

CHAMPION ENTERPRISES INC

Form 10-Q

October 28, 2005

**FORM 10-Q**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

(Mark one)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934.**

**For Quarterly period ended October 1, 2005**

**OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934.**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

Commission file number 1-9751

**CHAMPION ENTERPRISES, INC.**

(Exact name of registrant as specified in its charter)

Michigan  
(State or other jurisdiction of incorporation or  
organization)

38-2743168  
(I.R.S. Employer

Edgar Filing: CHAMPION ENTERPRISES INC - Form 10-Q

Identification No.)

2701 Cambridge Court, Suite 300

Auburn Hills, MI 48326  
(Address of principal executive offices)

Registrant's telephone number, including area code: (248) 340-9090

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes   
No

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

75,945,602 shares of the registrant's \$1.00 par value Common Stock were outstanding as of October 27, 2005.

---

**PART I. FINANCIAL INFORMATION**

Item 1. Financial Statements.

CHAMPION ENTERPRISES, INC.

Consolidated Statements of Operations

(In thousands, except per share amounts)

	Unaudited Three Months Ended		Unaudited Nine Months Ended	
	October 1, 2005	October 2, 2004	October 1, 2005	October 2, 2004
Net sales	\$ 335,728	\$ 276,949	\$ 897,103	\$ 754,167

Edgar Filing: CHAMPION ENTERPRISES INC - Form 10-Q

Cost of sales	277,819	226,590	746,357	630,757
<b>Gross margin</b>	<b>57,909</b>	<b>50,359</b>	<b>150,746</b>	<b>123,410</b>
Selling, general and administrative expenses	38,385	32,555	106,696	94,725
Mark-to-market charge (credit) for common stock warrant		2,300	(4,300)	3,500
Loss on debt retirement			901	2,776
<b>Operating income</b>	<b>19,524</b>	<b>15,504</b>	<b>47,449</b>	<b>22,409</b>
Interest income	980	470	2,682	954
Interest expense	(4,340)	(4,556)	(13,549)	(14,204)
<b>Income from continuing operations before income taxes</b>	<b>16,164</b>	<b>11,418</b>	<b>36,582</b>	<b>9,159</b>
Income tax expense (benefit)	950	800	1,850	(10,300)
<b>Income from continuing operations</b>	<b>15,214</b>	<b>10,618</b>	<b>34,732</b>	<b>19,459</b>
Loss from discontinued operations, net of taxes	(900)	(629)	(4,209)	(361)
<b>Net income</b>	<b>14,314</b>	<b>9,989</b>	<b>30,523</b>	<b>19,098</b>
<b>Basic income (loss) per share:</b>				
Income from continuing operations	\$ 0.20	\$ 0.14	\$ 0.45	\$ 0.25
Loss from discontinued operations	(0.01)	(0.01)	(0.06)	
Basic income per share	\$ 0.19	\$ 0.13	\$ 0.39	\$ 0.25
Weighted shares for basic EPS	75,837	71,300	74,520	70,020
<b>Diluted income (loss) per share:</b>				
Income from continuing operations	\$ 0.20	\$ 0.13	\$ 0.44	\$ 0.25
Loss from discontinued operations	(0.01)	(0.01)	(0.05)	(0.01)
Diluted income per share	\$ 0.19	\$ 0.12	\$ 0.39	\$ 0.24
Weighted shares for diluted EPS	76,886	72,522	75,559	71,610

See accompanying Notes to Consolidated Financial Statements.

---

CHAMPION ENTERPRISES, INC.

Consolidated Balance Sheets

(In thousands, except par value)

	<b>Unaudited</b>	
	<b>October 1, 2005</b>	<b>January 1, 2005</b>
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 131,059	\$ 142,266
Restricted cash	509	529
Accounts receivable, trade	52,246	22,119
Inventories	98,705	71,616
Current assets of discontinued operations	2,814	35,463

Edgar Filing: CHAMPION ENTERPRISES INC - Form 10-Q

Other current assets	14,738		13,535
Total current assets	300,071		285,528
<b>Property, plant and equipment</b>	213,365		207,216
Less-accumulated depreciation	122,811		126,259
	90,554		80,957
<b>Goodwill</b>	154,463		126,591
<b>Amortizable intangible assets</b>	4,050		
<b>Non-current assets of discontinued operations</b>	2,404		7,747
<b>Other non-current assets</b>	13,212		16,219
	\$ 564,754	\$	517,042
<b>LIABILITIES, REDEEMABLE CONVERTIBLE PREFERRED STOCK AND SHAREHOLDERS EQUITY</b>			
<b>Current liabilities</b>			
Accounts payable	\$ 40,630	\$	13,819
Accrued warranty obligations	32,365		33,551
Accrued volume rebates	32,992		30,234
Accrued compensation and payroll taxes	25,412		19,659
Accrued self-insurance	28,565		25,988
Current liabilities of discontinued operations	3,661		23,411
Other current liabilities	39,166		29,696
Total current liabilities	202,791		176,358
<b>Long-term liabilities</b>			
Long-term debt	191,494		200,758
Long-term liabilities of discontinued operations	18		432
Other long-term liabilities	37,356		41,444
	228,868		242,634
<b>Contingent liabilities (Note 8)</b>			
<b>Redeemable convertible preferred stock,</b>			
no par value, 5,000 shares authorized, 0 shares			
and 21 shares issued and outstanding, respectively			20,750
<b>Shareholders equity</b>			
Common stock, \$1 par value, 120,000 shares authorized,			
75,939 and 72,358 shares issued and outstanding, respectively	75,939		72,358
Capital in excess of par value	186,070		164,377
Accumulated deficit	(129,145)	)	(159,375)
Accumulated other comprehensive income (loss)	231		(60)
Total shareholders equity	133,095		77,300
	\$ 564,754	\$	517,042

See accompanying Notes to Consolidated Financial Statements.

---

CHAMPION ENTERPRISES, INC.

Consolidated Statements of Cash Flows

(In thousands)

Unaudited  
Nine Months Ended

Edgar Filing: CHAMPION ENTERPRISES INC - Form 10-Q

	October 1,		October 2,
	2005		2004
<b>Cash flows from operating activities</b>			
Income from continuing operations	\$ 34,732		\$ 19,459
Adjustments to reconcile income from continuing operations to net cash provided by (used for) operating activities:			
Depreciation and amortization	7,726		7,765
Loss on debt retirement	901		2,776
Mark-to-market (credit) charge for common stock warrant	(4,300)	)	3,500
Gain on disposal of fixed assets	(1,625)	)	(154)
Decrease in allowance for tax adjustments			(12,000)
Increase/decrease			
Accounts receivable	(27,617)	)	(23,799)
Refundable income taxes			3,123
Inventories	(13,039)	)	(22,937)
Accounts payable	20,840		9,393
Accrued liabilities	12,848		7,962
Other, net	9,224		1,943
Net cash provided by (used for) continuing operating activities	39,690		(2,969)
<b>Cash flows from discontinued operations</b>			
Loss from discontinued operations	(4,209)	)	(361)
Proceeds from sales of retail businesses	30,649		
Change in net assets of discontinued operations	(11,533)	)	(15,240)
Net cash provided by (used for) discontinued operations	14,907		(15,601)
<b>Cash flows from investing activities</b>			
Additions to property, plant and equipment	(7,976)	)	(6,247)
Acquisition of New Era group	(41,427)	)	
Investments in and advances to unconsolidated subsidiaries	(55)	)	(163)
Proceeds on disposal of fixed assets	5,221		3,645
Net cash used for investing activities	(44,237)	)	(2,765)
<b>Cash flows from financing activities</b>			
Decrease in short-term debt, net	(8,195)	)	(29)
Purchase of Senior Notes	(9,885)	)	(10,395)
Decrease in other long-term debt	(277)	)	(6,025)
Purchase of common stock warrant	(4,500)	)	
Decrease in restricted cash	1		7,888
Preferred stock issued, net			12,000
Common stock issued, net	1,582		5,154
Dividends paid on preferred stock	(293)	)	(419)
Net cash (used for) provided by financing activities	(21,567)	)	8,174
Net decrease in cash and cash equivalents	(11,207)	)	(13,161)
Cash and cash equivalents at beginning of period	142,266		145,868
Cash and cash equivalents at end of period	\$ 131,059		\$ 132,707

See accompanying Notes to Consolidated Financial Statements.

---

CHAMPION ENTERPRISES, INC.

Consolidated Statement of Shareholders Equity

Unaudited Nine Months Ended October 1, 2005

Edgar Filing: CHAMPION ENTERPRISES INC - Form 10-Q

(In thousands)

	Common stock Shares	Amount	Capital in excess of par value	Accumulated Deficit	Accumulated other comprehensive income (loss)	Total	Total comprehensive income (loss)
Balance at January 1, 2005	72,358	\$ 72,358	\$ 164,377	\$ (159,375	) \$ (60	) \$ 77,300	
Net income				30,523		30,523	\$ 30,523
Preferred stock dividends				(293	)	(293	)
Stock options and benefit plans	350	350	2,174			2,524	
Issuance for acquisition deferred purchase price payments	171	171	1,829			2,000	
Preferred stock conversion	3,060	3,060	17,690			20,750	
Foreign currency translation adjustments					291	291	291
Balance at October 1, 2005	75,939	\$ 75,939	\$ 186,070	\$ (129,145	) \$ 231	\$ 133,095	\$ 30,814

See accompanying Notes to Consolidated Financial Statements.

---

CHAMPION ENTERPRISES, INC.

Notes to Consolidated Financial Statements

(Unaudited)

1. The Consolidated Financial Statements are unaudited, but in the opinion of management include all adjustments necessary for a fair statement of the results of the interim period. All such adjustments are of a normal recurring nature. Financial results of the interim period are not necessarily indicative of results that may be expected for any other interim period or for the fiscal year. The balance sheet as of January 1, 2005 was derived from audited financial statements.

For a description of significant accounting policies used by Champion Enterprises, Inc. ( the Company ) in the preparation of its consolidated financial statements, please refer to Note 1 of Notes to Consolidated Financial Statements in the Company s Annual Report on Form 10-K for the year ended January 1, 2005.

During 2005, the Company completed the disposal of its traditional retail operations through the sale of its remaining 40 traditional retail sales centers, including the sale of ten sales centers during the quarter ended October 1, 2005. As a result, the Company s traditional retail operations, excluding its non-traditional California operations, are classified as discontinued operations for the periods reported. Also included in discontinued operations is the Company s former consumer finance business that was exited in the third quarter of 2003.

The Company accounts for its stock-based employee compensation programs under Accounting Principles Board ( APB ) Opinion No. 25. The additional disclosures and pro forma information required by Statement of Financial Accounting Standards ( SFAS ) No. 123 as amended by SFAS No. 148 follow. If compensation costs for the Company s stock-based compensation plans had been determined based on the fair value at the grant dates consistent with the requirements of SFAS No. 123, pro forma net income, income per share, and stock-based compensation expense would have been as indicated below:

<b>Three Months Ended</b>	
<b>October 1,</b>	<b>October 2,</b>
<b>2005</b>	<b>2004</b>

Edgar Filing: CHAMPION ENTERPRISES INC - Form 10-Q

	<b>(In thousands, except per share amounts)</b>	
Net income as reported	\$ 14,314	\$ 9,989
Net income pro forma	15,704	9,577
Basic income per share as reported	0.19	0.13
Diluted income per share as reported	0.19	0.12
Basic income per share pro forma	0.21	0.12
Diluted income per share pro forma	0.20	0.12
Stock-based employee compensation expense, net of related tax effects as reported	3,135	256
Stock-based employee compensation expense, net of related tax effects pro forma	\$ 1,745	\$ 668

**Nine Months Ended**



**October 1,**

**2005**

**October 2,**

**2004**

## Edgar Filing: CHAMPION ENTERPRISES INC - Form 10-Q

(In thousands, except per share amounts)			
Net income as reported	\$	30,523	\$ 19,098
Net income pro forma		31,585	18,521
Basic income per share as reported		0.39	0.25
Diluted income per share as reported		0.39	0.24
Basic income per share pro forma		0.41	0.24
Diluted income per share pro forma		0.40	0.23
Stock-based employee compensation expense, net of related tax effects as reported		5,649	586
Stock-based employee compensation expense, net of related tax effects pro forma	\$	4,586	\$ 1,163

In December 2004, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting

---

Standard ( SFAS ) No. 123R, Share-Based Payment. Under previous practice, the reporting entity could account for share-based payment under the provisions of APB Opinion No. 25 and disclose share-based compensation as accounted for under the provisions of SFAS No. 123. Under the provisions of SFAS No. 123R, a public entity is required to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. That cost is recognized over the period during which an employee is required to provide service in exchange for the award. In April 2005, the Securities and Exchange Commission ( SEC ) postponed the effective date of SFAS No. 123R until fiscal years beginning after June 15, 2005. The Company expects to adopt SFAS No. 123R no later than January 2006. Once the standard is adopted, the Company currently expects full-year 2006 diluted net earnings per share to be reduced by less than \$.01 for stock options outstanding at October 1, 2005. The effect of adopting the standard for the Company's other stock-based compensation plans is not determinable. Application of this pronouncement requires significant judgment regarding the inputs to an option-pricing model, including stock price volatility and employee exercise behavior. Most of these inputs are either highly dependent on the current economic environment at the date of grant or forward-looking over the expected term of the award. As a result, the actual impact of adoption on earnings for 2006 could differ significantly from the Company's current estimate.

2. On August 8, 2005, pursuant to three separate asset purchase agreements, the Company acquired the assets of New Era Building Systems, Inc. and its affiliates, Castle Housing of Pennsylvania, Ltd. and Carolina Building Solutions, L.L.C. (collectively, "the New Era group"), modular homebuilders, for aggregate cash consideration of \$41 million plus the assumption of certain current liabilities, including trade payables, assumed contracts, and working capital lines of credit. These lines of credit, totaling \$8.2 million, were subsequently retired. This acquisition expands the Company's presence in the modular homebuilding industry.

The results of operations of the New Era group from the acquisition date to October 1, 2005 are included in the Company's results from continuing operations and in its manufacturing segment for the three and nine months ended October 1, 2005.

Goodwill and other intangible assets recognized in the transactions amounted to \$31.9 million, substantially all of which is expected to be fully deductible for tax purposes. All of the goodwill and intangible assets were assigned to the manufacturing segment. As of October 1, 2005, intangible assets resulting from the purchase consisted of \$2.8 million for trade names, \$1.3 million for customer relationships, and \$27.8 million for non-amortizable goodwill. Costs of intangible assets were determined based on valuation information obtained from a third-party valuation expert. Trade names were valued based upon the royalty-saving method and customer relationships were valued based upon the excess earnings method. The straight-line amortization periods to be used are 15 years for trade names and seven years for customer relationships, resulting in annual amortization expense of \$0.4 million.

An unaudited condensed balance sheet of the acquired businesses at August 8, 2005 is as follows:

Edgar Filing: CHAMPION ENTERPRISES INC - Form 10-Q

	<b>August 8, 2005</b> <b>(in millions)</b>
Current assets	\$ 18.6
Property, plant, and equipment, net	12.2
Goodwill	27.8
Amortizable intangible assets, net	4.1
Other non-current assets	0.3
Total assets	\$ 63.0
Current liabilities	\$ 21.3
Net assets of acquired businesses	\$ 41.7

The following tables include the unaudited pro forma combined results as if Champion had acquired the New Era group as of the beginning of the periods presented, instead of August 8, 2005.

---

**Unaudited**

Edgar Filing: CHAMPION ENTERPRISES INC - Form 10-Q

	<b>Three Months Ended October 1, 2005 (in thousands)</b>	<b>October 2, 2004</b>
Net sales	\$ 347,208	\$ 306,109
Net income	13,865	10,960
Income per share	\$ 0.18	\$ 0.14

	<b>Unaudited Nine Months Ended October 1, 2005 (in thousands)</b>	<b>October 2, 2004</b>
Net sales	\$ 966,123	\$ 834,411
Net income	31,476	21,772
Income per share	\$ 0.41	\$ 0.28

The pro forma results include amortization of the intangibles presented above. The pro forma results are not necessarily indicative of what actually would have occurred if the transaction had been completed as of the beginning of each of the fiscal periods presented, nor are they indicative of future consolidated results.

3. The provisions for income tax differ from the amount of income tax determined by applying the applicable U.S. statutory federal income tax rate to pretax income from continuing operations and discontinued operations as a result of the following differences:

	<b>Nine Months Ended October 1, 2005 (In thousands)</b>	<b>October 2, 2004</b>
<b>Continuing operations</b>		
Statutory U.S. tax rate	\$ 12,800	\$ 2,900
(Decrease) increase in rate resulting from:		
Warrant mark-to-market and other permanent differences	(1,200 )	1,500
Deferred tax valuation allowance	(9,900 )	(3,300 )
Decrease in allowance for tax adjustments		(12,000 )
Foreign and state taxes	150	600
Total income tax expense (benefit)	\$ 1,850	\$ (10,300 )

	<b>Nine Months Ended October 1, 2005 (In thousands)</b>	<b>October 2, 2004</b>
<b>Discontinued operations</b>		
Statutory U.S. tax rate	\$ (1,500 )	\$ (100 )
Increase in rate resulting from:		
Deferred tax valuation allowance	1,500	100
Total income tax	\$	\$

The Company currently provides a 100% valuation allowance for its deferred tax assets. Deferred tax assets will continue to require a 100% valuation allowance until the Company has demonstrated their realizability through sustained profitability and/or from other factors. As of January 1, 2005, the Company had available federal net operating loss carryforwards of approximately \$120 million for tax purposes to offset certain future federal taxable

income. These loss carryforwards expire in 2023 and 2024. As a result of the divestiture of the Company's remaining traditional retail operations during 2005, an estimated \$80 million of additional tax loss carryforwards have been generated.

4. A summary of inventories by component follows:

	<b>October 1, 2005</b>		<b>January 1, 2005</b>
	<b>(In thousands)</b>		
New manufactured homes	\$ 30,196	\$	18,749
Raw materials	37,382		30,908
Work-in-process	12,986		7,166
Other inventory	18,141		14,793
	<b>\$ 98,705</b>	<b>\$</b>	<b>71,616</b>

Other inventory consists of land, park spaces, and improvements, net of inventory reserves.

5. The Company's manufacturing operations generally provide retail homebuyers with a twelve-month warranty from the date of purchase. Estimated warranty costs are accrued as costs of sales primarily at the time of the manufacturing sale. Warranty provisions and reserves are based on estimates of the amounts necessary to settle existing and future claims for homes sold by the manufacturing operations as of the balance sheet date. The following table summarizes the changes in accrued product warranty obligations during the nine months ended October 1, 2005 and October 2, 2004. A portion of warranty reserves was classified as other long-term liabilities in the consolidated balance sheet.

	<b>2005</b>		<b>2004</b>
	<b>(In thousands)</b>		
Reserves at beginning of year	\$ 40,051	\$	47,058
Warranty expense provided	36,160		34,327
Warranty reserves from acquisitions	1,783		
Cash warranty payments	(39,129)	)	(40,078)
Reserves at end of quarter	<b>\$ 38,865</b>	<b>\$</b>	<b>41,307</b>

6. Long-term debt consisted of the following:

	<b>October 1, 2005</b>		<b>January 1, 2005</b>
	<b>(In thousands)</b>		
7.625% Senior Notes due 2009	\$ 89,273	\$	89,273
11.25% Senior Notes due 2007	88,430		97,510
Obligations under industrial revenue bonds	12,430		12,430
Other debt	1,379		1,545
	<b>\$ 191,512</b>	<b>\$</b>	<b>200,758</b>

During the quarter ended July 2, 2005, the Company purchased and retired \$9.1 million of its Senior Notes due 2007 for cash payments of \$9.9 million, resulting in a pretax loss of \$0.9 million. During the quarter ended July 3, 2004, the Company purchased and retired \$10.9 million of its Senior Notes due 2009 for cash payments of \$10.4 million, resulting in a pretax gain of \$0.5 million. During the first quarter of 2004, the Company purchased and retired \$13.5 million of the Senior Notes due 2009 and \$13.5 million of the Senior Notes due 2007 in exchange for Company common stock totaling 3.9 million shares, resulting in a pretax loss of \$3.2 million. Also during the first quarter of 2004, the Company repaid a \$5.7 million obligation under an industrial revenue bond.

## Edgar Filing: CHAMPION ENTERPRISES INC - Form 10-Q

Champion Home Builders Co., a wholly-owned subsidiary of the Company, has a three-year, \$75 million revolving credit facility currently used for the issuance of letters of credit. Under this facility, as amended January 24, 2005,

---

letter of credit fees range from 1.75% to 2.25% annually and borrowings bear interest at either the prime interest rate plus up to 0.5% or the Eurodollar rate plus 2.0% to 2.5%. In addition, there is an annual fee of \$0.1 million and a 0.375% of the unused portion of the facility. Availability under the facility is determined by a monthly borrowing base calculation based on percentages of eligible accounts receivable, inventory, fixed assets, and, if necessary, cash on deposit. The facility agreement contains certain financial covenants that require the Company, only in the event that its liquidity, as defined, falls below \$35 million, to maintain certain levels of consolidated earnings before interest, taxes, depreciation, amortization, non-cash restructuring costs and gains (losses) from extinguishment of Senior Notes and certain ratios of earnings to fixed charges, as defined. Liquidity, as defined, consists of the majority of the Company's unrestricted cash and cash equivalents plus unused availability under the facility. Fixed charges, as defined, consist primarily of interest expense, capital expenditures, dividends paid in cash, required principal payments of debt and lease payments paid or accrued during the calculation period as well as cash losses under wholesale repurchase obligations. In addition, the facility contains covenants that limit the Company's ability to incur additional indebtedness and liens, sell assets and, if liquidity falls below \$35 million, make certain investments, pay dividends and purchase or redeem its common stock. The line of credit is collateralized by accounts receivable, inventories, fixed assets, cash, and other assets. As of October 1, 2005, availability under the facility was \$62.3 million, there were \$52.2 million of letters of credit issued and no borrowings outstanding, and the Company's liquidity, as defined, was \$143.6 million, which was in excess of \$35 million such that no other financial covenants were in effect.

During the quarter ended October 1, 2005, the Company announced plans to enter into new senior secured credit facilities in an aggregate amount of \$200 million. Approximately \$100 million of proceeds will represent funded debt to be used to finance a tender offer for the 11.25% Senior Notes due 2007. The remaining amount will be a back-up facility to support the Company's letters of credit, in addition to providing working capital through a revolving credit facility. It is anticipated that the new credit facility will close in late October 2005.

On September 30, 2005, the Company commenced a cash tender offer and consent solicitation for all of the \$88.4 million of its outstanding 11.25% Senior Notes due 2007. As of October 14, 2005, the Company had received tenders from holders of a total of \$82 million of the Senior Notes. As a result of the successful consent solicitation, most of the covenants in the indenture will be eliminated upon closing.

7. During the first quarter of 2004, the preferred shareholder exercised its right to purchase \$12 million of Series B-2 preferred stock. At January 1, 2005, redeemable convertible preferred stock consisted of \$8.75 million of Series C and \$12 million of Series B-2 with mandatory redemption dates of April 2, 2009 and July 3, 2008, respectively. Both Series had a 5% annual dividend that was payable quarterly, at the Company's option, in cash or common stock. Also at January 1, 2005, the preferred shareholder held a warrant that was issued by the Company, which was exercisable based on approximately 2.2 million shares at the strike price at April 2, 2005 of \$12.27 per share. The warrant had an expiration date of April 2, 2009 and was exercisable only on a non-cash, net basis, whereby the warrant holder would receive shares of common stock as payment for any net gain upon exercise.

On April 18, 2005, the Company repurchased and subsequently cancelled the common stock warrant in exchange for a cash payment of \$4.5 million and the preferred shareholder elected to immediately convert all of the outstanding Series B-2 and Series C preferred stock into 3.1 million shares of common stock under the terms of the respective preferred stock agreements.

During the nine months ended October 1, 2005, the Company recorded a mark-to-market credit of \$4.3 million for the change in estimated fair value of the warrant. During the quarter and nine months ended October 2, 2004, the Company recorded mark-to-market charges of \$2.3 million and \$3.5 million, respectively.

## Edgar Filing: CHAMPION ENTERPRISES INC - Form 10-Q

8. The majority of the Company's manufacturing sales to independent retailers are made pursuant to repurchase agreements with lending institutions that provide wholesale floor plan financing to the retailers. Pursuant to these agreements, generally for a period of up to 24 months from invoice date of the sale of the homes and upon default by the retailers and repossession by the financial institution, the Company is obligated to purchase the related floor plan loans or repurchase the homes from the lender. The contingent repurchase obligation at October 1, 2005 was estimated to be approximately \$265 million, without reduction for the resale value of the homes. Losses under repurchase obligations are determined by the difference between the repurchase price and the estimated net proceeds from the resale of the homes. Losses incurred on homes repurchased totaled \$0.3 million and \$0.2 million for the nine months ended October 1, 2005 and October 2, 2004, respectively.

At October 1, 2005 the Company was contingently obligated for approximately \$52.5 million under letters of credit, primarily comprised of \$35.3 million to support insurance reserves, \$12.6 million to support long-term debt, and \$3.1 million to secure surety bonds. Champion was also contingently obligated for \$10.6 million under surety bonds, generally to support license and service bonding requirements. Approximately \$48.0 million of the letters of credit support insurance reserves and long-term debt that are reflected as liabilities in the consolidated balance sheet.

At October 1, 2005 certain of the Company's subsidiaries were guarantors of \$4.6 million of debt of unconsolidated subsidiaries, none of which was reflected in the consolidated balance sheet. These guarantees are several or joint and several and are related to indebtedness of certain manufactured housing community developments which are collateralized by the properties being developed.

The Company has provided various representations, warranties, and other standard indemnifications in the ordinary course of its business, in agreements to acquire and sell business assets, and in financing arrangements. The Company is subject to various legal proceedings and claims that arise in the ordinary course of its business.

Management believes the ultimate liability with respect to these contingent obligations will not have a material effect on the Company's financial position, results of operations or cash flows.

9. During the three months ended October 1, 2005, the Company's potentially dilutive securities consisted of outstanding stock options and awards. During the nine months ended October 1, 2005 and the three and nine months ended October 2, 2004, the Company's potentially dilutive securities consisted of outstanding stock options and awards, convertible preferred stock, a common stock warrant, and, in the 2004 periods, deferred purchase price obligations. Convertible preferred stock and common stock warrants were not considered in determining the denominator for diluted earnings per share (EPS) in any period presented because the effect would have been antidilutive. A reconciliation of the numerators and denominators used in the Company's basic and diluted EPS calculations follows:

	Three Months Ended		Nine Months Ended	
	October 1, 2005 (In thousands)	October 2, 2004	October 1, 2005	October 2, 2004
Numerator				
Net income	\$ 14,314	\$ 9,989	\$ 30,523	\$ 19,098
Plus loss from discontinued operations	900	629	4,209	361
Less preferred stock dividend		(259 )	(293 )	(678 )
Less amount allocated to participating securities		(718 )	(952 )	(1,244 )

Edgar Filing: CHAMPION ENTERPRISES INC - Form 10-Q

holders Income from continuing operations available to common shareholders for basic and diluted EPS	15,214	9,641	33,487	17,537
Loss from discontinued operations available to common shareholders for basic and diluted EPS	(900 )	(629 )	(4,209 )	(361 )
Income available to common shareholders for basic and diluted EPS	\$ 14,314	\$ 9,012	\$ 29,278	\$ 17,176
Denominator Shares for basic EPS--weighted average shares outstanding Plus effect of dilutive securities Deferred purchase price obligations Stock options and awards	75,837	71,300	74,520	70,020
	1,049	423	1,039	647
		799		943

---

Shares for diluted EPS	76,886	72,522	75,559	71,610
------------------------	--------	--------	--------	--------

10. The Company evaluates the performance of its manufacturing and retail segments based on income before interest, income taxes, and general corporate expenses. Reconciliations of segment sales to consolidated net sales and segment income to consolidated income from continuing operations before income taxes follow:



Edgar Filing: CHAMPION ENTERPRISES INC - Form 10-Q

	<b>Three Months Ended</b>		
	<b>October 1,</b>		<b>October 2,</b>
	<b>2005</b>		<b>2004</b>
	<b>(In thousands)</b>		
Net sales			
Manufacturing	\$ 310,239		\$ 269,498
Retail	36,789		34,251
Less: intercompany	(11,300)	)	(26,800)
Consolidated net sales	\$ 335,728		\$ 276,949
Income from continuing operations before income taxes:			
Manufacturing segment income	\$ 27,023		\$ 22,092
Retail segment income	2,176		2,017
General corporate expenses	(9,875)	)	(6,505)
Mark-to-market charge for common stock warrant			(2,300)
Interest expense, net	(3,360)	)	(4,086)
Intercompany eliminations	200		200
Income from continuing operations before income taxes	\$ 16,164		\$ 11,418

	<b>Nine Months Ended</b>		
	<b>October 1,</b>		<b>October 2,</b>
	<b>2005</b>		<b>2004</b>
	<b>(In thousands)</b>		
Net sales			
Manufacturing	\$ 840,572		\$ 748,437
Retail	100,731		82,030
Less: intercompany	(44,200)	)	(76,300)
Consolidated net sales	\$ 897,103		\$ 754,167
Income from continuing operations before income taxes:			
Manufacturing segment income	\$ 62,880		\$ 44,313
Retail segment income	6,045		4,246
General corporate expenses	(26,675)	)	(19,374)
Mark-to-market credit (charge) for common stock warrant	4,300		(3,500)
Loss on debt retirement	(901)	)	(2,776)
Interest expense, net	(10,867)	)	(13,250)
Intercompany eliminations	1,800		(500)
Income from continuing operations before income taxes	\$ 36,582		\$ 9,159

11. Discontinued operations include the Company's traditional retail operations, excluding its California non-traditional retail operations, and its former consumer finance business that was exited in 2003. For the three and nine months ended October 1, 2005, revenues from discontinued retail operations were \$0.4 million and \$25.6 million, respectively. For the three and nine months ended October 2, 2004, revenues from discontinued retail operations were \$38.7 million and \$104.7 million, respectively. Losses from discontinued operations for the three and nine months ended October 1, 2005 and October 2, 2004 consist of the following:

---

<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
<b>October 1,</b>	<b>October 2,</b>	<b>October 1,</b>	<b>October 2,</b>
<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>

Edgar Filing: CHAMPION ENTERPRISES INC - Form 10-Q

	(In thousands)			
Loss from retail operations	\$ (872 )	\$ (557 )	\$ (4,159 )	\$ (1,405 )
(Loss) income from consumer finance business	(28 )	(73 )	(50 )	1,044
Total loss from discontinued operations	\$ (900 )	\$ (630 )	\$ (4,209 )	\$ (361 )

The assets and liabilities of discontinued operations consisted of the following:

	October 1, 2005 (In thousands)	January 1, 2005
Assets:		
Accounts receivable, trade	\$ 26	\$ 598
Inventories	2,096	33,964
Other current assets	692	901
Current assets of discontinued operations	2,814	35,463
Property, plant, and equipment, net	580	5,064
Other non-current assets	1,824	2,683
Non-current assets of discontinued operations	2,404	7,747
Liabilities:		
Floor plan payable	\$	\$ 11,835
Accounts payable	516	2,043
Other current liabilities	3,145	9,533
Current liabilities of discontinued operations	3,661	23,411
Long-term liabilities	18	432

On July 19, 2005, the Company's remaining ten traditional retail locations were sold. Loss from discontinued retail operations for the nine months ended October 1, 2005 included an operating loss of \$2.3 million and a net loss of \$1.9 million related to sales of 40 retail locations. In connection with the sales of retail businesses during 2005, intercompany profit of \$2.4 million, which had been previously eliminated in consolidation, was recognized in the consolidated statement of operations and was not classified as discontinued operations. Retail assets sold in 2005 consisted primarily of new homes and other inventory. During 2005 the aggregate sale price for the sold operations was cash of approximately \$30.6 million and the buyers' assumption of certain liabilities totaling approximately \$3.4 million. In connection with these sales, the Company paid down \$10.9 million of floor plan borrowings.

12. During the quarter ended April 2, 2005, the Company issued 171,000 shares of common stock in payment of the final \$2.0 million installment of deferred purchase price obligations. During the three and nine months ended October 2, 2004, the Company issued 214,000 shares and 683,000 shares, respectively, of common stock in payment of deferred purchase price obligations of \$2.0 million and \$6.0 million, respectively. In addition, during the second quarter of 2004, the Company issued 29,000 shares of common stock in payment of preferred stock dividends totaling \$0.3 million. During the first quarter of 2004, the Company purchased and retired \$13.5 million of its Senior Notes due 2009 and \$13.5 million of its Senior Notes due 2007 in exchange for 3.9 million shares of Company common stock.

Edgar Filing: CHAMPION ENTERPRISES INC - Form 10-Q

13. The following table provides information regarding current year activity for restructuring reserves recorded in previous periods relating to closures of manufacturing plants and retail sales centers.

	<b>Nine Months Ended October 1, 2005</b>			
	<b>2004</b>		<b>Prior</b>	
	<b>Closures</b>		<b>Closures</b>	<b>Total</b>
	<b>(In thousands)</b>			
Balance at beginning of year	\$ 810		\$ 3,611	\$ 4,421
Cash payments:				
Warranty costs			(675 )	(675 )
Other closing costs	(600 )		(379 )	(979 )
Reversals credited to earnings:				
Other closing costs	(190 )		(16 )	(206 )
Balance at October 1, 2005	\$ 20		\$ 2,541	\$ 2,561
Period end balance comprised of:				
Warranty costs	\$ 20		\$ 1,917	\$ 1,917
Other closing costs	20		624	644
	\$ 20		\$ 2,541	\$ 2,561

Warranty costs are expected to be paid over a three-year period after the related closures. Other closing costs are generally paid within one year of the related closures, though certain lease payments at abandoned retail locations are paid up to three years after the closures. The reversal of closing costs during the nine months ended October 1, 2005 consisted of an adjustment to accruals for employee severance.

14. Substantially all subsidiaries of CHB are guarantors and the Company is a subordinated guarantor of the Senior Notes due 2007. In addition, CHB is a guarantor and substantially all of its subsidiaries are guarantors of the Senior Notes due 2009 on a basis subordinated to their guarantees of the Senior Notes due 2007. The non-guarantor subsidiaries include the Company's foreign operations, its development companies and certain finance subsidiaries.

Separate financial statements for each guarantor subsidiary are not included in this filing because each guarantor subsidiary is 100%-owned and the guarantees are full and unconditional, as well as joint and several, for the Senior Notes due 2009 and for the Senior Notes due 2007. There were no significant restrictions on the ability of the parent company or any guarantor subsidiary to obtain funds from its subsidiaries by dividend or loan.

The following condensed consolidating financial information presents the financial position, results of operations and cash flows of (i) the Company ( Parent ) and CHB, as parents, as if they accounted for their subsidiaries on the equity method; (ii) the guarantor subsidiaries, and (iii) the non-guarantor subsidiaries.

Edgar Filing: CHAMPION ENTERPRISES INC - Form 10-Q

CHAMPION ENTERPRISES, INC.

Condensed Consolidating Statement of Operations

For the Three Months Ended October 1, 2005

	Parent (In thousands)	CHB	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Consolidating Eliminations	Consolidated
Net sales	\$	\$ 92,450	\$ 238,311	\$ 15,967	\$ (11,000 )	\$ 335,728
Cost of sales		76,774	199,999	12,246	(11,200 )	277,819
Gross margin		15,676	38,312	3,721	200	57,909
Selling, general, and administrative expenses		11,496	25,329	1,560		38,385
Operating income		4,180	12,983	2,161	200	19,524
Interest income	1,715	1,585	875	105	(3,300 )	980
Interest expense	(1,715 )	(2,523 )	(3,401 )	(1 )	3,300	(4,340 )
Income from continuing operations before income taxes		3,242	10,457	2,265	200	16,164
Income tax expense			150	800		950
Income from continuing operations		3,242	10,307	1,465	200	15,214
Loss from discontinued operations			(900 )			(900 )
Income before equity in income of consolidated subsidiaries		3,242	9,407	1,465	200	14,314
Equity in income of consolidated subsidiaries	14,114	10,872			(24,986 )	

Edgar Filing: CHAMPION ENTERPRISES INC - Form 10-Q

Net income \$ 14,114 \$ 14,114 \$ 9,407 \$ 1,465 \$ (24,786 ) \$ 14,314

CHAMPION ENTERPRISES, INC.

Condensed Consolidating Statement of Operations

For the Nine Months Ended October 1, 2005

	Parent (In thousands)	CHB	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Consolidating Eliminations	Consolidated
Net sales	\$	\$ 261,689	\$ 638,217	\$ 40,197	\$ (43,000 )	\$ 897,103
Cost of sales		219,950	539,347	31,860	(44,800 )	746,357
Gross margin		41,739	98,870	8,337	1,800	150,746
Selling, general, and administrative expenses	(1 )	32,491	69,939	4,267		106,696
Mark-to-market credit for common stock warrant	(4,300 )					(4,300 )
Loss on debt retirement		901				901
Operating income	4,301	8,347	28,931	4,070	1,800	47,449
Interest income	5,173	5,043	2,389	293	(10,216 )	2,682
Interest expense	(5,173 )	(8,082 )	(10,509 )	(1 )	10,216 )	(13,549 )
Income from continuing operations before income taxes	4,301	5,308	20,811	4,362	1,800	36,582
Income tax expense			150	1,700		1,850
Income from continuing	4,301	5,308	20,661	2,662	1,800	34,732

Edgar Filing: CHAMPION ENTERPRISES INC - Form 10-Q

operations							
Loss from discontinued operations			(4,151 )		(58 )		(4,209 )
Income before equity in income of consolidated subsidiaries	4,301	5,308	16,510	2,604	1,800		30,523
Equity in income of consolidated subsidiaries	24,422	19,114			(43,536 )		
Net income	\$ 28,723	\$ 24,422	\$ 16,510	\$ 2,604	\$ (41,736 )		\$ 30,523

CHAMPION ENTERPRISES, INC.

Condensed Consolidating Balance Sheet

As of October 1, 2005

	Parent (In thousands)	CHB	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Consolidating Eliminations	Consolidated
<b>Assets</b>						
Current assets						
Cash and cash equivalents	\$	\$ 102,182	\$ 5,677	\$ 23,200	\$	\$ 131,059
Restricted cash		294	215			509
Accounts receivable, trade		16,907	37,646	1,017	(3,324 )	52,246
Inventories		17,758	80,991	2,656	(2,700 )	98,705
Current assets of discontinued operations			2,814			2,814
Other current assets		8,495	5,700	643	(100 )	14,738
Total current assets		145,636	133,043	27,516	(6,124 )	300,071
Property, plant and equipment, net		26,254	61,780	2,520		90,554
Goodwill			157,678	835		158,513

Edgar Filing: CHAMPION ENTERPRISES INC - Form 10-Q

Investment in consolidated subsidiaries	32,370	310,416	183,840	6,789	(533,415 )	
Non-current assets of discontinued operations			2,404			2,404
Other non-current assets	566	1,338	3,677	7,631		13,212
	\$ 32,936	\$ 483,644	\$ 542,422	\$ 45,291	\$ (539,539 )	\$ 564,754
<b>Liabilities, Redeemable Convertible Preferred Stock and Shareholders Equity</b>						
Current liabilities						
Accounts payable	\$	\$ 12,652	\$ 28,615	\$ 2,230	\$ (2,867 )	\$ 40,630
Accrued warranty obligations		7,553	23,978	834		32,365
Accrued volume rebates		11,483	19,357	2,152		32,992
Current liabilities of discontinued operations			3,661			3,661
Other current liabilities	2,586	28,164	61,871	622	(100 )	93,143
Total current liabilities	2,586	59,852	137,482	5,838	(2,967 )	202,791
Long-term liabilities						
Long-term debt	89,273	95,764	6,457			191,494
Long-term liabilities of discontinued operations			18			18
Other long-term liabilities	89,273	8,125	29,108	123		37,356
		103,889	35,583	123		228,868
Intercompany balances	(180,408 )	35,152	476,414	4,964	(336,122 )	
Shareholders equity						
Common stock	75,939	1	62	3	(66 )	75,939
Capital in excess of par value	186,070	613,336	326,232	32,549	(972,117 )	186,070
Accumulated deficit	(140,524 )	(328,586 )	(433,315 )	1,547	771,733	(129,145 )

Edgar Filing: CHAMPION ENTERPRISES INC - Form 10-Q

Accumulated other							
comprehensive loss			((36	)	267		231
Total shareholders equity	121,485	284,751	(107,057	)	34,366	(200,450	)
	\$ 32,936	\$ 483,644	\$ 542,422		\$ 45,291	\$ (539,539	)
							\$ 133,095
							\$ 564,754

CHAMPION ENTERPRISES, INC.

Condensed Consolidating Statement of Cash Flows

For the Nine Months Ended October 1, 2005

	Parent (In thousands)	CHB	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Consolidating Eliminations	Consolidated
Net cash (used for) provided by operating activities	\$ (7,062 )	\$ 11,069	\$ 29,877	\$ 6,237	\$ (431 )	\$ 39,690
Net cash used for discontinued operations			14,965	(58 )		(14,907 )
Cash flows from investing activities						
Additions to property plant and equipment		(1,752 )	(5,789 )	(435 )		(7,976 )
Acquisition of New Era		(41,427 )				(41,427 )
Investments in and advances to unconsolidated subsidiaries				(55 )		(55 )
Investments in and advances to consolidated subsidiaries	10,273	31,834	(41,436 )	(621 )	(50 )	5,221
Proceeds on disposal of		146	4,524	551		



Edgar Filing: CHAMPION ENTERPRISES INC - Form 10-Q

fixed assets							
Net cash							
provided by							
(used for)							
investing							
activities	10,273	11,199	(42,701 )	(560 )	(50 )	(44,237 )	
Cash flows							
from							
financing							
activities							
Decrease in							
short-term							
debt, net		(8,195 )				(8,195 )	
Decrease in							
other long-							
term debt			(277 )			(277 )	
Purchase of							
Senior Notes		(9,885 )				(9,885 )	
Decrease							
(increase) in							
restricted cash		15	(14 )			1	
Purchase of							
common							
stock warrant	(4,500 )					(4,500 )	
Common stock							
issued, net	1,582					1,582	
Dividends paid							
on							
preferred stock	(293 )					(293 )	
Net cash used							
for							
financing							
activities	(3,211 )	(18,065 )	(291 )			(21,567 )	
Net (decrease)							
increase							
in cash and							
cash							
equivalents		(18,195 )	1,850	5,619	(481 )	(11,207 )	
Cash and cash							
equivalents at							
beginning of							
period		120,377	3,827	17,581	481	142,266	
Cash and cash							
equivalents at							
end of period	\$	\$ 102,182	\$ 5,677	\$ 23,200	\$	\$ 131,059	

Edgar Filing: CHAMPION ENTERPRISES INC - Form 10-Q

Condensed Consolidating Statement of Operations

For the Three Months Ended October 2, 2004

	Parent (In thousands)	CHB	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Consolidating Eliminations	Consolidated
Net sales	\$	\$ 77,158	\$ 212,676	\$ 13,915	\$ (26,800 )	\$ 276,949
Cost of sales		65,591	177,248	10,751	(27,000 )	226,590
Gross margin		11,567	35,428	3,164	200	50,359
Selling, general and administrative expenses		6,007	24,814	1,734		32,555
Mark-to-market charge for common stock warrant	2,300					2,300
Operating income	(2,300 )	5,560	10,614	1,430	200	15,504
Interest income	1,716	1,832	449	20	(3,547 )	470
Interest expense	(1,716 )	(2,783 )	(3,604 )		3,547	(4,556 )
(Loss) income from continuing operations before income taxes	(2,300 )	4,609	7,459	1,450	200	11,418
Income tax expense (benefit)		50	50	700		800
(Loss) income from continuing operations	(2,300 )	4,559	7,409	750	200	10,618
(Loss) income from discontinued operations			(630 )	1		(629 )
(Loss) income before equity in income of consolidated subsidiaries	(2,300 )	4,559	6,779	751	200	9,989
Equity in income of consolidated	12,089	7,530			(19,619)	

Edgar Filing: CHAMPION ENTERPRISES INC - Form 10-Q

subsidiaries  
 Net income \$ 9,789 \$ 12,089 \$ 6,779 \$ 751 \$ (19,419 ) \$ 9,989

CHAMPION ENTERPRISES, INC.

Condensed Consolidating Statement of Operations

For the Nine Months Ended October 2, 2004

	Parent (In thousands)	CHB	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Consolidating Eliminations	Consolidated
Net sales	\$	\$ 213,960	\$ 581,536	\$ 34,971	\$ (76,300 )	\$ 754,167
Cost of sales		184,227	494,951	27,379	(75,800 )	630,757
Gross margin		29,733	86,585	7,592	(500 )	123,410
Selling, general and administrative expenses		20,599	69,217	4,909		94,725
Mark-to-market charge for common stock warrant	3,500					3,500
Loss on debt retirement	12	2,696	68			2,776
Operating (loss) income	(3,512 )	6,438	17,300	2,683	(500 )	22,409
Interest income	5,621	5,597	871	83	(11,218 )	954
Interest expense	(5,621 )	(8,449 )	(11,351 )	(1 )	11,218	(14,204 )
(Loss) income from continuing operations before income taxes	(3,512 )	3,586	6,820	2,765	(500 )	9,159
Income tax expense (benefit)		150	(11,850 )	1,400		(10,300 )
(Loss) income from continuing operations	(3,512 )	3,436	18,670	1,365	(500 )	19,459
Loss from discontinued operations			(323 )	(38 )		(361 )
(Loss) income before equity in (loss) income of consolidated	(3,512 )	3,436	18,347	1,327	(500 )	19,098

Edgar Filing: CHAMPION ENTERPRISES INC - Form 10-Q

subsidiaries							
Equity in income of							
consolidated							
subsidiaries	23,110	19,674			(42,784	)	
Net income	\$ 19,598	\$ 23,110	\$ 18,347	\$ 1,327	\$ (43,284	)	\$ 19,098

CHAMPION ENTERPRISES, INC.

Condensed Consolidating Balance Sheet

As of January 1, 2005

	Parent (In thousands)	CHB	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Consolidating Eliminations	Consolidated
<b>Assets</b>						
Current assets						
Cash and cash equivalents	\$	\$ 120,377	\$ 3,827	\$ 17,581	\$ 481	\$ 142,266
Restricted cash		309	220			529
Accounts receivable, trade		9,273	13,995	1,058	(2,207	) 22,119
Inventories		16,153	56,383	2,780	(3,700	) 71,616
Current assets of discontinued operations			35,442	21		35,463
Other current assets		9,507	3,809	519	(300	) 13,535
Total current assets		155,619	113,676	21,959	(5,726	) 285,528
Property, plant and equipment, net		26,608	52,024	2,325		80,957
Goodwill			125,783	808		126,591
Investment in consolidated subsidiaries	26,641	310,177	146,242	6,819	(489,879	)
Non-current assets of discontinued operations			7,009	738		7,747
Other non-current assets	692	2,653	5,002	7,872		16,219
	\$ 27,333	\$ 495,057	\$ 449,736	\$ 40,521	\$ (495,605	) \$ 517,042
<b>Liabilities, Redeemable Convertible Preferred Stock and Shareholders Equity</b>						
Current liabilities						
Accounts payable	\$	\$ 8,232	\$ 4,696	\$ 891	\$	\$ 13,819
Accrued warranty obligations		7,338	25,434	779		33,551

Edgar Filing: CHAMPION ENTERPRISES INC - Form 10-Q

Accrued volume rebates		10,244	18,232	2,377	(619	)	30,234	
Current liabilities of								
discontinued operations			21,411				21,411	
Other current liabilities	975	24,519	52,775	(726	)	(200	)	77,343
Total current liabilities	975	50,333	122,548	3,321	(819	)	176,358	
Long-term liabilities								
Long-term debt	89,273	104,879	6,606				200,758	
Long-term liabilities of								
discontinued operations			432				432	
Other long-term liabilities	8,800	8,125	24,376	143			41,444	
	98,073	113,004	31,414	143			242,634	
Intercompany balances	(160,246 )	48,972	441,453	5,974	(336,153	)		
Redeemable convertible preferred stock	20,750						20,750	
Shareholders' equity								
Common stock	72,358	1	63	3	(67	)	72,358	
Capital in excess of par value	164,377	613,336	274,324	32,724	(920,384	)	164,377	
Accumulated deficit	(168,954 )	(330,589 )	(420,066 )	(1,584	)	761,818	(159,375)	
Accumulated other comprehensive loss				(60	)		(60)	
Total shareholders' equity	\$ 67,781	\$ 282,748	\$ (145,679 )	\$ 31,083	\$ (158,633	)	\$ 77,300	
	\$ 27,333	\$ 495,057	\$ 449,736	\$ 40,521	\$ (495,605	)	\$ 517,042	

CHAMPION ENTERPRISES, INC.

Condensed Consolidating Statement of Cash Flows

For the Nine Months Ended October 2, 2004

	Parent (In thousands)	CHB	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Consolidating Eliminations	Consolidated
Net cash provided by (used for) operating activities	\$ 4,997	\$ (28,928 )	\$ 20,336	\$ 1,218	\$ (592 )	\$ (2,969 )
Net cash used for discontinued operations			(15,563 )	(38 )		(15,601 )
Cash flows from investing						

Edgar Filing: CHAMPION ENTERPRISES INC - Form 10-Q

activities						
Additions to property plant and equipment		(1,153 )	(4,833 )	(261 )		(6,247 )
Investments in and advances to unconsolidated subsidiaries			(54 )	(109 )		(163 )
Investments in and advances to consolidated subsidiaries	(11,337 )	14,323	(6,681 )	3,174	521	
Proceeds on disposal of fixed assets		1	3,584	60		3,645
Net cash (used for) provided by investing activities	(11,337 )	(13,171 )	(7,984 )	2,864	521	(2,765 )
Cash flows from financing activities						
Decrease in floor plan payable, net				(29 )		(29 )
Decrease in other long-term debt			(6,025 )			(6,025 )
Purchase of Senior Notes (Increase)	(10,395 )					(10,395 )
decrease in restricted cash		1	7,887			7,888
Preferred stock issued, net	12,000					12,000
Common stock issued, net	5,154					5,154
Dividends paid on preferred stock	(419 )					(419 )
Net cash provided by (used for) financing activities	6,340	1	1,862	(29 )		8,174
Net (decrease) increase in cash and cash equivalents		(15,756 )	(1,349 )	4,015	(71 )	(13,161 )
Cash and cash equivalents at beginning of period		129,072	3,824	12,972		145,868

## Edgar Filing: CHAMPION ENTERPRISES INC - Form 10-Q

Cash and cash  
equivalents  
at end of  
period

\$	\$	113,316	\$	2,475	\$	16,987	\$	(71	)\$	132,707
----	----	---------	----	-------	----	--------	----	-----	-----	---------

---

Item 2. Management's Discussion and Analysis of  
Financial Condition and Results of Operations.

### CHAMPION ENTERPRISES, INC.

#### **Results of Operations**

##### **Three and Nine Months Ended October 1, 2005**

##### **versus the Three and Nine Months Ended October 2, 2004**

#### **Overview**

We are a leading producer of factory-built housing in the U.S. As of October 1, 2005, we operated 32 homebuilding facilities in 14 states and two provinces in western Canada. As of October 1, 2005, our homes were sold through 3,000 independent sales centers, builders, and developers across the U.S. and western Canada. Approximately 850 of the independent retailer locations were members of our Champion Home Centers ( CHC ) retail distribution network. As of October 1, 2005, our homes were also sold through 20 Company-owned sales locations in California.

On August 8, 2005 we acquired New Era Building Systems, a leading modular homebuilder, and its affiliates, Castle Housing of Pennsylvania and Carolina Building Solutions (the New Era group ), for cash consideration of \$41 million and the assumption of certain liabilities. The results of operations of the New Era group from the acquisition date to October 1, 2005 are included in our results from continuing operations and in our manufacturing segment for the three and nine months ended October 1, 2005.

Our pretax income from continuing operations for the quarter ended October 1, 2005 was \$16.2 million, an increase of \$4.7 million over 2004. Improvement in our third quarter results is attributable to higher sales levels, improved manufacturing pricing and material purchasing, the acquisition of the New Era group, as well as improved operating efficiencies at our manufacturing facilities. Included in income from continuing

## Edgar Filing: CHAMPION ENTERPRISES INC - Form 10-Q

operations for the 2004 quarter is a charge of \$2.3 million for the change in estimated fair value of an outstanding common stock warrant.

Our pretax income from continuing operations for the nine months ended October 1, 2005 was \$36.6 million, an increase of \$27.4 million over 2004. Improvement in our nine-month results is attributable to the same factors as cited for improvement in our third quarter results. Included in income from continuing operations for the nine months ended October 1, 2005 is a credit of \$4.3 million for the change in estimated fair value of the common stock warrant, compared to a charge of \$3.5 million for the comparable period of 2004. Results in 2005 also include a loss on debt retirement of \$0.9 million compared to a loss of \$2.8 million in 2004. Additionally, results in 2005 include gains of \$1.5 million from the sale of three idle plants that are included in selling, general, and administrative expense.

During the nine months ended October 1, 2005, we completed the disposal of our traditional retail operations through the sale of our remaining 40 traditional retail sales centers, including the sale of ten sales centers during the quarter ended October 1, 2005. As a result, our retail operations, excluding our ongoing California operations, have been classified as discontinued operations for the periods presented.

In September 2005, we were awarded a contract to supply manufactured homes to the Federal Emergency Management Agency ( FEMA ) in connection with its Hurricane Katrina relief efforts. In September 2005 we obtained an order from FEMA for the delivery of 2,000 new homes for \$60 million, plus delivery, under this contract. We expect to construct and deliver these homes during the quarter ended December 31, 2005, subject to delivery instructions and quantities to be received from FEMA.

We continue to focus on matching our manufacturing capacity to industry and local market conditions and improving or eliminating under-performing manufacturing facilities. We continually review our manufacturing capacity and will make further adjustments as deemed necessary.

---

### Consolidated Results

	<b>Three Months Ended October 1, 2005</b>	<b>October 2, 2004</b>	<b>% Change</b>	
Net sales	<b>(Dollars in millions)</b>			
Manufacturing	\$ 310.2	\$ 269.5	15	%
Retail	36.8	34.3	7	%
Less: Intercompany	(11.3 )	(26.8 )		
Total net sales	\$ 335.7	\$ 277.0	21	%
Gross margin	\$ 57.9	\$ 50.4	15	%
Selling, general and administrative expenses ( SG&A )	38.4	32.6	18	%
Mark to market charge for common stock warrant		2.3		
Operating income	\$ 19.5	\$ 15.5	26	%
As a percent of net sales				
Gross margin	17.2	18.2	%	%



Edgar Filing: CHAMPION ENTERPRISES INC - Form 10-Q

SG&A	11.4	%	11.8	%
Operating income	5.8	%	5.6	%

	Nine Months Ended October 1, 2005 (Dollars in millions)		October 2, 2004		% Change	
Net sales						
Manufacturing	\$	840.6	\$	748.4	12	%
Retail		100.7		82.0	23	%
Less: Intercompany		(44.2)		(76.3)		
Total net sales	\$	897.1	\$	754.1	19	%
Gross margin	\$	150.7	\$	123.4	22	%
Selling, general and administrative expenses ( SG&A )		106.7		94.7	13	%
Mark to market (credit) charge for common stock warrant		(4.3)		3.5		
Loss on debt retirement		0.9		2.8		
Operating income	\$	47.4	\$	22.4	112	%
As a percent of net sales						
Gross margin		16.8	%	16.4	%	
SG&A		11.9	%	12.6	%	
Operating income		5.3	%	3.0	%	

Net sales for the three and nine months ended October 1, 2005 increased from the comparable periods in 2004 due to sales price increases and changes in product mix in the manufacturing segment, the inclusion of the New Era group which was acquired on August 8, 2005, and increased selling prices in the retail segment. Gross margin for the three and nine months ended October 1, 2005 increased \$7.5 million and \$27.3 million, respectively, from the comparable periods of 2004. Manufacturing gross margin increased significantly due to improved pricing, product mix, and purchasing, and from improved operating efficiencies at our manufacturing facilities. SG&A for the three and nine months ended October 1, 2005 increased by \$5.8 million and \$12.0 million, respectively, from the comparable

---

periods of 2004 primarily due to increased sales in the manufacturing segment, SG&A from the New Era group subsequent to its acquisition and increased general corporate expenses due to information technology projects and corporate compensation programs, including higher stock-based compensation costs due to a rise in our common stock share price during the third quarter. Also during the 2005 year-to-date period, retail SG&A increased over the prior year due to operating a greater average number of retail sales centers and increased retail sales.

During the nine months ended October 1, 2005, we recorded a mark-to-market credit of \$4.3 million for the decrease in estimated fair value of an outstanding common stock warrant. On April 18, 2005, we repurchased and subsequently cancelled the common stock warrant in exchange for a cash payment of \$4.5 million. During the three and nine months ended October 2, 2004, we recorded mark-to-market charges of \$2.3 million and \$3.5 million, respectively, for the change in estimated fair value of the outstanding common stock warrant.

During the nine months ended October 1, 2005, operating results included a loss of \$0.9 million from the purchase and retirement of \$9.1 million of Senior Notes for cash payments totaling \$9.9 million. During the nine months ended October 2, 2004, operating results included a net loss of \$2.8 million on the extinguishment of debt primarily from the purchase and retirement of \$37.9 million of Senior Notes in exchange for 3.9 million shares of Company common stock and \$10.4 million of cash.

## Edgar Filing: CHAMPION ENTERPRISES INC - Form 10-Q

As presented in the tables above, the inclusion of the New Era group business in consolidated results contributed to an increase in net sales and operating income during the three and nine months ended October 1, 2005. On a pro forma basis, assuming we had owned the New Era group during the entire three and nine month periods ended October 1, 2005 and October 2, 2004, consolidated net sales would have increased by 13% and 16% for the three and nine months ended October 1, 2005, respectively, versus the prior year periods. Pro forma operating income would have increased by 16% and 93% for the three and nine months ended October 1, 2005, respectively, versus the prior year periods.

### Manufacturing Operations

We evaluate the performance of our manufacturing segment based on income before interest, income taxes, and general corporate expenses.

	<b>Three Months Ended October 1, 2005</b>		<b>October 2, 2004</b>	<b>% Change</b>	
Manufacturing segment net sales (in millions)	\$ 310.2		\$ 269.5	15	%
Manufacturing segment income (in millions)	\$ 27.0		\$ 22.1	22	%
Manufacturing segment margin %	8.7	%	8.2	%	
HUD-code home shipments	4,717		4,891	(4	%)
Modular and Canadian code home shipments	1,360		1,148	18	%
Total homes sold	6,077		6,039	1	%
Floors sold	11,799		11,582	2	%
Multi-section mix	85	%	84	%	
Average home price	\$ 47,300		\$ 43,000	10	%

---

	<b>Nine Months Ended October 1, 2005</b>		<b>October 2, 2004</b>	<b>% Change</b>	
Manufacturing segment net sales (in millions)	\$ 840.6		\$ 748.5	12	%
Manufacturing segment income (in millions)	\$ 62.9		\$ 44.3	42	%
Manufacturing segment margin %	7.5	%	5.9	%	
HUD-code home shipments	13,574		14,277	(5	%)
Modular and Canadian code home shipments	3,468		3,121	11	%
Total homes sold	17,042		17,398	(2	%)
Floors sold	32,814		33,343	(2	%)
Multi-section mix	85	%	85	%	
Average home price	\$ 45,900		\$ 41,500	11	%
Manufacturing facilities at period end	32		29	10	%

Manufacturing net sales for the three and nine months ended October 1, 2005 increased compared to the same periods of 2004 primarily from the inclusion of the New Era group net sales of approximately \$19 million, higher average home selling prices and greater delivery revenues.

## Edgar Filing: CHAMPION ENTERPRISES INC - Form 10-Q

Average manufacturing selling prices increased in 2005 as compared to 2004 as a result of price increases which, in part, offset rising material costs. Additionally, product mix, including increased sales of higher priced modular homes, contributed to the increased selling prices. Increased sales of modular homes in the quarter ended October 1, 2005, resulted primarily from the inclusion of the New Era group.

Manufacturing segment income for the three and nine months ended October 1, 2005 increased over the comparable periods of 2004 by \$4.9 million and \$18.6 million, respectively, on increased sales. The improvement in our manufacturing operations is attributable to improved pricing, material purchasing, and production efficiencies. In addition, manufacturing segment income in the first quarter of 2005 included net gains of \$1.5 million from the sale of three idle plants.

As presented in the tables above, the inclusion of the New Era group business in manufacturing results contributed to an increase in net sales and operating income during the three and nine months ended October 1, 2005. On a pro forma basis, assuming we had owned the New Era group during the entire three and nine month periods ended October 2, 2004 and October 1, 2005, manufacturing net sales would have increased by 8% and 10% for the three and nine months ended October 1, 2005, respectively, versus the prior year periods. Pro forma manufacturing segment income would have increased by 15% and 36% for the three and nine months ended October 1, 2005, respectively, versus the prior year periods.

Although orders from retailers can be cancelled at any time without penalty, and unfilled orders are not necessarily an indication of future business, our unfilled manufacturing orders for homes at October 1, 2005 totaled approximately \$228 million, compared to \$116 million at October 2, 2004. Backlog at October 1, 2005 included approximately \$58 million related to the order received from FEMA.

### Retail Operations

We evaluate the performance of our retail segment based on income before interest, income taxes, and general corporate expenses.

---

	<b>Three Months Ended October 1, 2005</b>		<b>October 2, 2004</b>	<b>% Change</b>	
Retail segment net sales (in millions)	\$ 36.8		\$ 34.3	7	%
Retail segment income (in millions)	\$ 2.2		\$ 2.0	8	%
Retail segment margin %	5.9	%	5.9	%	
New homes retail sold	193		211	(9)	%)
% Champion-produced new homes sold	85	%	78	%	
New home multi-section mix	96	%	98	%	
Average new home retail price	\$ 188,100		\$ 160,500	17	%

  

	<b>Nine Months Ended October 1, 2005</b>		<b>October 2, 2004</b>	<b>% Change</b>	
Retail segment net sales (in millions)	\$ 100.7		\$ 82.0	23	%
Retail segment income (in millions)	\$ 6.0		\$ 4.2	42	%
Retail segment margin %	6.0	%	5.2	%	

## Edgar Filing: CHAMPION ENTERPRISES INC - Form 10-Q

New homes retail sold	560		516	9	%
% Champion-produced new homes sold	81	%	77	%	
New home multi-section mix	96	%	97	%	
Average new home retail price	\$ 177,700		\$ 156,300	14	%
Sales centers at period end	20		18	11	%

Retail sales for the three and nine months ended October 1, 2005 increased versus the comparable periods last year due to an increased average selling price per home and, in the year-to-date period, from selling more homes from a greater number of sales offices in operation. The increased average home selling price resulted from improved market conditions and the sale of homes with more add-ons, improvements, and amenities. Additionally, retail prices have increased to offset higher prices from the manufacturers due to rising material costs. Retail segment income for the three and nine months ended October 1, 2005 improved by \$0.2 million and \$1.8 million, respectively, compared to the same period in 2004 primarily due to increased sales.

### Discontinued Operations

During the nine months ended October 1, 2005, we completed the disposal of our traditional retail operations through the sale of our remaining 40 traditional retail sales centers, including the sale of ten sales centers during the quarter ended October 1, 2005. As a result, our retail operations, other than our ongoing California business, have been classified as discontinued operations for the periods presented. Also included in discontinued operations is our former consumer finance business that was exited in the third quarter of 2003.

Loss from discontinued retail operations included operating losses of \$0.2 million and \$2.3 million for the three and nine months ended October 1, 2005, respectively. Net losses of \$0.7 million and \$1.9 million were recorded during the three and nine months ended October 1, 2005 for the sales of retail businesses. In connection with the sales of retail businesses during 2005, intercompany manufacturing profit of \$2.4 million was recognized in the consolidated statement of operations as a result of the liquidation of inventory, which is not classified as discontinued operations.

For the three months ended October 2, 2004, loss from discontinued operations consisted primarily of a retail operating loss of \$0.6 million. Loss from discontinued operations for the nine months ended October 2, 2004 consisted a retail operating loss of \$1.4 million, partially offset by income from the consumer finance business of \$1.0 million that resulted from a favorable adjustment from the settlement of contractual obligations.

---

### Restructuring Charges

We did not incur any significant restructuring charges during the three and nine months ended October 1, 2005 and October 2, 2004. As of October 1, 2005, accrued but unpaid restructuring costs totaled \$2.6 million compared to \$3.1 million at July 2, 2005 and \$4.4 million at January 1, 2005, consisting primarily of warranty reserves for closed manufacturing plants.

### **Interest Income and Interest Expense**

Interest income in three and nine months ended October 1, 2005 was higher than in the comparable 2004 periods due to higher cash balances and increased interest rates. Interest expense in the nine months ended October 1, 2005 was lower than in comparable 2004 period due to debt reduction during the first half of 2004. Since the beginning of 2003, we have reduced indebtedness by more than \$190 million.

### **Income Taxes**

We currently provide a 100% valuation allowance for our deferred tax assets, which totaled \$125.8 million at January 1, 2005. As of January 1, 2005, we had net operating losses for tax purposes totaling approximately \$120 million that are available to offset certain future taxable income. As a result of the divestiture of our remaining traditional retail operations during 2005, an estimated \$80 million of additional tax loss carryforwards have been generated. Income tax expense for the three and nine months ended October 1, 2005 and October 2, 2004 consisted of foreign and state income taxes.

### **Liquidity and Capital Resources**

Unrestricted cash balances totaled \$131.1 million at October 1, 2005. During the nine months ended October 1, 2005, net cash of \$39.7 million was provided by continuing operating activities. Excluding the working capital acquired in the purchase of the New Era group, during the period, inventories, accounts receivable, and accounts payable increased by \$13.0 million, \$27.6 million, and \$20.8 million, respectively, primarily as a result of typical seasonal factors. Other cash provided during the period included \$30.6 million from the sale of retail businesses, of which \$10.9 million was used to pay down related floor plan borrowings. Additionally, \$5.2 million of cash proceeds resulted from the disposal of fixed assets primarily from the sale of three idle plants. During the period cash totaling \$41.4 million was used in the acquisition of the New Era group, and \$8.2 million of cash was used to retire short-term debt assumed in the acquisition. Other cash uses during the period included \$9.9 million to purchase and retire Senior Notes due 2007, \$8.0 million for capital expenditures, and \$4.5 million to repurchase the outstanding common stock warrant.

We have a committed \$75 million revolving credit facility for letters of credit and general corporate purposes that expires in January 2006. Availability under this facility is determined by a monthly borrowing base calculation based on percentages of accounts receivable, inventories, fixed assets, and, if necessary, cash on deposit. As of October 1, 2005, there were \$52.5 million of letters of credit issued under the facility and there were no borrowings outstanding. The facility contains financial covenants that become effective only in the event that our liquidity, as defined, falls below \$35 million. These covenants include required earnings, as defined, of \$45.2 million and a required ratio of earnings to fixed charges, as defined, of 1.0 to 1.0 for each 12-month period ending on a fiscal quarter. For the twelve months ended October 1, 2005, our earnings, as defined, were \$67.2 million and our ratio of earnings to fixed charges was 1.9 to 1.0. At October 1, 2005, our liquidity, as defined, was \$143.6 million, which was in excess of \$35 million such that these financial covenants were not in effect.

On April 18, 2005, the preferred shareholder converted all of the outstanding Series B-2 and Series C preferred stock into 3.1 million shares of common stock under the terms of the respective preferred stock agreements.

We continuously evaluate our capital structure. Strategies considered to improve our capital structure include without limitation, purchasing, refinancing, exchanging, or otherwise retiring our outstanding indebtedness, restructuring of obligations, new financings, and issuances of securities, whether in the open market or by other means and to the extent permitted by our existing financing arrangements. We evaluate all potential transactions in light of existing and expected market conditions. The amounts involved in any such transactions, individually or in the aggregate, may be material.

The debt incurrence covenant in the indenture governing the Senior Notes due 2007 currently limits additional debt to: i) a working capital line of credit up to a borrowing base equal to 60% of otherwise unencumbered inventories and 75% of otherwise unencumbered accounts receivable; ii) warehouse financing meeting certain parameters up to \$200 million; iii) other debt up to \$30 million; and iv) ordinary course indebtedness and contingent obligations including non-speculative hedging obligations, floor plan financing, letters of credit, surety bonds, bankers acceptances, repurchase agreements related to retailer floor plan financing and guarantees of additional debt otherwise permitted to be incurred. The resulting effect at October 1, 2005, when combined with limits in our Senior Notes due 2009, was a working capital line of credit limit of approximately \$84 million of which no more than approximately \$30 million of cash borrowings could be secured debt, as defined.

During the quarter ended October 1, 2005, we announced plans to enter into new senior secured credit facilities in an aggregate amount of \$200 million. Approximately \$100 million of proceeds will represent funded debt to be used to finance a tender offer for the 11.25% Senior Notes due 2007. The remaining amount will be a back-up facility to support our letters of credit, in addition to providing working capital through a revolving credit facility. It is anticipated that the new credit facility will close in late October 2005.

On September 30, 2005, we commenced a cash tender offer and consent solicitation for all of the \$88.4 million of our outstanding 11.25% Senior Notes due 2007. As of October 14, 2005, we had received tenders from holders of a total of \$82 million of the Senior Notes. As a result of the settlement of the Senior Notes due 2007 and the replacement of the current \$75 million revolving credit facility, we will record charges of approximately \$9.5 million in the quarter ended December 31, 2005 for the redemption premium and the write off of remaining deferred financing costs and original issue discount. As a result of the successful consent solicitation, most of the covenants in the indenture will be eliminated upon closing.

We expect to spend less than \$7 million on capital expenditures during the remainder of 2005. We do not plan to pay cash dividends on our common stock in the near term.

#### ***Contingent liabilities and obligations***

We had significant contingent liabilities and obligations at October 1, 2005, including surety bonds and letters of credit totaling \$63.2 million, guarantees by certain of our consolidated subsidiaries of \$4.6 million of debt of unconsolidated subsidiaries, and estimated wholesale repurchase obligations.

We are contingently obligated under repurchase agreements with certain lending institutions that provide floor plan financing to our independent retailers. We use information, which is generally available only from the primary national floor plan lenders, to estimate our contingent repurchase obligations. With the exit of certain national floor plan lenders from the industry and the shift to alternative inventory financing sources, this estimate of our contingent repurchase obligation may not be precise. We estimate our contingent repurchase obligation as of October 1, 2005 was approximately \$265 million, without reduction for the resale value of the homes. As of October 1, 2005, our largest independent retailer, a nationwide retailer, had approximately \$9.5 million of inventory subject to repurchase for up to 24 months from date of invoice. As of October 1, 2005 our next 24 largest independent retailers had an aggregate of approximately \$67.5 million of inventory subject to repurchase for up to 24 months from date of invoice, with individual amounts ranging from approximately \$1.3 million to \$6.8 million per retailer. For the nine months ended October 1, 2005, we paid \$1.8 million and incurred losses of \$0.3 million for the repurchase of 43 homes. In the comparable period last year we paid \$1.2 million and incurred losses of \$0.2 million for the repurchase of 35 homes.

## Edgar Filing: CHAMPION ENTERPRISES INC - Form 10-Q

We have provided various representations, warranties and other standard indemnifications in the ordinary course of our business, in agreements to acquire and sell business assets and in financing arrangements. We are also subject to various legal proceedings that arise in the ordinary course of our business.

Management believes the ultimate liability with respect to these contingent liabilities and obligations will not have a material effect on our financial position, results of operations or cash flows.

---

### *Summary of liquidity and capital resources*

In the fourth quarter of 2005 we expect to close on a new senior secured credit facility in an aggregate amount of \$200 million, complete a tender offer and consent solicitation for \$88.4 million of our 11.25% Senior Notes due 2007 and terminate our current \$75 million revolving credit facility. The new credit facility will finance the tender offer, provide a back-up facility of approximately \$60 million to support our letters of credit and provide working capital through a \$40 million revolving credit facility. We expect capital expenditures for the next two years to be less than \$15 million per year and we have less than \$2 million of scheduled principal payments due in 2005 and 2006. At October 1, 2005, our unrestricted cash balances totaled \$131.1 million.

Our level of cash availability from our cash balances, our expected operating cash flows and availability under our new credit facility is projected to be substantially in excess of cash needed to operate our businesses for the next two years. In the event one or more of our capital resources were to become unavailable, we would revise our operating strategies accordingly.

### **Critical Accounting Policies**

For information regarding critical accounting policies, see **Critical Accounting Policies** in Item 7 of Part II of the our Form 10-K for 2004. There have been no material changes to our critical accounting policies described in such Form 10-K.

### **Impact of Recently Issued Accounting Pronouncements**

For information regarding the impact of recently issued accounting pronouncements, see Note 1 of **Notes to Consolidated Financial Statements** in Item 1 of this Report.

### **Forward Looking Statements**

## Edgar Filing: CHAMPION ENTERPRISES INC - Form 10-Q

Certain statements contained in this Report, including our plans and beliefs regarding availability of liquidity and financing, anticipated capital expenditures, outlook for the manufactured housing industry in particular and the economy in general, availability of wholesale and consumer financing and characterization of and our ability to control our contingent liabilities, could be construed to be forward looking statements within the meaning of the Securities Exchange Act of 1934. In addition, we or persons acting on our behalf may from time to time publish or communicate other items that could also be construed to be forward looking statements. Statements of this sort are or will be based on our estimates, assumptions and projections, and are subject to risks and uncertainties, including those specifically listed below that could cause actual results to differ materially from those included in the forward looking statements. We do not undertake to update our forward looking statements or risk factors to reflect future events or circumstances. The following risk factors could materially effect our operating results or financial condition.

***Significant leverage*** *Our significant debt could limit our ability to obtain additional financing, require us to dedicate a substantial portion of our cash flows from operations for debt service and prevent us from fulfilling our debt obligations. If we are unable to pay our debt obligations when due, we could be in default under our debt agreements and our lenders could accelerate our debt or take other actions which could restrict our operations.*

As discussed in Note 6 of the Notes to Consolidated Financial Statements in Item 1 of this Report, we have a significant amount of debt outstanding, which consists primarily of long-term debt due in 2007 and 2009. This indebtedness could, among other things:

- limit our ability to obtain future financing for working capital, capital expenditures, acquisitions, debt service requirements, surety bonds or other requirements;
- require us to dedicate a substantial portion of our cash flows from operations to the payment of principal and interest on our indebtedness and reduce our ability to use our cash flows for other purposes;
- limit our flexibility in planning for, or reacting to, changes in our business and the factory-built housing industry;
- place us at a competitive disadvantage to competitors with less indebtedness; and

---

make us more vulnerable in the event of a further downturn in our business or in general economic conditions.

Our business may not generate cash flows from operations in amounts sufficient to pay our debt or to fund other liquidity needs. The factors that affect our ability to generate cash can also affect our ability to raise additional funds through the sale of equity securities, the refinancing of debt or the sale of assets.

We may need to refinance all or a portion of our debt on or before maturity. We may not be able to refinance any of our debt on commercially reasonable terms or at all. If we are unable to refinance our debt obligations, we could be in default under our debt agreements and our lenders could accelerate our debt or take other actions that could restrict our operations.

***General industry conditions*** *As a result of the downturn in the manufactured housing industry which began in 1999, during the period beginning in 2000 through 2003 we experienced a decline in sales and incurred operating losses and costs for the closures and*



*consolidations of operations, fixed asset impairment charges and goodwill impairment charges. If industry conditions deteriorate further, our sales could decline further and our operating results and cash flows could suffer.*

From mid-1999 through 2003 the manufactured housing industry experienced substantial declines in manufacturing shipments and retail sales. Tightened consumer credit standards, reduced availability of consumer financing, high levels of homes repossessed from consumers, higher interest rates on manufactured housing loans relative to those generally available to site-built homebuyers, a reduced number of consumer and floor plan lenders and reduced floor plan availability were all factors contributing to this decline. Since the beginning of the industry downturn, we have closed a significant number of homebuilding facilities and retail sales locations in an attempt to limit losses and return to profitability. From 2000 through 2003, we reported significant net losses including goodwill impairment charges, a valuation allowance of 100% of our deferred tax assets, and restructuring charges, which are each discussed in more detail in Item 7 of our Form 10-K for 2004. If industry conditions deteriorate further, our sales could decline further, our operating results and cash flows could suffer and we may incur further losses including additional costs for the closures and/or consolidations of existing operations, fixed asset impairment charges and goodwill impairment charges.

*Fluctuations in operating results The cyclical and seasonal nature of the manufactured housing market has caused our sales and operating results to fluctuate. These fluctuations may continue in the future, which could result in operating losses during downturns.*

The manufactured housing industry has been highly cyclical and is influenced by many national and regional economic and demographic factors, including:

terms and availability of financing for homebuyers and retailers;  
consumer confidence;

interest rates;  
population and employment trends;  
income levels;

housing demand; and  
general economic conditions, including inflation and recessions.

In addition, the manufactured housing industry is affected by seasonality. Sales during the period from March to November are traditionally higher than in other months. As a result of the foregoing factors, our sales and operating results fluctuate, and we expect that they will continue to fluctuate in the future. Moreover, we may experience operating losses during cyclical and seasonal downturns in the manufactured housing market.

*Consumer financing availability - Tight credit standards and loan terms, curtailed lending activity, and increased interest rates among consumer lenders have reduced our sales. If consumer financing were to become further curtailed, our sales could decline further and our operating results and cash flows could suffer.*

The consumers who buy our homes have historically secured consumer financing from third party lenders. The

## Edgar Filing: CHAMPION ENTERPRISES INC - Form 10-Q

availability, terms and costs of consumer financing depend on the lending practices of financial institutions, governmental regulations and economic and other conditions, all of which are beyond our control. A consumer seeking to finance the purchase of a manufactured home without land will generally pay a higher interest rate and have a shorter loan term than a consumer seeking to finance the purchase of land and the home. Manufactured home consumer financing is at times more difficult to obtain than financing for site-built homes. Since 1999, consumer lenders have tightened the credit underwriting standards and loan terms and increased interest rates for loans to purchase manufactured homes, which have reduced lending volumes and caused our sales to decline.

The poor performance of portfolios of manufactured housing consumer loans in recent years has made it more difficult for industry consumer finance companies to obtain long-term capital in the asset-backed securitization market. As a result, consumer finance companies have curtailed their industry lending and many have exited the manufactured housing market. Additionally, the industry has seen certain traditional real estate mortgage lenders tighten terms or discontinue financing for manufactured housing.

If consumer financing for manufactured homes were to become further curtailed, we would likely experience further retail and manufacturing sales declines and our operating results and cash flows would suffer.

***Floor plan financing availability*** *A reduction in floor plan credit availability or tighter loan terms to our independent retailers may cause our manufacturing sales to decline. As a result, our operating results and cash flows could suffer.*

Independent retailers of our manufactured homes generally finance their inventory purchases with floor plan financing provided by lending institutions. Reduced availability of floor plan lending or tighter floor plan terms may affect our independent retailers' inventory levels of new homes, the number of retail sales centers and related wholesale demand. As a result, we could experience manufacturing sales declines or a higher level of retailer defaults and our operating results and cash flows could suffer.

***Contingent liabilities*** *We have, and will continue to have, significant contingent wholesale repurchase obligations and other contingent obligations, some of which could become actual obligations that we must satisfy. We may incur losses under these wholesale repurchase obligations or be required to fund these or other contingent obligations that would reduce our cash flows.*

In connection with a floor plan arrangement for our manufacturing shipments to independent retailers, the financial institution that provides the retailer financing customarily requires us to enter into a separate repurchase agreement with the financial institution. Under this separate agreement, generally for a period up to 24 months from the date of our sale to the retailer, upon default by the retailer and repossession of the home by the financial institution, we are generally obligated to purchase from the lender the related floor plan loan or the home at a price equal to the unpaid principal amount of the loan, plus certain administrative and handling expenses, reduced by the cost of any damage to the home and any missing parts or accessories. Our estimated aggregate contingent repurchase obligation at October 1, 2005 was significant and includes significant contingent repurchase obligations relating to our largest independent retail customers. For additional discussion see **Contingent Repurchase Obligations** in Item 2 of this Report and in Item 7 of our Form 10-K for 2004. We may be required to honor some or all of our contingent repurchase obligations in the future, which would result in operating losses and reduced cash flows.

At October 1, 2005, we also had contingent obligations related to surety bonds and letters of credit. For additional detail and discussion, see **Liquidity and Capital Resources** in Item 2 of this Report. If we were required to fund a material amount of these contingent obligations, we would have reduced cash flows and could incur losses.

***Dependence upon independent retailers*** *If we are unable to establish or maintain relationships with independent retailers who sell our homes, our sales could decline and our operating results and cash flows could suffer.*

During 2004, approximately 78% of our manufacturing shipments of homes were made to independent retail locations throughout the United States and western Canada. With the divestiture of our traditional retail operations, the proportion of our manufacturing sales to independent retailers has increased. As is common in the industry, independent retailers may sell manufactured homes produced by competing manufacturers. We may not be able to

---

establish relationships with new independent retailers or maintain good relationships with independent retailers that sell our homes. Even if we do establish and maintain relationships with independent retailers, these retailers are not obligated to sell our manufactured homes exclusively, and may choose to sell our competitors' homes instead. The independent retailers with whom we have relationships can cancel these relationships on short notice. In addition, these retailers may not remain financially solvent as they are subject to the same industry, economic, demographic and seasonal trends that we face. If we do not establish and maintain relationships with solvent independent retailers in the markets we serve, sales in those markets could decline and our operating results and cash flows could suffer.

***Effect on liquidity*** *Industry conditions and our operating results have limited our sources of capital during the past few years. If we are unable to locate alternative sources of capital when needed we may be unable to maintain or expand our business.*

We depend on our cash balances, cash flows from operations, and our revolving credit facility to finance our operating requirements, capital expenditures and other needs. The downturn in the manufactured housing industry, combined with our operating results and other changes, limited our sources of financing during the past few years. If our cash balances, cash flows from operations, and availability under our revolving credit facility are insufficient to finance our operations and alternative capital is not available, we may not be able to expand our business, or we may need to curtail or limit our existing operations.

***Competition*** *The factory-built housing industry is very competitive. If we are unable to effectively compete, our growth could be limited, our sales could decline and our operating results and cash flows could suffer.*

The factory-built housing industry is highly competitive at both the manufacturing and retail levels, with competition based, among other things, on price, product features, reputation for service and quality, merchandising, terms of retailer promotional programs and the terms of consumer financing. Numerous companies produce factory-built homes in our markets. Some of our manufacturing competitors have captive retail distribution systems and consumer finance operations. In addition, there are many independent factory-built housing retail locations in most areas where we have retail operations. Because barriers to entry for manufactured housing retailers are low, we believe that it is relatively easy for new retailers to enter our markets as competitors. In addition, our products compete with other forms of low to moderate-cost housing, including site-built homes, panelized homes, apartments, townhouses and condominiums. If we are unable to effectively compete in this environment, our retail sales and manufacturing shipments could be reduced. As a result, our sales could decline and our operating results and cash flows could suffer.

***Zoning*** *If the factory-built housing industry is not able to secure favorable local zoning ordinances, our sales could decline and our operating results and cash flows could suffer.*

## Edgar Filing: CHAMPION ENTERPRISES INC - Form 10-Q

Limitations on the number of sites available for placement of manufactured homes or on the operation of manufactured housing communities could reduce the demand for manufactured homes and our sales. Manufactured housing communities and individual home placements are subject to local zoning ordinances and other local regulations relating to utility service and construction of roadways. In the past, property owners often have resisted the adoption of zoning ordinances permitting the use of manufactured homes in residential areas, which we believe has restricted the growth of the industry. Manufactured homes may not receive widespread acceptance and localities may not adopt zoning ordinances permitting the development of manufactured home communities. If the manufactured housing industry is unable to secure favorable local zoning ordinances, our sales could decline and our operating results and cash flows could suffer.

***Dependence upon executive officers and other key personnel*** *The loss of any of our executive officers or other key personnel could reduce our ability to manage our businesses and achieve our business plan, which could cause our sales to decline and our operating results and cash flows to suffer.*

We depend on the continued services and performance of our executive officers and other key personnel. If we lose the service of any of our executive officers or other key personnel, it could reduce our ability to manage our businesses and achieve our business plan, which could cause our sales to decline and our operating results and cash flows to suffer.

***Restrictive covenants*** *The terms of our debt place operating restrictions on us and our subsidiaries and contain*

---

*various financial performance and other covenants with which we must remain in compliance. If we do not remain in compliance with these covenants, certain of our debt facilities could be terminated and the amounts outstanding thereunder could become immediately due and payable.*

The documents governing the terms of our Senior Notes, primarily the Senior Notes due 2007, contain covenants that place restrictions on us and our subsidiaries. The terms of our debt agreements include covenants that, to varying degrees, restrict our and our subsidiaries' ability to:

- incur additional indebtedness, contingent liabilities and liens;
- issue additional preferred stock;
- pay dividends or make other distributions on our common stock;
- redeem or repurchase common stock and redeem, repay or repurchase subordinated debt;
- make investments in subsidiaries that are not restricted subsidiaries;
- enter into joint ventures;
- use assets as security in other transactions;
- sell certain assets or enter into sale and leaseback transactions;
- restrict the ability of our restricted subsidiaries to pay dividends or make other distributions on their common stock;
- engage in new lines of business;
- guarantee or secure indebtedness;
- consolidate with or merge with or into other companies; and
- enter into transactions with affiliates.

## Edgar Filing: CHAMPION ENTERPRISES INC - Form 10-Q

We have a \$75 million revolving credit facility to use for letters of credit and general corporate purposes. Availability under this credit facility is limited to a borrowing base, and is collateralized by accounts receivable, inventories, property, plant and equipment, cash and other assets. The agreement contains certain financial covenants that require us, only in the event that our liquidity, as defined, falls below \$35 million, to maintain certain levels of earnings, as defined, and certain ratios of earnings to fixed charges, as defined in the agreement. In addition, the facility contains covenants that limit our ability to incur additional indebtedness and liens, sell assets and, if liquidity falls below \$35 million, make certain investments, pay dividends and purchase or redeem our common stock. For additional detail and discussion concerning these financial covenants see *Liquidity and Capital Resources* in Item 2 of this Report.

If we fail to comply with any of these covenants, the lenders could cause our debt to become due and payable prior to maturity. If our debt were accelerated, our assets might not be sufficient to repay our debt in full.

***Potential Dilution*** *Potential capital or debt reduction transactions could result in potential dilution and impair the price of our common stock.*

In a series of transactions during 2003 and the first half of 2004, we purchased and retired \$71.7 million of our Senior Notes due 2007 and 2009 in exchange for 10.4 million shares of our common stock. Additionally, during 2005, a preferred shareholder converted \$20.8 million of preferred stock into 3.1 million shares of common stock.

To the extent that we decide to further reduce debt obligations through the issuance of common stock and/or convertible preferred stock, our then existing common shareholders would experience dilution in their percentage ownership interests. We may seek additional sources of capital and financing in the future or issue securities in connection with retiring our outstanding indebtedness, the terms of which may result in additional potential dilution.

---

### Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Our obligations under industrial revenue bonds are subject to variable rates of interest based on short-term tax-exempt rate indices. A 100 basis point increase in the underlying interest rates would result in additional annual interest cost of approximately \$124,000, assuming average related debt of \$12.4 million, the amount of outstanding borrowings at October 1, 2005.

### Item 4. Controls and Procedures.

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15 of the Securities Exchange Act of 1934. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective to cause material information required to be disclosed by the Company in the reports that we file or submit under the Securities Exchange Act of 1934 to be recorded, processed, summarized and reported

## Edgar Filing: CHAMPION ENTERPRISES INC - Form 10-Q

within the time periods specified in the Commission's rules and forms. During the quarter ended October 1, 2005, there were no changes in our internal control over financial reporting which materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. The Company is in the process of implementing a new enterprise resource planning ( ERP ) system for its manufacturing operations. The completion of the ERP system implementation is targeted for the first half of 2006. Management does not currently believe that this will adversely affect the Company's internal control over financial reporting.

---

### PART II. OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K.

(a) The following exhibits are filed as part of this report:

<u>Exhibit No.</u>	<u>Description</u>
31.1	Certification of Chief Executive Officer dated October 28, 2005, relating to the Registrant's Quarterly Report on Form 10-Q for the quarter ended October 1, 2005.
31.2	Certification of Chief Financial Officer dated October 28, 2005, relating to the Registrant's Quarterly Report on Form 10-Q for the quarter ended October 1, 2005.
32.1	Certification of Chief Executive Officer and Chief Financial Officer of the Registrant, dated October 28, 2005, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, relating to the Registrant's Quarterly Report on Form 10-Q for the quarter ended October 1, 2005.

---

### SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CHAMPION ENTERPRISES, INC.

By:

/s/ PHYLLIS A. KNIGHT

Edgar Filing: CHAMPION ENTERPRISES INC - Form 10-Q

Phyllis A. Knight  
Executive Vice President and

Chief Financial Officer  
(Principal Financial Officer)

And:

/s/ RICHARD HEVELHORST  
Richard Hevelhorst  
Vice President and Controller  
(Principal Accounting Officer)

Dated: October 28, 2005