CHAMPION ENTERPRISES INC
Form 10-Q
July 27, 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 July 2, 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 (State or other jurisdiction of incorporation or organization)	38-2743168 (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 the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

75,730,293 shares of the registrant s $1.00 par value Common Stock were outstanding as of July 25, 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 July 2, 2005	July 3, 2004	Unaudited Six Months Ended July 2, 2005	July 3, 2004
Net sales	$317,100	$270,484	$561,375	$477,218
Cost of sales	261,527	224,890	468,538	404,167
Gross margin	55,573	45,594	92,837	73,051
Selling, general and administrative expenses	36,642	33,927	68,311	62,170
Mark-to-market (credit) charge for common stock warrant	(500)	(3,900)	(4,300)	1,200
Loss (gain) on debt retirement	901	(450)	901	2,776
Operating income	18,530	16,017	27,925	6,905
Interest income	929	245	1,702	484
Interest expense	(4,628)	(4,586)	(9,209)	(9,648)
Income (loss) from continuing operations before income taxes	14,831	11,676	20,418	(2,259)
Income tax expense (benefit)	600	(11,400)	900	(11,100)
Income from continuing operations	14,231	23,076	19,518	8,841
(Loss) income from discontinued operations, net of taxes	(751)	356	(3,309)	268
Net income	$ 13,480	$ 23,432	$ 16,209	$ 9,109
Basic income (loss) per share:				
Income from continuing operations	$ 0.19	$ 0.30	$ 0.25	$ 0.11
(Loss) income from discontinued operations	(0.01)	0.01	(0.05)	0.01
Basic income per share	$ 0.18	$ 0.31	$ 0.20	$ 0.12
Weighted shares for basic EPS	75,176	70,657	73,861	69,380
Diluted income (loss) per share:				
Income from continuing operations	$ 0.18	$ 0.29	$ 0.25	$ 0.11
(Loss) income from discontinued operations	(0.01)	0.01	(0.05)	0.00
Diluted income per share	$ 0.17	$ 0.30	$ 0.20	$ 0.11

Weighted shares for diluted EPS	76,042	72,253	74,756	71,152

See accompanying Notes to Consolidated Financial Statements.

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CHAMPION ENTERPRISES, INC.

Consolidated Balance Sheets

(In thousands, except par value)

	Unaudited July 2, 2005	January 1, 2005
ASSETS		
Current assets		
Cash and cash equivalents	$ 149,899	$ 142,266
Restricted cash	528	529
Accounts receivable, trade	41,694	22,119
Inventories	80,886	71,616
Current assets of discontinued operations	9,780	35,463
Other current assets	13,736	13,535
Total current assets	296,523	285,528
Property, plant and equipment	198,397	207,216
Less-accumulated depreciation	120,190	126,259
	78,207	80,957
Goodwill	126,564	126,591
Non-current assets of discontinued operations	4,701	7,747
Other non-current assets	13,371	16,219
	$ 519,366	$ 517,042
LIABILITIES, REDEEMABLE CONVERTIBLE PREFERRED STOCK AND SHAREHOLDERS EQUITY		
Current liabilities		
Accounts payable	33,673	13,819
Accrued warranty obligations	32,011	33,551
Accrued volume rebates	27,564	30,234
Accrued compensation and payroll taxes	20,264	19,659
Accrued self-insurance	26,797	25,988
Current liabilities of discontinued operations	5,422	21,411
Other current liabilities	29,984	31,696
Total current liabilities	175,715	176,358
Long-term liabilities		
Long-term debt	191,543	200,758
Long-term liabilities of discontinued operations	342	432
Other long-term liabilities	34,660	41,444
	226,545	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, 75,730 and 72,358 shares issued and outstanding, respectively	75,730	72,358
Capital in excess of par value	185,287	164,377
Accumulated deficit	(143,459)	(159,375)
Accumulated other comprehensive loss	(452)	(60)
Total shareholders equity	117,106	77,300
	$ 519,366	$ 517,042

See accompanying Notes to Consolidated Financial Statements.

CHAMPION ENTERPRISES, INC.

Consolidated Statements of Cash Flows

(In thousands)

	Unaudited Six Months Ended July 2, 2005	July 3, 2004
Cash flows from operating activities		
Income from continuing operations	$ 19,518	$ 8,841
Adjustments to reconcile income from continuing operations to net cash provided by (used for) operating activities:		
Depreciation and amortization	5,063	5,342
Loss on debt retirement	901	2,776
Mark-to-market (credit) charge for common stock warrant	(4,300)	1,200
Gain on disposal of fixed assets	(1,599)	(74)
Decrease in allowance for tax adjustments		(12,000)
Increase/decrease		
Accounts receivable	(19,575)	(16,150)
Refundable income taxes		376
Inventories	(9,269)	(17,776)
Accounts payable	19,701	7,061
Accrued liabilities	(2,222)	(6,025)
Other, net	5,141	(1,343)
Net cash provided by (used for) continuing operating activities	13,359	(27,772)
Cash flows from discontinued operations		
(Loss) income from discontinued operations	(3,309)	268
Proceeds from sales of retail businesses	24,312	
Change in net assets of discontinued operations	(12,232)	(6,273)
Net cash provided by (used for) discontinued operations	8,771	(6,005)
Cash flows from investing activities		
Additions to property, plant and equipment	(5,290)	(4,016)
Investments in and advances to unconsolidated subsidiaries	(55)	(109)
Proceeds on disposal of fixed assets	5,056	203
Net cash used for investing activities	(289)	(3,922)
Cash flows from financing activities		
Decrease in floor plan payable, net		(29)
Decrease in other long-term debt	(128)	(5,939)
Purchase of Senior Notes	(9,885)	(10,395)
Purchase of common stock warrant	(4,500)	
Decrease in restricted cash	1	7,710
Preferred stock issued, net		12,000
Common stock issued, net	597	4,512
Dividends paid on preferred stock	(293)	(160)
Net cash (used for) provided by financing activities	(14,208)	7,699
Net increase (decrease) in cash and cash equivalents	7,633	(30,000)
Cash and cash equivalents at beginning of period	142,266	145,868
Cash and cash equivalents at end of period	$ 149,899	$ 115,868

See accompanying Notes to Consolidated Financial Statements.

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CHAMPION ENTERPRISES, INC.

Consolidated Statement of Shareholders Equity

Unaudited Six Months Ended July 2, 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				16,209		16,209	$ 16,209
Preferred stock dividends				(293)		(293)	
Stock options and benefit plans	141	141	1,391			1,532	
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					(392)	(392)	(392)
Balance at July 2, 2005	75,730	$ 75,730	$ 185,287	$ (143,459)	$ (452)	$ 117,106	$ 15,817

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 the six months ended July 2, 2005, the Company sold 30 of its retail sales centers pursuant to a plan to dispose of the remainder of its retail operations except for its non-traditional retail operation in California. As a result retail operations, excluding this California operation, were classified as held for sale and, for the periods reported, are classified as discontinued operations. 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 (loss), income (loss) per share, and stock-based compensation expense would have been as indicated below:

	Three Months Ended	
	July 2, 2005	**July 3, 2004**

	(In thousands, except per share amounts)			
Net income as reported	$	13,480	$	23,432
Net income pro forma		13,263		23,404
Basic income per share as reported		0.18		0.31
Diluted income per share as reported		0.17		0.30
Basic income per share pro forma		0.18		0.30
Diluted income per share pro forma		0.17		0.30
Stock-based employee compensation expense, net of related tax effects as reported		1,407		185
Stock-based employee compensation expense, net of related tax effects pro forma	$	1,624	$	213

Six Months Ended

July 2, 2005	July 3, 2004

	(In thousands, except per share amounts)			
Net income as reported	$	16,209	$	9,109
Net income pro forma		15,881		8,944
Basic income per share as reported		0.20		0.12
Diluted income per share as reported		0.20		0.11
Basic income per share pro forma		0.20		0.11
Diluted income per share pro forma		0.20		0.11
Stock-based employee compensation expense, net of related tax effects as reported		2,514		330
Stock-based employee compensation expense, net of related tax effects pro forma	$	$ 2,841	$	$ 495

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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 in 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 July 2, 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. The Company is currently considering the modified prospective method of transition, which would be first effective for the Company s 2006 fiscal first quarter.

2. 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.

	Six Months Ended July 2, 2005								
	2004			**Prior**					
	Closures			**Closures**			**Total**		
	(In thousands)								
Balance at beginning of year	$	810		$	3,611		$	4,421	
Cash payments:									
Warranty costs					(443	)		(443	)
Other closing costs		(528	)		(122	)		(650	)
Reversals credited to earnings:									
Other closing costs		(190	)		(16	)		(206	)
Balance at July 2, 2005	$	92		$	3,030		$	3,122	
Period end balance comprised of:									
Warranty costs	$			$	2,149		$	2,149	
Other closing costs		92			881			973	
	$	92		$	3,030		$	3,122	

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 six months ended July 2, 2005 consisted of an adjustment to accruals for employee severance.

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:

	Six Months Ended July 2, 2005	July 3, 2004
Continuing operations	**(In thousands)**	
Statutory U.S. tax rate	$ 7,200	$ (800)
(Decrease) increase in rate resulting from:		
Warrant mark-to-market and other permanent differences	(1,300)	600
Deferred tax valuation allowance	(5,100)	700
Decrease in allowance for tax adjustments		(12,000)
Foreign and state taxes	100	400
Total income tax expense (benefit)	$ 900	$ (11,100)

	Six Months Ended July 2, 2005	July 3, 2004
Discontinued operations	**(In thousands)**	
Statutory U.S. tax rate	$ (1,200)	$ 100
(Decrease) increase in rate resulting from:		
Deferred tax valuation allowance	1,200	(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.

4. A summary of inventories by component follows:

	July 2, 2005	January 1, 2005
	(In thousands)	
New manufactured homes	$ 22,547	$ 18,749
Raw materials	29,107	30,908
Work-in-process	11,632	7,166
Other inventory	17,600	14,793
	$ 80,886	$ 71,616

Other inventory consists of land and park spaces and improvements.

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 cost 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 six months ended July 2, 2005 and July 3, 2004. A portion of warranty reserves was classified as other long-term liabilities in the consolidated balance sheet.

	Accrued Warranty Obligations 2005 (In thousands)	2004
Reserves at beginning of year	$ 40,051	$ 47,058
Warranty expense provided	24,365	24,302
Cash warranty payments	(25,905)	(27,721)
Reserves at end of quarter	$ 38,511	$ 43,639

6. Long-term debt consisted of the following:

	July 2, 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	1,410	1,545
	$ 191,543	$ 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, 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 plus 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 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 July 2, 2005, availability under the facility was $61.6 million, there were $61.0 million of letters of credit issued and no borrowings outstanding, and the Company s liquidity, as defined, was $138.5 million, which was in excess of $35 million such that no other financial covenants were in effect.

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

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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 would have expired on April 2, 2009 and was exercisable only on a non-cash, net basis, whereby the warrant holder would have received 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 quarter and six months ended July 2, 2005, the Company recorded mark-to-market credits of $0.5 million and $4.3 million, respectively, for the change in estimated fair value of the warrant. During the quarter and six months ended July 3, 2004, the Company recorded mark-to-market adjustments of a $3.9 million credit and a $1.2 million charge, 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 July 2, 2005 was estimated to be approximately $250 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 six months ended July 2, 2005 and July 3, 2004, respectively.

At July 2, 2005 the Company was contingently obligated for approximately $61.3 million under letters of credit, primarily comprised of $14.5 million to support insurance reserves, $12.6 million to support long-term debt, $27.7 million to secure surety bonds, and $5.0 million to support floor plan facilities of independent retailers. Champion was also contingently obligated for $29.9 million under surety bonds, generally to support insurance and license and service bonding requirements. Approximately $27.2 million of the letters of credit and $20.8 million of the surety bonds support insurance reserves and long-term debt that are reflected as liabilities in the consolidated balance sheet.

At July 2, 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.

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9. During the three and six months ended July 2, 2005 and July 3, 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		**Six Months Ended**	
	July 2, 2005	**July 3, 2004**	**July 2, 2005**	**July 3, 2004**
Numerator	**(In thousands)**			
Net income	$ 13,480	$ 23,432	$ 16,209	$ 9,109
Plus loss (less income) from discontinued operations	751	(356)	3,309	(268)
Less preferred stock dividend	(34)	(259)	(293)	(419)
Less amount allocated to participating securities holders	(195)	(1,594)	(793)	(545)
Income from continuing operations available to common shareholders for basic and diluted EPS	14,002	21,223	18,432	7,877
(Loss) income from discontinued operations	(751)	356	(3,309)	268
Less amount allocated to participating securities		(25)		(17)
(Loss) income from discontinued operations available to common shareholders for basic and diluted EPS	(751)	331	(3,309)	251

Income available to common shareholders for basic and diluted EPS	$13,251	$21,554	$15,123	$8,128
Denominator				
Shares for basic EPS--weighted average shares outstanding	75,176	70,657	73,861	69,380
Plus effect of dilutive securities				
Deferred purchase price obligations		610		758
Stock options and awards	866	986	895	1,014
Shares for diluted EPS	76,042	72,253	74,756	71,152

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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 (loss) from continuing operations before income taxes follow:

	Three Months Ended					
	July 2,			July 3,		
	2005			2004		
Net sales	**(In thousands)**					
Manufacturing	$	291,595		$	269,084	
Retail		38,805			28,300	
Less: intercompany		(13,300	)		(26,900	)
Consolidated net sales	$	317,100		$	270,484	
Income from continuing operations before income taxes:						
Manufacturing segment income		$24,6	67		$17,5	67
Retail segment income		2,602			1,445	
General corporate expenses		(8,738	)		(6,845	)
Mark-to-market credit for common stock warrant		500			3,900	
(Loss) gain on debt retirement		(901	)		450	
Interest expense, net		(3,699	)		(4,341	)
Intercompany eliminations		400			(500	)
Income from continuing operations before income taxes	$	14,831		$	11,676	

	Six Months Ended					
	July 2,			July 3,		
	2005			2004		
Net sales	**(In thousands)**					
Manufacturing	$	530,333		$	478,940	
Retail		63,942			47,778	
Less: intercompany		(32,900	)		(49,500	)
Consolidated net sales	$	561,375		$	477,218	
Income from continuing operations before income taxes:						
Manufacturing segment income		$35,857			$22,221	
Retail segment income		3,869			2,228	
General corporate expenses		(16,800	)		(12,868	)
Mark-to-market credit (charge) for common stock warrant		4,300			(1,200	)
Loss on debt retirement		(901	)		(2,776	)
Interest expense, net		(7,507	)		(9,164	)
Intercompany eliminations		1,600			(700	)
Income (loss) from continuing operations before income taxes	$	20,418		$	(2,259	)

11. Discontinued operations include the Company s traditional retail operations, excluding its California retail operations, and its former consumer finance business that was exited in 2003. For the three and six months ended July 2, 2005, revenues from discontinued retail operations were $6.2 million and $25.1 million, respectively. For the three and six months ended July 3, 2004, revenues from discontinued retail operations were $35.6 million and $66.0 million, respectively. (Loss) income from discontinued operations for the three and six months ended July 2, 2005 and July 3, 2004 consist of the following:

	Three Months Ended		Six Months Ended	
	July 2, 2005	July 3, 2004	July 2, 2005	July 3, 2004
	(In thousands)			
(Loss) income from retail operations	$ (739)	$ 388	$ (3,287)	$ (849)
(Loss) income from consumer finance business	(12)	(32)	(22)	1,117
Total (loss) income from discontinued operations	$ (751)	$ 356	$ (3,309)	$ 268

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

	July 2, 2005 (In thousands)	January 1, 2005
Assets:		
Accounts receivable, trade	$ 141	$ 598
Inventories	9,167	33,964
Other current assets	472	901
Current assets of discontinued operations	$ 9,780	$ 35,463
Property, plant, and equipment, net	$ 2,507	$ 5,064
Other non-current assets	2,194	2,683
Non-current assets of discontinued		
Operations	$ 4,701	$ 7,747
Liabilities:		
Floor plan payable	$ 29	$ 11,835
Accounts payable	710	2,043
Other current liabilities	4,683	7,533
Current liabilities of discontinued operations	$ 5,422	$ 21,411
Long-term debt	$ 342	$ 432

Loss from discontinued retail operations for the six months ended July 2, 2005 included an operating loss of $2.1 million and a net loss of $1.2 million related to sales of 30 retail locations. In connection with the sales of retail businesses during 2005, intercompany profit of $1.4 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 consisted primarily of new homes and other inventory. The total sale price was cash of approximately $24.3 million and the buyers assumption of certain liabilities totaling approximately $1.2 million. In connection with these sales, the Company paid down $10.9 million of floor plan borrowings. On July 19, 2005, the Company s remaining ten traditional retail locations were sold.

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 six months ended July 3, 2004, the Company issued 193,000 shares and 469,000 shares, respectively, of common stock in payment of deferred purchase price obligations of $2.0 million and $4.0 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.

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13. On July 18, 2005 the Company entered into an agreement to acquire New Era Building Systems, a leading modular homebuilder, and its affiliates, Castle Housing of Pennsylvania and Carolina Building Solutions, for cash consideration of $41 million and the assumption of certain liabilities, pending regulatory and the sellers shareholder approvals.

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 July 2, 2005

	Parent (In thousands)	CHB	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Consolidating Eliminations	Consolidated
Net sales	$	$ 94,431	$ 221,393	$ 14,276	$ (13,000)	$ 317,100
Cost of sales		78,780	184,910	11,237	(13,400)	261,527
Gross margin		15,651	36,483	3,039	400	55,573
Selling, general, and administrative expenses	(111)	10,969	24,405	1,379		36,642
Mark-to-market credit for common stock warrant	(500)					(500)
Loss on debt retirement		901				901
Operating income	611	3,781	12,078	1,660	400	18,530
Interest income	1,743	1,766	4,261	97	(6,938)	929
Interest expense	(1,743)	(2,776)	(7,025)		6,916	(4,628)
Income from continuing operations before income taxes	611	2,771	9,314	1,757	378	14,831
Income tax expense			50	550		600
Income from continuing operations	611	2,771	9,264	1,207	378	14,231
(Loss) income from discontinued operations			(989)	216	22	(751)
Income before equity in income of consolidated subsidiaries	611	2,771	8,275	1,423	400	13,480

Equity in income of consolidated subsidiaries		12,469		9,698						(22,167	)		
Net income	$	13,080	$	12,469	$	8,275	$	1,423	$	(21,767	)	$	13,480

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CHAMPION ENTERPRISES, INC.

Condensed Consolidating Statement of Operations

For the Six Months Ended July 2, 2005

	Parent (In thousands)	CHB	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Consolidating Eliminations	Consolidated
Net sales	$	$ 169,239	$ 399,906	$ 24,230	$ (32,000)	$ 561,375
Cost of sales		143,176	339,348	19,614	(33,600)	468,538
Gross margin		26,063	60,558	4,616	1,600	92,837
Selling, general, and administrative expenses	(1)	20,995	44,610	2,707		68,311
Mark-to-market credit for common stock warrant	(4,300)					(4,300)
Loss on debt retirement		901				901
Operating income	4,301	4,167	15,948	1,909	1,600	27,925
Interest income	3,458	3,458	1,514	188	(6,916)	1,702
Interest expense	(3,458)	(5,559)	(7,108)		6,916	(9,209)
Income from continuing operations before income taxes	4,301	2,066	10,354	2,097	1,600	20,418
Income tax expense			100	800		900
Income from continuing operations	4,301	2,066	10,254	1,297	1,600	19,518
Loss from discontinued operations			(3,251)	(58)		(3,309)

Income before equity in income of consolidated subsidiaries		4,301		2,066		7,003		1,239		1,600				16,209
Equity in income of consolidated subsidiaries		10,308		8,242						(18,550	)			
Net income	$	14,609	$	10,308	$	7,003	$	1,239	$	(16,950	)		$	16,209

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CHAMPION ENTERPRISES, INC.

Condensed Consolidating Balance Sheet

As of July 2, 2005

	Parent	CHB	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Consolidating Eliminations	Consolidated
Assets	**(In thousands)**					
Current assets						
Cash and cash equivalents	$	$ 124,799	$ 6,387	$ 18,712	$ 1	$ 149,899
Restricted cash		294	234			528
Accounts receivable, trade		13,953	27,907	1,589	(1,755)	41,694
Inventories		17,001	63,612	3,073	(2,800)	80,886
Current assets of discontinued operations			9,780			9,780
Other current assets		9,791	3,627	418	(100)	13,736
Total current assets		165,838	111,547	23,792	(4,654)	296,523
Property, plant and equipment, net		26,528	49,320	2,359		78,207
Goodwill			125,783	781		126,564
Investment in consolidated subsidiaries	20,100	310,393	162,379	6,788	(499,660)	
Non-current assets of discontinued operations			4,701			4,701
Other non-current assets	535	1,748	3,360	7,728		13,371
	$ 20,635	$ 504,507	$ 457,090	$ 41,448	$ (504,314)	$ 519,366
Liabilities, Redeemable Convertible Preferred Stock and Shareholders Equity						
Current liabilities						
Accounts payable	$	$ 11,095	$ 22,061	$ 1,934	$ (1,417)	$ 33,673
		7,890	23,376	745		32,011

Accrued warranty obligations						
Accrued volume rebates		9,748	16,478	1,338		27,564
Current liabilities of discontinued operations			5,422			5,422
Other current liabilities	1,107	23,384	51,524	1,130	(100)	77,045
Total current liabilities	1,107	52,117	118,861	5,.147	(1,517)	175,715
Long-term liabilities						
Long-term debt	89,273	95,764	6,506			191,543
Long-term liabilities of discontinued operations			342			342
Other long-term liabilities		8,125	26,420	115		34,660
	89,273	103,889	33,268	115		226,545
Intercompany balances	(176,124)	65,758	441,674	4,594	(335,902)	
Shareholders equity						
Common stock	75,730	1	62	3	(66)	75,730
Capital in excess of par value	185,287	613,336	326,219	32,549	(972,104)	185,287
Accumulated deficit	(154,638)	(330,594)	(462,784)	(718)	805,275	(143,459)
Accumulated other comprehensive loss			(210)	(242)		(452)
Total shareholders equity	106,379	282,743	(136,713)	31,592	(166,895)	117,106
	$ 20,635	$ 504,507	$ 457,090	$ 41,448	$ (504,314)	$ 519,366

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CHAMPION ENTERPRISES, INC.

Condensed Consolidating Statement of Cash Flows

For the Six Months Ended July 2, 2005

	Parent (In thousands)	CHB	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Consolidating Eliminations	Consolidated
Net cash (used for) provided by operating activities	$ (8,716)	$1,347	$18,734	$2,644	$(650)	$13,359
Net cash provided by (used for) discontinued operations			8,829	(58)		8,771
Cash flows from investing activities						
Additions to property plant and equipment		(1,185)	(3,794)	(311)		(5,290)
Investments in and advances to unconsolidated subsidiaries				(55)		(55)
Investments in and advances to consolidated subsidiaries	12,912	14,130	(26,123)	(1,089)	170	
Proceeds on disposal of fixed assets			5,056			5,056
Net cash provided by (used for) investing activities	12,912	12,945	(24,861)	(1,455)	170	(289)
Cash flows from financing activities						

Decrease in floor plan payable, net						
Decrease in other long-term debt			(128)			(128)
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	597					597
Dividends paid on preferred stock	(293)					(293)
Net cash (used for) provided by financing activities	(4,196)	(9,870)	(142)			(14,208)
Net (decrease) increase in cash and cash equivalents		4,422	2,560	1,131	(480)	7,633
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	$	$ 124,799	$ 6,387	$ 18,712	$ 1	$ 149,899

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CHAMPION ENTERPRISES, INC.

Condensed Consolidating Statement of Operations

For the Three Months Ended July 3, 2004

	Parent (In thousands)	CHB	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Consolidating Eliminations	Consolidated
Net sales	$	$ 77,307	$ 208,057	$ 12,020	$ (26,900)	$ 270,484
Cost of sales		65,716	176,275	9,299	(26,400)	224,890
Gross margin		11,591	31,782	2,721	(500)	45,594
Selling, general and administrative expenses		10,550	21,634	1,743		33,927
Mark-to-market credit for common stock warrant	(3,900)					(3,900)
Gain on debt retirement	(450)					(450)
Operating income	4,350	1,041	10,148	978	(500)	16,017
Interest income	1,837	1,795	209	37	(3,633)	245
Interest expense	(1,837)	(2,692)	(3,690)		3,633	(4,586)
Income from continuing operations before income taxes	4,350	144	6,667	1,015	(500)	11,676
Income tax expense (benefit)		50	(11,950)	500		(11,400)
Income from continuing operations	4,350	94	18,617	515	(500)	23,076
Income (loss) from discontinued operations			373	(17)		356

Income before equity in income of consolidated subsidiaries		4,350		94		18,990		498		(500	)		23,432
Equity in income of consolidated subsidiaries		19,582		19,488						(39,070	)		
Net income	$	23,932	$	19,582	$	18,990	$	498	$	(39,570	)	$	23,432

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CHAMPION ENTERPRISES, INC.

Condensed Consolidating Statement of Operations

For the Six Months Ended July 3, 2004

	Parent (In thousands)	CHB	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Consolidating Eliminations	Consolidated
Net sales	$	$ 136,802	$ 368,860	$ 21,056	$ (49,500)	$ 477,218
Cost of sales		118,636	317,703	16,628	(48,800)	404,167
Gross margin		18,166	51,157	4,428	(700)	73,051
Selling, general and administrative expenses		14,592	44,403	3,175		62,170
Mark-to-market charge for common stock warrant	1,200					1,200
Loss on debt retirement	12	2,696	68			2,776
Operating (loss) income	(1,212)	878	6,686	1,253	(700)	6,905
Interest income	3,905	3,765	422	63	(7,671)	484
Interest expense	(3,905)	(5,666)	(7,747)	(1)	7,671	(9,648)
(Loss) income from continuing operations before income taxes	(1,212)	(1,023)	(639)	1,315	(700)	(2,259)
Income tax expense (benefit)		100	(11,900)	700		(11,100)
(Loss) income from continuing operations	(1,212)	(1,123)	11,261	615	(700)	8,841
Income (loss) from discontinued operations			307	(39)		268
	)	)			)	

(Loss) income before equity in (loss) income of consolidated subsidiaries		(1,212		(1,123		11,568		576		(700				9,109
Equity in income of consolidated subsidiaries		11,021		12,144						(23,165	)			
Net income	$	9,809	$	11,021	$	11,568	$	576	$	(23,865	)		$	9,109

CHAMPION ENTERPRISES, INC.

Condensed Consolidating Balance Sheet

As of January 1, 2005

Assets	Parent (In thousands)	CHB	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Consolidating Eliminations	Consolidated
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
Liabilities, Redeemable Convertible Preferred Stock and Shareholders Equity						
Current liabilities						
Accounts payable	$	$ 8,232	$ 4,696	$ 891	$	$ 13,819
		7,338	25,434	779		33,551

Accrued warranty obligations						
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

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CHAMPION ENTERPRISES, INC.

Condensed Consolidating Statement of Cash Flows

For the Six Months Ended July 3, 2004

	Parent (In thousands)	CHB	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Consolidating Eliminations	Consolidated
Net cash provided by (used for) operating activities	$ 1,167	$ (27,772)	$ (3,071)	$ 2,019	$ (115)	$ (27,772)
Net cash used for discontinued operations			(5,966)	(39)		(6,005)
Cash flows from investing activities						
Additions to property plant and equipment		(804)	(3,061)	(151)		(4,016)
Investments in and advances to unconsolidated subsidiaries				(109)		(109)
Investments in and advances to consolidated subsidiaries	(7,124)	(576)	8,199	(639)	140	
Proceeds on disposal of fixed assets		12	140	51		203
Net cash (used for) provided by investing activities	(7,124)	(1,368)	5,278	(848)	140	(3,922)
Cash flows from financing activities						
Decrease in floor plan payable, net				(29)		(29)
Decrease in other long-term debt			(5,939)			(5,939)
Purchase of Senior Notes	(10,395)					(10,395)

(Increase) decrease in restricted cash		(112)	7,822			7,710
Preferred stock issued, net	12,000					12,000
Common stock issued, net	4,512					4,512
Dividends paid on preferred stock	(160)					(160)
Net cash provided by (used for) financing activities	5,957	(112)	1,883	(29)		7,699
Net (decrease) increase in cash and cash equivalents		(29,252)	(1,876)	1,103	25	(30,000)
Cash and cash equivalents at beginning of period		129,072	3,824	12,972		145,868
Cash and cash equivalents at end of period	$	$ 99,820	$ 1,948	$ 14,075	$ 25	$ 115,868

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Item 2. Management s Discussion and Analysis of

Financial Condition and Results of Operations.

CHAMPION ENTERPRISES, INC.

Results of Operations

Three and Six Months Ended July 2, 2005

versus the Three and Six Months Ended July 3, 2004

Overview

We are a leading producer of factory-built housing in the U.S. As of July 2, 2005, we operated 29 homebuilding facilities in 14 states and two provinces in western Canada. As of July 2, 2005, our homes were sold through approximately 2,400 independent sales centers across the U.S. and western Canada and directly to an estimated 500 builders and developers. Approximately 850 of the independent retailer locations were members of our Champion Home Centers (CHC) retail distribution network. As of July 2, 2005, our homes were also sold through 19 Company-owned sales locations in California, in addition to ten sales centers in seven states that were classified as discontinued operations.

Our pretax income from continuing operations for the quarter ended July 2, 2005 was $14.8 million, an increase of $3.2 million over 2004. Improvement in our second quarter results is attributable to improved manufacturing pricing and purchasing and our restructuring actions in 2004 and prior years to eliminate under-performing operations. Included in income from continuing operations for the 2005 quarter is a credit of $0.5 million for the change in estimated fair value of an outstanding common stock warrant compared to a credit of $3.9 million in the 2004 quarter. Results in the 2005 quarter also include a loss on debt retirement of $0.9 million compared to a gain of $0.5 million in the 2004 quarter.

Our pretax income from continuing operations for the six months ended July 2, 2005 was $20.4 million, an increase of $22.7 million over 2004. Improvement in our six month results is attributable to same factors as cited for improvement in our second quarter results. Included in income from continuing operations for the six months ended July 2, 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 $1.2 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 six months ended July 2, 2005, we sold 30 retail sales centers and, on July 19, 2005, our remaining ten traditional retail locations were sold, pursuant to our plan to dispose of our traditional retail operations, excluding our non-traditional California operations. As a result, our retail operations, excluding our ongoing California operations, have been classified as discontinued operations for the periods presented.

On July 18, 2005 we entered into an agreement to acquire New Era Building Systems, a leading modular homebuilder, and its affiliates, Castle Housing of Pennsylvania and Carolina Building Solutions, for cash consideration of $41 million and the assumption of certain liabilities, pending regulatory and the sellers shareholder approvals.

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. Our continuing retail operations consist of 19 sales offices specializing in selling homes for the redevelopment of manufactured housing communities in California.

Consolidated Results

	Three Months Ended July 2, 2005		July 3, 2004		% Change	
Net sales	**(Dollars in millions)**					
Manufacturing	$ 291.6		$ 269.1		8	%
Retail	38.8		28.3		37	%
Less: Intercompany	(13.3	)	(26.9	)		
Total net sales	$ 317.1		$ 270.5		17	%
Gross margin	$ 55.5		$ 45.6		22	%
Selling, general and administrative expenses (SG&A)	36.6		33.9		8	%
Mark to market credit for common stock warrant	(0.5	)	(3.9	)		
Loss (gain) on debt retirement	0.9		(0.5	)		
Operating income	$ 18.5		$ 16.1		16	%
As a percent of net sales						
Gross margin	17.5	%	16.9	%		
SG&A	11.6	%	12.5	%		
Operating income	5.8	%	5.9	%		

	Six Months Ended July 2, 2005		July 3, 2004		% Change	
Net sales	**(Dollars in millions)**					
Manufacturing	$ 530.3		$ 478.9		11	%
Retail	64.0		47.8		34	%
Less: Intercompany	(32.9	)	(49.5	)		
Total net sales	$ 561.4		$ 477.2		18	%
Gross margin	$ 92.8		$ 73.0		27	%
Selling, general and administrative expenses (SG&A)	68.3		62.2		10	%
Mark to market (credit) charge for common stock warrant	(4.3	)	1.2			
Loss (gain) on debt retirement	0.9		2.7			
Operating income	$ 27.9		$ 6.9		304	%

As a percent of net sales