

Annual Reports

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*Thousand
Trails*, Inc.

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A N N U A L R E P O R T

OUR BUSINESS

Thousand Trails, based in Bellevue, Washington, owns, operates and sells memberships in a network of 39 campground resorts in 14 states and in British Columbia, Canada. Nearly 93,000 families are members of Thousand Trails.

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

| | 1987 | 1986 |
|--------------------------------|-------------|-------------|
| Total revenues, in thousands | \$ 81,088 | \$ 94,182 |
| Net loss, in thousands | \$ (16,805) | \$ (50,422) |
| Loss per share | | |
| Primary | \$ (1.33) | \$ (4.87) |
| Fully diluted | \$ (1.33) | \$ (4.87) |
| Shareholders' equity per share | \$ 1.50 | \$ 2.76 |
| Family memberships | 92,820 | 91,000 |
| Resorts | 39 | 43 |

LETTER TO SHAREHOLDERS

Dear Shareholder:

The past year was one of great challenge and major transition for the entire Thousand Trails family — shareholders, members and employees.

In 1987, your company reported a net loss of \$16.8 million. As in the previous year, we were required to make tough decisions on cost control, marketing strategy and the operation of our preserves.

These are issues being faced by virtually every operator of membership resorts in the country.

The most significant development during 1987 and early 1988 was, however, a positive one: the recapitalization of Thousand Trails, with the objective of providing a financially solid future for your company. As you probably know, Southmark Corporation, a real estate-based financial services company with over \$3 billion in assets, purchased approximately two-thirds of

the outstanding common shares of Thousand Trails. As part of the acquisition and related recapitalization, and from routine debt reduction during the year, borrowing decreased by \$110 million. Southmark, on June 1, 1988, transferred its ownership interest in Trails to San Jacinto Savings Association, Southmark's wholly owned Houston-based thrift. This investment by Southmark is important in permitting management to make decisions with a focus on future member satisfaction and long-term growth of our system. But the investment from Southmark means much, much more:

Member benefits — One of San Jacinto's wholly-owned subsidiaries is National American Corporation, or NACO, which also operates a network of over 40 quality membership resorts. Together, the two systems form the largest and highest-quality network in the industry. We are convinced that more resorts will mean happier members and more sales.

Financial integrity — Southmark brings to Trails the experience, management skill and financial strength to secure Thousand Trails' position as an industry leader and resort of choice for its many loyal members. The past few years have seen much financial instability for the industry and for Trails. This is beginning to change, as evidenced by Trails' return to profitability in first quarter 1988, the first black ink we have recorded for a full quarter since 1985. Additionally, the company generated positive cash flow from operations last year. This increasing generation of cash is continuing in 1988.

Operational efficiencies — The reductions in administrative and marketing expenses that your management began in 1986 were continued in 1987. By combining certain common functions, Trails and NACO have accelerated those cost-savings — and without reducing the quality of member service that's expected at our preserves. In the first five months of 1988, for example, Thousand Trails has reduced its general and administrative costs by 23 percent.

Marketing enhancements — Efforts are actively underway to sell existing and new Trails members on the benefits of a membership that allows use of NACO's system of resorts. A reciprocal arrangement is being offered to NACO members. To date, such sales are progressing according to plan, providing a doubling of parks available to members and additional cash flow to your company.

Your management team, which includes some people new to Thousand Trails, has many, many years of experience in the resort and leisure industry. We are committed to building on the tradition of quality expected by our members and to making the Thousand Trails membership the standard of excellence in its industry.

Much progress has been made already:

■ The recapitalization of Trails and reduction of debt have restored the positive spread between interest income and interest expense — an important milestone in our return to profitability.

■ Revenues from annual membership dues are fully covering resort operational costs for the first time in the company's history.

■ Three Trails preserves were closed in early 1988 as a result of their low use. Members whose home resorts are among those three are being transferred to other nearby preserves.

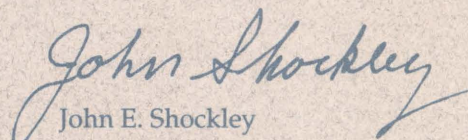
Trails has been positioned to be profitable on lower membership sales. While we achieved our goals for sales of new memberships and marketing expenses in first quarter 1988, we do not intend to make a substantial increase in sales until we see an improvement in the market for memberships.

In closing, your management would like to thank our 93,000 members for their support and patience during this time of change.

Also, the entire staff of Thousand Trails, at headquarters and around our resort system, has endured a couple of difficult years; we are grateful for their forbearance and diligence through some unsettled months.

Finally, to mirror the fiscal year of Southmark and San Jacinto, Thousand Trails will report annual results for a year ending June 30 in the future. As such, we look forward to communicating our progress to you again very soon.

Sincerely yours,


John E. Shockley
President and Chief Operating Officer

THOUSAND TRAILS, INC.

DOCUMENTS INCORPORATED BY REFERENCE

Document

How in Form 10-K

The Company's annual report to shareholders for the year ended December 31, 1987, is incorporated by reference to the Securities and Exchange Commission's Form 10-K for the year ended December 31, 1987, filed with the Commission on March 22, 1988.

FORM 10-K

1 YEAR

Annual Report Pursuant to Section 13 or 15(d) of

The Securities Exchange Act of 1934

THOUSAND TRAILS, INC.

A Thousand Trails member for the year ended December 31, 1987, is incorporated by reference to the Securities and Exchange Commission's Form 10-K for the year ended December 31, 1987, filed with the Commission on March 22, 1988.

In November 1987, the Company's annual report to shareholders for the year ended December 31, 1987, is incorporated by reference to the Securities and Exchange Commission's Form 10-K for the year ended December 31, 1987, filed with the Commission on March 22, 1988.

Securities registered pursuant to Section 12(b) of the Act: None

On March 22, 1988, the aggregate market value of the voting stock held by nonaffiliates of the registrant was \$15,832,000.

As of March 22, 1988, the registrant had 1,000,000 shares of common stock outstanding, of which 1,000,000 shares were held by nonaffiliates of the registrant.

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
2-65020

THOUSAND TRAILS, INC.

(Exact name of registrant as specified in its charter)

Washington
(State or other jurisdiction of
incorporation or organization)

91-1280876
(I.R.S. Employer
Identification No.)

15375 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 X

No

On March 22, 1988, the aggregate market value of the voting stock held by nonaffiliates of the registrant was \$15,838,000.

Number of shares of Common Stock (no par value) of the registrant outstanding as of March 22, 1988: 24,022,161.

THOUSAND TRAILS, INC.

DOCUMENTS INCORPORATED BY REFERENCE

| <u>Document</u> | <u>Item in Form 10-K</u> |
|---|--------------------------|
| The Company's Proxy Statement to Shareholders for its 1988 Annual Shareholders' Meeting | Part III (Items 10-13) |

PART I

ITEM 1. BUSINESS

Thousand Trails, Inc. (the "Company") owns and operates one of the largest membership-based destination campground resort systems 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. The resorts are used by both members who bring their own recreational vehicle, and by those who rent Company-owned travel trailers or cabins located at the resorts.

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. There were 92,820 memberships outstanding at December 31, 1987, approximately 59,000 (63%) of which were fully paid and the balance of which are being purchased on an installment basis.

In November 1987, Southmark Corporation of Dallas, Texas, acquired 66.9% of the outstanding Common Stock of the Company. Southmark also owns 100% of the outstanding common stock of National American Corporation ("NACO"), which is engaged in substantially the same business as the Company. See "Combination of the Company and NACO."

Resort Facilities

The Company presently owns and operates a network of 39 resorts located in 15 states and British Columbia, Canada. The location and year of acquisition of each of the 39 operating resorts are indicated on the map located on page 6.

Between 1983 and 1985, the Company rapidly acquired and developed new properties in order to establish a national network of resorts. This network reached a peak of 43 resorts in 1986 and 1987. As part of its efforts to reduce costs, the Company has announced its intention to discontinue operations at four of the 43 resorts. The closures are scheduled to occur on April 30, 1988. See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations."

The resorts feature campsites with electrical and water connections for recreational vehicles, restroom and shower facilities, rental trailers or cabins, and other recreational amenities. See the Facilities and Amenities Chart on page 7. At each resort, the Company employs a recreational staff to organize activities for members and a year-round maintenance and security staff.

Memberships

Prior to 1983, the Company sold camping memberships designed for owners of recreational vehicles ("RVs"). During 1983, the Company purchased travel trailers, installed them on its resorts for use by members, and began selling vacation memberships to individuals who do not own a RV as well as to owners of RVs. In 1985, the Company began selling a combined membership, called a resort membership, which entitles the member's family to rent a Company-owned travel trailer or, at the member's option, to use an individual campsite without charge in a RV provided by the member.

All 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, the Company does not contractually obligate itself to provide additional facilities at any future date.

Prior to 1986, the Company sold only lifetime memberships which could be used for the lifetime of the members and allowable transferee members. During 1986 and 1987, the Company also sold non-transferable memberships which expire after a definite term ranging from 3 to 15 years. Approximately 33% of the Company's membership sales in 1987 were term memberships. The sale of term memberships has been discontinued for 1988.

The lifetime memberships currently sold by the Company cannot be transferred except under certain circumstances. Transfers under the current contract are not permitted at a price higher than the purchase price paid by the member plus a transfer charge payable to the Company. The number of membership transfers has been less than 1.2% of the total memberships outstanding at the end of each year.

The Company presently sells a resort membership for \$5,995, which entitles the member's family to use the Company's resorts. In addition, pursuant to an agreement with NACO, the Company sells an upgrade to this membership for \$1,495, which entitles the member's family to use also the network of resorts operated by NACO. The combined membership gives the member's family use of 78 resorts. The Company is also marketing this membership upgrade to its existing members at prices ranging from \$199 to \$1,495, depending on the price paid by the member for his or her original membership. As part of this upgrade, existing members agree to increase their annual dues. Through February 29, 1988, the Company had sold 273 of the upgraded memberships.

Marketing Programs and Strategy

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 the Company has a joint marketing arrangement, including Fleetwood Industries, Camping World, and FMCA.

Since 1985, the Company and other companies in the membership campground industry have experienced rising marketing costs as a result of decreases in the response rate to traditional marketing programs and, in particular, direct mail solicitations. As a result, the Company has made increased use of marketing programs involving more selective targeting of tour recipients and emphasizing referrals of prospective members by existing members and independent contractors paid to solicit referrals. The Company believes that such programs may result in lower marketing costs as a percentage of 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 may eventually lead to reduced sales volume and reduced profitability. As a result, the Company is exploring continually alternative membership programs to broaden its appeal within a given market area, such as the marketing arrangement with NACO discussed above.

Membership Sales

Membership sales are made primarily at Company resorts after a tour of the resort. 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 65% in 1985, 67% in 1986, and 58% in 1987. 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.

Resort Operations

At each operational resort, the Company employs a manager, supervisor, and staff to provide recreational programs, security, and maintenance. The resorts are open year round, but usage of resorts by members is greatest during the summer months.

In 1987, annual membership dues and other resort revenues provided fully for the expenses of operating the resorts and related general and administrative expenses. Dues are subject to annual increases not greater than the percentage increase in the consumer price index, except that, for memberships sold prior to April 1987, the dues of senior citizen and disabled members, of which there were 27,065 as of December 31, 1987, are not subject to escalation. Average annual membership dues as of December 31, 1987, were \$245. Annual dues for new members are currently \$330.

Membership Receivables

Memberships may be purchased for cash or on an installment basis. The downpayment on installment sales must be at least 10% of the sales price and averaged approximately \$1,658 in 1987. The outstanding balance is payable in monthly installments over periods ranging from 10 to 84 months, with the unpaid balance bearing interest at fixed rates which averaged 14.6% on contracts executed in 1987 and which vary depending upon the size of the downpayment and length of the contract. The average term of installment contracts executed in 1987 was 72 months. In 1987, 2.9% 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, 1987, approximately 59,000 (63%) were fully paid. The total contracts receivable portfolio as of December 31, 1987 was approximately \$106,211,000 with an annual yield of 15%.

The Company allows new members who do not wish to make the downpayment at the time of sale to pay the full downpayment over a period of up to four months without interest. Such downpayment-financed sales are recorded as sales and membership contracts receivable at such time as sufficient payments have been made to aggregate the minimum downpayment; however, in the interim, the members are entitled to limited membership privileges. During 1985, 1986, and 1987, respectively, 16.6%, 18.1%, and 11% of the Company's membership sales were downpayment-financed.

The Company has increased its cash flow by developing programs to encourage members to pay their accounts in full prior to maturity. In 1985, 1986, and 1987, these programs generated additional principal payments of approximately \$12,735,000, \$14,413,000, and \$13,247,000, respectively, in excess of scheduled payments.

Arrangements with NACO

In December 1987, the Company entered into a servicing agreement with NACO pursuant to which NACO is collecting contracts receivable for the Company for which the Company will pay NACO \$3.50 per month for each active contract receivable relating to the membership purchase price and \$.30 per month for each active receivable relating to annual dues. The Company paid NACO \$76,000 under this agreement for services rendered during December 1987, and expects to pay NACO approximately \$140,000 per month for NACO's services in 1988 under this agreement. The Company expects this agreement to decrease its collection costs by approximately \$1,185,000 in 1988 compared with 1987.

The Company and NACO have entered into an agreement pursuant to which the Company and NACO granted to each other the right to sell to their respective members the ability to use the resort system operated by the other company. The Company and NACO are each entitled to retain the proceeds from sales to its own members, and each will bear its respective incremental costs associated with providing resort amenities to members who participate. See "Memberships" above.

Also, pursuant to an agreement with NACO, the Company will make a substitute resort operated by NACO available for use by members of the Company who purchased their membership at three

resorts which the Company plans to close in 1988. The Company will pay NACO its costs, approximately \$194,000 per year, for allowing these members to use the NACO resorts, but the Company will benefit from an overall reduction in costs. See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations."

In the future, NACO will perform management and certain other services for the Company and the Company will perform reservation and certain other services for NACO. See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations." The Company owes NACO approximately \$145,000 for management services rendered by NACO officers and employees, and the direct expenses of those persons, during the period from November 6, 1987 through December 31, 1987. For 1988, the Company has agreed to pay NACO \$15,000 per month for executive management services to be provided by Messrs. Steelman and Shockley on an as-needed basis.

In February 1988, the Company also sold to NACO certain computer and office equipment and other personal property for an aggregate sales price of \$150,000. The Company believes the sales price equalled the fair market value of this property.

NACO West Incentive Sales, Inc. ("NWIS"), an indirect wholly-owned subsidiary of NACO, buys, in volume, merchandise premiums which are offered to prospective members as an inducement to visit campgrounds. NWIS is a purchasing entity and resells these premiums to NACO and the Company at NWIS' cost. In February 1988, the Company paid approximately \$1,300,000 to NWIS to acquire premiums.

Combination of the Company and NACO

The Company reported in January 1988 that it was negotiating with its majority shareholder, Southmark Corporation, to acquire all of the capital stock of NACO in exchange for equity securities of the Company. NACO is a wholly-owned subsidiary of Southmark. The transaction was subject to approval of the Board of Directors of both the Company and Southmark and to approval of the Company's shareholders as discussed below. The Company announced in April 1988 that these negotiations have been discontinued.

At the Company's 1988 annual shareholders meeting, which is scheduled for August 1988, the shareholders will be asked to approve an amendment to the Company's Articles of Incorporation which, if adopted, will increase the total number of authorized shares of Common Stock from 25 million shares to 75 million shares, and authorize 2 million shares of Preferred Stock. Approval of this proposed amendment would be necessary for the Company to complete the proposed acquisition of NACO. In general, it was contemplated that Southmark would contribute the capital stock of NACO to the Company in exchange for Common and Preferred Stock of the Company such that, after the exchange, and upon conversion of the Preferred Stock, Southmark would own approximately 88% of the voting control of the Company.

Southmark has informed the Company that it intends to transfer to its wholly-owned subsidiary, San Jacinto Savings Association, all of Southmark's interest in the Company and NACO. San Jacinto is a Texas-chartered, federally-insured savings and loan association. This transfer to San Jacinto is subject to approval of the Federal Home Loan Bank Board.

Employees

At December 31, 1987, the Company had approximately 861 full-time employees, of which 233 were executive, clerical, marketing, and administrative personnel employed at the Company's corporate headquarters in Bellevue, Washington. At December 31, 1987, the Company also had approximately 41 part-time employees engaged in sales, operations, and construction activities. During the summer of 1987, the Company had peak employment of approximately 1,544 persons.

Following Southmark's acquisition of control in November 1987, the number of headquarters employees was reduced significantly in order to achieve operating efficiencies and to reduce general and administrative costs. It is contemplated that certain administrative and financial functions of the

Company will be merged with similar functions of NACO, or that NACO will provide those services on a fee basis, at a cost to the Company significantly less than prior operating costs.

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 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. 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 39 operating resorts, although the Company has not yet received permits necessary for all of its planned campsites. See table on page 11.

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. Most of the 15 states in which the Company does business have enacted legislation governing sales activities of the type conducted by the Company. The legislation generally requires comprehensive disclosure to prospective purchasers and a three- to five-day right of rescission.

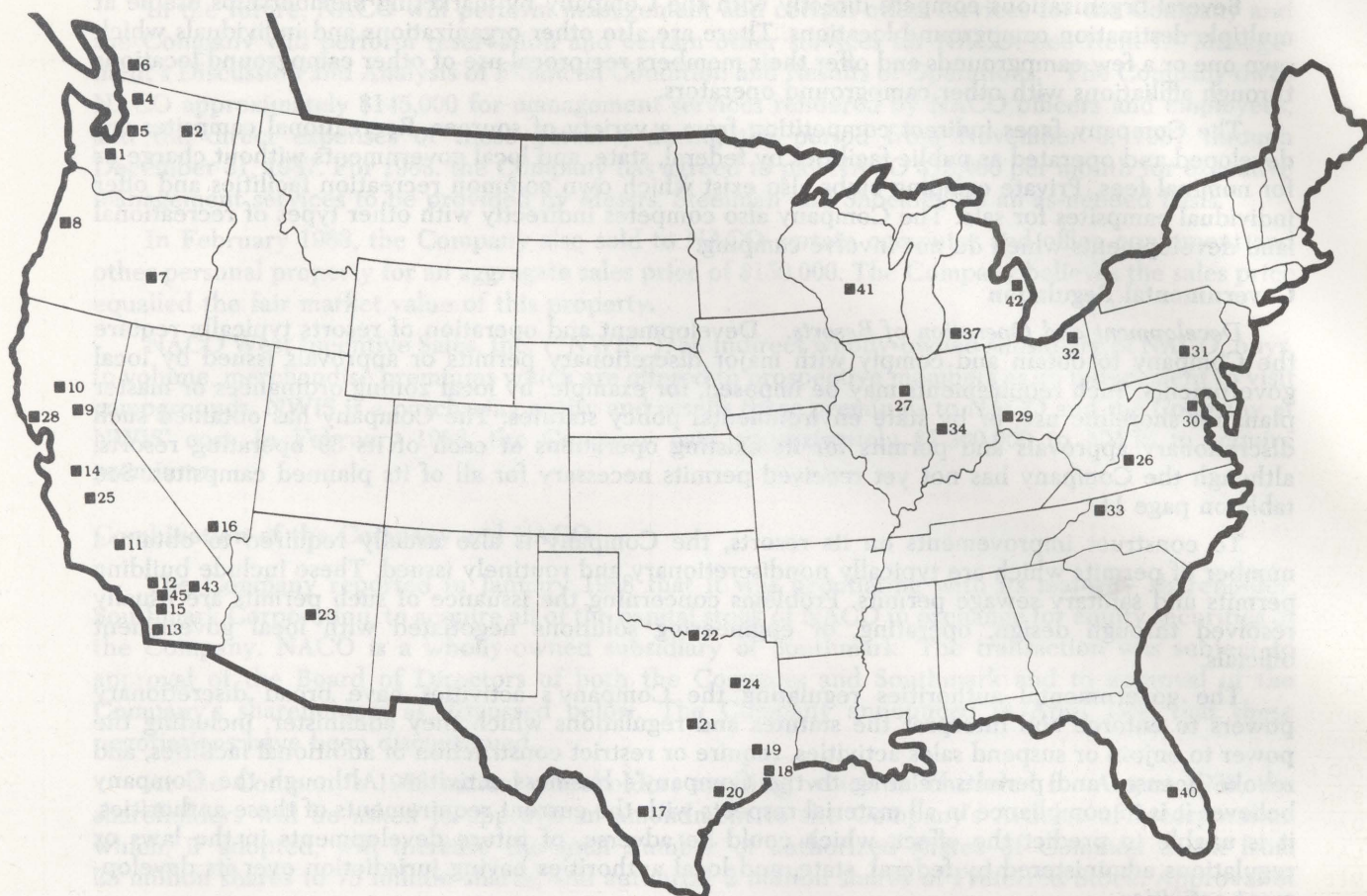
The Company's marketing and sales activities are also regulated by a variety of consumer protection statutes and regulations, including general lottery laws and various types of advertising and promotion laws. To control practices that might violate consumer protection laws and regulations or give rise to such complaints, the Company monitors its tour solicitation programs, and attempts are made to standardize sales presentations. The Company 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.

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.

Resort Locations

Set forth on the following page are the locations of the Company's 39 operating resorts and the year of acquisition of each resort. The table on page 7 includes information on the facilities which have been completed at the Company's operating resorts as of December 31, 1987.

Thousand Trails[®] Inc.



Northwest

- 1972 Chehalis, WA ■1
- 1975 Leavenworth, WA ■2
- 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

Southwest

- 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

Texas

- 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

East Coast

- 1983 Lynchburg, VA ■26
- 1984 Chesapeake Bay, VA ■30
- 1984 Hershey, PA ■31
- 1984 Forest Lake, NC ■33
- 1984 Orlando, FL ■40

Midwest

- 1983 Fox River, IL ■27
- 1984 Wilmington, OH ■29
- 1984 Kenisee Lake, OH ■32
- 1984 Horseshoe Lakes, IN ■34
- 1984 Nottawa Lake, MI ■37
- 1984 Wisconsin Dells, WI ■41
- 1984 St. Clair, MI ■42

Thousand Trails Inc.

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 | 16 | 1 | 7 | 2 | 1 | 1 | | | 1 | | 1 | |
| LEAVENWORTH | 2 | 272 | | 1 | 1 | 2 | 4 | 2 | 1 | 1 | 6 | 19 | 1 | 8 | 2 | 1 | 1 | 4 | | 1 | | 2 | |
| MT. VERNON | 4 | 285 | 10 | 2 | 1 | 1 | | 2 | 3 | 1 | 5 | 12 | 1 | 4 | 3 | 1 | | 2 | | 1 | | 1 | |
| LA CONNER | 5 | 316 | | 1 | 1 | | | 2 | 1 | 1 | 6 | 22 | | 3 | 2 | 1 | 1 | | 1 | 1 | 1 | 1 | 18 |
| CULTUS LAKE | 6 | 471 | 12 | 1 | 1 | 1 | 2 | 2 | 2 | 1 | 4 | 6 | | 2 | 2 | 1 | | 1 | | 1 | | 1 | |
| BEND | 7 | 301 | | 1 | 1 | 2 | 2 | 1 | 1 | 1 | 6 | 18 | 1 | 4 | 2 | 1 | | | | 1 | | 1 | |
| PACIFIC CITY | 8 | 316 | 1 | 1 | 1 | 1 | | 2 | | 1 | 5 | 34 | 1 | 4 | 3 | 1 | | 1 | | | | 1 | |
| DONNER PASS | 9 | 408 | | | 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 | 48 | | 8 | 3 | 1 | 1 | 1 | | 1 | 1 | 1 | |
| SOLEDAD CANYON | 11 | 1027 | 9 | 1 | 1 | 2 | 2 | 7 | 1 | 1 | 12 | 79 | | 13 | 9 | 1 | 1 | 5 | 1 | 6 | | 1 | |
| IDYLLWILD | 12 | 287 | 38 | 1 | 1 | 1 | | 3 | | 1 | 6 | 32 | 1 | 4 | 3 | 1 | 1 | 2 | | 2 | | 3 | |
| PIO PICO | 13 | 500 | 45 | 1 | 1 | 2 | | 3 | 2 | 1 | 6 | 45 | 2 | 12 | 3 | 1 | 1 | 8 | 2 | 1 | | 2 | |
| SAN JOSE | 14 | 318 | 28 | 1 | 1 | 1 | 1 | 1 | 2 | 1 | 5 | 40 | | 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 | 6 | | 1 | 1 | | 2 | | | 3 | 21 | | 2 | 1 | 1 | | 1 | | 1 | | 3 | |
| MEDINA LAKE | 17 | 387 | | | 1 | 1 | | 1 | 1 | 1 | 3 | 55 | 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 | 40 | 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 | | 2 | 2 | 2 | | 1 | 3 | 35 | | | 3 | 1 | | 1 | 1 | 2 | | 1 | |
| LAKE TEXOMA | 22 | 259 | 2 | 1 | 1 | 2 | | 1 | 1 | 1 | 4 | 53 | 1 | 6 | 2 | 1 | | 2 | 2 | 1 | 1 | 1 | 18 |
| VERDE VALLEY | 23 | 346 | | 1 | 1 | 1 | | 2 | 1 | 1 | 3 | 46 | | 2 | 3 | 1 | | 1 | 1 | 2 | | 1 | |
| LAKE TAWAKONI | 24 | 318 | 1 | 1 | 1 | 2 | | 1 | 1 | 1 | 5 | 62 | 1 | 8 | 2 | 1 | | 6 | 2 | 2 | 1 | | |
| SAN BENITO | 25 | 518 | 51 | 1 | 1 | 2 | | 1 | 1 | 1 | 7 | 60 | | 6 | 4 | 1 | 1 | 1 | 1 | 2 | | 2 | |
| 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 | 47 | 1 | 7 | 4 | 1 | | 6 | | 3 | 1 | | 18 |
| DUNCANS MILLS | 28 | 123 | | | 1 | | | | | | 2 | 30 | | 2 | 1 | | | 1 | 1 | 1 | | | |
| WILMINGTON | 29 | 126 | | 1 | | 2 | 1 | 2 | | 1 | 2 | 25 | 1 | 6 | 2 | 1 | | 4 | 1 | 1 | | 1 | |
| CHESAPEAKE BAY | 30 | 316 | | 1 | 1 | 2 | 1 | 2 | 2 | 1 | 4 | 105 | 1 | 4 | 3 | 1 | 1 | 1 | 1 | 2 | 2 | 1 | 18 |
| HERSHEY | 31 | 223 | | 1 | 1 | 1 | 2 | 1 | | 1 | 3 | 45 | 1 | 4 | 1 | | 1 | | 1 | 1 | | 1 | |
| KENISEE LAKE | 32 | 119 | | | 1 | | | 2 | | | 2 | 14 | | 2 | 2 | 1 | 1 | 1 | 1 | 1 | | | |
| FOREST LAKE | 33 | 214 | 10 | 1 | 1 | 1 | 2 | 1 | 1 | 1 | 2 | 46 | | 2 | 2 | | 1 | 2 | | 1 | | | 18 |
| HORSESHOE LAKES | 34 | 119 | | | 1 | | 2 | 1 | | | 1 | 24 | | 4 | 4 | 1 | | 2 | | 1 | | | |
| NOTTAWA LAKE | 37 | 100 | | 1 | | 1 | | 1 | | 1 | 3 | 8 | | 4 | 2 | | 1 | | | 1 | 1 | | |
| ORLANDO | 40 | 477 | | | 1 | 1 | 1 | | | 1 | 4 | 75 | 1 | 6 | 2 | 1 | 1 | 7 | 1 | | 1 | 1 | |
| WISCONSIN DELLS | 41 | 52 | | | 1 | 1 | | 1 | | 1 | 1 | 16 | | 2 | 2 | | | 2 | | 1 | 1 | 1 | |
| SAINT CLAIR | 42 | 101 | | | 1 | 1 | | | | | 1 | 19 | | 2 | 2 | | 1 | | | 1 | | | |
| PALM SPRINGS | 43 | 397 | | | 1 | 1 | | 1 | | | 4 | 33 | | 4 | | 1 | | 2 | 1 | | | 3 | |
| PALOMAR VALLEY | 45 | 286 | | | 1 | 1 | | 1 | | 1 | 3 | 11 | | 6 | 1 | | | 2 | | 1 | | 1 | |

ITEM 2. PROPERTIES

The Company's principal properties are its 39 operating resorts. See Item 1. "Business—Resort Facilities." Except as noted below, the Company owns all of its resorts subject to mortgages in favor of its principal lenders 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.

In addition to its 39 operating resorts, the Company has six properties, including the four resorts to be closed in early 1988, which are classified on its balance sheet as investment in real estate. The Company intends to sell or otherwise dispose of its investment in real estate.

The Company's corporate offices are located in a facility which the Company leases at 15375 S.E. 30th Place, Bellevue, Washington 98007.

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.

After the Company commenced sales and marketing activities in Illinois in 1984, the Attorney General of that state notified the Company that it believed certain of the Company's sales and marketing practices violated 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 settlement. If a settlement is not reached, the Attorney General has threatened to seek 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 class action complaint filed in Seattle in federal district court naming the Company, two of its former principal officers, and its former 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, 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. In early 1988, the Company filed a motion for summary judgment which has not been decided, and the Company and its counsel believe it is too early to assess the ultimate outcome. However, based on the discovery which has been completed 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 1987.

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 1986 and 1987.

| <u>Bid</u> | <u>High</u> | <u>Low</u> |
|----------------------|---------------------------------|--------------------------------|
| 1986 | | |
| First Quarter | 8¾ | 4¼ |
| Second Quarter | 7 | 4 |
| Third Quarter | 5¾ | 2¾ |
| Fourth Quarter | 3¼ | 1¾ |
| 1987 | | |
| First Quarter | 3¾ | 2 ⁵ / ₁₆ |
| Second Quarter | 3 ¹¹ / ₁₆ | 2¾ |
| Third Quarter | 3½ | 2 ⁷ / ₁₆ |
| Fourth Quarter | 3¼ | 1¾ |

The closing price of the Company's Common Stock on the NASDAQ National Market System as of March 22, 1988, was \$2 per share. The approximate number of record holders of the Company's Common Stock as of March 22, 1988 was 2,560.

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 banks' approval.

ITEM 6. SELECTED FINANCIAL DATA

The selected financial information set forth on the following page has been taken from the Consolidated Financial Statements included in this report and from previously published financial information of the Company not appearing herein. Such selected financial information should be read in conjunction with the Consolidated Financial Statements, and the notes thereto, appearing elsewhere herein.

(Dollars in thousands, except per share amounts)

Statement of Operations Data

| | Years Ended December 31, | | | | |
|---|--------------------------|------------------|-----------------|--------------------|--------------------|
| | 1983 | 1984 | 1985 | 1986 | 1987 |
| REVENUES | | | | | |
| Membership sales, net | \$ 75,994 | \$111,103 | \$109,959 | \$ 40,629 | \$ 30,387 |
| Resort operations | 10,104 | 15,465 | 22,725 | 28,019 | 30,876 |
| Interest | 10,147 | 16,067 | 23,406 | 25,534 | 19,571 |
| Total revenues | 96,287 | 143,639 | 156,180 | 94,182 | 81,088 |
| EXPENSES | | | | | |
| Selling and marketing | 35,209 | 54,181 | 74,081 | 41,766 | 23,267 |
| Real estate adjustment(1) | — | — | — | 63,281 | — |
| Resort operations | 9,615 | 16,403 | 23,202 | 30,428 | 30,668 |
| Interest | 3,957 | 5,124 | 16,286 | 27,818 | 21,421 |
| Effect of recapitalization | — | — | — | — | 38,210 |
| Total expenses | 73,655 | 108,243 | 153,200 | 195,585 | 136,085 |
| INCOME (LOSS) BEFORE EXTRAORDINARY ITEMS | 12,004 | 19,110 | 1,788 | (53,399) | (55,015) |
| EXTRAORDINARY ITEMS(2) | | | | | |
| Gain from extinguishment of debt, net of tax | — | — | — | 2,977 | 38,210 |
| NET INCOME (LOSS) | <u>\$ 12,004</u> | <u>\$ 19,110</u> | <u>\$ 1,788</u> | <u>\$ (50,422)</u> | <u>\$ (16,805)</u> |
| PRIMARY EARNINGS PER SHARE | | | | | |
| Income (loss) before extraordinary items .. | \$1.23 | \$1.78 | \$.17 | \$ (5.16) | \$ (4.34) |
| Extraordinary items | — | — | — | .29 | 3.01 |
| Net earnings (loss) | <u>\$1.23</u> | <u>\$1.78</u> | <u>\$.17</u> | <u>\$ (4.87)</u> | <u>\$ (1.33)</u> |
| FULLY DILUTED EARNINGS PER SHARE | | | | | |
| Income (loss) before extraordinary items .. | \$1.21 | \$1.76 | \$.16 | \$ (5.16) | \$ (4.34) |
| Extraordinary items | — | — | — | .29 | 3.01 |
| | <u>\$1.21</u> | <u>\$1.76</u> | <u>\$.16</u> | <u>\$ (4.87)</u> | <u>\$ (1.33)</u> |

Balance Sheet Data

| | Years Ended December 31, | | | | |
|--|--------------------------|-----------|-----------|-----------|-----------|
| | 1983 | 1984 | 1985 | 1986 | 1987 |
| Contracts receivables, net | \$ 82,373 | \$134,351 | \$169,282 | \$138,660 | \$ 71,499 |
| Real estate, net | 53,181 | 105,770 | 139,734 | 75,867 | 55,588 |
| Total assets | 151,767 | 270,741 | 353,818 | 241,442 | 140,218 |
| Bank borrowings and secured debt | 53,239 | 122,117 | 125,493 | 129,245 | 52,233 |
| Subordinated notes | — | — | 73,893 | 56,371 | 12,359 |
| Stockholders' equity | 60,299 | 80,917 | 78,697 | 28,547 | 36,012 |
| Book value per share | \$5.91 | \$7.59 | \$7.63 | \$2.76 | \$1.50 |

(1) See Note G to the accompanying financial statements included herein.

(2) See Note C to the accompanying financial statements included herein.

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

Results Of Operations

The Company incurred a loss of \$50.4 million in 1986, and \$16.8 million in 1987. The loss in 1986 included a \$63.3 million writedown of resort land and improvement costs and a \$19.2 million provision for doubtful accounts. The loss in 1987 reflected the effects of lower membership sales. Further information with respect to various elements of the Company's operating results are included in the following paragraphs.

Membership Sales. The substantial declines in revenues from membership sales during 1986 and 1987 were due primarily to the Company's decision to limit marketing activities to its most cost-effective resorts. This decision was made in response to lowered expectations of the Company's ability to market memberships, particularly in economically depressed regions, and due to financial constraints on the Company's operations. Marketing expenses and resort land and improvement costs charged to membership sales also declined substantially during the period. However, as a percentage of membership sales, the aggregate of these expenses increased from 87% in 1985 to 134% in 1986, and decreased to 95% in 1987. The variations primarily reflect that the decline in membership sales in 1986 occurred in advance of the reduction in marketing expenses and that in 1986 land and improvement costs included higher estimated development expenses.

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, 1987, in the following table. The cost of existing resort land and improvements in this table results from the application of certain accounting procedures required as a result of Southmark's acquisition of the Company. Other information in the table relating to memberships available for sale and planned campsites is based upon management's estimate. See "Adjustment in Valuation of Real Estate Assets" below.

| Below. | | | | | | | | | | Cumulative |
|----------------------|-----------------------------------|--------------------|--------------------------|--------------------------------------|------------------------|----------|----------|--|--|---|
| Area | Number of Operating Resorts | Average Acreage | Member- ships Sold | Memberships Available For Sale | Campsites | | | Existing Resort Land and Improvements | Estimated Cost of Additional Planned Improve- ments | Costs Expensed to Member- ship Sales |
| | | | | | Total Planned | Existing | Approved | | | |
| | | | | | (Dollars in Thousands) | | | | | |
| Northwest | 7 | 271 | 19,713 | 9,407 | 2,912 | 2,241 | 2,429 | \$ 17,295 | \$ 2,354 | \$13,799 |
| Southwest | 13 | 282 | 45,441 | 31,359 | 7,680 | 5,041 | 6,675 | 66,672 | 17,745 | 52,390 |
| Texas | 7 | 242 | 12,159 | 32,021 | 4,418 | 1,744 | 3,236 | 21,208 | 13,531 | 9,009 |
| East Coast | 5 | 244 | 10,616 | 26,384 | 3,700 | 1,489 | 4,003 | 24,972 | 13,757 | 9,875 |
| Midwest | 7 | 209 | 484 | 46,489 | 5,138 | 688 | 2,137 | 9,700 | 25,284 | 4,167 |
| | 39 | | 92,820 | 145,660 | 23,848 | 11,203 | 18,480 | \$139,847 | \$72,671 | \$89,220 |

The Company allocates its land acquisition costs and actual and estimated future resort improvement costs to membership sales based on the total number of memberships that it expects to sell. For the Company to amortize the total of actual and estimated future land and improvement costs for the above 23,848 existing and planned campsites, it will be necessary to sell the approximately 145,600 memberships that are currently available for sale.

The Company provides for estimated losses on installment sales of memberships based on its historical collection experience. The amount provided in 1986 increased substantially, as a percentage of membership sales, due to a higher default rate experienced in 1986. This default rate is believed to reflect depressed economic conditions in Texas, a higher volume of sales to individuals who do not own recreational vehicles and who tend to make less use of the Company's resorts, and negative publicity concerning the financial condition of the Company in particular and the industry in general. The provision for doubtful accounts in 1987 is approximately the same percentage of sales as in 1985, and the Company expects this provision to remain at a similar level during 1988.

Resort Operations. Revenues from resort operations have increased as the base of members grew from 69,000 at January 1, 1985, to 93,000 at December 31, 1987, and the Company expects this source of revenues to continue to increase as new memberships are sold. As a result of cost reduction efforts, losses from resort operations in 1985 and 1986 have been reversed and resort operations generated a profit of \$566,000 in 1987. In a continuing effort to improve the financial results of resort operations, during 1988 the Company will discontinue operations at four resorts that have operated at a loss due to the small number of memberships that have been sold.

Interest Income and Expense. The changes in interest income for membership contracts reflect that the average balance of outstanding contracts receivable increased during 1986, but declined in 1987. The 1987 decline was due to principal repayments and write-offs exceeding the rate of new receivables being generated from membership sales. Also, in November 1987, the Company sold \$30 million of contracts receivable to Southmark, which will result in further declines in interest income in 1988.

The increase in interest expense in 1986 is primarily due to higher outstanding loan balances. The 1987 decrease reflects a reduction in outstanding balances, in part due to the December 1986 repurchase of \$17,870,000 principal amount of Senior Subordinated Notes.

As a result of the recapitalization occurring in November 1987, the Company expects that its interest expense during 1988 will be substantially less than in prior years, and possibly as low as \$8.9 million.

Adjustment in Valuation of Real Estate Assets. Resort land and improvements are carried at the lower of cost or estimated net realizable value. Net realizable value is estimated based on anticipated membership sales, and is reviewed annually in the light of current levels of membership sales, resort utilization rates, cost of improvements required to market additional memberships, and the availability of necessary financial and other resources. In 1986, this review resulted in a reduction of \$63.3 million in the Company's estimate of the net realizable value of its real estate assets, and this amount was included as an expense in that year. In 1987, the Company reduced the value of its real estate assets by an additional \$17.2 million as described in Note C of Notes to Consolidated Financial Statements.

Other Expenses. General and administrative expenses have increased as a percentage of revenues due to the 1986 and 1987 declines in membership sales. However, staff reductions made in late 1986 resulted in a decline in the gross amount of these expenses in 1987. Also, during 1987 the Company reduced the space under lease for its corporate headquarters from 104,883 square feet to 64,712 square feet, which will result in savings of \$813,000 per year beginning in 1988. In addition, the Company has begun to participate in Southmark's insurance program, which is expected to result in annualized savings of more than \$1 million per year beginning in 1988. Membership contract collection expense has remained relatively stable in recent years, but is expected to decline by \$1.2 million beginning in 1988 as a result of large staff reductions made possible by the transfer of collection activities to NACO. In 1988, management intends to reduce further the Company's general and administrative expenses as a result of consolidation of functions with NACO.

Effects of Recapitalization. As described more fully in the Financial Statements, the Recapitalization of the Company resulted in a reduction in the carrying value of its assets, including receivables and resort land and improvements. In future years, this reduction will result in increased profit on the collection of existing receivables and a decrease in the amount of land and improvements expensed per sale.

Liquidity and Capital Resources

The Company incurs substantial resort acquisition, improvement and marketing costs prior to and concurrently with membership sales. However, members typically pay for their memberships in installments over periods of up to 84 months, and the Company on average receives only 28% of sales

revenues in cash at the time of sale. As a result, the Company requires substantial long-term and current capital resources in order to acquire, develop and market its resorts.

Cash flow has improved from a negative \$56 million in 1985 to a positive \$13 million in 1987. This improvement reflects the effects of the Company's decision to reduce its marketing and resort development activities and reductions in interest expense. The Company anticipates that its cash flow will be aided in 1988 by further substantial reductions in interest expense associated with the November 1987 recapitalization, and by reduction in general and administrative and receivables collection expenses as discussed above. However, cash flow from collections of receivables may decline due to lower outstanding balances and due to difficulty in continuing to obtain prepayments by offering incentives. Also, \$1.5 million of cash will be required during 1988 for federal and state income taxes with respect to 1987. While the Company anticipates that the net effect of these various factors will be positive cash flow for 1988, cash flow will be heavily affected by the amount of the Company's memberships sales and its success in collecting receivables.

On February 12, 1988, the Company completed the restructuring of its previous revolving line of credit into a \$33,300,000 term loan payable in 12 equal quarterly installments commencing April 1, 1988. This term loan accrues interest at prime.

The restructuring also provided for a new committed revolving credit line from the Company's senior lenders in the maximum amount of \$37,600,000, commencing April 1, 1988. This revolving credit line accrues interest at the prime lending rate plus 1½%, and borrowings may not exceed 70% of the aggregate amount of the Company's qualifying membership contracts receivable. At December 31, 1987, qualifying membership contracts receivable totaled \$100,700,000, which would permit the Company to borrow the maximum amount. The credit line is secured by substantially all of the Company's assets, and contains performance covenants relating to net worth, marketing expenses, general and administrative expenses, income from resort operations, membership contracts receivable, construction expenditures, and cash flow.

The Company is not planning any substantial increase in its rate of marketing expenses or capital expenditures unless improvements in the markets for its memberships become apparent. Based on its anticipated positive cash flow, on its financial condition following the November 1987 recapitalization, and on the credit available under its restructured bank lending arrangements, the Company believes that its capital resources are sufficient to meet its obligations and to finance its operations during the foreseeable future.

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, 1987 and December 31, 1986.

Consolidated Statements of Operations—Three years ended December 31, 1987.

Consolidated Statements of Changes in Financial Position—Three years ended December 31, 1987.

Consolidated Statements of Stockholders' Equity—Three years ended December 31, 1987.

Notes to Consolidated Financial Statements.

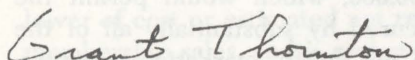
AUDITORS' REPORT

BOARD OF DIRECTORS AND STOCKHOLDERS
THOUSAND TRAILS, INC.

We have examined the consolidated balance sheets of Thousand Trails, Inc. and Subsidiaries as of December 31, 1987 and 1986, and the related consolidated statements of operations, stockholders' equity, and changes in financial position for each of the three years in the period ended December 31, 1987. 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.

In our opinion, the financial statements referred to above present fairly the consolidated financial position of Thousand Trails, Inc. and Subsidiaries at December 31, 1987 and 1986, and the consolidated results of their operations and changes in their financial position for each of the three years in the period ended December 31, 1987, in conformity with generally accepted accounting principles applied on a consistent basis.

We have also examined Schedules IV and VIII of Thousand Trails, Inc. and Subsidiaries as of December 31, 1987, and for each of the three years then ended. In our opinion, these schedules present fairly the information required to be set forth therein.



GRANT THORNTON

Dallas, Texas
April 29, 1988

THOUSAND TRAILS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands)

| | December 31, | |
|---|------------------|------------------|
| | 1987 | 1986 |
| ASSETS | | |
| CASH | \$ 2,683 | \$ 970 |
| CONTRACTS RECEIVABLE, net | 71,499 | 138,660 |
| OPERATING REAL ESTATE, net | 139,847 | 160,916 |
| Costs applicable to membership sales | (89,220) | (87,514) |
| | 50,627 | 73,402 |
| EQUIPMENT, net of accumulated depreciation of \$11,930 and \$10,555 in 1987 and 1986, respectively | 5,528 | 17,008 |
| INVESTMENT IN REAL ESTATE, net | 4,961 | 2,465 |
| OTHER ASSETS | 4,920 | 8,937 |
| | <u>\$140,218</u> | <u>\$241,442</u> |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| ACCOUNTS PAYABLE | \$ 2,912 | \$ 2,902 |
| ACCRUED LIABILITIES | 17,701 | 13,599 |
| BORROWINGS | | |
| Revolving credit agreement | 30,187 | 100,029 |
| Notes and mortgages | 22,046 | 29,216 |
| Subordinated notes | 12,359 | 56,371 |
| Due to Southmark | 11,144 | — |
| DEFERRED INCOME TAXES | — | 780 |
| PREPAID MEMBERSHIP DUES AND DEFERRED REVENUE | 7,857 | 9,998 |
| | 104,206 | 212,895 |
| STOCKHOLDERS' EQUITY | | |
| Common stock, no par value; authorized, 25,000,000 and 15,000,000 shares; issued and outstanding, 24,022,000 and 10,357,000 shares | 51,456 | 27,268 |
| Retained earnings (deficit) | (15,444) | 1,279 |
| | 36,012 | 28,547 |
| | <u>\$140,218</u> | <u>\$241,442</u> |

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

THOUSAND TRAILS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Dollars in thousands, except per share amounts)

| | Years Ended December 31, | | |
|--|--------------------------|--------------------------|------------------------|
| | 1987 | 1986 | 1985 |
| REVENUES | | | |
| Membership sales, net | \$ 30,387 | \$ 40,629 | \$109,959 |
| Resort operations | 30,876 | 28,019 | 22,725 |
| Interest | 19,571 | 25,534 | 23,406 |
| Other | 254 | — | 90 |
| | <u>81,088</u> | <u>94,182</u> | <u>156,180</u> |
| EXPENSES | | | |
| Selling and marketing | 23,267 | 41,766 | 74,081 |
| Resort land and improvement costs | 5,511 | 12,520 | 21,029 |
| Real estate adjustment | — | 63,281 | — |
| Resort operations | 30,668 | 30,594 | 23,202 |
| General and administrative | 17,008 | 19,606 | 18,602 |
| Interest | 21,421 | 27,818 | 16,286 |
| Effect of recapitalization on carrying value of assets | 38,210 | — | — |
| | <u>136,085</u> | <u>195,585</u> | <u>153,200</u> |
| INCOME (LOSS) BEFORE INCOME TAXES AND EXTRAORDINARY ITEMS | (54,997) | (101,403) | 2,980 |
| INCOME TAX PROVISION (BENEFIT) | | | |
| Current | 1,450 | — | — |
| Deferred | (1,432) | (48,004) | 1,192 |
| | <u>18</u> | <u>(48,004)</u> | <u>1,192</u> |
| INCOME (LOSS) BEFORE EXTRAORDINARY ITEMS | (55,015) | (53,399) | 1,788 |
| EXTRAORDINARY ITEMS | | | |
| Gain from extinguishment of debt, less applicable income taxes of \$2,676 in 1986 | 38,210 | 2,977 | — |
| NET INCOME (LOSS) | <u>\$(16,805)</u> | <u>\$(50,422)</u> | <u>\$ 1,788</u> |
| PRIMARY EARNINGS PER SHARE | | | |
| Income (loss) before extraordinary items | \$(4.34) | \$(5.16) | \$.17 |
| Extraordinary items | 3.01 | .29 | — |
| Net earnings (loss) | <u>\$(1.33)</u> | <u>\$(4.87)</u> | <u>\$.17</u> |
| FULLY DILUTED EARNINGS PER SHARE | | | |
| Income (loss) before extraordinary items | \$(4.34) | \$(5.16) | \$.16 |
| Extraordinary items | 3.01 | .29 | — |
| Net earnings (loss) | <u>\$(1.33)</u> | <u>\$(4.87)</u> | <u>\$.16</u> |

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

THOUSAND TRAILS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION
(Dollars in thousands)

| | Years Ended December 31, | | |
|---|--------------------------|----------------|-----------------|
| | 1987 | 1986 | 1985 |
| OPERATIONS | | | |
| Cash received— | | | |
| Membership sales | \$ 9,621 | \$ 19,211 | \$ 34,362 |
| Collections on contracts receivable, including interest | 64,942 | 77,306 | 67,574 |
| Dues and resort revenues | 28,116 | 25,364 | 21,248 |
| Other | 1,636 | 968 | 244 |
| | <u>104,315</u> | <u>122,849</u> | <u>123,428</u> |
| Cash expended— | | | |
| Marketing expenses | 22,080 | 40,334 | 76,146 |
| Administrative and collection expenses | 11,476 | 15,635 | 17,085 |
| Resort operating and administrative expenses | 27,965 | 27,925 | 21,677 |
| | <u>61,521</u> | <u>83,894</u> | <u>114,908</u> |
| Cash provided by operations before debt service and resort acquisition and development | 42,794 | 38,955 | 8,520 |
| Cash expended for resort acquisition and development | (4,038) | (12,356) | (38,440) |
| Interest expense | (20,103) | (26,930) | (18,082) |
| Principal payments on debt related to resort properties | (5,173) | (5,677) | (8,293) |
| Cash provided by (used in) operations | <u>13,480</u> | <u>(6,008)</u> | <u>(56,295)</u> |
| RECAPITALIZATION | | | |
| Proceeds from sale of membership contracts receivable, net of gain of \$737 | \$ 29,263 | — | — |
| Extinguishment of \$43,144 senior subordinated notes and \$49,514 secured bank debt, net of \$38,210 related to reduction of carrying value of assets | (54,448) | — | — |
| Issuance of common stock | 24,185 | — | — |
| Issuance of note to Southmark | 1,000 | — | — |
| Effect of recapitalization | <u>—</u> | <u>—</u> | <u>—</u> |
| OTHER SOURCES (USES) OF CASH | | | |
| Issuance of common stock | 3 | 328 | 3,025 |
| Issuance (purchase) of subordinated notes | — | (11,523) | 71,555 |
| Purchase of treasury stock | — | — | (7,020) |
| Proceeds (repayments) of borrowings collateralized by contracts receivable | (9,842) | 12,636 | (942) |
| Purchase of equipment, net of related borrowings of \$410 in 1986 and \$5,513 in 1985 | (220) | (1,096) | (4,690) |
| Payments on other debt | (2,433) | (3,028) | (2,689) |
| Other investments | — | (2,995) | (3,926) |
| Sale of assets to related party | — | 12,250 | — |
| Other, net | 725 | (589) | 315 |
| | <u>11,767</u> | <u>5,983</u> | <u>55,646</u> |
| INCREASE (DECREASE) IN CASH | <u>1,713</u> | <u>(25)</u> | <u>(649)</u> |
| CASH | | | |
| Beginning of year | 970 | 995 | 1,644 |
| End of year | <u>\$ 2,683</u> | <u>\$ 970</u> | <u>\$ 995</u> |

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

THOUSAND TRAILS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(Dollars in thousands)

| | Common Stock | | Retained Earnings (Deficit) |
|---|--------------|----------|-----------------------------------|
| | Shares | Amount | |
| BALANCE, January 1, 1985 | 10,658,476 | \$30,934 | \$ 49,983 |
| Exercise of stock options | 202,871 | 2,255 | — |
| Purchase and retirement of treasury stock | (552,500) | (6,249) | — |
| Foreign currency translation | — | — | (14) |
| Net earnings for the year | — | — | 1,788 |
| BALANCE, December 31, 1985 | 10,308,847 | 26,940 | 51,757 |
| Exercise of stock options | 48,172 | 328 | — |
| Foreign currency translation | — | — | (56) |
| Net loss for the year | — | — | (50,422) |
| BALANCE, December 31, 1986 | 10,357,019 | 27,268 | 1,279 |
| Exercise of stock options | 850 | 3 | — |
| Issuance of stock | 13,664,292 | 24,185 | — |
| Foreign currency translation | — | — | 82 |
| Net loss for the year | — | — | (16,805) |
| BALANCE, December 31, 1987 | 24,022,161 | \$51,456 | \$ (15,444) |

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

THOUSAND TRAILS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Three Years Ended December 31, 1987

NOTE A—SIGNIFICANT ACCOUNTING POLICIES

General

The Company and its subsidiaries operate membership-based 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. An allowance for estimated contract collection losses and sales cancellations (based on historical loss occurrence rates) is recorded currently.

Certain membership contracts provide for prepaid use by members of Company-owned rental trailers. 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 Real Estate

Operating resort land and improvement costs plus estimated costs to complete resorts are charged to costs applicable 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 Real Estate" and is stated at cost, net of an allowance reducing reported cost to estimated net realizable value. Estimated net realizable value takes into consideration the total estimated market for membership sales, total planned and existing memberships available for sale, and total costs to complete and market the resorts. The total memberships available for sale are based on the Company's estimate at a particular point in time of the market demand for memberships and the expected utilization of the resorts by members. The Company currently plans to sell ten memberships for each campsite.

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.

The Company announced its intention to close four resorts in early 1988. The net carrying value of the four properties is included in Investment in Real Estate.

Investment in real estate is stated at the lower of cost or estimated net realizable value. Where cost exceeds estimated net realizable value, the Company records a valuation allowance. Such allowance will not be reduced until the Company sells or otherwise disposes of the properties.

THOUSAND TRAILS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
Three Years Ended December 31, 1987

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.

Presentation of Balance Sheet

During 1987 the Company changed its balance sheet presentation to a nonclassified format. The Company believes that a nonclassified balance sheet provides a more meaningful presentation consistent with the business cycles of the Company's operations. The 1986 balance sheet has been restated accordingly.

Reclassifications

Certain 1985 and 1986 amounts have been reclassified to conform with the 1987 presentation.

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 and warrants are included in the computation of earnings per share when dilutive.

NOTE B—CHANGE IN CONTROL AND RECAPITALIZATION OF THE COMPANY

During 1987, the Company engaged in discussions with its institutional lenders, certain holders of its subordinated notes, and third parties regarding a restructuring of the Company's debt. These discussions culminated in a recapitalization of the Company in November 1987. In a series of transactions between the Company and Southmark Corporation ("Southmark") and related transactions between Southmark and Western Savings and Loan Association ("Western"), Southmark acquired 16,071,792 shares of the Company's Common Stock, or 66.9% of the 24,022,161 shares currently outstanding, for a purchase price of \$24.2 million. In addition, the Company's outstanding debt was reduced by \$92 million.

The Company issued 13,664,292 shares of its authorized but unissued Common Stock to Southmark in exchange for the cancellation of \$44.6 million principal amount of the Company's 14% Senior Subordinated Notes due 1992 ("Subordinated Notes") and \$20 million principal amount of secured debt under the Company's bank line of credit ("Senior Debt") that Southmark had acquired from Western. Southmark also received from the Company a \$1 million ten-year 14% promissory note and \$1.4 million which represents primarily interest accrued on the Subordinated Notes and Senior Debt for periods prior to their acquisition by Southmark. Southmark acquired 2,407,500 shares of the Company's Common Stock directly from Western.

In order to acquire the shares of Common Stock from the Company as described above, Southmark, on November 3, 1987, purchased Western's \$50 million participation in the Company's Senior Debt and \$44.6 million principal amount of the Company's Subordinated Notes held by Western.

THOUSAND TRAILS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS— (Continued)
Three Years Ended December 31, 1987

In November 1987, Southmark also acquired from a financial institution a \$10 million participation in the Company's Senior Debt. This \$10 million participation in the Senior Debt was not exchanged for Common Stock of the Company and is reflected as due to Southmark in the accompanying financial statements.

In November 1987, the Company sold to Southmark on a recourse basis approximately \$30 million of the Company's membership contracts receivable in exchange for the cancellation of \$30 million principal amount of the Company's Senior Debt which Southmark acquired from Western as described above.

NOTE C—EXTRAORDINARY ITEMS AND REDUCTION IN CARRYING VALUE OF ASSETS

The shares issued to Southmark as described in Note B were valued at \$24.2 million, resulting in a gain on extinguishment of debt of \$38.2 million. Since the gain on extinguishment of debt resulted entirely from the recapitalization of the Company by Southmark, there has not been a net increase in equity. Accordingly, valuation allowances have been recorded to reduce the net carrying value of assets by \$38.2 million to appropriately disclose the effects of the recapitalization on the net carrying value of assets, as follows:

| <u>ASSETS</u> | <u>VALUATION ALLOWANCE</u> |
|----------------------------|--------------------------------|
| | (Dollars in thousands) |
| Contracts Receivable | \$12,913 |
| Real Estate | 17,200 |
| Equipment | 6,088 |
| Other Assets | 2,009 |
| | <u>\$38,210</u> |

In December 1986, the Company purchased \$17.9 million principal amount of its 14% senior subordinated notes due 1992 at a cost of \$11.5 million, resulting in a gain of \$3 million, net of related taxes of \$2.7 million. 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 Western, resulting in an aggregate net pretax gain of \$1.5 million.

NOTE D—CONTRACTS RECEIVABLE

Contracts receivable at December 31, 1987 and 1986 are summarized as follows:

| | <u>1987</u> | <u>1986</u> |
|---|------------------------|------------------|
| | (Dollars in thousands) | |
| Contracts Receivable | \$106,211 | \$167,268 |
| Allowance for Sales Cancellations | (1,311) | (1,952) |
| Allowance for Doubtful Accounts | (33,401) | (26,656) |
| | <u>\$ 71,499</u> | <u>\$138,660</u> |

Contracts receivable bear interest at a weighted average interest rate of 15.1% and currently are written with initial terms of 10 to 84 months (average 72 months in 1987). 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.

THOUSAND TRAILS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
Three Years Ended December 31, 1987

Scheduled aggregate annual principal payments on contracts are as follows:

| | <u>Years Ending December 31,</u> (Dollars in thousands) |
|------------------|--|
| 1988 | \$25,497 |
| 1989 | 22,354 |
| 1990 | 20,199 |
| 1991 | 17,891 |
| 1992 | 12,016 |
| Thereafter | 8,254 |

The Company received principal payments in excess of scheduled payments of \$13.2 million, \$14.4 million and \$12.7 million in 1987, 1986 and 1985, respectively, by utilizing early payment incentive programs.

Substantially all contracts receivable are pledged as collateral for debt.

NOTE E—OPERATING REAL ESTATE

Operating real estate at December 31, 1987 and 1986 is summarized as follows:

| | <u>1987</u> (Dollars in thousands) | <u>1986</u> (Dollars in thousands) |
|--|---------------------------------------|---------------------------------------|
| Land and Improvement Cost | \$209,094 | \$220,515 |
| Allowance to reduce cost to net realizable value | (69,247) | (59,599) |
| | <u>\$139,847</u> | <u>\$160,916</u> |

The Company announced its intention to close four resorts in early 1988. The net carrying value of the four properties was reclassified to Investment in Real Estate at December 31, 1987.

NOTE F—INVESTMENT IN REAL ESTATE

Investment in real estate at December 31, 1987 and 1986 is summarized as follows:

| | <u>1987</u> (Dollars in thousands) | <u>1986</u> (Dollars in thousands) |
|--|---------------------------------------|---------------------------------------|
| Cost of real estate | \$ 16,195 | \$ 6,147 |
| Allowance to reduce cost to net realizable value | (11,234) | (3,682) |
| | <u>\$ 4,961</u> | <u>\$ 2,465</u> |

NOTE G—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 and circumstances existing in 1986, the Company reduced the number of campsites planned for construction in the future at several resorts and charged against operations \$63.3 million to reduce land and improvements and investment in real estate to estimated net realizable value. In 1987, the Company reduced the value of its real estate assets by an additional \$17.2 million as described in Note C.

THOUSAND TRAILS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
Three Years Ended December 31, 1987

NOTE H—BORROWINGS

| | December 31, | |
|--|------------------------|------------------|
| | 1987 | 1986 |
| | (Dollars in thousands) | |
| Revolving credit agreement..... | \$30,187 | \$100,029 |
| 14% senior subordinated notes due 1992, interest paid semi-annually, (effective rate 15%) net of discount of \$.8 million and \$.1 million | 12,359 | 56,371 |
| Real estate contracts, 6½% to 15% payable in monthly installments of \$.7 million and \$.8 million, including interest | 18,706 | 23,767 |
| Equipment and other contracts, 8% to 12½% payable in monthly installments of \$.2 million, including interest | 3,226 | 4,922 |
| Other | 114 | 527 |
| | <u>64,592</u> | <u>185,616</u> |
| Due to Southmark | 11,144 | — |
| | <u>\$75,736</u> | <u>\$185,616</u> |

Aggregate annual principal payments over the next five years are as follows:

| Years ending December 31, | (Dollars in thousands) |
|------------------------------|---------------------------|
| 1988 | \$11,916 |
| 1989 | 16,938 |
| 1990 | 13,717 |
| 1991 | 4,078 |
| 1992 | 15,199 |

On December 31, 1987, the Company's unused sources of liquidity consisted principally of \$2.7 million in cash and approximately \$3.1 million of additional borrowing capacity under its then existing \$33.3 million bank line of credit.

On February 12, 1988, the Company completed the restructuring of its bank line of credit. The Company increased its borrowings to \$33.3 million which were then converted into a term loan payable in 12 equal quarterly installments commencing April 1, 1988. This term loan accrues interest at the prime lending rate (8¾% at December 31, 1987).

The restructuring also provided for a new committed revolving credit line from the Company's senior lenders in the maximum amount of \$37.6 million commencing April 1, 1988. This revolving credit line accrues interest at the prime lending rate plus 1½%.

Borrowings under the bank line of credit may not exceed 70% of the aggregate amount of the Company's qualifying contracts receivable. At December 31, 1987, qualifying contracts receivable totaled \$100.7 million, which would permit the Company to borrow the maximum line of credit. The credit line is secured by substantially all of the assets of the Company. The credit line contains performance covenants relating to net worth, marketing expenses, general and administrative expenses, resort operations, contracts receivable, construction expenditures and cash flow.

In November 1987, Southmark purchased a \$10 million term loan outstanding under the Company's previous bank line of credit. (See Note B) This term loan accrues interest at 14%. As part of

THOUSAND TRAILS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS— (Continued)

Three Years Ended December 31, 1987

the restructuring of the credit line, Southmark agreed to subordinate this term loan to the Company's indebtedness to its senior lenders and to defer receipt of any payment of principal or interest on this term loan until the Company's indebtedness to its senior lenders is paid in full. In November 1987, Southmark also received from the Company a \$1 million ten year promissory note which accrues interest at 14%.

NOTE I—MEMBERSHIP SALES

Membership sales for the three years ended December 31, 1987, 1986 and 1985 are as follows:

| | December 31, | | |
|---------------------------------------|------------------------|------------------|------------------|
| | 1987 | 1986 | 1985 |
| | (Dollars in thousands) | | |
| Membership sales..... | \$35,632 | \$ 59,860 | \$127,603 |
| Provision for doubtful accounts | (5,245) | (19,231) | (17,644) |
| Membership sales, net..... | <u>\$30,389</u> | <u>\$ 40,629</u> | <u>\$109,959</u> |

NOTE J—INCOME TAXES

The provision for income taxes consists of the following:

| | Years Ended December 31, | | |
|-------------------------|--------------------------|-------------------|----------------|
| | 1987 | 1986 | 1985 |
| | (Dollars in thousands) | | |
| Current | | | |
| Federal | \$ 650 | \$ — | \$ — |
| Foreign and state | 800 | — | — |
| | <u>\$ 1,450</u> | <u>\$ —</u> | <u>\$ —</u> |
| Deferred | | | |
| Federal | \$(1,282) | \$(40,445) | \$ 794 |
| Foreign and state | (150) | (4,883) | 398 |
| | <u>\$(1,432)</u> | <u>\$(45,328)</u> | <u>\$1,192</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 \$.3 million in 1985 and increased by investment tax credit recapture of \$.1 million in 1986 and \$.1 million in 1987.

The tax net operating loss carryforward at December 31, 1987 totaled \$1.5 million and will expire in the year ending December 31, 2000. The Company has net operating loss carryforwards for financial statement purposes of approximately \$15 million at December 31, 1987. The Company also has general business tax credit carryforwards at December 31, 1987 of \$1.4 million which will expire in years ending 1991 through 2001. As a result of the change in control of the Company in November 1987, the net operating loss and general business credit carryforwards are subject to limitations. The Company expects to utilize these carryforwards before they expire.

The tax provision in 1987 bears a disproportionate relationship to the statutory federal income tax rate due principally to losses which provide no current tax benefit.

THOUSAND TRAILS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
Three Years Ended December 31, 1987

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

| | Years Ended December 31, | | |
|--|--------------------------|--------------------|-----------------|
| | 1987 | 1986 | 1985 |
| | (Dollars in thousands) | | |
| Installment sales | \$(19,703) | \$(16,810) | \$ 6,639 |
| Capitalized interest | 455 | 563 | 440 |
| Resort land and improvement costs | (69) | (31,243) | (1,608) |
| Decrease (increase) in tax basis net operating loss carryforward | 13,009 | 2,403 | (4,839) |
| Excess of tax over book depreciation and effect of account- ing for capital leases as operating leases for tax purposes | (903) | 391 | 783 |
| Tax benefit not realized, subject to future realization | 6,301 | — | (3) |
| Other, net | (522) | (632) | (223) |
| | <u>\$ (1,432)</u> | <u>\$ (45,328)</u> | <u>\$ 1,192</u> |

NOTE K—STOCK OPTIONS AND WARRANTS

The Company has three stock option plans under which Common Stock is reserved for issuance to officers and key employees. As a result of the change in control of the Company in November 1987, substantially all outstanding options are 100% vested and exercisable at any time. Under all three plans, options granted in the future will be exercisable 25% each year commencing one year after the date of grant and will expire five or ten years after the date of grant. Options are priced at not less than the market price of the Company's Common Stock at the date of grant.

At December 31, 1987, a total of 866,828 shares of Common Stock were reserved for issuance under the plans. Information with respect to options granted under the plans is as follows:

| | Number of Shares | Option Price Per Share |
|--|---------------------|---------------------------|
| Options outstanding at January 1, 1985 | 290,865 | \$2.37-\$15.33 |
| Granted | 205,900 | |
| Exercised | (11,570) | |
| Lapsed | (87,275) | |
| Options outstanding at December 31, 1985 | 397,920 | \$2.37-\$ 7.00 |
| Granted | 123,310 | |
| Exercised | (2,653) | |
| Lapsed | (395,019) | |
| Options outstanding at December 31, 1986 | 123,558 | \$2.18-\$ 2.37 |
| Granted | 304,180 | |
| Lapsed | (18,110) | |
| Options outstanding at December 31, 1987 | 409,628 | \$2.18-\$ 2.81 |

During 1982, in connection with the execution of a promotional services agreement, the Company granted warrants to purchase an aggregate of 10,125 shares of Common Stock at \$2.67 per share which remain outstanding at December 31, 1987. The warrants expire on June 30, 1988.

THOUSAND TRAILS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Three Years Ended December 31, 1987

NOTE L—POST-EMPLOYMENT AGREEMENTS

During 1983, the Company entered into post-employment agreements with certain officers which 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 \$.7 million in 1985, \$.8 million in 1986 and \$.5 million in 1987. During 1986 and 1987, the Company extended offers to participants to terminate their respective agreements in exchange for cash settlements, which offers were accepted by five of the seven participants.

NOTE M—COMMITMENTS AND CONTINGENCIES

The Company has operating lease obligations of approximately \$.7 million annually until 1992.

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 former principal officers and its former 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. In early 1988, the Company filed a motion for summary judgment which has not been decided, and the Company and its counsel believe it is too early to assess the ultimate outcome. However, based on the discovery which has been completed to date, the Company believes the lawsuit will not have a material impact on its operations or financial position.

NOTE N—CAPITALIZED INTEREST

The Company capitalizes interest as a component of the cost of significant improvements to resorts. Total interest costs were \$21.4 million in 1987, \$28.7 million in 1986 and \$22 million in 1985, of which \$0, \$.9 million and \$5.8 million, respectively, were capitalized.

NOTE O—RELATED PARTY TRANSACTIONS

At November 3, 1987, Western owned 23.2% of the Company's then outstanding Common Stock and approximately \$44.6 million principal amount of the Company's 14% Senior Subordinated Notes due 1992 ("Subordinated Notes"). In addition, the Company's bank line of credit included a \$50 million term loan funded by Western. For the years ended 1987, 1986 and 1985, the Company paid Western interest on this term loan of \$5.1 million, \$5 million and \$1.4 million, respectively. On November 3, 1987, Western sold its participation in this term loan to Southmark.

THOUSAND TRAILS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
Three Years Ended December 31, 1987

On March 15, 1987, the Company paid Western the semi-annual interest of \$2.2 million due on \$30.1 million principal amount of the Subordinated Notes then held by Western. In addition, on November 3, 1987, the Company sold to Western 5,000 ten-year term memberships in the Company's network of campground resorts in exchange for the cancellation of the interest accrued through November 3, 1987 (\$2.2 million), on \$30.1 million principal amount of the Subordinated Notes then held by Western. Income from the sale of the memberships was deferred and will be recognized as the memberships are transferred to consumers by Western.

In December 1986, the Company sold to Western certain assets not related to its 39 operating resorts for a total sales price of \$12.2 million. The assets sold and sales price for each asset were as follows: 10 shares of Western's Series A cumulative preferred guarantee stock (\$3 million); 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 a subsidiary of the Company (\$2 million); 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 a subsidiary of the Company (\$7.2 million). The sale resulted in an aggregate net gain of \$1.5 million.

In December 1986, the Company entered into an agreement with Western which provided for a subsidiary of the Company to manage the operations and sales and marketing of Western's Happy Trails subdivision in Surprise, Arizona. This management contract was terminated by the parties as of September 30, 1987.

During 1986, Western paid the Company \$.1 million under the Western VISA card programs which a subsidiary of the Company marketed to Thousand Trails members and other persons.

On November 3, 1987, the Company sold to Southmark for a \$1 million gain certain assets owned by a subsidiary of the Company. The assets sold included the subsidiary's interest in profits from a VISA card program operated by Western and its interest in an automobile club for owners of recreational vehicles. The Company received from Southmark a \$1 million seven-year 12% promissory note. Also see Note B included herein for further descriptions of transactions with Southmark.

In December 1987, the Company entered into a servicing agreement with National American Corporation ("NACO"), a wholly-owned subsidiary of Southmark, pursuant to which NACO is collecting for the Company contracts receivable which are delinquent. This agreement provides that the Company will pay NACO \$3.50 per month for each active contract receivable and \$.30 per month for each active dues receivable. The Company incurred costs of \$.1 million under this agreement for services rendered in 1987.

The Company and NACO have entered into an agreement pursuant to which the Company and NACO granted to each other the right to sell to their respective members the ability to use the resort system operated by the other company. The Company and NACO are each entitled to retain the proceeds from sales to its own members and each will bear its respective incremental costs associated with providing resort amenities to members who participate.

On February 12, 1988, for no consideration, Southmark agreed to guarantee all of the Company's borrowings under its restructured bank line of credit in excess of \$33.3 million. In addition, as part of the restructuring of the credit line, Southmark agreed to subordinate a \$10 million term loan held by Southmark to the Company's indebtedness to its senior lenders and to defer receipt of any payment of principal or interest on this term loan until the Company's indebtedness to its senior lenders is paid in full.

THOUSAND TRAILS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Three Years Ended December 31, 1987

NOTE P—SUBSEQUENT EVENTS

Southmark has informed the Company that it intends to transfer to its wholly-owned subsidiary, San Jacinto Savings Association, all of Southmark's interest in the Company. San Jacinto is a Texas-chartered, federally-insured savings and loan association. This transfer to San Jacinto is subject to approval of the Federal Home Loan Bank Board.

NOTE Q—FINANCIAL ACCOUNTING STANDARDS BOARD PRONOUNCEMENTS

In the fourth quarter of 1987, the Financial Accounting Standards Board ("FASB") issued Statement Nos. 95 and 96, neither of which is expected to materially impact the Company's accounting policies. Statement No. 95, which will be implemented by the Company effective July 1, 1988, alters the Company's external financial reporting with respect to its cash flows. Statement No. 96, which will be effective July 1, 1989, will change the method of accounting for deferred income taxes to reflect the liability method of computing deferred income taxes using currently enacted tax rates. The Company anticipates becoming a part of Southmark's consolidated return and the ultimate effect, if any, of adopting the new statements is not determinable.

THOUSAND TRAILS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Three Years Ended December 31, 1987

NOTE R—QUARTERLY FINANCIAL INFORMATION (unaudited)

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

| | <u>First Quarter</u> | <u>Second Quarter</u> | <u>Third Quarter</u> | <u>Fourth Quarter</u> |
|--|--------------------------|---------------------------|--------------------------|---------------------------|
| 1987 | | | | |
| Total revenue | \$17,984 | \$20,787 | \$23,930 | \$18,387 |
| Loss before taxes and extraordinary item | (4,614) | (4,121) | (3,924) | (42,338) |
| Extraordinary item | — | — | — | 38,210 |
| Net loss | (3,890) | (4,063) | (3,924) | (4,928) |
| Loss per share— | | | | |
| Primary loss before extraordinary item | \$ (.38) | (.39) | \$ (.38) | \$ (3.19) |
| Extraordinary item | — | — | — | 3.01 |
| Net primary loss | <u>\$ (.38)</u> | <u>\$ (.39)</u> | <u>\$ (.38)</u> | <u>\$ (.18)</u> |
| Fully diluted loss before extraordinary item | \$ (.38) | \$ (.39) | \$ (.38) | \$ (3.19) |
| Extraordinary item | — | — | — | 3.01 |
| Net fully diluted loss | <u>\$ (.38)</u> | <u>\$ (.39)</u> | <u>\$ (.38)</u> | <u>\$ (.18)</u> |
| 1986 | | | | |
| Total revenue | \$24,206 | \$30,243 | \$28,874 | \$10,859 |
| Loss before taxes and extraordinary item | (3,673) | (6,671) | (10,852) | (80,207) |
| Extraordinary item, less applicable income tax of \$2.7 million | — | — | — | 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> |

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

As has previously been reported on Form 8-K, on November 12, 1987, the Board of Directors of the Company appointed Grant Thornton as the independent certified public accountants for the Company for 1987. The appointment of Grant Thornton resulted in the termination of the former auditors, Touche Ross & Co.

By letter dated November 20, 1987, Touche Ross & Co. informed the Company that, in connection with the audits of the two most recent fiscal years and any subsequent interim periods preceding the termination of Touche Ross, there were no disagreements between the Company and Touche Ross on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreements, if not resolved to the satisfaction of Touche Ross, would have caused it to make reference in connection with its report to the subject matter of the disagreement. Subsequently, Touche Ross informed the Company that it would be unable to express an opinion on the Company's financial statements with respect to the year ended December 31, 1985, because of the possible impact on such financial statements of information allegedly requested by Touche Ross in connection with its audit of the Company's financial statements for the year ended December 31, 1984. Touche Ross has taken the position that such information was not made available to it, and that it is no longer in a position to apply adequate audit procedures with respect to such information. The Company believes that it furnished Touche Ross with all information requested by Touche Ross in an appropriate manner during the course of such audit. The Company also believes that the nature of the information is such that appropriate audit procedures could be applied at the present time.

Touche Ross & Co. has informed the Company that the matters at issue with respect to the Company's fiscal year ended December 31, 1985, do not affect its fiscal year ended December 31, 1986. Accordingly, the Company requested that Touche Ross provide an opinion with respect to the Company's financial statements as of that date and for the period then ended. However, Touche Ross has declined to do so in the circumstances.

In response to the foregoing, the Company has engaged Grant Thornton to audit its financial statements for the years ended December 31, 1985 and December 31, 1986, and believes that such audit will be completed as expeditiously as possible.

Touche Ross & Co. is presently a co-defendant with the Company and others in a class action lawsuit. See Item 3. "Legal Proceedings." In March 1988, Touche Ross and the plaintiffs asked the Court to approve a \$50,000 settlement of Touche Ross' liability in this lawsuit.

The opinion of Touche Ross & Co. on the financial statements of the Company for the year ended December 31, 1986 was qualified with respect to the effects on the financial statements of such adjustments, if any, as might have been required had the outcome of the Company's efforts to restructure its outstanding debt been known.

The Company is requesting that Touche Ross & Co. furnish a letter addressed to the Commission stating whether it agrees with the statements made in response to this Item and, if not, stating the respects in which it does not agree. Such letter will be filed with the Commission promptly after its receipt by the Company.

PART III

The information required by Part III (Items 10-13) is set forth in the Company's definitive proxy statement to be filed pursuant to Regulation 14A within 120 days after December 31, 1987. Such information is incorporated herein by this reference.

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, 1987 and 1986.

Consolidated Statements of Operations—Three years ended December 31, 1987.

Consolidated Statements of Changes in Financial Position—Three years ended December 31, 1987.

Consolidated Statements of Stockholders' Equity—Three years ended December 31, 1987.

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, 1987:

IV. Indebtedness of and to Related Parties—Not Current.

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

- 2.1 Agreement and Plan of Recapitalization dated September 25, 1987, between the Company and Southmark Corporation.*
- 2.2 Road Vantage Purchase and Sale Agreement dated September 25, 1987, between Southmark Corporation, the Company, and Road Vantage, Inc., a subsidiary of the Company.*
- 2.3 Agreement for Sale of Receivables dated September 25, 1987, between the Company and Southmark Corporation, and First Amendment to Agreement for Sale of Receivables dated as of November 3, 1987.*
- 2.4 Agreement Regarding Interest Payment dated November 3, 1987, between Western Savings and Loan Association and the Company.*
- 3.1 Articles of Incorporation of the Company, as amended to date.
- 3.2 By-laws of the Company, as amended to date.
- 4.1 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 Credit Agreement dated February 10, 1988, between the Company as borrower, The First National Bank of Boston, First Interstate Bank of Washington, and First Interstate Bank of California as lenders, and The First National Bank of Boston as agent.
- 10.2 Agreement dated December 29, 1986, between Western Savings and Loan Association and Happy Trails Resorts, Inc., a subsidiary of the Company.***
- 10.3 Agreement dated December 29, 1986, between Western Savings and Loan Association and Outdoor Enterprises, Inc., a subsidiary of the Company.***

- 10.4 Letter dated December 29, 1986, from Western Savings and Loan Association to the Company.***
- 10.5 Lease dated June 24, 1987, between Martin Selig as lessor and the Company as lessee.
- 10.6 1979 Key Employee Stock Option Plan.****
- 10.7 1980 Key Employee Stock Option Plan.***
- 10.8 1987 Key Employee Stock Option Plan.
- 10.9 Employment Agreement dated November 6, 1987, between C. James Jensen and the Company.
- 10.10 Consulting Agreement dated December , 1987, between C. James Jensen and the Company.
- 10.11 Employment Agreement dated November 6, 1987, between Howard P. Behar and the Company.
- 10.12 Employment Agreement dated November 6, 1987, between S. Duke Campbell and the Company.
- 10.13 Employment Agreement dated November 6, 1987, between James E. Claus and the Company.
- 10.14 Employment Agreement dated November 6, 1987, between Walter B. Jaccard and the Company.
- 10.15 Sample form of current Membership Contract.
- 10.16 Agreement dated December 11, 1987, between National American Corporation and the Company.
- 10.17 Servicing Agreement dated December 11, 1987, between National American Corporation and the Company.
- 10.18 Premium Purchase Agreement dated February 25, 1988, between National American Corporation and the Company.
- 10.19 Agreements For Consolidated Tax Allocation dated , 1988, between Southmark Corporation and the Company.
- 10.20 Servicing Agreement dated November 6, 1987, between the Company and Southmark Corporation, and termination thereof dated November 10, 1987.
- 11.1 Calculation of earnings per share of common stock.
- 16.1 Letter dated November 20, 1987, from Touche Ross & Co. to the Company.*
- 16.2 Letter dated April 26, 1988, from Touche Ross & Co. to the Company.
- 24.1 Consent of Grant Thornton.

*Indicates that such document was filed previously with, and is incorporated by reference from, the Company's Report on Form 8-K dated November 20, 1987, File No. 2-65020.

**Indicates that such document was filed previously with, and is incorporated 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 by reference from, the Company's Annual Report on Form 10-K for the year ended December 31, 1986, File No. 2-65020.

****Indicates that such document was filed previously with, and is incorporated 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

During the fourth quarter of 1987, the Company filed a report on Form 8-K dated November 20, 1987, which reported the recapitalization of the Company and the sale of certain assets. See Note B of Notes to Consolidated Financial Statements.

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)

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

Date: March 29, 1988

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

| <u>Signature</u> | <u>Title</u> | <u>Date</u> |
|---|--|----------------|
| <u>/s/ GENE E. PHILLIPS</u> (Gene E. Phillips) | Chairman of the Board | March 28, 1988 |
| <u>/s/ LAWRENCE E. STEELMAN</u> (Lawrence E. Steelman) | Vice Chairman of the Board and Chief Executive Officer | March 28, 1988 |
| <u>/s/ JOHN E. SHOCKLEY</u> (John E. Shockley) | President, Chief Operating Officer, and Director | March 28, 1988 |
| <u>/s/ D. VINSON MARLEY</u> (D. Vinson Marley) | Vice President and Director | March 29, 1988 |
| <u>/s/ WILLIAM S. FRIEDMAN</u> (William S. Friedman) | Director | March 29, 1988 |
| <u>/s/ RICHARD L. PARK</u> (Richard L. Park) | Director | March 28, 1988 |

THOUSAND TRAILS, INC.

INDEBTEDNESS OF AND TO RELATED PARTIES—NOT CURRENT

(Dollars in thousands)

| Description | Beginning Balance | Additions | Deductions | Ending Balance |
|--|-------------------|-----------|------------|----------------|
| Term loan provided by Western Savings and Loan Association | | | | |
| Year Ended 12/31/87..... | \$48,384 | \$ 1,616 | \$50,000 | \$ — |
| Year Ended 12/31/86..... | \$28,400 | \$19,984 | \$ — | \$48,384 |
| Year Ended 12/31/85..... | \$24,975 | \$ 3,425 | \$ — | \$28,400 |
| 14% senior subordinated notes due 1992 owned by Western Savings and Loan Association | | | | |
| Year Ended 12/31/87..... | \$30,140 | \$14,488 | \$44,628 | \$ — |
| Year Ended 12/31/86..... | \$ — | \$30,140 | \$ — | \$30,140 |
| Notes Payable to Southmark Corporation | | | | |
| Year Ended 12/31/87..... | \$ — | \$11,144 | \$ — | \$11,144 |
| Notes Receivable from Southmark Corporation | | | | |
| Year Ended 12/31/87..... | \$ — | \$ 1,017 | \$ — | \$ 1,017 |

*Indicates that such document was filed previously with and is incorporated by reference from the Company's Report on Form 8-K dated November 20, 1987, File No. 2-65020.

**Indicates that such document was filed previously with and is incorporated by reference from the Company's Amendment No. 1 to its Quarterly Report on Form 10-Q dated March 31, 1988, File No. 2-65020.

***Indicates that such document was filed previously with and is incorporated 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

During the fourth quarter of 1987, the Company filed a report on Form 8-K dated November 20, 1987, which reported the recapitalization of the Company and the sale of certain assets. See Note 2 of Notes to Consolidated Financial Statements.

THOUSAND TRAILS, INC.

VALUATION AND QUALIFYING ACCOUNTS

(Dollars in thousands)

| Description | Beginning Balance | Additions | Deductions (1) | Ending Balance |
|--|----------------------|-----------|----------------|-------------------|
| Allowance for doubtful accounts deducted from related assets: | | | | |
| Year Ended 12/31/87 | \$26,656 | \$18,158 | \$11,413 | \$33,401 |
| Year Ended 12/31/86 | \$19,779 | \$19,231 | \$12,354 | \$26,656 |
| Year Ended 12/31/85 | \$ 8,802 | \$17,644 | \$ 6,667 | \$19,779 |
| Allowance to reduce land and improvements and investment in real estate to net realizable value: | | | | |
| Year Ended 12/31/87 | \$63,281 | \$17,200 | \$ — | \$80,481 |
| Year Ended 12/31/86 | \$ — | \$63,281 | \$ — | \$63,281 |
| Allowance to reduce other assets | | | | |
| Year Ended 12/31/87 | \$ — | \$ 2,009 | \$ — | \$ 2,009 |
| Allowance to reduce equipment | | | | |
| Year Ended 12/31/87 | \$ — | \$ 6,088 | \$ — | \$ 6,088 |

(1) Contracts receivable written off, net of recoveries. As to column omitted, the answer is none.

THOUSAND TRAILS, INC.

CALCULATION OF EARNINGS PER SHARE OF COMMON STOCK

(Dollars in thousands except per share amounts)

| | Years Ended December 31, | | |
|--|--------------------------|--------------------|-------------------|
| | 1987 | 1986 | 1985 |
| Primary | | | |
| Weighted average number of shares outstanding | 12,673,139 | 10,346,470 | 10,393,017 |
| Effect of stock options | — | — | 322,679 |
| Average number of shares for calculation of primary earnings per share | <u>12,673,139</u> | <u>10,346,470</u> | <u>10,715,696</u> |
| Income (loss) before extraordinary item | \$ (55,015) | \$ (53,399) | \$ 1,788 |
| Extraordinary item | | | |
| Gain from extinguishment of debt, less applicable income tax of \$2,676 in 1986 | 38,210 | 2,977 | — |
| Net earnings (loss) | <u>\$ (16,805)</u> | <u>\$ (50,422)</u> | <u>\$ 1,788</u> |
| Primary earnings per share | | | |
| Income (loss) before extraordinary item | \$ (4.34) | \$ (5.16) | \$.17 |
| Extraordinary item | 3.01 | .29 | .17 |
| Net earnings (loss) | <u>\$ (1.33)</u> | <u>\$ (4.87)</u> | <u>\$.17</u> |
| Fully Diluted | | | |
| Average number of shares for calculation of fully diluted earnings per share | 12,673,139 | 10,346,470 | 10,715,696 |
| Incremental shares using the higher of year-end or average market prices for stock options | — | — | 318,678 |
| | <u>12,673,139</u> | <u>10,346,470</u> | <u>11,034,374</u> |
| Net earnings (loss) before extraordinary item | \$ (55,015) | \$ (53,399) | \$ 1,788 |
| Extraordinary item: | | | |
| Gain from extinguishment of debt, less applicable income tax of \$2,676 in 1986 | 38,210 | 2,977 | — |
| Adjusted earnings (loss) | <u>\$ (16,805)</u> | <u>\$ (50,422)</u> | <u>\$ 1,788</u> |
| Fully diluted earnings per share: | | | |
| Income (loss) before extraordinary item | \$ (4.34) | \$ (5.16) | \$.16 |
| Extraordinary item | 3.01 | .29 | — |
| Net earnings (loss) | <u>\$ (1.33)</u> | <u>\$ (4.87)</u> | <u>\$.16</u> |

OFFICERS

| | |
|---------------------|--|
| John E. Shockley | <i>President and Chief Operating Officer</i> |
| Nick B. Herman | <i>Chief Financial Officer</i> |
| Walter B. Jaccard | <i>Vice President — General Counsel</i> |
| Carroll R. Lowe | <i>Vice President — Operations</i> |
| James J. Oestreich | <i>Vice President — Marketing</i> |
| James S. Phillips | <i>Vice President — Sales</i> |
| Tammy C. Smolkowski | <i>Vice President and Controller</i> |

DIRECTORS

| | |
|-----------------------|--|
| H. Robert Bartell Jr. | <i>Chairman San Jacinto Savings Association</i> |
| William S. Friedman | <i>Vice Chairman Southmark Corporation</i> |
| D. Vinson Marley | <i>Executive Vice President Southmark Corporation</i> |
| Richard L. Park | <i>Executive Vice President Southwest Savings and Loan Association of Dallas</i> |
| Gene E. Phillips | <i>Chairman Southmark Corporation</i> |
| John E. Shockley | <i>President Thousand Trails, Inc.</i> |

CORPORATE DATA

| | |
|---|---|
| <i>Corporate Headquarters</i> | 15375 S.E. 30th Place Bellevue, WA 98007 |
| <i>Legal Counsel</i> | Trotter, Smith & Jacobs, a Professional Corporation Atlanta, Georgia Cromwell, Mendoza & Belur Seattle, Washington |
| <i>Independent Accountants</i> | Grant Thornton Dallas, Texas |
| <i>Transfer Agent and Registrar</i> | American Stock Transfer & Trust Company 99 Wall Street New York, NY 10005 (212) 936-5100 |

THOUSAND TRAILS, INC.
15375 S.E. 30th Place
Bellevue, Washington 98007
(206) 644-1100