CHAMPION ENTERPRISES INC
Form 10-Q
October 28, 2005

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

(Mark one)

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

For Quarterly period ended October 1, 2005

OR

o **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	38-2743168
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer

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 X No

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

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

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

Cost of sales	277,819	226,590	746,357	630,757
Gross margin	57,909	50,359	150,746	123,410
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
Operating income	19,524	15,504	47,449	22,409
Interest income	980	470	2,682	954
Interest expense	(4,340)	(4,556)	(13,549)	(14,204)
Income from continuing operations before income taxes	16,164	11,418	36,582	9,159
Income tax expense (benefit)	950	800	1,850	(10,300)
Income from continuing operations	15,214	10,618	34,732	19,459
Loss from discontinued operations, net of taxes	(900)	(629)	(4,209)	(361)
Net income	14,314	9,989	30,523	19,098
Basic income (loss) per share:				
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
Diluted income (loss) per share:				
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)

	Unaudited October 1, 2005	**January 1, 2005**
ASSETS		
Current assets		
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

Other current assets		14,738		13,535
Total current assets		300,071		285,528
Property, plant and equipment		213,365		207,216
Less-accumulated depreciation		122,811		126,259
		90,554		80,957
Goodwill		154,463		126,591
Amortizable intangible assets		4,050		
Non-current assets of discontinued operations		2,404		7,747
Other non-current assets		13,212		16,219
	$	564,754	$	517,042
LIABILITIES, REDEEMABLE CONVERTIBLE PREFERRED STOCK AND SHAREHOLDERS EQUITY				
Current liabilities				
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
Long-term liabilities				
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
Contingent liabilities (Note 8)				
Redeemable convertible preferred stock, no par value, 5,000 shares authorized, 0 shares and 21 shares issued and outstanding, respectively				20,750
Shareholders equity				
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

	October 1, 2005	October 2, 2004
Cash flows from operating activities		
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)
Cash flows from discontinued operations		
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)
Cash flows from investing activities		
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)
Cash flows from financing activities		
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

(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:

	Three Months Ended	
	October 1,	**October 2,**
	2005	**2004**

	(In thousands, except per share amounts)	
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

	(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

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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:

	August 8, 2005 (in millions)	
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

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

	Unaudited Nine Months Ended October 1, 2005 (in thousands)	October 2, 2004
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:

	Nine Months Ended October 1, 2005 (In thousands)	October 2, 2004
Continuing operations		
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)

Discontinued operations	Nine Months Ended October 1, 2005 (In thousands)	October 2, 2004
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:

	October 1, 2005 (In thousands)	January 1, 2005
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
	$ 98,705	$ 71,616

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.

	2005 (In thousands)	2004
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	$ 38,865	$ 41,307

6. Long-term debt consisted of the following:

	October 1, 2005 (In thousands)	January 1, 2005
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
	$ 191,512	$ 200,758

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.

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,

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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.

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	**October 2, 2004**	**October 1, 2005**	**October 2, 2004**
Numerator	**(In thousands)**			
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)

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		75,837			71,300			74,520			70,020	
Plus effect of dilutive securities Deferred purchase price obligations					423						647	
Stock options and awards		1,049			799			1,039			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:

	Three Months Ended October 1, 2005		October 2, 2004	
Net sales	(In thousands)			
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	

	Nine Months Ended October 1, 2005		October 2, 2004	
Net sales	(In thousands)			
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:

	Three Months Ended October 1, 2005	October 2, 2004	Nine Months Ended October 1, 2005	October 2, 2004

	(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.

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.

	Nine Months Ended October 1, 2005		
	2004 Closures (In thousands)	**Prior Closures**	**Total**
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	$	$ 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.

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