1					1		1	
MT. VERNON	4	285	10	2	1	1		2	3	1	5	10	1	4	3	1		2		1		1	
LA CONNER	5	316		1	1			2	1	1	6	18		3	2	1	1		1	1	1	1	18
CULTUS LAKE	6	471		1	1	1	2	2	2	1	4	5		2	2	1		1		1		1	
BEND	7	301		1	1	2	2	1	1	1	6	14	1	4	2	1				1		1	
PACIFIC CITY	8	316	1	1	1	1		2		1	5	25	1	4	3	1		1				1	
DONNER PASS	9	408	2		1		2	2	1	1	8	29		8	4	1		1	1	1		1	
LK. OF THE SPRINGS	10	540	12	1	1	1	1	2	1	1	10	49		8	3	1	1	1		1	1	1	
SOLEDAD CANYON	11	1027		1	1	2	2	7	1	1	12	67		13	9	1	1	5	1	6			
IDYLLWILD	12	287	12	1	1	1		3		1	6	28	1	4	3	1	1	2		2		3	
PIO PICO	13	500	41	1	1	2		3	2	1	6	43	2	12	3	1	1	8	2	1		2	
SAN JOSE	14	318	28	1	1	1	1	1	2	1	5	41		4	3	1	1	4		1		1	
OAKZANITA SPRINGS	15	121	30	1	1	1		1		1	2	15	1	4	3	1	1	2	1	1		1	
LAS VEGAS	16	214			1	1		2			3	21		2	1	1		1		1		3	
MEDINA LAKE	17	387			1	1		1	1	1	3	48	1	6	3	1		6	1	2	1	1	
GALVESTON ISLAND	18	76			1	1		1	1	1	1	25		2	1	1		1		1			
LAKE CONROE	19	347	12		1	1	2	2	1	1	5	36	1	8	3	1		2	1	2	1	1	
COLORADO RIVER	20	128		1		1	1	2	1	1	2	21		6	2		1	1		2	1		
LAKE WHITNEY	21	241	3	1		1	2	2		1	3	40			3	1		1	1	2		1	
LAKE TEXOMA	22	259	2	1	1	2		1	1	1	4	44	1	6	2	1		2	2	1	1	1	18
VERDE VALLEY	23	346		1	1	1		2	1	1	3	51		2	3	1		1	1	2		1	
LAKE TAWAKONI	24	318	1	1	1	2		1	1	1	5	65	1	8	2	1		6	2	2	1		
SAN BENITO	25	518		1	1	2		1	1	1	7	63		6	4	1	1	1	1	2		1	
LYNCHBURG	26	224				1	2	6	1	1	3	34		7	2			2	1	2			
FOX RIVER	27	185	20	1	1	1	1	1	1	1	4	42	1	7	4	1		6		3	1		18
DUNCANS MILLS	28	123			1						2	24		2	1			1		1			
WILMINGTON	29	126		1		2	1	2		1	2	16	1	6	2	1		4	1	1		1	
CHESAPEAKE BAY	30	316		1	1	1	1	2	2	1	4	96	1	4	3	1	1	1	1	2	2	1	18
HERSHEY	31	128		1	1	1	2	1		1	2	44	1	4	1		1		1	1		1	
KENISEE LAKE	32	119			1			2			2	13		2	2	1		1	1	1			
FOREST LAKE	33	214	10	1		1	2	1	1	1	2	41		2	2		1	2		1			18
HORSESHOE LAKES	34	119			1		2	1			1	22		4	4	1		2		1			
HOOSIER LAKES	36	131		1				2			2	16		2	1			2		1			
NOTTAWA LAKE	37	100		1		1		1		1	3	8		4	2		1			1	1		
ILLINOIS PINES	38	124		1	1	1			1	1	1	6	1	6	2			2		1			
LAKE PERRYWOOD	39	54								1	1	10		2	2					1	1	1	
ORLANDO	40	249			1	1	1			1	4	73	1	6	2	1	1	7	1		1	1	
WISCONSIN DELLS	41	52			1	1		1		1	1	14		2	2			2		1	1	1	
SAINT CLAIR	42	101			1	1					1	8		2	2		1			1			
PALM SPRINGS	43	397			1	1		1			4	24		4		1		2	1			3	
PALOMAR VALLEY	45	284			1	1		1		1	3	15		6	1			2		1		1	

ITEM 2. PROPERTIES

The Company's principal properties are its resorts. See "Item 1. Business — Resort Network." Except as noted below, the Company owns all of its resorts subject to mortgages in favor of its principal bank and, in most cases, to real estate contracts or mortgages in favor of the sellers of the resort properties.

The following resorts are leased by the Company: La Conner, which is leased until 2028; Duncans Mills, which is leased until 1998 with a 10-year renewal option; a portion of Lake Tawakoni, which is leased until 2008 with a renewal provision; and a portion of Pio Pico, which is leased until the year 2000.

The Company's corporate offices are located in a facility which the Company leases at 15325 S.E. 30th Place, Bellevue, Washington 98007. The Company has been engaged in discussions with its landlord to reduce the space under lease from 104,883 to 64,712 square feet, which would result in an annualized savings of \$813,000 commencing in 1988.

ITEM 3. LEGAL PROCEEDINGS

The Company is involved in a dispute with the Washington Department of Revenue regarding application of a 1.5% business and occupation tax on interest income from membership contracts sold outside Washington and a 6.5% retail sales tax on the Company's membership sales and dues assessments in Washington. The Company has also been notified by the Virginia Department of Revenue that it believes the Company's membership sales and dues assessments in Virginia are subject to a 4% retail sales tax. The Company has not collected or accrued for all state taxes currently in dispute. The Company intends to contest the application of these state taxes and believes the eventual outcome will not have a material impact on the Company's operations or financial position.

The sales and marketing activities of the Company are regulated by certain state and federal consumer protection laws. Prior to commencing sales and marketing activities in a new state, the Company reviews its sales and marketing practices in light of the state's consumer protection laws to ensure that its practices comply with such laws. However, after the Company commenced sales and marketing activities in Illinois in 1984, the Attorney General of that state took the position that certain of the Company's sales and marketing practices violate Illinois' consumer protection laws. Although the Company does not believe its sales and marketing practices have violated such laws, it is negotiating with the Attorney General in an attempt to reach a mutually agreeable settlement. If a settlement is not reached, the Attorney General has threatened to take legal action against the Company to enjoin the practices which it believes violate Illinois' consumer protection laws and to seek monetary damages and penalties. The Company believes the eventual outcome of this matter will not have a material impact on the Company's operations or financial position.

On February 26, 1986, the Company was served with a purported class action complaint filed in Seattle in federal district court naming the Company, two of its principal officers, and its independent auditors as defendants. The complaint alleges claims under Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5 promulgated thereunder, and certain common law principles based on alleged misrepresentations by the Company in certain financial disclosures, including reports filed with the Securities and Exchange Commission, in 1985 and seeks unspecified damages. In July 1986, the Court dismissed the plaintiff's common law claims and certified the case as a class action lawsuit. At the present time, the case is in the stage of discovery, and the Company and its counsel believe it is too early to assess the ultimate outcome. However, based on the information which has been reviewed to date, the Company believes it has meritorious defenses and that the lawsuit will not have a material impact on its operations or financial position.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matter was submitted to a vote of the Company's shareholders during the fourth quarter of 1986.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Market and Market Price of Common Stock

The Company's Common Stock is traded over-the-counter under the symbol TRLS. The following table sets forth the high and low closing bid prices in the NASDAQ National Market System for the Company's Common Stock as reported by NASDAQ for the fiscal years 1985 and 1986.

<u>Bid</u>	<u>High</u>	<u>Low</u>
1985		
First Quarter	20 $\frac{1}{8}$	14 $\frac{7}{8}$
Second Quarter	19 $\frac{1}{2}$	13 $\frac{3}{8}$
Third Quarter	15 $\frac{5}{8}$	6 $\frac{3}{4}$
Fourth Quarter	9	5 $\frac{1}{2}$
1986		
First Quarter	8 $\frac{3}{8}$	4 $\frac{1}{4}$
Second Quarter	7	4
Third Quarter	5 $\frac{3}{8}$	2 $\frac{5}{8}$
Fourth Quarter	3 $\frac{1}{4}$	1 $\frac{3}{4}$

The approximate number of holders of record of the Company's Common Stock as of April 30, 1987 was 2,610. This computation includes only record holders of the Company's Common Stock.

Dividend Policy

The Company has paid no cash dividends and anticipates that for the foreseeable future it will continue to retain its earnings for use in the business. The indenture under which the Company's 14.625% Senior Subordinated Notes due 1992 were issued limits the payment of cash dividends, and the Company's bank line of credit prohibits the payment of cash dividends without the bank's approval. See Note D of Notes to Consolidated Financial Statements.

ITEM 6. SELECTED FINANCIAL DATA

The selected financial information set forth on the following two pages has been taken from the Consolidated Financial Statements included in this report and from previously published financial information of the Company not appearing herein. The Consolidated Financial Statements for each of the three years in the period ended December 31, 1986 were examined by Touche Ross & Co. whose report with respect thereto appears elsewhere in this report. The selected financial data with respect to the years ended December 31, 1982, and December 31, 1983 are derived from Consolidated Financial Statements, also examined by Touche Ross & Co., but not included in this report. Such selected financial information should be read in conjunction with the Consolidated Financial Statements, and the notes thereto, appearing elsewhere herein.

Except for per share data, the amounts shown are in thousands.

Income Statement Data:

	Year ended December 31,				
	1982	1983	1984	1985	1986
REVENUES					
Membership Sales	\$56,454	\$ 79,971	\$116,983	\$127,603	\$ 59,860
Resort Operations	6,997	10,104	15,465	22,725	28,019
Interest Income From Membership Contracts ...	6,622	10,147	16,067	23,406	25,534
	<u>70,073</u>	<u>100,222</u>	<u>148,515</u>	<u>173,734</u>	<u>113,413</u>
EXPENSES					
Marketing Expenses	24,892	35,209	54,181	74,081	41,766
Resort Land and Improvement Costs	8,389	13,047	17,842	21,029	12,520
Provision for Doubtful Accounts	2,241	3,977	5,880	17,644	19,231
Resort Operating and Administrative Expense ..	6,672	9,615	16,403	23,202	30,428
Membership Contract Collection Expense	942	1,340	2,180	2,882	3,091
General and Administrative Expenses	7,670	10,487	12,513	15,720	16,515
Interest Expense	4,203	3,957	5,124	16,286	27,818
	<u>55,009</u>	<u>77,632</u>	<u>114,123</u>	<u>170,844</u>	<u>151,369</u>
INCOME (LOSS) FROM MEMBERSHIP SALES AND					
RESORT OPERATIONS	15,064	22,590	34,392	2,890	(37,956)
OTHER INCOME (EXPENSE)					
Real estate adjustment	—	—	—	—	(63,281)
Other	35	42	1,004	90	(166)
	<u>35</u>	<u>42</u>	<u>1,004</u>	<u>90</u>	<u>(63,447)</u>
INCOME (LOSS) BEFORE TAX AND EXTRAORDINARY					
ITEM	15,099	22,632	35,396	2,980	(101,403)
DEFERRED INCOME TAXES	7,338	10,628	16,286	1,192	(48,004)
INCOME (LOSS) BEFORE EXTRAORDINARY ITEM ...	7,761	12,004	19,110	1,788	(53,399)
EXTRAORDINARY ITEM					
Gain from Extinguishment of Debt, Less					
Applicable Income Tax of \$2,676	—	—	—	—	2,977
NET EARNINGS (LOSS)	<u>\$ 7,761</u>	<u>\$ 12,004</u>	<u>\$ 19,110</u>	<u>\$ 1,788</u>	<u>\$ (50,422)</u>
NET PRIMARY EARNINGS PER SHARE					
Income (loss) before extraordinary item	\$.97	\$ 1.23	\$ 1.78	\$.17	\$ (5.16)
Extraordinary item	—	—	—	—	.29
Net Earnings (Loss)	<u>\$.97</u>	<u>\$ 1.23</u>	<u>\$ 1.78</u>	<u>\$.17</u>	<u>\$ (4.87)</u>
NET FULLY DILUTED EARNINGS PER SHARE					
Income (loss) before extraordinary item	\$.89	\$ 1.21	\$ 1.76	\$.16	\$ (5.16)
Extraordinary item	—	—	—	—	.29
Net Earnings (Loss)	<u>\$.89</u>	<u>\$ 1.21</u>	<u>\$ 1.76</u>	<u>\$.16</u>	<u>\$ (4.87)</u>
WEIGHTED AVERAGE SHARES AND EQUIVALENTS					
Primary	7,998	9,721	10,729	10,678	10,346
Fully Diluted	8,787	10,003	10,883	11,034	10,346

Balance Sheet Data:

	Year ended December 31,				
	1982	1983	1984	1985	1986
Current assets	\$ 15,981	\$ 23,666	\$ 36,558	\$ 44,408	\$ 34,695
Current liabilities	15,001	22,118	34,977	39,607	33,553
Membership contracts receivable (net)	53,443	82,373	134,351	169,282	138,660
Operating resorts (net)	30,740	43,816	92,737	123,766	71,966
Total assets	102,299	151,767	270,741	353,818	241,442
Long-term debt (including current portion):					
Bank borrowings	24,279	25,033	88,317	87,393	100,029
14.625% senior subordinated notes				73,893	56,371
Other long-term debt	23,183	28,206	33,800	38,100	29,216
Total deferred income taxes	18,505	29,033	45,053	46,315	780
Shareholders' equity	30,194	60,299	80,917	78,697	28,547

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The Company acquires, develops, and operates destination campground resorts and sells memberships conveying the right to use these resorts. Memberships are sold either on a cash or an installment basis. All marketing costs and an allowance for estimated losses on installment contracts are recorded currently. Operating resort land and improvement costs, including the Company's estimated costs to develop fully the resorts, are aggregated by geographic area and recorded as a cost of membership sales based upon the ratio of actual memberships sold within each area to the total memberships planned for sale within the area. Members are assessed annual dues which are intended to cover resort operating costs when approximately 50% of the memberships planned for sale in a geographic area have been sold. The Company derives revenues from membership sales, resort operations (principally membership dues), and interest earned on the receivable portfolio arising from the sale of memberships on an installment basis. Set forth below is a table of the Company's sources of revenue as a percentage of total revenues.

	Year Ended December 31,				
	1982	1983	1984	1985	1986
Sources of revenue:					
Membership sales	80.5%	79.8%	78.2%	73.4%	51.4%
Resort operations	10.0	10.1	10.3	13.1	24.1
Interest income	9.5	10.1	10.8	13.5	21.9
Other	—	—	.7	—	(.1)
Extraordinary item (net)	—	—	—	—	2.7
	100.0%	100.0%	100.0%	100.0%	100.0%

Membership sales are made primarily at Company resorts. During 1986, sales activities were conducted at 27 of the Company's 43 operating resorts. Prior to 1983, substantially all membership sales were made to owners of recreational vehicles. During 1983, the Company purchased travel trailers, installed them on its resorts for use by members, and began marketing vacation memberships to individuals who do not have a recreational vehicle. During 1985, the Company combined the camping membership formerly offered to owners of recreational vehicles and the vacation membership formerly offered to individuals who do not have a recreational vehicle. The combined membership, called a resort membership, allows the member to rent a Company-owned travel trailer at the preferential rates available to vacation members or, at the member's option, to use a campsite with a recreational vehicle provided by the member. During 1986, the Company began marketing term memberships and erected rental cabins at certain of its resorts to further broaden the market appeal of its product.

The following table provides historical information on membership sales by type of membership, the number of resorts operated by the Company ("operating resorts"), and the number of operating resorts at which memberships are sold ("selling resorts").

	Year Ended December 31,				
	1982	1983	1984	1985	1986
Number of memberships sold:					
Camping — lifetime	9,743	9,989	8,037	3,108	—
Vacation — lifetime	377	3,852	10,588	4,400	—
Resort — lifetime	—	—	—	11,719	7,848
Resort — term	—	—	—	—	1,484
Other	—	—	—	—	10
Total	10,120	13,841	18,625	19,227	9,342
Operating Resorts:					
Selling	16	21	30	37	27
Non-Selling	3	4	6	5	16
Resorts under initial development	2	3	6	1	—
Total resorts owned	21	28	42	43	43

During the years prior to 1986, the Company acquired and developed 43 properties in order to establish a national network of resorts. In addition, the Company has acquired two additional properties which are classified on the balance sheet as investment in real estate. The Company has no plans to develop these properties in 1987, although they are available for development or disposition in subsequent years.

Prior to 1986, the Company generated growth in membership sales by adding new selling resorts. During 1986, in an effort to reduce marketing costs and make the best use of its available resources, the Company consolidated its operations and concentrated its sales efforts at 27 of its 43 resorts. During 1987, the Company plans to further concentrate its sales efforts on its 12 most cost-efficient properties. As a result, fewer membership sales are anticipated in 1987 than in 1986.

By consolidating its operations, limiting expenditures for construction and financing of new membership sales, and conducting incentive programs to encourage members to pay their installment contracts prior to maturity, the Company achieved positive cash flow from operations during the fourth quarter of 1986 and first quarter of 1987. Since December 31, 1986, the Company's institutional lenders have indicated that they will not increase the Company's bank line of credit, and the Company anticipates that, in 1987, it will be required to rely solely on internally generated funds to provide its sources of liquidity. The Company believes that these internally generated sources of liquidity will not provide sufficient cash flow to fund the Company's existing level of operations unless the Company is able to restructure its existing bank line of credit and 14.625% senior subordinated notes due 1992. As a result, since December 31, 1986, the Company has been engaged in discussions with the financial institutions funding its bank line of credit to restructure the credit line, which at December 31, 1986 represented aggregate borrowings of \$100,029,000. The Company also intends to begin discussions with the holders of its senior subordinated notes to restructure such notes. Although there can be no assurance that a restructuring of the Company's debt can be accomplished, based upon meetings with the financial institutions that have been held to date and upon proposals shared by the Company, the financial institutions, and certain holders of the senior subordinated notes, the Company believes there is a reasonable likelihood that it will be able to restructure its debt in a manner that should provide the Company with sufficient cash flow to continue its existing level of operations.

The Company's operating results for 1987 will depend primarily upon the level of membership sales achieved, the Company's success in reducing marketing and operational costs, and the Company's ability to restructure its outstanding debt or otherwise obtain adequate financing for its operations.

Membership Sales

Revenues from membership sales during the three years ended December 31, 1984, 1985, and 1986 were \$116,983,000, \$127,603,000, and \$59,860,000, respectively. The increase in revenues from membership sales between 1985 and 1984 was a result of an increase in the number of memberships sold and an increase in the average membership price from \$6,300 in 1984 to \$6,600 in 1985. The decrease in revenues from membership

sales between 1986 and 1985 resulted from a significant decrease in the number of memberships sold. This decrease was due primarily to the Company's decision to limit marketing activities to its most cost-effective selling resorts. The Company limited its sales efforts in 1986 because its traditional marketing methods were not cost-effective, which resulted in high marketing costs and financial constraints on the Company's operations. The average membership price for 1986 increased to \$7,000.

Because of the possibility of sales cancellations, which are defined as members who do not make two payments on their contracts, the Company does not record every membership sale for financial reporting purposes, but rather records membership sales net of an estimated provision for future sales cancellations. As a result of this provision, actual membership sales were reduced by \$8,785,000 in 1984, \$14,271,000 in 1985, and \$6,668,000 in 1986. Sales cancellations were higher in 1985 than in 1984 and, as a result, the Company elected to increase the rate at which it provides for future sales cancellations from 7% of membership sales in 1984 and the first half of 1985 to 11% of membership sales in the second half of 1985. In addition, the Company elected to provide an additional \$1,000,000 for future sales cancellations at December 31, 1985. During 1986, the Company experienced some improvement in sales cancellations compared with 1985 and, accordingly, provided for future sales cancellations at a rate of 10% of membership sales.

Marketing expenses as a percentage of sales increased from 46.3% in 1984 to 58.1% in 1985, and to 69.8% in 1986. The significant increase in marketing costs as a percentage of sales in 1985 was due primarily to an overall decrease in the closing percentages at the resorts. The significant increase in 1986 was due primarily to an overall decrease in the response rate to the Company's marketing programs and the disproportionate relationship between certain relatively fixed marketing expenses and the low sales volume experienced by the Company during 1986.

In an effort to reduce marketing costs, the Company has reorganized and consolidated the sales and marketing corporate staff to reduce fixed costs. In addition, the Company has focused its sales efforts on its most cost-effective properties and has reduced its reliance on direct mail solicitations. The Company is also emphasizing more cost-effective programs such as member referrals and joint marketing arrangements with other companies. The Company's objective is to reduce marketing costs as a percentage of sales in 1987 compared with 1986; however, any reduction is dependent on the success of the actions taken by the Company.

Where fewer than 50% of planned memberships for a selling resort have been sold, certain resort operations costs are expensed as marketing costs to reflect the support resort operations provide to the Company's sales efforts. These costs increased from \$3,040,000 in 1984 to \$4,562,000 in 1985, and decreased to \$2,694,000 in 1986. The increase in 1985 was due primarily to the addition of seven new resorts in 1985. The decrease in 1986 was due to a decrease in the number of resorts at which sales were made.

Resort land and improvement costs attributable to membership sales were \$17,842,000 (15.3% of sales) in 1984, \$21,029,000 (16.5% of sales) in 1985, and \$12,520,000 (20.9% of sales) in 1986. The average land and improvement costs expensed per membership sold in 1984, 1985, and 1986 were approximately \$960, \$1,090, and \$1,260, respectively. The percentage increase in 1985 compared with 1984 was due to the increase in the average land and improvement costs expensed per membership sold. This increase resulted from changes in estimates during 1985 regarding the estimated cost of completing planned improvements. Because of these changes in estimates, the Company expensed an additional \$706,000 of resort land and improvement costs during the fourth quarter of 1985. The percentage increase in 1986 compared with 1985 is discussed below.

The Company allocates its land acquisition costs and actual and estimated future resort improvement costs to membership sales based upon the total number of memberships which it estimates it will be able to sell in each geographic area. Estimates of future improvement costs are subject to adjustment due to uncertainty inherent in predicting such costs. For purposes of determining the number of planned campsites in an area, the Company currently estimates the number of memberships it will be able to sell in that area and applies an average ratio of ten memberships per campsite. The Company believes this ratio will permit optimal resort use without resulting in overcrowding. While the Company believes that this average ten-to-one ratio is appropriate and consistent with industry practice, it is periodically reviewed by the Company and may eventually have to be adjusted in light of future experience. If the Company determines that ten memberships cannot be sold per campsite in one or more areas, or that it has misestimated resort improvement costs, generally accepted accounting principles would require the Company to adjust earnings currently, if necessary, and allocate to subsequent membership sales the remaining unamortized land and improvements costs for the resorts in that area. An adjustment in estimated future resort improvements costs, in the membership-to-campsite ratio, in the

number of planned campsites, or as a result of the estimated net realizable value of resort land and improvements being in excess of the existing unamortized land and improvement costs could adversely affect the profitability of current and future sales.

During the fourth quarter of 1986, the Company reevaluated the market for membership sales at each of its resorts. This reevaluation was prompted by the lower level of membership sales achieved by the Company in 1986, the financial constraints on the Company's ability to finance new membership sales, and other relevant market considerations. As a result of this reevaluation, the Company significantly reduced the number of campsites planned for construction in the future at its resorts and charged against earnings approximately \$63,281,000 to reduce land and improvement costs in certain areas to reflect estimated net realizable value. The adjustment reduced the total number of campsites planned for construction in the future from 16,292 to 7,763 and reduced the number of memberships available for sale in the future from 183,000 to 99,000. The adjustment also reduced the Company's future construction requirements by \$50,538,000 to \$51,703,000.

For the Company to amortize fully in accordance with its accounting practices the total of incurred and all estimated future land and improvement costs with respect to the 18,973 existing and planned campsites at its current 43 operating resorts, of which 11,210 campsites currently exist (59.1%), it would be necessary for it to sell approximately 190,000 memberships, of which 91,000 memberships (47.9%) were outstanding at December 31, 1986.

General and administrative expenses as a percentage of membership sales increased from 10.7% in 1984 to 12.3% in 1985, and to 27.6% in 1986. The increase in 1985 compared with 1984 was due primarily to increased staffing at the Company's corporate office for anticipated higher sales volume which did not materialize and additional expenses related to the Company's corporate office facility. The increase in 1986 compared with 1985 is due primarily to the decrease in sales volume. During 1986, the corporate staff was reduced by 36% which will result in an annualized saving of \$2,176,000. However, the effect of these reductions has been offset during 1986 primarily by severance payments, increased insurance expenses, and increased legal fees. Since December 31, 1986, the Company has been engaged in discussions with the landlord for the Company's corporate headquarters to reduce the space under lease from 104,883 square feet to 64,712 square feet, which would result in an annualized savings of \$813,000 commencing in 1988.

The Company provides for estimated losses on installment sales based on its historical collection experience. The provision for doubtful accounts as a percentage of membership sales increased from 5.0% in 1984 to 13.8% in 1985, and to 32.1% in 1986. The increase in 1985 compared with 1984 was primarily a result of the Company's election to provide an additional \$4,400,000 for future contract losses at September 30, 1985 and an additional \$5,500,000 for future contract losses at December 31, 1985. The increase in 1986 compared with 1985 was due primarily to the lower volume of membership sales in 1986 and the Company's election to provide an additional \$2,500,000 for future contract losses at September 30, 1986 and an additional \$8,000,000 for future contract losses at December 31, 1986. The Company experienced higher delinquencies and contract losses in 1986 compared with 1985 and in 1985 compared with 1984. Upon analysis, the Company believes the higher contract losses were primarily attributable to three factors: (1) a higher default rate on memberships sold to individuals who do not have a recreational vehicle, who have a tendency to use the Company's resorts less than owners of recreational vehicles, (2) a higher default rate on installment contracts arising from membership sales in Texas (19.9% of the total portfolio), which may be related to economic problems in that state, and (3) the negative publicity arising from the losses incurred by the Company in 1986 and the bankruptcy proceedings involving other companies in the industry in 1986.

The higher contract losses experienced in 1986 related primarily to membership sales made in 1984 and 1985. The average down payment increased from approximately \$1,153 in 1985 to \$1,315 in 1986. In addition, approximately 75% of installment sales made in 1986 have monthly payments transferred automatically from the member's bank account to a Company bank account under the Company's preauthorized payment program. 48% and 73% of installment sales made in 1984 and 1985, respectively, utilized this program. The Company also intends to implement a new credit screening program to better identify potential contract losses. The Company does not presently anticipate any further adjustments to its allowance for doubtful accounts, but this allowance and the rate at which the Company provides for future contract losses could be increased if the Company experiences higher than anticipated contract losses in the future, which would adversely affect profit margins and earnings.

The Company has been able to offset the impact of inflation on its operations through increases in the membership sales prices and increases in annual dues for new members.

Resort Operations

Revenues from resort operations continued to increase as the base of members grew from 51,000 at January 1, 1984 to 91,000 at December 31, 1986. As a percentage of total revenues, membership dues and other resort revenues increased from 10.4% in 1984 to 24.7% in 1986, and the Company expects this source of revenues to continue to increase as new memberships are sold. After allocating to marketing expenses certain costs related to membership sales (\$3,040,000 in 1984, \$4,562,000 in 1985, and \$2,694,000 in 1986), resort operations incurred losses of \$938,000, \$477,000, and \$2,409,000 in 1984, 1985, and 1986, respectively.

The losses from resort operations in 1984 and 1985 were due primarily to the addition of 11 new operating resorts in 1984 and 6 new operating resorts in 1985. There are high fixed costs associated with opening and operating a resort until sufficient memberships have been sold to generate self sustaining revenues. The losses from resort operations in 1986 were due primarily to the cost of insurance applicable to resort operations which increased by \$1,597,000 compared with 1985. For 1987, the Company has reduced staff and discontinued certain programs at the resorts in an effort to reduce costs. The Company currently expects resort operations to break even in 1987 without any allocation of the cost of resort operations to marketing expenses.

Interest Income and Expense

The Company charges interest on the unpaid portion of its membership contracts receivable portfolio at fixed rates which averaged approximately 14.8% in 1984 and 1985 and 15% in 1986. Interest income increased from \$16,067,000 in 1984 to \$23,406,000 in 1985, and to \$25,534,000 in 1986, due to substantial increases in the Company's membership contracts receivable portfolio. The total membership contracts receivable portfolio increased from an average of \$115,138,000 in 1984 to \$166,107,000 in 1985, and to \$177,189,000 in 1986.

The Company finances its acquisition and development of resorts through borrowings under its bank line of credit and seller-financed real estate contracts. Seller financing of resort acquisitions accrues interest at fixed rates, which averaged 9.8% in 1986. Financing under the Company's bank line of credit bears interest at variable rates which averaged 12.3% in 1986.

The average cost to the Company of all borrowed funds over the past three years has varied but increased from 11.9% in 1984 to 13.0% in 1985, and decreased to 12.7% in 1986. The increase in 1985 resulted primarily from the Company's sale in March 1985 of \$75,000,000 of 14.625% senior subordinated notes due 1992, which have an effective interest rate of 15.0%. The decrease in 1986 was due primarily to decreases in the average interest rate on the Company's bank line of credit as a result of decreases in the prime lending rate.

The Company capitalizes interest as a component of the cost of significant improvements to resorts. Interest is capitalized only during periods of major construction activities to prepare a resort for use and during the construction of specific major improvements at subsequent dates. Total interest costs were \$11,007,000 in 1984, \$22,078,000 in 1985, and \$28,721,000 in 1986, of which \$5,883,000, \$5,792,000, and \$903,000, respectively, were capitalized.

Happy Trails Resorts

Under an agreement made in September 1984, Happy Trails Resorts, Inc., a wholly owned subsidiary of the Company, provided sales, marketing, and development services for a recreational vehicle subdivision which Western Savings and Loan Association ("Western") is developing in Arizona. On December 29, 1986, Happy Trails and Western terminated the 1984 agreement and entered into a new agreement under which Happy Trails will be paid a fee for operating and managing the subdivision, and for marketing and sale of the subdivision lots. Costs incurred by Happy Trails are reimbursed monthly by Western, which has the right to terminate the agreement if projected sales and operating results are not achieved. See "Item 13. Certain Relationships and Related Transactions."

Net Earnings (Loss)

Net earnings decreased from \$19,110,000 in 1984 to \$1,788,000 in 1985, to a loss of \$50,422,000 in 1986. The decrease in net earnings in 1985 compared with 1984 was due primarily to lower than expected sales, higher marketing costs, and higher than expected bad debts. The loss reported for 1986 was due primarily to a \$63,281,000 writedown of resort land and improvement costs and a \$38,123,000 operating loss, which included a \$10,500,000 increase in the Company's allowance for doubtful accounts.

Liquidity and Capital Resources

The Company incurs substantial resort acquisition and improvement costs and membership marketing costs prior to and concurrently with membership sales, while members pay for their memberships either entirely in cash at the time of sale or by making a minimum down payment of at least 10% and then paying the balance in installments over periods up to 84 months, with interest averaging 15% on contracts executed in 1986. For 1986, down payments on financed membership sales averaged 19.1%, and the average installment term was 71 months. The Company financed 81.5% of membership sales in 1986. Revenues from membership sales, net of an allowance for sales cancellations, are recorded in full at the time of sale, while cash flow from installment sales is received over a period of years following the sale.

Down payments and cash sales as a percentage of membership sales were 26.1% in 1984, 27.1% in 1985, and 27.8% in 1986. The Company has developed incentive programs intended to accelerate cash flow by encouraging members to pay their installment contracts in full prior to maturity. These incentive programs generated additional cash of approximately \$9,800,000 in 1984, \$12,735,000 in 1985, and \$14,413,000 in 1986.

Below is a table showing a historical summary of cash received and expended as it relates to operations of the Company.

	Year Ended December 31,		
	1984	1985	1986
Cash received from operations	(In thousands)		
Membership Sales	\$ 30,044	\$ 34,362	\$ 19,211
Collection on contracts receivable including interest	49,352	67,574	77,306
Dues and resort revenues	15,481	21,248	25,364
Other	57	244	968
	<u>94,934</u>	<u>123,428</u>	<u>122,849</u>
Principal operating expenditures	<u>(79,563)</u>	<u>(114,908)</u>	<u>(83,894)</u>
Cash provided by operations before debt service and resort acquisition and development	15,371	8,520	38,955
Cash expended for resort acquisition and development	(54,600)	(38,440)	(12,356)
Interest expense	(10,019)	(18,082)	(26,930)
Principal payments on debt related to resort properties	<u>(4,281)</u>	<u>(8,293)</u>	<u>(5,677)</u>
Cash used in operations	<u>\$(53,529)</u>	<u>\$ (56,295)</u>	<u>\$ (6,008)</u>

Cash received from sales, resort operations, and collections on membership contracts receivable has not been sufficient to fund the Company's operations because of expenditures relating to membership sales, the expansion and improvement of the Company's resort network, and the additional cost of the debt required to finance this growth. However, the amount of cash used in operations decreased from \$53,529,000 and \$56,295,000 in 1984 and 1985, respectively, to only \$6,008,000 during 1986. The decrease is due primarily to decreased construction expenditures and the Company's decision to limit marketing activities to its most cost-effective properties.

In 1986, the Company spent more as a percentage of membership sales than in previous years on marketing, general and administrative, and resort operations expenses, as the Company was not as cost-effective in generating prospective customers. Interest expense also increased due primarily to the Company's sale in March 1985 of \$75,000,000 of 14.625% senior subordinated notes due 1992. The Company has reduced funds spent for resort acquisition and development from \$54,600,000 and \$38,440,000 in 1984 and 1985, respectively, to \$12,356,000 in 1986.

The Company also decreased spending for construction and operating equipment from \$11,924,000 and \$10,203,000 in 1984 and 1985, respectively, to \$1,506,000 in 1986. A portion of these expenditures was financed through borrowings secured by such equipment. These expenditures include approximately \$6,774,000 in 1984, \$5,425,000 in 1985, and \$830,000 in 1986 for purchase of rental trailers and construction of cabins.

On December 29, 1986, the Company purchased \$17,870,000 principal amount of its 14.625% senior subordinated notes due 1992 at a cost of \$11,523,000. Purchase of these notes will reduce interest costs during 1987 by \$2,734,000. The cash for this purchase came from the Company's sale of certain assets to Western Savings and Loan Association. See "Item 13. Certain Relationships and Related Transactions."

The Company has relied upon external financing to provide cash to fund working capital and the expansion of its resort network, as follows:

	Year Ended December 31,		
	1984	1985	1986
	(In thousands)		
Issuance of common stock (net of repurchases)	\$ 975	\$ (3,995)	\$ 328
Bank Borrowings (net of repayments)	63,283	(924)	12,636
14.625% senior subordinated notes due 1992 (net of discount and repurchases)	—	71,555	(11,523)
	<u>\$64,258</u>	<u>\$66,636</u>	<u>\$ 1,441</u>

The Company has taken several actions intended to reduce its cash requirements in 1987 compared with prior years. The Company does not plan to acquire any new properties in 1987. The Company plans to spend significantly less on construction in 1987 than it did in either 1985 or 1986. During 1987, the Company anticipates spending no more than \$5,000,000 for additional development of its 43 resorts and it does not anticipate a need to acquire additional rental trailers or cabins in 1987. In addition, the Company expects to finance fewer membership sales in 1987 and has taken a number of steps designed to reduce marketing and operational costs. As a result of the actions taken to date, and principally as a result of the Company's incentive programs to encourage members to pay their contracts prior to maturity, the Company achieved positive cash flow from operations during the fourth quarter of 1986 and the first quarter of 1987.

At January 1, 1986, the Company had a bank line of credit of \$110,000,000, which was reduced to \$103,000,000 in October 1986, and to \$95,500,000 in February 1987. The principal security for this line of credit is the Company's qualifying membership contracts receivable which totaled \$186,337,000 as of January 1, 1986, \$162,341,000 as of December 31, 1986, and \$143,994,000 as of March 31, 1987. The reasons for the reductions in the credit line were the lower volume of membership sales achieved by the Company in 1986 which required less financing, excess funds generated by incentive programs to encourage members to pay their installment contracts prior to maturity, and the lower level of eligible membership contracts receivable, which resulted primarily from the lower volume of membership sales, incentive programs, and an increase in bad debts.

At December 31, 1986, the Company's unused sources of liquidity consisted principally of \$970,000 in cash and approximately \$2,972,000 of additional borrowing capacity under its bank line of credit, which was subsequently reduced from \$103,000,000 to \$95,500,000 effective February 20, 1987. The Company's bank line of credit includes a \$35,500,000 revolving working capital credit line (\$43,000,000 at December 31, 1986), a \$50,000,000 term loan restricted to acquisition and development of resorts, and a \$10,000,000 working capital term loan. At December 31, 1986, the Company had borrowed \$41,644,000 of the revolving credit line, \$48,384,000 of the \$50,000,000 term loan, and all of the \$10,000,000 term loan. Borrowings under the revolving credit line were reduced to \$31,917,000 at March 31, 1987 primarily as a result of an incentive program to encourage members to pay their installment contracts prior to maturity. At March 31, 1987, the Company's unused sources of liquidity consisted principally of \$1,369,000 in cash and approximately \$5,199,000 of additional borrowing capacity under its \$95,500,000 line of credit.

Since December 31, 1986, the Company has been engaged in discussions with the financial institutions funding its bank line of credit to restructure the credit line. The Company also intends to begin discussions with the holders of its 14.625% senior subordinated notes due 1992 to restructure such notes. The Company believes that restructuring this debt is necessary to provide the Company with sufficient cash flow to continue its existing level of operations and to avoid default under the collateral coverage requirements imposed by the Company's bank line of credit. Although there can be no assurance that a restructuring of the Company's debt will be accomplished, based upon meetings with the financial institutions that have been held to date and upon proposals shared by the Company, the financial institutions, and certain holders of the senior subordinated notes, the Company believes there is a reasonable likelihood that it will be able to restructure its debt in a manner that should provide the Company with sufficient cash flow to continue its existing level of operations.

During 1986 and prior years, the Company has generated additional liquidity through the deferral of income taxes, principally as a result of reporting membership sales on the installment method for income tax purposes. As a result of a reduction in the membership contracts receivable portfolio due to lower membership sales and the success of incentive programs to encourage members to pay their installment contracts prior to maturity, the Company expects to pay income taxes in 1988.

Provided that a restructuring of its bank line of credit and senior subordinated notes is accomplished, the Company believes its capital requirements through the end of 1987 will be met by the remaining borrowing capacity under its credit line, deferral of income taxes, and cash generated by operations. Should the Company require working capital in excess of these sources, the Company would seek additional funds through debt financing and/or the sale of debt or equity securities. There is no assurance that such financing could be accomplished or, if accomplished, that it would be on terms favorable to the Company and its existing shareholders.

Impact of Tax Reform Act

The Company's liquidity will be affected in 1987 and future years by the Tax Reform Act of 1986 (the "Act"). Among other things, the Act established lower corporate tax rates for years beginning after December 31, 1986, required the accrual of interest on taxes deferred as a result of reporting sales on the installment method, and repealed the investment tax credit and lengthened depreciation lives for certain capital expenditures. Assuming the Company has taxable income in future years, the reduction in rates will increase cash flow, and the accrual and payment of interest on taxes deferred as a result of reporting membership sales on the installment method will reduce cash flow. With respect to the repeal of the investment tax credit and the lengthened depreciation lives, the Company is not a capital intensive business and thus does not anticipate that these provisions of the Act will significantly affect the conduct of, or its investment in, its business.

The Company's financial results for 1987 and subsequent years may also be affected by a proposal (the "Proposal") of the Financial Accounting Standards Board to change the present method of accounting for income taxes. The Proposal in its current form would require the Company to adjust its deferred income tax account periodically to reflect changes in the federal income tax rates.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The following financial statements of the Company are included:

Report of Certified Public Accountants on Consolidated Financial Statements.

Consolidated Balance Sheets as of December 31, 1986 and December 31, 1985.

Consolidated Statements of Earnings — Three years ended December 31, 1986.

Consolidated Statements of Changes in Financial Position — Three years ended December 31, 1986.

Consolidated Statements of Shareholders' Equity — Three years ended December 31, 1986.

Notes to Consolidated Financial Statements.

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Directors
Thousand Trails, Inc.
Bellevue, Washington

We have examined the consolidated balance sheets of Thousand Trails, Inc. and subsidiaries as of December 31, 1985 and 1986 and the related statements of operations, shareholders' equity and changes in financial position for each of the three years in the period ended December 31, 1986. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As discussed in Note D, the Company is currently engaged in discussions with its senior lenders to restructure the Company's existing loan arrangements. The Company also intends to begin discussions with holders of its 14⁵/₈% Senior Subordinated Notes to restructure such notes. Management of the Company believes that restructuring its debt is necessary to avoid default under current loan coverage requirements, to provide the Company sufficient cash flow to continue its existing level of operations and to realize the recorded value of its primary assets, contracts receivable and land and improvements. No assurances can be given, however, that such restructuring will be accomplished.

In our opinion, subject to the effects on the financial statements of such adjustments, if any, as might have been required had the outcome of the debt restructuring discussed in the preceding paragraph been known, the consolidated financial statements referred to above present fairly the financial position of Thousand Trails, Inc. and subsidiaries as of December 31, 1985 and 1986, and the results of their operations and the changes in their financial position for each of the three years in the period ended December 31, 1986, in conformity with generally accepted accounting principles applied on a consistent basis.

Touche Ross & Co.

Touche Ross & Co.
Certified Public Accountants
Seattle, Washington
April 30, 1987

THOUSAND TRAILS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	December 31,	
	1985	1986
ASSETS		
CURRENT ASSETS:		
Cash	\$ 995,000	\$ 970,000
Membership contracts receivable, net of sales reversal allowance of \$4,410,000 and \$1,952,000 and allowance for doubtful accounts of \$3,897,000 and \$5,346,000	33,357,000	27,809,000
Inventory and other assets	10,056,000	5,916,000
TOTAL CURRENT ASSETS	44,408,000	34,695,000
MEMBERSHIP CONTRACTS RECEIVABLE, net of allowance of \$15,882,000 and \$21,310,000	135,925,000	110,851,000
OPERATING RESORTS:		
Land	35,259,000	28,573,000
Improvements	164,758,000	130,907,000
	200,017,000	159,480,000
Costs attributable to membership sales	(76,251,000)	(87,514,000)
	123,766,000	71,966,000
RESORTS UNDER INITIAL DEVELOPMENT	5,181,000	—
RESORT OPERATING EQUIPMENT, net of accumulated depreciation of \$4,180,000 and \$6,216,000	14,594,000	12,883,000
CONSTRUCTION AND OTHER EQUIPMENT, net of accumulated depreciation of \$4,478,000 and \$4,339,000	6,392,000	4,125,000
INVESTMENT IN REAL ESTATE	10,787,000	3,901,000
OTHER INVESTMENTS	4,554,000	—
OTHER ASSETS	8,211,000	3,021,000
	<u>\$353,818,000</u>	<u>\$241,442,000</u>

See notes to consolidated financial statements.

THOUSAND TRAILS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

LIABILITIES AND SHAREHOLDERS' EQUITY

	December 31,	
	1985	1986
CURRENT LIABILITIES:		
Accounts payable	\$ 5,096,000	\$ 2,902,000
Accrued salaries and related taxes	3,570,000	2,598,000
Accrued interest	4,313,000	3,564,000
Other accrued liabilities	1,473,000	3,354,000
Accrued taxes	548,000	1,836,000
Prepaid membership dues and rental revenues	7,950,000	7,771,000
Current portion of long-term debt	7,531,000	11,372,000
Deferred income taxes	9,126,000	156,000
TOTAL CURRENT LIABILITIES	39,607,000	33,553,000
LONG-TERM DEBT	191,855,000	174,244,000
DEFERRED INCOME TAXES	37,189,000	624,000
DEFERRED RENTAL REVENUE AND OTHER LIABILITIES	6,470,000	4,474,000
SHAREHOLDERS' EQUITY:		
Common stock, no par value—Authorized, 15,000,000 shares;		
Issued and outstanding, 10,308,847 and 10,357,019 shares	26,940,000	27,268,000
Retained earnings	51,757,000	1,279,000
	<u>78,697,000</u>	<u>28,547,000</u>
	<u>\$353,818,000</u>	<u>\$241,442,000</u>

See notes to consolidated financial statements.

THOUSAND TRAILS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

	Year ended December 31,		
	1984	1985	1986
REVENUES:			
Membership sales	\$116,983,000	\$127,603,000	\$ 59,860,000
Resort operations	15,465,000	22,725,000	28,019,000
Interest income from membership contracts	16,067,000	23,406,000	25,534,000
	<u>148,515,000</u>	<u>173,734,000</u>	<u>113,413,000</u>
EXPENSES:			
Marketing expenses	54,181,000	74,081,000	41,766,000
Resort land and improvement costs	17,842,000	21,029,000	12,520,000
Provision for doubtful accounts	5,880,000	17,644,000	19,231,000
Resort operating and administrative expense	16,403,000	23,202,000	30,428,000
Membership contract collection expense	2,180,000	2,882,000	3,091,000
General and administrative expenses	12,513,000	15,720,000	16,515,000
Interest expense	5,124,000	16,286,000	27,818,000
	<u>114,123,000</u>	<u>170,844,000</u>	<u>151,369,000</u>
INCOME (LOSS) FROM MEMBERSHIP SALES AND RESORT OPERATIONS	34,392,000	2,890,000	(37,956,000)
OTHER INCOME (EXPENSE):			
Real estate adjustment	—	—	(63,281,000)
Other	1,004,000	90,000	(166,000)
	<u>1,004,000</u>	<u>90,000</u>	<u>(63,447,000)</u>
INCOME (LOSS) BEFORE TAX AND EXTRAORDINARY ITEM ...	35,396,000	2,980,000	(101,403,000)
DEFERRED INCOME TAX EXPENSE (BENEFIT)	16,286,000	1,192,000	(48,004,000)
INCOME (LOSS) BEFORE EXTRAORDINARY ITEM	\$ 19,110,000	\$ 1,788,000	\$ (53,399,000)
EXTRAORDINARY ITEM:			
Gain from extinguishment of debt, less applicable income tax of \$2,676,000	—	—	2,977,000
NET EARNINGS (LOSS)	<u>\$ 19,110,000</u>	<u>\$ 1,788,000</u>	<u>\$ (50,422,000)</u>
NET PRIMARY EARNINGS PER SHARE			
Income (loss) before extraordinary item	\$1.78	\$.17	\$(5.16)
Extraordinary item	—	—	.29
Net Earnings (Loss)	<u>\$1.78</u>	<u>\$.17</u>	<u>\$(4.87)</u>
NET FULLY DILUTED EARNINGS PER SHARE			
Income (loss) before extraordinary item	\$1.76	\$.16	\$(5.16)
Extraordinary item	—	—	.29
Net Earnings (Loss)	<u>\$1.76</u>	<u>\$.16</u>	<u>\$(4.87)</u>

See notes to consolidated financial statements.

THOUSAND TRAILS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

	Year ended December 31,		
	1984	1985	1986
OPERATIONS:			
Cash received —			
Membership sales	\$30,044,000	\$ 34,362,000	\$ 19,211,000
Collections on contracts receivable, including interest ...	49,352,000	67,574,000	77,306,000
Dues and resort revenues	15,481,000	21,248,000	25,364,000
Other	57,000	244,000	968,000
	<u>94,934,000</u>	<u>123,428,000</u>	<u>122,849,000</u>
Cash expended —			
Marketing expenses	51,873,000	76,146,000	40,334,000
Administrative and collection expenses	14,277,000	17,085,000	15,635,000
Resort operating and administrative expenses	13,413,000	21,677,000	27,925,000
	<u>79,563,000</u>	<u>114,908,000</u>	<u>83,894,000</u>
Cash provided by operations before debt service and resort acquisition and development	15,371,000	8,520,000	38,955,000
Cash expended for resort acquisition and development	(54,600,000)	(38,440,000)	(12,356,000)
Interest expense	(10,019,000)	(18,082,000)	(26,930,000)
Principal payments on debt related to resort properties	(4,281,000)	(8,293,000)	(5,677,000)
Cash used in operations	<u>(53,529,000)</u>	<u>(56,295,000)</u>	<u>(6,008,000)</u>
OTHER SOURCES (USES) OF CASH:			
Issuance of common stock	975,000	3,025,000	328,000
Issuance of debentures, net of discount of \$1,195,000 and related costs of \$2,250,000	—	71,555,000	—
Treasury stock acquired	—	(7,020,000)	—
Subordinated notes acquired	—	—	(11,523,000)
Proceeds (repayments) of borrowings collateralized by contracts receivable	63,283,000	(924,000)	12,636,000
Purchase of equipment, net of related borrowings of \$3,186,000, \$5,513,000 and \$410,000	(8,738,000)	(4,690,000)	(1,096,000)
Payments on other debt	(2,014,000)	(2,689,000)	(3,028,000)
Other investments	(886,000)	(3,926,000)	(2,995,000)
Sale of assets to related party	—	—	12,250,000
Other, net	<u>1,783,000</u>	<u>315,000</u>	<u>(589,000)</u>
	<u>54,403,000</u>	<u>55,646,000</u>	<u>5,983,000</u>
INCREASE (DECREASE) IN CASH	874,000	(649,000)	(25,000)
CASH:			
Beginning of year	<u>770,000</u>	<u>1,644,000</u>	<u>995,000</u>
End of Year	<u>\$ 1,644,000</u>	<u>\$ 995,000</u>	<u>\$ 970,000</u>

See notes to consolidated financial statements.

THOUSAND TRAILS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

	Common stock		Retained earnings
	Shares	Amount	
BALANCE, January 1, 1984	10,197,145	\$29,358,000	\$ 30,941,000
Debt conversion	230,135	587,000	
Exercise of stock options	231,196	989,000	
Foreign currency translation			(68,000)
Net earnings			19,110,000
BALANCE, December 31, 1984	10,658,476	30,934,000	49,983,000
Exercise of stock options	202,871	2,255,000	
Purchase and retirement of treasury stock	(552,500)	(6,249,000)	
Foreign currency translation			(14,000)
Net earnings			1,788,000
BALANCE, December 31, 1985	10,308,847	26,940,000	51,757,000
Exercise of stock options	48,172	328,000	
Foreign currency translation			(56,000)
Net loss			(50,422,000)
BALANCE, December 31, 1986	10,357,019	\$27,268,000	\$ 1,279,000

See notes to consolidated financial statements.

THOUSAND TRAILS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Three Years Ended December 31, 1986

NOTE A — SIGNIFICANT ACCOUNTING POLICIES:

General

The Company and its subsidiaries operate membership-based destination campground resorts in the United States and Canada. All significant intercompany transactions and balances have been eliminated in the accompanying financial statements.

Revenue Recognition

The Company sells memberships for cash or on an installment basis. Membership sales, net of an allowance for sales cancellations, are recorded in full upon execution of membership contracts. Installment sales require a down payment of at least 10% of the sales price. All marketing costs and an allowance for estimated contract collection losses and sales cancellations (based on historical loss occurrence rates) are recorded currently.

Certain membership contracts provide for prepaid use by members of Company-owned rental trailers or cabins. Revenue attributable to prepaid use is recorded as deferred rental revenue and recognized over the period of expected use.

Members are assessed annual dues which are used for resort maintenance and operations, member services and related general and administrative expenses. The Company establishes dues at rates intended to fully provide for such expenses when active memberships sold reach approximately 50% of total memberships available for sale. Membership contracts provide for annual adjustment of dues to reflect increases in the Consumer Price Index.

Operating Resorts

Operating resort land and improvement costs plus estimated costs to complete resorts are charged to costs attributable to membership sales based on the relationship of memberships sold to total memberships which the Company estimates it will sell. The unamortized balance of such costs is carried on the balance sheet under "Operating Resorts" and is stated at the lower of cost or estimated net realizable value as determined on a geographic area basis. Estimated net realizable value takes into consideration the total estimated market for membership sales, the Company's total planned memberships and existing memberships available for sale, and total costs to complete and market the resorts. The total memberships available for sale are based on estimated members' usage of the Company's resort facilities. The Company currently plans to sell ten memberships for each campsite. The Company reviews resort occupancy statistics regularly and will revise the total planned memberships available for sale as required.

Resorts Under Initial Development

Resorts under initial development are classified as operating resorts when development has been completed to the extent that the resorts are available for regular use by members.

Investment in Real Estate

Real estate acquired for potential future development as resorts and real estate acquired in excess of that necessary for operating resorts is classified as investment in real estate. Real estate contiguous to operating resorts is infrequently used but is generally available for use by members until disposition or further development. Certain parcels of real estate contiguous to operating resorts are subject to land use permits obtained in connection with development of the resorts. Prior to disposition or development of such parcels, the Company will be required to obtain waivers or modifications of such permits from local governmental authorities.

Depreciation

Depreciation of equipment is provided on the straight-line method over the assets' respective useful lives which range from three to twenty years.

Foreign Currency Translation

The Company translates the financial statements of its Canadian subsidiary into U.S. dollars at exchange rates in effect as of the balance sheet dates. Unrealized translation gains and losses are included in retained earnings.

Earnings Per Share

Earnings per share of common stock is computed based on weighted average common and equivalent shares outstanding during the year. Stock options, warrants and rights to purchase stock are included in the computation of earnings per share when dilutive.

Reclassifications

Certain reclassifications have been made in the 1984 and 1985 financial statements to conform with 1986 classifications.

NOTE B — MEMBERSHIP CONTRACTS RECEIVABLE:

Membership contracts receivable bear interest at an average rate of 15% and currently are written with initial terms of 10 to 84 months (average 71 months in 1986). The Company has no obligation to refund monies received or to provide further services to members in the event a membership is cancelled for nonpayment of contractual obligations.

Scheduled aggregate annual principal payments on membership contracts are as follows:

Year ending December 31,

1987	\$33,155,000
1988	31,654,000
1989	29,051,000
1990	26,236,000
1991	23,272,000
1992	15,959,000
1993	5,989,000

The Company received principal payments in excess of the scheduled payments in 1984, 1985 and 1986 of \$9,800,000, \$12,735,000 and \$14,413,000, respectively, by utilizing early payment incentive programs.

Substantially all membership contracts receivable are pledged as collateral for debt.

NOTE C — REAL ESTATE ADJUSTMENT:

During the fourth quarter of 1986, the Company reevaluated the market for membership sales at each of its resorts. This reevaluation was prompted by the lower level of membership sales achieved by the Company in 1986, the financial constraints on the Company's ability to finance new membership sales, and other relevant market considerations. As a result of this reevaluation, the Company significantly reduced the number of campsites planned for construction in the future at several resorts and charged against operations approximately \$63,281,000 to reduce land and improvement costs in certain areas to reflect estimated net realizable value. The adjustment, which included estimates based on historically attainable marketing costs and bad debt rates, reduced the total number of existing and planned campsites from 27,502 to 18,973 and reduced the number of memberships available for sale in the future from 183,000 to 99,000. The adjustment also reduced the Company's future construction requirements by \$52,054,000 to \$51,703,000.

The real estate adjustment was charged to operations and was recorded in the balance sheet accounts as follows:

	Cost Prior to Adjustment	Adjustment	Adjusted Cost
OPERATING RESORTS			
Land	\$ 39,089,000	\$10,516,000	\$ 28,573,000
Improvements	179,139,000	48,232,000	130,907,000
INVESTMENT IN REAL ESTATE	8,434,000	4,533,000	3,901,000
TOTAL	<u>\$226,662,000</u>	<u>\$63,281,000</u>	<u>\$163,381,000</u>

NOTE D — LONG-TERM DEBT AND LINE OF CREDIT:

Long-term debt and line of credit consist of the following:

	December 31,	
	1985	1986
14.625% senior subordinated notes due 1992, interest paid semi annually, (effective rate 15%) net of discount of \$1,107,000 and \$759,000	\$ 73,893,000	\$ 56,371,000
Real estate contracts, 6.5% to 15% (average 9.8%), payable in monthly installments of \$611,000 and \$690,000 including interest	29,975,000	23,767,000
Equipment and other contracts, 8.8% to 18.6% (average 12.5%), payable in monthly installments of \$240,000 and \$193,000 including interest	7,139,000	4,922,000
Notes, 9.25% to 12.0% (average 11.6%), payable in monthly installments of approximately \$68,000 and \$63,000 including interest	986,000	527,000
	111,993,000	85,587,000
Line of credit	87,393,000	100,029,000
	199,386,000	185,616,000
Current portion	(7,531,000)	(11,372,000)
	<u>\$191,855,000</u>	<u>\$174,244,000</u>

Substantially all of the Company's assets are pledged as collateral for the above debt. Aggregate annual principal payments over the next five years are as follows:

1987	\$11,372,000
1988	14,663,000
1989	14,875,000
1990	11,911,000
1991	10,641,000

At December 31, 1986, the Company had a bank line of credit of \$103,000,000 which was subsequently reduced to \$95,500,000 effective February 20, 1987. The line of credit is funded by several financial institutions and includes a \$35,500,000 working capital credit line (\$43,000,000 at December 31, 1986), a \$50,000,000 term loan restricted to acquisition and development of resorts and a \$10,000,000 working capital term loan. Borrowings under the credit line may not exceed 70% of the aggregate amount of the Company's qualifying membership contracts receivable. At December 31, 1986, qualifying membership contracts receivable totaled \$162,060,000, which would permit the Company to borrow the maximum line of credit. The Company is restricted from payment of cash dividends without the institutions' approval.

The revolving credit line accrues interest at the prime lending rate plus 1% (8.5% as of December 31, 1986) and may be converted at the option of the Company or the bank to a term loan payable over 36 months. The Company had borrowed \$41,644,000 of the revolving credit line as of December 31, 1986. Borrowings under the revolving credit line were reduced to \$31,917,000 at March 31, 1987. None of the amount due under the revolving credit line is included in the current portion of long-term debt or in the schedule of annual principal repayments. The bank can at its option cease making additional advances under the revolving credit line, in which case the outstanding revolving balance would convert to a three-year term loan.

The \$50,000,000 term loan is comprised of two \$25,000,000 components. The first \$25,000,000 component bears interest at the 26-week treasury bill rate plus 3.5%, with a minimum of 12% and a maximum of 17% (12% as of December 31, 1986). The Company had borrowed the entire \$25,000,000 as of December 31, 1986. The second \$25,000,000 component of this term loan bears interest at a fixed rate of 12.875%. The Company had borrowed \$23,384,000 of this second \$25,000,000 component as of December 31, 1986. The term loan is payable in 12 monthly principal installments of \$400,000 commencing June 1987 with the remaining balance due in equal principal payments over 72 months.

As of December 31, 1986, the Company had borrowed all of the \$10,000,000 working capital term loan which bears interest at 14.875%. This loan is payable in five equal annual principal installments commencing in 1988.

Since December 31, 1986, the Company has been engaged in discussions with the financial institutions funding its bank line of credit to restructure the credit line. The Company also intends to begin discussions with the holders of its 14.625% senior subordinated notes due 1992 to restructure such notes. The Company believes that restructuring this debt is necessary to provide the Company with sufficient cash flow to continue its existing level of operations and to avoid default under the collateral coverage requirements imposed by the Company's bank line of credit. Although there can be no assurance that a restructuring of the Company's debt will be accomplished, based upon meetings with the financial institutions that have been held to date and upon proposals shared by the Company, the financial institutions and certain holders of the senior subordinated notes, the Company believes there is a reasonable likelihood that it will be able to restructure its debt in a manner that should provide the Company with sufficient cash flow to continue its existing level of operations and to realize the recorded value of its primary assets, contracts receivable and land and improvements.

NOTE E — DEFERRED INCOME TAXES:

The provision for deferred income taxes consists of the following:

	Year ended December 31,		
	1984	1985	1986
Federal	\$14,434,000	\$ 794,000	\$(40,445,000)
Foreign and state	1,852,000	398,000	(4,883,000)
	<u>\$16,286,000</u>	<u>\$1,192,000</u>	<u>\$(45,328,000)</u>

Investment tax credits are recorded as a reduction of the income tax provision in the year available. The income tax provision was reduced by investment tax credits of \$934,000 in 1984, \$318,000 in 1985 and increased by a reduction in investment tax credit carryforward of \$50,000 in 1986. The Company's tax provision was reduced by \$140,000 in 1984 and 1985 and by \$144,000 in 1986 from an 85% dividend received deduction.

The tax basis net operating loss carryovers at December 31, 1986 totaled \$32,100,000 and will expire in years ending December 31, 1996 through 2000.

The tax effect of items reported in different periods for financial statement and income tax purposes is as follows:

	Year ended December 31,		
	1984	1985	1986
Installment sales	\$18,514,000	\$6,639,000	\$(16,810,000)
Capitalized interest	1,379,000	440,000	563,000
Resort land and improvement costs	(1,877,000)	(1,608,000)	(31,243,000)
Decrease (increase) in tax basis net operating loss carryforward ...	(2,079,000)	(4,839,000)	2,403,000
Excess of tax over book depreciation and effect of accounting for capital leases as operating leases for tax purposes	457,000	783,000	391,000
Other, net	<u>(108,000)</u>	<u>(223,000)</u>	<u>(632,000)</u>
	<u>\$16,286,000</u>	<u>\$1,192,000</u>	<u>\$(45,328,000)</u>

NOTE F — INCENTIVE STOCK PLANS:

Stock Option Plans

The Company has two stock option plans under which common stock is reserved for issuance to officers and key employees. Under the 1979 plan, options are exercisable 25% each year commencing one year after the date of grant and expire after ten years. Under the 1980 plan, options are exercisable in full commencing one year after the date of grant and expire after five years. Options are priced at not less than the market price of the Company's common stock at the date of grant.

Information with respect to options granted under the plans is as follows:

	Options outstanding				Options currently exercisable	Exercised
	Authorized	Available for grant	Shares	Price per share		
Balance at January 1, 1986	1,162,575	71,561	397,920	\$2.37-\$7.00	27,414	693,094
Options forfeited		395,019	(395,019)		(24,513)	
Options exercised			(2,653)		(2,653)	2,653
Options granted		(123,310)	123,310			
Balance at December 31, 1986	<u>1,162,575</u>	<u>343,270</u>	<u>123,558</u>	<u>\$2.18-\$2.37</u>	<u>248</u>	<u>695,747</u>

On November 14, 1986, with the approval of the Board of Directors, the Company offered stock options for 123,310 shares with an exercise price of \$2.18 per share (the fair market value of a share of the Company's common stock on that date) in substitution of outstanding stock options for 242,425 shares with exercise prices ranging from \$2.37 to \$7.00 per share.

Stock Purchase Plan

Since 1982, the Company has reserved 975,000 shares for issuance under a stock purchase plan for officers and key employees. The plan provides for sale of common stock to participants on a cash or installment basis at a price not less than market value. Shares sold on the installment basis are issued and recorded in the financial statements upon receipt of payment. Of the shares reserved for issuance under the plan, 113,375 shares were sold in 1984 at an average of \$15.27 per share and 88,400 shares were sold in 1985 at an average of \$15.63 per share. On August 18, 1986, with approval of the Board of Directors, the Company offered to modify outstanding installment contracts under the plan to reduce the purchase price to \$3.63 per share (the fair market value of a share of the Company's common stock on that date). On August 18, 1986, the Board of Directors also elected to terminate the plan with respect to shares not yet sold. During 1984, 1985 and 1986, 88,743, 37,676 and 45,519 shares, respectively, were issued under the plan.

NOTE G — POST-EMPLOYMENT AGREEMENTS:

During 1983, the Company entered into post-employment agreements with certain key officers. The agreements provide for pre-retirement death benefits, post-employment consulting, retirement benefits and an agreement not to compete. Costs to the Company under these agreements including settlement payments were \$300,000 in 1984, \$686,000 in 1985, and \$794,000 in 1986. During 1986, the Company extended offers to participants to terminate their respective agreements in exchange for cash settlements, which offers were accepted by some participants.

NOTE H — COMMITMENTS AND CONTINGENCIES:

The Company has operating lease obligations of approximately \$1,052,000 annually until 1992.

Certain of the Company's resorts have been developed and must be operated in compliance with the provisions of applicable land use permits. Management believes the Company is in compliance with such permits and, in the future, will make applications for new permits or for modifications of existing permits as considered necessary for resort operations or for further development.

The Company is involved in a dispute with the Washington Department of Revenue regarding application of a 1.5% business and occupation tax on interest income from membership contracts sold outside Washington and a 6.5% retail sales tax on the Company's membership sales and dues assessments in Washington. The Company has also been notified by the Virginia Department of Revenue that it believes the Company's membership sales and dues assessments in Virginia are subject to a 4% retail sales tax. The Company has not collected or accrued for all state taxes currently in dispute. The Company intends to contest the application of these state taxes, and management believes the eventual outcome will not have a material impact on the Company's operations or financial position.

On February 26, 1986, the Company was served with a purported class action complaint filed in Seattle in federal district court naming the Company, two of its principal officers, and its independent auditors as defendants. The complaint alleges claims under Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5 promulgated thereunder, and certain common law principles based on alleged misrepresentations by the Company in certain financial disclosures, including reports filed with the Securities and Exchange Commission, in 1985 and seeks unspecified damages. In July 1986, the Court dismissed the plaintiff's common law claims and certified the case as a class action lawsuit. At the present time, the case is in the stage of discovery, and the Company and its counsel believe it is too early to access the ultimate outcome. However, based on the information which has been reviewed to date, the Company believes it has meritorious defenses and that the lawsuit will not have a material impact on its operations or financial position.

NOTE I — COSTS AND EXPENSES:

The Company capitalizes interest as a component of the cost of significant improvements to resorts. Total interest costs were \$11,007,000 in 1984, \$22,078,000 in 1985 and \$28,721,000 in 1986, of which \$5,883,000, \$5,792,000 and \$903,000, respectively, were capitalized.

Certain resort operating costs which support sales activity are charged to marketing expense in areas where less than 50% of planned memberships have been sold. These costs are as follows:

Year ended December 31,

1984	\$3,040,000
1985	4,562,000
1986	2,694,000

NOTE J — EXTINGUISHMENT OF DEBT:

On December 29, 1986, the Company purchased \$17,870,000 principal amount of its 14.625% senior subordinated notes due 1992 at a cost of \$11,523,000, resulting in a gain of \$2,977,000, net of related taxes of \$2,676,000. Earnings per share reported in connection with the extinguishment of debt were \$.29.

Funds used to extinguish the debt were obtained from the sale of certain of the Company's assets to its major shareholder, resulting in an aggregate net pretax gain of \$1,483,000.

NOTE K — RELATED PARTY TRANSACTIONS:

At December 31, 1986, Western Savings and Loan Association ("Western") owned 23.2% of the Company's outstanding common stock and approximately \$30,100,000 principal amount of the Company's 14.625% senior subordinated notes due 1992.

The Company's bank line of credit includes a \$50,000,000 term loan funded by Western. During the three years ended December 31, 1986, the Company paid interest to Western of \$1,366,000, \$1,424,000 and \$5,097,000, respectively.

On December 29, 1986, the Company sold to Western certain assets not related to its 43 operating resorts for a total purchase price of \$12,250,000. The assets sold and purchase price for each asset were as follows: 10 shares of Western's Series A cumulative preferred guarantee stock, \$1.00 par value (\$3,000,000); the Company's right to 50% of the profits from an offering by Western of VISA cards to members of the Company under an agreement dated March 7, 1985, between Western and Outdoor Enterprises, Inc., a subsidiary of the Company (\$2,000,000); and the Company's right to 50% of the profits from the sale of lots in a recreational vehicle subdivision and the future development or sale of real property adjacent to the subdivision under an agreement dated September 6, 1984, between Western and Happy Trails Resorts, Inc., a subsidiary of the Company (\$7,250,000). The sale resulted in an aggregate net gain of \$1,483,000.

During 1986, Western paid the Company \$119,000 under the Western VISA card programs which Outdoor Enterprises, Inc. markets and intends to continue to market to Thousand Trails members and other persons.

NOTE L — QUARTERLY FINANCIAL INFORMATION (unaudited):

The following table sets forth quarterly financial information (in thousands except per share data).

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
1985:				
Total revenue	\$ 31,794	\$ 49,872	\$ 56,482	\$ 35,586
Income (loss) from membership sales and resort operations . . .	4,972	7,909	2,024	(12,015)
Earnings (loss) before taxes	5,862	8,338	1,937	(13,157)
Net earnings (loss)	3,102	4,425	1,026	(6,765)
Earnings (loss) per share				
Primary	\$.29	\$.41	\$.10	\$(.66)
Fully diluted29	.41	.10	(.66)
1986:				
Total revenue	\$ 25,839	\$ 33,085	\$ 34,474	\$20,015
Income (loss) from membership sales and resort operations . . .	537	(1,948)	(5,871)	(30,674)
(Loss) before taxes and extraordinary item	(3,673)	(6,671)	(10,852)	(80,207)
Extraordinary item, less applicable income tax of \$2,676	—	—	—	2,977
Net (loss)	(1,946)	(3,744)	(5,948)	(38,784)
(Loss) per share				
Primary (loss) before extraordinary item	\$ (.19)	\$ (.36)	\$ (.57)	\$ (4.04)
Extraordinary item	—	—	—	.29
Net primary (loss)	<u>\$ (.19)</u>	<u>\$ (.36)</u>	<u>\$ (.57)</u>	<u>\$ (3.75)</u>
Fully diluted (loss) before extraordinary item	\$ (.19)	\$ (.36)	\$ (.57)	\$ (4.04)
Extraordinary item	—	—	—	.29
Net fully diluted (loss)	<u>\$ (.19)</u>	<u>\$ (.36)</u>	<u>\$ (.57)</u>	<u>\$ (3.75)</u>

During the fourth quarter of 1986, the Company charged against operations approximately \$63,281,000 to reduce land and improvement costs in certain areas to reflect estimated net realizable value.

The Company experienced higher than expected contract losses in the second half of 1986 resulting in an increase to its allowance for doubtful accounts of \$2,500,000 in the third quarter and \$8,000,000 in the fourth quarter.

ITEM 9. DISAGREEMENTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The executive officers and directors of the Company are listed below, followed by brief summaries of their business experience and other information.

<u>Name</u>	<u>Age</u>	<u>Position with The Company</u>
C. James Jensen	46	Chairman of the Board and Chief Executive Officer
Howard P. Behar	42	President, Chief Operating Officer, and Director
James E. Claus	35	Vice President, Chief Financial Officer, and Treasurer
Robert T. Davis	66	Director
James F. Nordstrom	47	Director
Edwin M. Stanley	49	Director
Charles E. Swanson	59	Director
J. P. Weyerhaeuser III	61	Director

Mr. Jensen, a director of the Company since September 1980, served as Vice Chairman of the Board from September 1980 to September 1981. He was elected Chairman of the Board in September 1981. Mr. Jensen served as Chief Executive Officer from September 1981 until April 1984 and was reelected Chief Executive Officer in January 1985. He also served as President from June 1982 to April 1983 and from May 1985 to August 1986. From 1979 to 1981, Mr. Jensen was engaged in private consulting and financial management, and acted as a management consultant to the Company from February 1980 to September 1981. Prior to 1979, he was President of GranTree Furniture Rental Corporation, a publicly held distributor and lessor of household and office furniture.

Mr. Behar joined the Company in January 1983 and served as Vice President from January 1984 to July 1986 when he was appointed Senior Vice President. In August 1986, he was made President and Chief Operating Officer and he became a director in January 1987. Prior to 1983, Mr. Behar held various management positions with GranTree Furniture Rental Corporation.

Mr. Claus joined the Company as corporate controller in August 1979 and was made a Vice President in May 1984. He was appointed Chief Financial Officer and Treasurer in August 1986. Before joining the Company, Mr. Claus was a certified public accountant with Touche Ross & Co.

Mr. Davis has been Professor of Marketing at the Graduate School of Business at Stanford University since 1958 and holds the Sebastian S. Kresge chair. While on a sabbatical from Stanford, from 1983 to March 1986, he served as Vice President of Sales and Marketing for NIKE, Inc. He has also provided consulting services to a number of companies. Mr. Davis is a director of NIKE, Inc., Anthem Electronics, Inc., Roman Meal Company, and Armor All Products Corporation.

Mr. Nordstrom has been a director of the Company since 1982. Since 1977, he has been President, and is a director, of Nordstrom, Inc., a publicly held corporation which operates specialty retail stores.

Mr. Stanley has been a director of the Company since 1982. For more than five years, he has been Chairman of Management Compensation Group Northwest, Inc., a consultant in corporate finance and management compensation.

Mr. Swanson has been a director of the Company since January 1986. He retired from Encyclopedia Britannica, Inc. in 1985 after serving for 18 years as President and is currently a director of that company. Mr. Swanson is also a director of Health-Mor, Inc.

Mr. Weyerhaeuser has been a director of the Company since 1972 and is a private investor.

All of the directors of the Company, except Howard P. Behar, were elected at the annual meeting of shareholders held on June 26, 1986. Mr. Behar was appointed to fill a vacancy on the Board of Directors at the regular meeting of the Board held on January 29, 1987. The directors are elected to serve until the next annual meeting of shareholders and until their successors are elected or appointed. Mr. Jensen was elected an executive officer of the Company by the Board of Directors in June 1986 and Messrs. Behar and Claus were elected executive officers of the Company by the Board of Directors in August 1986. The executive officers are elected to serve until the next annual meeting of the Board of Directors and until their successors are elected or appointed.

ITEM 11. EXECUTIVE COMPENSATION

The following table sets forth the aggregate cash compensation paid by the Company during 1986 to the three executive officers of the Company and the fourth and fifth most highly compensated officers of the Company and to such individuals as a group:

<u>Name of Individual or Number in Group</u>	<u>Capacities in Which Served⁽¹⁾</u>	<u>Cash Compensation⁽²⁾</u>
C. James Jensen	Chairman of the Board and Chief Executive Officer	\$349,000
Howard P. Behar	President and Chief Operating Officer	\$220,899
James E. Claus	Vice President, Chief Financial Officer, and Treasurer	\$124,046
S. Duke Campbell	Senior Vice President, Operations	\$174,468
Jerol E. Andres	Vice President and President of Happy Trails Resorts, Inc. and Outdoor Enterprises, Inc.	\$133,262
Such individuals as a group ⁽³⁾		\$1,001,675

(1) Current positions which reflect changes made in 1986 and 1987.

(2) Includes base salaries, awards under the Company's Incentive Compensation Plan, and payments by the Company for legal and accounting services and personal use of automobiles provided by the Company.

(3) During 1986, the Company also paid R. Craig Kirsch \$147,501 for his services as Senior Vice President, Chief Financial Officer, and Treasurer of the Company. Mr. Kirsch resigned in September 1986. During 1986, the Company also paid Melvyn R. Kays \$18,750 for his services as Executive Vice President, Chief Financial Officer, and director of the Company. Mr. Kays resigned in January 1986. In addition, during 1986, the Company paid Robert M. Mayes \$234,379 for his services as Senior Vice President and director of the Company. Mr. Mayes resigned in September 1986.

The following is a brief summary of employee benefit plans in effect during 1986 under which the executive officers of the Company received benefits:

Stock Option Plans

The Company has two key employee stock option plans: the 1979 Key Employee Stock Option Plan (the "1979 Plan") and the 1980 Key Employee Stock Option Plan (the "1980 Plan"). The Plans are designed to encourage stock ownership by officers and other key employees of the Company and its subsidiaries by providing them with a means of acquiring or increasing their proprietary interests in the Company. The Plans are administered by the Compensation Committee, subject to approval of the Board of Directors. The number of options granted to each employee is based on the Compensation Committee's determination of the employee's past and expected future contributions to the Company.

Each option granted under the 1979 Plan may be exercised at any time within ten years from the date on which it is granted, to the extent permitted by the following schedule: 25% of optioned shares after one year, 50% after two years, 75% after three years, and 100% after four years. Each option granted under the 1980 Plan prior to January 29, 1987 may be exercised, in full or in part, at any time after one year and before five years

from the date on which it is granted. In January 1987, the 1980 Plan was amended to provide that each option granted thereafter may be exercised, in full or in part, within five years from the date on which it is granted to the extent permitted by the following schedule: 25% of optioned shares after one year, 50% after two years, 75% after three years, and 100% after four years. Options granted under the 1980 Plan after May 1985 will become exercisable in full immediately in the event of a change in control of the Company. The per share option price is determined by the Board of Directors on the date the option is granted, but cannot be less than the fair market value of the Company's common stock on the date the option is granted. Under the 1979 Plan, the option price is payable in full upon exercise of the option. Under the 1980 Plan, the option price may be paid in installments.

Under both Plans, the optionee must agree to remain in the employ of the Company for a period of at least 12 months from the date on which the option is granted. Any termination of the optionee's employment during that period which is either (a) for cause or (b) voluntary on the part of the optionee and without the consent of the Company will result in the termination of all outstanding options held by the optionee. No option is assignable or transferable, except at the death of the optionee, by will, or by the law of descent and distribution.

Options granted under both Plans may be designated incentive stock options ("ISO's") within the meaning of Section 422A of the Internal Revenue Code. All options not so designated are treated as non-statutory stock options. The terms of both Plans place an annual limit on the amount of stock for which any optionee may be granted ISO's, based on the aggregate fair market value of the underlying stock as of the date of grant of the ISO. The aggregate fair market value of all stock for which any optionee may be granted ISO's by the Company in any calendar year cannot exceed \$100,000, plus any unused limit carryover to such year. The unused limit carryover from any calendar year equals one-half of the amount by which \$100,000 exceeds the aggregate fair market value (as of the time of grant) of all stock for which the optionee has been granted ISO's in such calendar year. Any unused limit carryover may be carried over to each of the next three succeeding calendar years. ISO's granted in any calendar year are treated as first using up the \$100,000 limitation described above and then any unused limit carryovers to such year in the order of the calendar years in which the carryovers arose.

The Company has reserved 487,575 shares of its common stock for issuance under the 1979 Plan and 675,000 shares under the 1980 Plan.

The following table sets forth as to each of the five individuals named in the compensation table above and as to such individuals as a group: (a) the number of shares subject to options granted from January 1, 1986 to January 1, 1987, (b) the average per share exercise price thereof, and (c) the net value (market value on date of exercise less exercise price) of shares acquired during the period upon exercise of options.

	STOCK OPTION TABLE					
	<u>C. James Jensen</u>	<u>Howard P. Behar</u>	<u>S. Duke Campbell</u>	<u>James E. Claus</u>	<u>Jerol E. Andres</u>	<u>Such individuals as a Group</u>
Granted —						
1/1/86-1/1/87						
Number of shares	—	35,000	7,000	7,250	10,000	59,250
Average per share exercise price ...	—	\$2.18	\$2.18	\$2.18	\$2.18	\$2.18
Exercised —						
1/1/86-1/1/87						
Number of Shares	—	—	—	—	—	—
Net value of shares	—	—	—	—	—	—

In November 1986, the Company's Board of Directors offered holders of outstanding options for 242,425 shares the opportunity to exchange such options for nonstatutory options for 123,310 shares having an exercise price of \$2.18 per share. The options for the remaining 119,115 shares were cancelled. The effect of this exchange was to reduce the weighted average exercise price of outstanding options from \$6.55 to \$2.18 per share. The figures in the stock option table give effect to these exchanges by using the lower exercise price of the options issued in exchange and by subtracting from the number of shares granted the shares which were subject to the options surrendered in exchange or cancelled.

With respect to options to be granted in the future, the Board of Directors may, insofar as permitted by law, suspend or discontinue the Plans or revise or amend them in any respect whatsoever.

Stock Purchase Plan

The Company's Key Employee Stock Purchase Plan (the "Plan") is designed to encourage stock ownership by officers of the Company and its subsidiaries by providing them with a means of acquiring or increasing their proprietary interests in the Company. The Plan is administered by the Compensation Committee whose actions are final unless overridden by the full Board of Directors.

Under the terms of the Plan, the Compensation Committee may offer eligible employees the right to purchase a fixed number of shares of the Company's common stock at a price per share equal to 100% of the fair market value of such stock on the date of purchase. The number of shares offered to each employee is based on the Compensation Committee's determination of the employee's past and expected future contributions to the Company. The employee must pay at least 5% of the total purchase price each year during the first four years and the remaining balance must be paid in full by the end of the fifth year following the date of purchase. The employee may prepay the full amount of the purchase price at any time. Certificates for the stock are issued to the employee as the Company receives payment therefor. Employees purchasing stock prior to October 1984 were not charged interest on the unpaid balance of the purchase price. Employees purchasing stock after October 1984 are charged the minimum rate of interest necessary to avoid the imputation of interest at a greater rate under the applicable sections of the Internal Revenue Code.

A participating employee acquires a nonforfeitable right to portions of the stock upon payment therefor and in accordance with the following schedule: one-third of the shares after one year; two-thirds after two years; and the full amount after three years. The employee cannot transfer the stock or any portion thereof until he has acquired nonforfeitable rights in the shares to be transferred. Notwithstanding the foregoing, employees purchasing stock after October 1984 will immediately acquire nonforfeitable rights in all such shares in the event of a change in control of the Company.

If a participating employee's employment with the Company is terminated for any reason during the five-year payment period, the Board of Directors may elect either (a) to declare the unpaid balance of the purchase price immediately due and payable; (b) to rescind the employee's purchase of any shares for which payment has not been received by the Company and require the employee to resell to the Company, at the price paid by the employee, any shares in which the employee has not acquired nonforfeitable rights; or (c) to permit the employee to acquire the stock on the original terms.

The Plan may be amended by the Board of Directors, provided that shareholder approval is obtained for any amendment which (a) increases the total number of shares that may be sold under the Plan; (b) modifies the requirements as to eligibility for participation in the Plan; (c) modifies the provisions relating to the purchase price or otherwise materially increases the benefits accruing to participants under the Plan; or (d) extends the term of the Plan. The Plan may also be discontinued by the Board of Directors, provided, however, that such discontinuance shall not, without the consent of the employee, alter or impair any rights or obligations of an employee with respect to shares previously sold under the Plan.

The Company originally reserved 975,000 shares of its common stock for issuance under the Plan. However, in June 1986, the Board of Directors terminated the Plan with respect to all shares not yet sold and in August 1986, the Board of Directors modified the purchase price for all outstanding installment contracts to \$3.625 per share, the fair market value of the Company's common stock on the date of the Board's action.

Incentive Compensation Plans

The Company's Incentive Compensation Plan is designed to provide awards to officers of the Company and its subsidiaries who make substantial contributions to the success of the Company. The Plan is intended to benefit the Company by enhancing the productivity of its officers and strengthening the ability of the Company to attract and retain in its employ persons of outstanding ability. The Incentive Compensation Plan is administered in part by the Compensation Committee and in part by the full Board of Directors.

Awards are made to officers of the Company and its subsidiaries annually based in part on their achievement of certain performance goals set by management and approved by the Compensation Committee. In addition, an incentive compensation fund is computed annually based on the earnings of the Company and allocated among the officers of the Company and its subsidiaries by the Compensation Committee. The full Board of Directors may also make discretionary awards at year-end. The final determination of awards is based on a review of each individual's performance, the earnings of the Company, and the Board of Directors' assessment of the total compensation to be paid to each individual. All awards are paid from the general funds of the Company.

The Company's Deferred Compensation Plan is designed to permit officers of the Company and its subsidiaries to provide for their future financial security by deferring receipt of a portion of their annual bonus for a fiscal year. All officers of the Company and its subsidiaries are eligible to participate in the Deferred Compensation Plan, which is administered by the Compensation Committee of the Board of Directors.

Under the Deferred Compensation Plan, a participating officer may elect to defer receipt of a portion of his or her annual bonus for a fiscal year. The amount of the deferral is credited to a deferred compensation account on the books of the Company and is payable, together with an agreed-upon return on the amount deferred, to the officer (or his beneficiary), commencing at the officer's death, disability, or termination of employment. The officer may generally elect to receive his benefits under the plan in equal annual or monthly installments over a period not to exceed 15 years. The officer's deferred compensation account is 100% vested and nonforfeitable at all times.

The Deferred Compensation Plan was terminated by the Board of Directors in October 1986 and amounts in the deferred compensation accounts of participants were distributed to the participants.

The Company's Supplemental Income and Retirement Plans (the "Post-Employment Plans") are designed to provide retirement income for key officers of the Company and to induce such officers to be available as consultants to the Company after retirement and to refrain from engaging in competitive activity without the consent of the Board of Directors. The Post-Employment Plans are administered in part by the Compensation Committee and in part by the full Board of Directors.

The Post-Employment Plans provide for an annual retirement benefit (assuming retirement at age 65) in an amount equal to 60% of the participant's 1982 compensation (or estimated 1982 compensation if the participant was not employed by the Company in 1982). The amount of the annual benefit is decreased if the participant retires before age 65. The annual benefit is payable over a period of years commencing no sooner than the date on which the participant attains age 55 (except that the benefit payable to Mr. Jensen may commence after 10 years' participation in the plan) and continuing through the year in which the participant attains age 80. In the event of the termination of his employment for any reason following a change in control of the Company, Mr. Jensen has the right to demand payment of a lump sum amount equal to the present value of the annual benefits otherwise payable to him.

The right of participants to annual benefits under the Post-Employment Plans vests according to a schedule set by the Board of Directors for each participant, ranging from immediate vesting to incremental vesting over a five-year period. In the event of the death or disability of any participant, or in the event of a change in control of the Company, the participant's right to the annual benefits will immediately vest 100%.

The Post-Employment Plans also provide for pre-retirement death benefits payable to the participant's beneficiaries from a portion of the proceeds of the life insurance described below. The Post-Employment Plans do not provide for a post-retirement death benefit; however, if a participant dies after beginning to receive his annual benefits, such benefits will be paid to the participant's beneficiaries.

The Company's obligations under the Post-Employment Plans are not currently funded and will be satisfied from the general funds of the Company. However, the Company has purchased cost recovery life insurance on the lives of officers participating in the plans and, if certain assumptions as to mortality experience, policy dividends, and other factors are realized, the Company will recover an amount equal to all benefit payments under the Post-Employment Plans and the premium payments on the insurance policies, plus a portion of the interest on the use of funds. Such insurance will be split dollar life insurance which splits the death benefit payable under the policy between the Company and the participant's beneficiaries according to the terms of the policy.

The annual retirement benefit (assuming retirement at age 65) under the Post-Employment Plans for Mr. Jensen is presently \$162,300. In May 1987, Mr. Jensen voluntarily agreed to reduce his annual retirement benefit from \$317,400 to its current level.

At the time of his resignation as Senior Vice President, Chief Financial Officer, and Treasurer of the Company in September 1986, R. Craig Kirsch had a vested retirement benefit (assuming retirement at age 65) of \$40,000 per year under the Post-Employment Plans. At the time of his resignation as Senior Vice President and director of the Company in September 1986, Robert M. Mayes had a vested retirement benefit (assuming retirement at age 65) of \$75,000 per year under the Post-Employment Plans. At the time of his resignation as Executive Vice President, Chief Financial Officer, and director of the Company in January 1986, Melvyn R. Kays had a vested retirement benefit (assuming retirement at age 65) of \$191,580 per year under the Post-Employment Plans. In connection with his resignation, Mr. Kays agreed to the termination of his right to

benefits under the Post-Employment Plans in exchange for the Company transferring to him certain property and other benefits having a present value of approximately \$464,000. Since December 31, 1986, Jerol E. Andres agreed to the termination of his vested retirement benefit (assuming retirement at age 65) of \$50,000 per year under the Post-Employment Plans in exchange for a payment from the Company of \$55,084.

Each participant has agreed not to compete with the Company for a period of five years following the termination of his employment with the Company, or so long as any benefits remain payable to him under the plan, whichever is longer, and his annual benefit is subject to forfeiture in the event he engages in competitive activity during such period without the consent of the Board of Directors.

For 1986, each member of the Board of Directors who was not an employee of the Company was paid an annual fee of \$10,000. The chairman and members of each committee of the Board of Directors were also paid an annual fee of \$2,000 and \$1,500, respectively. Board members living out of state are entitled to reimbursement for reasonable travel expenses, including lodging, incurred in connection with attendance at Board and committee meetings.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth certain information regarding the Company's common stock owned on March 31, 1987 by each person who is known by the Company to beneficially own more than 5% of its outstanding stock, all directors, and all officers and directors of the Company as a group:

Name and Address of Beneficial Owner	Amount and Nature of Beneficial Ownership	
	No. Shares	%
Western Savings and Loan Association 3443 North Central Avenue Phoenix, Arizona 85012-2204	2,407,500	23.2
Harris Associates, Inc. ⁽¹⁾ 120 South LaSalle Street, Suite 1330 Chicago, Illinois 60603	550,521	5.3
The Prudential Insurance Company of America ⁽²⁾ Prudential Plaza Newark, New Jersey 07107	657,625	6.3
C. James Jensen ⁽³⁾	455,900	4.4
Howard P. Behar	27,050	*
Robert T. Davis	1,000	*
James F. Nordstrom ⁽⁴⁾	13,066	*
Edwin M. Stanley	-0-	*
Charles E. Swanson	10,000	*
J. P. Weyerhaeuser III ⁽⁵⁾	99,050	*
All Officers and Directors As a Group (13 persons) ⁽⁶⁾	765,097	7.4

*Does not exceed 1% of the Company's outstanding common stock.

(1) Based on information in Amendment No. 1 to the Schedule 13D filed with the Securities and Exchange Commission in December 1986 by Harris Associates, Inc. ("Harris"). Harris is a securities brokerage firm and investment advisor. By reason of advisory and other relationships with the persons who own these shares, Harris may be deemed to be the indirect beneficial owner of the shares. However, Harris disclaims beneficial ownership of these shares.

(2) Based on information in a Schedule 13G filed with the Securities and Exchange Commission in February 1987 by The Prudential Insurance Company of America, which has sole voting and dispositive power over 366,400 of these shares and shared voting and dispositive power over 291,225 of these shares.

(3) Includes 200,000 shares held by J J Consulting Corporation, a management consulting and investment company of which Mr. Jensen is President and the principal shareholder, and 900 shares owned by Mr. Jensen's wife and minor children.

(4) Includes 1,816 shares owned by Mr. Nordstrom's wife and minor children.

(5) Includes 93,050 shares held of record by the trustees of revocable trusts established by Mr. Weyerhaeuser, who can effectively control the voting and sale or other disposition of the shares. Also includes 3,000 shares held of record by the trustees of a revocable trust established by Mr. Weyerhaeuser's wife, who can effectively control the voting and sale or other disposition of the shares. Also includes 3,000 shares held of record by the trustees of an irrevocable trust, of which Mr. Weyerhaeuser is a trustee.

(6) Includes 124,551 shares which officers have subscribed to purchase under the Company's Key Employee Stock Purchase Plan, and 4,716 shares owned by spouses and minor children of officers and directors and 6,000 shares held in trusts where the officer or director is named as trustee.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

On March 31, 1987, Western Savings and Loan Association ("Western") owned 23.2% of the Company's outstanding common stock and approximately \$30,100,000 principal amount of the Company's 14.625% senior subordinated notes due 1992. Gary H. Driggs, President and Chief Executive Officer of Western, was a director of the Company from June 1982 to November 1986. Mr. Driggs was elected to the Board of Directors of the Company pursuant to an agreement between the Company and Western entered into in 1982 when Western purchased stock from the Company. This agreement provides that, for so long as Western owns over 15% of the Company's outstanding common stock, the Company will take all actions within its power to cause one designated nominee of Western to be elected to the Company's Board of Directors. Mr. Driggs resigned as a director in November 1986 and Western has not designated a replacement nominee.

The Company's bank line of credit includes a \$50,000,000 term loan funded by Western. This loan bears interest on the outstanding principal balance not exceeding \$25,000,000 at the 26-week treasury bill rate plus 3.5% with a minimum of 12% and a maximum of 17% (12% as of December 31, 1986). This loan bears interest on the outstanding principal balance exceeding \$25,000,000 at the rate of 12.875% per annum. As of December 31, 1986, the Company had borrowed \$48,384,000 of this loan. During 1986, the Company paid Western \$5,097,000 as interest on this loan.

On December 29, 1986, the Company sold to Western certain assets not related to its 43 operating resorts for a total purchase price of \$12,250,000. The assets sold and purchase price for each asset were as follows: 10 shares of Western's Series A cumulative preferred guarantee stock, \$1.00 par value (\$3,000,000); the Company's right to 50% of the profits from an offering by Western of VISA cards to members of the Company under an agreement dated March 7, 1985, between Western and Outdoor Enterprises, Inc., a subsidiary of the Company (\$2,000,000); and the Company's right to 50% of the profits from the sale of lots in a recreational vehicle subdivision and the future development or sale of real property adjacent to the subdivision under an agreement dated September 6, 1984, between Western and Happy Trails Resorts, Inc., a subsidiary of the Company (\$7,250,000). The sale resulted in an aggregate net gain of \$1,483,000.

On December 29, 1986, the Company used \$11,523,000 of the proceeds from the sale of the above-described assets to purchase \$17,870,000 principal amount of its 14.625% senior subordinated notes due 1992. See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations."

During 1986, Western paid the Company \$119,000 under certain VISA card programs operated by Western and marketed by Outdoor Enterprises, Inc. to Thousand Trails members and other persons.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

Financial Statements and Schedules

The following financial statements are filed as part of this report:

Consolidated Balance Sheets as of December 31, 1986 and 1985.

Consolidated Statements of Earnings — Three years ended December 31, 1986.

Consolidated Statements of Changes in Financial Position — Three years ended December 31, 1986.

Consolidated Statements of Shareholders' Equity — Three years ended December 31, 1986.

Report of Certified Public Accountants on Consolidated Financial Statements.

Additional financial information required to be furnished is set forth in the following schedules:

Schedules for the three years ended December 31, 1986:

IV Indebtedness of and to Related Parties.

VIII Valuation and Qualifying Accounts.

Consent of Certified Public Accountants and Report on Schedules.

All schedules, other than the schedules listed above, are omitted, as the information is not required, is not material, or is otherwise furnished. Separate financial statements of the registrant have been omitted since it is primarily an operating company, all significant subsidiaries are wholly owned, and long-term debt of the subsidiaries held by others than the registrant is less than 5% of consolidated assets.

Exhibits

- 4.1 Articles of Incorporation of the Company, as amended to date.*
- 4.2 By-laws of the Company, as amended to date.
- 4.3 Form of Indenture between the Company and First Interstate Bank of Washington, dated as of March 14, 1985, relating to the Company's 14% Senior Subordinated Notes due 1992.**
- 10.1 Amended and Restated Loan and Security Agreement dated February 16, 1983, between the Registrant and Thousand Trails (Canada) Inc., as Borrowers, and The First National Bank of Boston, as Lender (the "Bank Loan Agreement").*
- 10.2 First Amendment to the Bank Loan Agreement dated as of August 1, 1983.*
- 10.3 Second Amendment to the Bank Loan Agreement dated as of April 20, 1984.*
- 10.4 Third Amendment to the Bank Loan Agreement dated as of December 7, 1984.*
- 10.5 Fourth Amendment to the Bank Loan Agreement dated as of March 5, 1985.*
- 10.6 Fifth Amendment to the Bank Loan Agreement dated as of January 31, 1986.***
- 10.7 Sixth Amendment to the Bank Loan Agreement dated as of February 28, 1986.***
- 10.8 Master Lease Agreement dated as of May 10, 1985, between General Electric Credit Corporation as lessor and the Company as lessee, relating to the Company's acquisition of rental trailers in 1985.***
- 10.9 1979 Key Employee Stock Option Plan, as amended to date.***
- 10.10 1980 Key Employee Stock Option Plan, as amended to date.
- 10.11 Key Employee Stock Purchase Plan, as amended to date.***
- 10.12 Supplemental Income Plan for Key Executives.***
- 10.13 Supplemental Retirement Plan for Key Executives.***
- 10.14 Deferred Compensation Plan.***
- 10.15 Agreements dated as of November 1, 1983 and April 9, 1984, between Jerry D. Horn and the Company, and supplemental agreements dated as of January 31, 1984 and April 9, 1984.*
- 10.16 Agreement dated May 3, 1985, between Jerry D. Horn and the Company, and agreement dated December 10, 1985, between Jerry D. Horn and the Company.***
- 10.17 Agreement dated as of February 27, 1986, between Melvyn R. Kays and the Company.***
- 10.18 Agreement dated September 15, 1986, between R. Craig Kirsch and the Company.
- 10.19 Agreement dated September 2, 1986, between Robert M. Mayes and the Company.
- 10.20 Sample form of current Membership Contract.

Exhibits

- 10.21 Happy Trails Development Agreement between Western Savings and Loan Association and Happy Trails Resorts, Inc. (formerly known as Thousand Trails Development Corporation) dated September 6, 1984, related to the Happy Trails development.*
- 10.22 Agreement dated December 29, 1986, between Western Savings and Loan Association and Happy Trails Resorts, Inc. and Supplemental Agreement dated December 29, 1986, relating to the Happy Trails development.
- 10.23 Agreement dated March 7, 1985, between Western Savings and Loan Association and Outdoor Enterprises, Inc., relating to certain VISA card programs.
- 10.24 Agreement dated December 29, 1986, between Western Savings and Loan Association and Outdoor Enterprises, Inc., relating to certain VISA card programs.
- 10.25 Agreement dated March 13, 1987, between Western Savings and Loan Association and Road Vantage, Inc., a subsidiary of the Company, relating to certain VISA card programs.
- 10.26 Letter dated December 29, 1986, from Western Savings and Loan Association to the Company, relating to Western's redemption of its preferred stock.
- 10.27 Lease dated September 23, 1983, between Martin Selig as lessor and the Company as lessee, relating to the Company's corporate headquarters in Bellevue, Washington, and amendment to lease dated October 23, 1984.***
- 10.28 Agreement dated March 7, 1985, between Western Savings and Loan Association and Road Vantage, Inc., a subsidiary of the Company, relating to certain VISA card programs.
- 11.1 Calculation of earnings per share of common stock.
- 24.1 Consent of Touche Ross & Co.

* Indicates that such document was filed previously with, and is incorporated herein by reference from, the Company's Annual Report on Form 10-K for the year ended December 31, 1984, File No. 2-65020.

** Indicates that such document was filed previously with, and is incorporated herein by reference from, the Company's Amendment No. 1 to its Quarterly Report on Form 10-Q for the quarter ended March 31, 1985, File No. 2-65020.

*** Indicates that such document was filed previously with, and is incorporated herein by reference from, the Company's Annual Report on Form 10-K for the year ended December 31, 1985, File No. 2-65020.

Reports on Form 8-K

No reports on Form 8-K were filed during the fourth quarter of 1986.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

THOUSAND TRAILS, INC.
(Registrant)

Date: May 5, 1987

By /s/ JAMES E. CLAUS
James E. Claus, Vice President
and Chief Financial Officer

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

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u> /s/ C. JAMES JENSEN </u> C. James Jensen	Chairman of the Board, Chief Executive Officer	<u>May 5, 1987</u>
<u> /s/ JAMES E. CLAUS </u> James E. Claus	Vice President, Chief Financial and Accounting Officer	<u>May 5, 1987</u>
<u> /s/ HOWARD P. BEHAR </u> Howard P. Behar	President, Chief Operating Officer and Director	<u>May 5, 1987</u>
<u> /s/ ROBERT T. DAVIS </u> Robert T. Davis	Director	<u>May 5, 1987</u>
<u> /s/ JAMES F. NORDSTROM </u> James F. Nordstrom	Director	<u>May 5, 1987</u>
<u> /s/ EDWIN M. STANLEY </u> Edwin M. Stanley	Director	<u>May 5, 1987</u>
<u> /s/ CHARLES E. SWANSON </u> Charles E. Swanson	Director	<u>May 5, 1987</u>
<u> /s/ J. P. WEYERHAEUSER </u> J. P. Weyerhaeuser	Director	<u>May 5, 1987</u>

/s/

Schedule IV

THOUSAND TRAILS, INC.

INDEBTEDNESS OF AND TO RELATED PARTIES — NOT CURRENT

Description	Beginning Balance	Additions	Deductions	Ending Balance
Term loan provided by Western Savings and Loan Association:				
Year Ended 12/31/84	\$ 6,675,000	\$18,300,000	-0-	\$24,975,000
Year Ended 12/31/85	\$24,975,000	\$ 3,425,000	-0-	\$28,400,000
Year Ended 12/31/86	\$28,400,000	\$19,984,000	-0-	\$48,384,000
14.625% senior subordinated notes due 1992 owned by Western Savings and Loan Association				
Year Ended 12/31/86	\$ -0-	\$30,100,000	-0-	\$30,100,000

Schedule VIII

THOUSAND TRAILS, INC.

VALUATION AND QUALIFYING ACCOUNTS

Description	Beginning Balance	Additions	Deductions(1)	Ending Balance
Allowance for doubtful accounts deducted from related assets:				
Year Ended 12/31/84	\$ 4,749,000	\$ 5,880,000	\$ 1,827,000	\$ 8,802,000
Year Ended 12/31/85	\$ 8,802,000	\$17,644,000	\$ 6,667,000	\$19,779,000
Year Ended 12/31/86	\$19,779,000	\$19,231,000	\$12,354,000	\$26,656,000

(1) Membership contracts receivable written off, net of recoveries.

As to column omitted, the answer is none.

ACCOUNTANTS' REPORT ON SCHEDULES

Board of Directors
Thousand Trails, Inc.
Seattle, Washington

In connection with our examination of the consolidated financial statements of Thousand Trails, Inc. and subsidiaries as of December 31, 1986 and 1985 and for each of the three years in the period ended December 31, 1986, which report is included herein and is qualified subject to the effects on the financial statements, if any, as might have been required had the outcome of the company's current discussions regarding its debt restructuring been known, we also examined the schedules listed in the accompanying index at Item 14. In our opinion subject to the matter discussed in our report dated April 30, 1986, referred to in the preceding sentence, these schedules present fairly, when read in conjunction with the related consolidated financial statements, the financial data required to be set forth therein.

Touche Ross & Co.
Certified Public Accountants
Seattle, Washington
April 30, 1987

THOUSAND TRAILS, INC.

CALCULATION OF EARNINGS PER SHARE OF COMMON STOCK

	Year ended December 31,		
	1984	1985	1986
Primary			
Weighted average number of shares outstanding	10,368,500	10,393,017	10,346,470
Effect of stock options	<u>360,220</u>	<u>322,679</u>	<u>—</u>
Average number of shares for calculation of primary earnings per share	<u>10,728,720</u>	<u>10,715,696</u>	<u>10,346,470</u>
Income (loss) before extraordinary item	\$19,110,000	\$1,788,000	\$(53,399,000)
Extraordinary item:			
Gain from extinguishment of debt, less applicable income tax of \$2,676,000	<u>—</u>	<u>—</u>	<u>2,977,000</u>
Net earnings	<u>\$19,110,000</u>	<u>\$ 1,788,000</u>	<u>\$(50,422,000)</u>
Primary earnings per share:			
Income (loss) before extraordinary item	\$1.78	\$.17	\$(5.16)
Extraordinary Item	<u>—</u>	<u>—</u>	<u>.29</u>
Net earnings (loss)	<u>\$1.78</u>	<u>\$.17</u>	<u>\$(4.87)</u>
Fully Diluted:			
Average number of shares for calculation of fully diluted earnings per share	10,728,720	10,715,696	10,346,470
Incremental shares using the higher of year-end or average market prices for stock options	7,770	318,678	—
Assumed conversion of convertible debentures	<u>151,573</u>	<u>—</u>	<u>—</u>
	<u>10,888,063</u>	<u>11,034,374</u>	<u>10,346,470</u>
Net earnings (loss) before extraordinary item	\$19,110,000	\$ 1,788,000	\$(53,399,000)
Interest on debentures, net of taxes	<u>30,000</u>	<u>—</u>	<u>—</u>
Adjusted earnings (loss) before extraordinary item	\$19,140,000	\$ 1,788,000	\$(53,399,000)
Extraordinary item:			
Gain from extinguishment of debt, less applicable income tax of \$2,676,000	<u>—</u>	<u>—</u>	<u>2,977,000</u>
Adjusted earnings (loss)	<u>\$19,140,000</u>	<u>\$ 1,788,000</u>	<u>\$(50,422,000)</u>
Fully diluted earnings per share:			
Income (loss) before extraordinary item	\$1.76	\$.16	\$(5.16)
Extraordinary item	<u>—</u>	<u>—</u>	<u>.29</u>
Net earnings (loss)	<u>\$1.76</u>	<u>\$.16</u>	<u>\$(4.87)</u>

Thousand Trails, Inc.
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