CHAMPION ENTERPRISES INC
Form 10-Q
May 01, 2006

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 April 1, 2006

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 a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Exchange Act Rule 12b-2 of the Act).

Large accelerated filer x Accelerated filer o Non-accelerated filer o

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.

76,248,977 shares of the registrant s $1.00 par value Common Stock were outstanding as April 28, 2006.

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 April 1, 2006	April 2, 2005 (Restated)
Net sales	$ 346,529	$ 244,275
Cost of sales	292,236	207,011
Gross margin	54,293	37,264
Selling, general, and administrative expenses	37,323	31,747
Mark-to-market credit for common stock warrant		(3,800)
Operating income	16,970	9,317
Interest income	1,541	773
Interest expense	(3,611)	(4,581)
Income from continuing operations before income taxes	14,900	5,509
Income tax expense	1,200	300
Income from continuing operations	13,700	5,209
Loss from discontinued operations, net of taxes	(53)	(2,558)
Net income	$ 13,647	$ 2,651
Basic income (loss) per share:		
Income from continuing operations	$ 0.18	$ 0.06
Loss from discontinued operations		(0.03)
Basic income per share	$ 0.18	$ 0.03
Weighted shares for basic EPS	76,081	72,547
Diluted income (loss) per share:		
Income from continuing operations	$ 0.18	$ 0.06
Loss from discontinued operations		(0.03)
Diluted income per share	$ 0.18	$ 0.03
Weighted shares for diluted EPS	77,300	73,345

See accompanying Notes to Consolidated Financial Statements.

CHAMPION ENTERPRISES, INC.

Consolidated Balance Sheets

(In thousands, except par value)

	Unaudited April 1, 2006	December 31, 2005
ASSETS		
Current assets		
Cash and cash equivalents	$ 132,136	$ 126,979
Restricted cash	325	713
Accounts receivable, trade	45,899	49,146
Inventories	106,747	108,650
Current assets of discontinued operations	1,262	1,836
Other current assets	6,922	10,832
Total current assets	293,291	298,156
Property, plant and equipment	222,196	215,146
Less-accumulated depreciation	126,129	123,973
	96,067	91,173
Goodwill	171,670	154,174
Amortizable intangible assets, net	3,836	3,927
Non-current assets of discontinued operations	1,720	2,226
Other non-current assets	17,327	16,998
	$ 583,911	$ 566,654
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities		
Accounts payable	$ 40,896	$ 29,115
Accrued warranty obligations	33,899	33,509
Accrued volume rebates	30,024	33,056
Accrued compensation and payroll taxes	17,883	26,757
Accrued self-insurance	32,277	30,968
Current liabilities of discontinued operations	2,893	3,279
Other current liabilities	30,106	29,407
Total current liabilities	187,978	186,091
Long-term liabilities		
Long-term debt	201,418	201,727
Other long-term liabilities	31,383	31,531
	232,801	233,258
Contingent liabilities (Note 8)		
Shareholders equity		
Common stock, $1 par value, 120,000 shares authorized, 76,142 and 76,045 shares issued and outstanding, respectively	76,142	76,045
Capital in excess of par value	195,087	192,905
Accumulated deficit	(108,216)	(121,863)
Accumulated other comprehensive income	119	218
Total shareholders equity	163,132	147,305
	$ 583,911	$ 566,654

See accompanying Notes to Consolidated Financial Statements.

CHAMPION ENTERPRISES, INC.

Consolidated Statements of Cash Flows

(In thousands)

	Unaudited Three Months Ended April 1, 2006	April 2, 2005* (Restated)
Cash flows from operating activities		
Net income	**$ 13,647**	$ 2,651
Loss from discontinued operations	**53**	2,558
Adjustments to reconcile net income to net cash provided by (used for) operating activities:		
Depreciation and amortization	**3,231**	2,539
Stock-based compensation	**1,817**	964
Mark-to-market credit for common stock warrant		(3,800)
Gain on disposal of fixed assets	**(3,986)**	(1,595)
Increase/decrease		
Accounts receivable	**5,486**	(12,126)
Inventories	**3,635**	(12,253)
Accounts payable	**9,865**	14,845
Accrued liabilities	**(10,491)**	(1,814)
Other, net	**3,375**	2,939
Net cash provided by (used for) continuing operating activities	**26,632**	(5,092)
Cash flows from investing activities		
Additions to property, plant and equipment	**(4,511)**	(2,468)
Acquisition of Highland Manufacturing Company	**(22,828)**	
Investments in and advances to unconsolidated subsidiaries		(55)
Proceeds on disposal of fixed assets	**4,620**	4,746
Net cash (used for) provided by investing activities	**(22,719)**	2,223
Cash flows from financing activities		
Decrease in long-term debt	**(301)**	(51)
Increase in deferred financing costs	**(15)**	
Decrease (increase) in restricted cash	**388**	(4,165)
Common stock issued, net	**622**	182
Dividends paid on preferred stock		(259)
Net cash provided by (used for) financing activities	**694**	(4,293)
Cash flows from discontinued operations		
Net cash provided by (used for) operating activities of discontinued operations	**550**	(2,271)
Net cash provided by investing activities of discontinued operations		19,568
Net cash used for financing activities of discontinued operations		(10,282)
Net cash provided by discontinued operations	**550**	7,015
Net increase (decrease) in cash and cash equivalents	**5,157**	(147)
Cash and cash equivalents at beginning of period	**126,979**	142,266
Cash and cash equivalents at end of period	**$ 132,136**	$ 142,119

* The 2005 statement of cash flows has been revised to separately disclose the operating, investing, and financing portions of the cash flows attributable to discontinued operations. These amounts were previously reported on a combined basis.

See accompanying Notes to Consolidated Financial Statements.

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CHAMPION ENTERPRISES, INC.

Consolidated Statement of Shareholders Equity

Unaudited Three Months Ended April 1, 2006

(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 December 31, 2005	76,045	$ 76,045	$ 192,905	$ (121,863)	$ 218	$ 147,305	
Net income				13,647		13,647	$ 13,647
Stock options and benefit plans	97	97	2,182			2,279	
Foreign currency translation adjustments					(99)	(99)	(99)
Balance at April 1, 2006	76,142	$ 76,142	$ 195,087	$ (108,216)	$ 119	$ 163,132	$ 13,548

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 periods. All such adjustments are of a normal recurring nature. Financial results of the interim periods 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 December 31, 2005 was derived from audited financial statements but does not include all disclosures required by accounting principles generally accepted in the United States.

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 December 31, 2005.

During 2005, the Company completed the disposal of its traditional retail operations through the sale of its remaining 42 traditional retail sales centers. 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 2003. Continuing retail operations in 2006 and 2005 consist of our ongoing non-traditional California retail operations.

The Company has various stock option and stock-based incentive plans and agreements whereby stock options, performance share awards, restricted stock awards, and other stock-based incentives are made available to certain employees, directors, and others. The Company accounts for these stock-based employee compensation programs under Statement of Financial Accounting Standards (SFAS) No. 123(R), Share-Based Payment. Awards of performance shares and restricted stock are accounted for by valuing unvested shares expected to be earned at grant date market value. The fair value of stock options has been determined by using the Black-Scholes option-pricing model. Stock-based compensation cost was $1.8 million and $1.0 million for the three months ended April 1, 2006 and April 2, 2005, respectively, and is included in selling, general, and administrative expenses. Future stock-based compensation costs related to unvested stock options is approximately $0.1 million.

The Company early adopted Statement of Financial Accounting Standards No. 123(R), Share-Based Payment. (SFAS No. 123(R)) in the fourth quarter of 2005, effective January 2, 2005 using the modified prospective method of transition. The quarter ended April 2, 2005, has been restated to reflect the adoption of SFAS No. 123(R), which required adjustments for the cumulative effect of the accounting change at January 2, 2005 of $0.2 million (income) and additional stock compensation expense of $0.1 million for the quarter ended April 2, 2005. These adjustments were included in selling, general, and administrative expenses.

SFAS No. 123(R) provides that any corporate income tax benefit realized upon exercise or vesting of an award in excess of that previously recognized in earnings (referred to as a windfall tax benefit) will be presented in the consolidated statement of cash flows as a financing (rather than an operating) cash flow. Realized windfall tax benefits are credited to capital in excess of par in the consolidated balance sheet. Realized shortfall tax benefits (amounts which are less than that previously recognized in earnings) are first offset against the cumulative balance of windfall tax benefits, if any, and then charged directly to income tax expense. Under the transition rules for adopting SFAS No. 123(R) using the modified prospective method, the Company was permitted to calculate a cumulative memo balance of windfall tax benefits from post-1995 years for the purpose of accounting for future shortfall tax benefits. The Company completed such study during the quarter ended December 31, 2005, the period of adoption, and currently has sufficient cumulative memo windfall tax benefits to absorb arising shortfalls, such that earnings were not affected in the periods presented. Because the Company provides a 100% valuation allowance for its deferred tax assets (see Note 3), there are no windfall tax benefit cash flows realized in the periods presented.

2. On March 31, 2006, the Company acquired 100% of the membership interests of Highland Manufacturing Company, LLC (Highland), a manufacturer of modular and HUD-code homes, for cash consideration of $23 million. This acquisition expanded the Company s presence in the modular homebuilding industry and increased the Company s manufacturing and distribution in several states under-served by Champion in the north central United States.

Due to the acquisition date, the results of operations of Highland are not included in the Company s results for the three months ended April 1, 2006. However, the assets and liabilities of Highland are included in the consolidated balance sheet as of April 1, 2006. Highland s results of operations will be included in the Company s results as of the period beginning April 2, 2006.

Goodwill and other intangible assets recognized in the transaction amounted to approximately $17.6 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. Trade names were valued based upon the royalty-saving method and customer relationships were valued based upon the excess earnings method. The estimated fair values assigned to the assets and liabilities from the Highland acquisition include current assets totaling $4.1 million, plant, property and equipment totaling $4.0 million, current liabilities totaling $2.9 million, and the following for amortizable intangible assets and goodwill, and the respective amortization periods and annual amortization expense:

	Amount (In thousands)	**Amortization Period (yrs.)**	**Expected Annual Amortization (In thousands)**
Tradenames	$ 2,600	15	$ 173
Customer relationships	4,200	15	280
Other amortizable intangible assets	520	7	74
Goodwill	10,291		
Total Goodwill and Intangible Assets	$ 17,611		$ 527

On August 8, 2005, pursuant to three separate asset purchase agreements, the Company acquired the assets and business 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 $41.4 million plus the assumption of certain current liabilities.

The following table presents unaudited pro forma combined results as if Champion had acquired the New Era group and Highland as of the beginning of 2005, instead of August 8, 2005 and March 31, 2006, respectively.

	Unaudited Three Months Ended April 1, 2006 (In thousands)	**April 2, 2005**
Net sales	$ 353,953	$ 275,766
Net income	14,389	3,939
Diluted income per share	$ 0.19	$ 0.04

The pro forma results include amortization of intangible assets acquired and valued in the transactions. The pro forma results are not necessarily indicative of what actually would have occurred if the transactions had been completed as of the beginning of 2005, nor are they necessarily 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:

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	Three Months Ended April 1, 2006 (In thousands)	April 2, 2005
Continuing operations		
Statutory U.S. tax rate	$ 5,200	$ 1,900
(Decrease) increase in rate resulting from:		
Warrant mark-to-market and other permanent differences	(100)	(1,200)
Deferred tax valuation allowance	(4,000)	(500)
Foreign and state taxes	100	100
Total income tax expense	$ 1,200	$ 300

	Three Months Ended April 1, 2006 (In thousands)	April 2, 2005
Discontinued operations		
Statutory U.S. tax rate	$	$ (900)
Increase in rate resulting from:		
Deferred tax valuation allowance		900
Total income tax	$	$

The Company currently provides a 100% valuation allowance for its deferred tax assets, which, at December 31, 2005, totaled $116 million. 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 December 31, 2005, the Company had available federal net operating loss carryforwards of approximately $130 million for tax purposes to offset certain future federal taxable income. These loss carryforwards expire in 2023 through 2025. Additionally, as a result of the sale of our remaining traditional retail operations during 2005, approximately $49 million of additional net operating losses will become available during 2006, upon completion of certain disposal activities. The Company s deferred tax assets and liabilities pertaining to tax-deductible goodwill are determined on an aggregate basis versus an acquisition-by-acquisition basis. When future tax deductions result in a net deferred tax liability for tax-deductible goodwill, in the absence of the reversal of the valuation allowance for deferred tax assets, this deferred tax liability will be established through a deferred tax provision, which, as of April 1, 2006, would have been approximately $12 million.

As of December 31, 2005, the Company had available state net operating loss carryforwards of approximately $156 million for tax purposes to offset future state taxable income. These carryforwards expire in 2016 through 2025.

During 2005 and 2004, the Company had U.S. pretax income totaling approximately $37 million for financial reporting purposes and expects to be profitable in 2006. Depending on the Company s level of U.S. pretax income in 2006 and expectation of future profitability, it is possible that substantially all of the then remaining deferred tax asset valuation allowance will be reversed to income during 2006.

4. A summary of inventories by component follows:

	April 1, 2006 (In thousands)	December 31, 2005
New manufactured homes	$ 29,152	$ 36,843
Raw materials	42,817	41,525
Work-in-process	13,060	10,621
Other inventory	21,718	19,661
	$ 106,747	$ 108,650

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

5. The Company s manufacturing operations generally provide the retail homebuyer or the builder/developer 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 three months ended April 1, 2006 and April 2, 2005. A portion of warranty reserves was classified as other long-term liabilities in the consolidated balance sheet.

	Three Months Ended	
	2006	**2005**
	(In thousands)	
Reserves at beginning of year	$ 40,009	$ 40,051
Warranty expense provided	13,479	12,579
Warranty reserves from acquisitions	483	
Cash warranty payments	(13,572)	(13,439)
Reserves at end of quarter	$ 40,399	$ 39,191

6. Long-term debt consisted of the following:

	April 1, 2006	**December 31, 2005**
	(In thousands)	
7.625% Senior Notes due 2009	$ 89,273	$ 89,273
Term Loan due 2012	99,500	99,750
Obligations under industrial revenue bonds	12,430	12,430
Other debt	1,488	1,539
Total debt	202,691	202,992
Less: Current portion of long-term debt	(1,273)	(1,265)
Long-term debt	$ 201,418	$ 201,727

On October 31, 2005, the Company entered into a senior secured credit agreement (the Credit Agreement), with various financial institutions. The Credit Agreement represents a $200 million senior secured credit facility comprised of a $100 million term loan, a revolving line of credit in the amount of $40 million, and a $60 million letter of credit facility. As of April 1, 2006 there was $99.5 million of term debt, no borrowings under the line of credit, and $58.8 million of letters of credit issued under the facility. The Credit Agreement is secured by a first security interest in substantially all of the assets of the domestic operating subsidiaries of the Company.

The interest rate for borrowings under the term loan is currently a LIBOR based rate (4.83% at April 1, 2006) plus 2.5%. The maturity date for each of the term loan and the letter of credit facility is October 31, 2012 and the maturity date for the revolving line of credit is October 31, 2010, unless, as of February 3, 2009, more than $25 million in aggregate principal amount of the Company s 7.625% Senior Notes due 2009 are outstanding, then the maturity date for the three facilities will be February 3, 2009.

The Credit Agreement contains affirmative and negative covenants. Under the Credit Agreement, the Company is required to maintain a maximum Leverage Ratio (as defined) of no more than 4.0 to 1, for the first and second fiscal quarters of 2006, 3.5 to 1 for the third and fourth fiscal quarters of 2006, 3.25 to 1 for the first, second and third fiscal quarters of 2007, 3.0 to 1 for the fourth fiscal quarter of 2007, and 2.75 to 1 thereafter. The Leverage Ratio is the ratio of Total Debt (as defined) of the Company on the last day of a fiscal quarter to its consolidated

EBITDA (as defined) for the four-quarter period then ended. The Company is also required to maintain a minimum Interest Coverage Ratio (as defined) of not less than 3.0 to 1. The Interest Coverage Ratio is the ratio of the Company s consolidated EBITDA for the four-quarter period then ended to its Cash Interest Expense (as defined) over the same four-quarter period. In addition, annual mandatory prepayments are required should the Company generate Excess Cash Flow (as defined). As of April 1, 2006, the Company was in compliance with all Credit Agreement covenants.

Letter of credit fees are 2.6% annually and revolver borrowings bear interest at either the prime interest rate plus up to 1.5% or LIBOR plus up to 2.5%. In addition, there is a fee on the unused portion of the facility ranging from 0.50% to 0.75% annually.

The Senior Notes due 2009 are secured equally and ratably with the $200 million senior credit facility dated October 31, 2005. Interest is payable semi-annually at an annual rate of 7.625%. The indenture governing the Senior Notes due 2009 contains covenants, which, among other things, limit the Company s ability to incur additional indebtedness and incur liens on assets.

7. At April 2, 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 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 three months ended April 2, 2005, the Company recorded a mark-to-market credit of $3.8 million for the change in estimated fair value of the warrant.

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 April 1, 2006 was estimated to be approximately $275 million, without reduction for the resale value of the homes. Losses under repurchase obligations represent the difference between the repurchase price and the estimated net proceeds from the resale of the homes. Losses incurred on homes repurchased totaled less than $0.1 million for the three months ended April 1, 2006 and $0.1 million for the three months ended April 2, 2005.

At April 1, 2006, the Company was contingently obligated for approximately $59.1 million under letters of credit, primarily comprised of $41.5 million to support insurance reserves, $12.6 million to support long-term debt and $1.9 million to secure surety bonds. Champion was also contingently obligated for $8.0 million under surety bonds, generally to support license and service bonding requirements. Approximately $54.5 million of the letters of credit support insurance reserves and debt that are reflected as liabilities in the consolidated balance sheet.

At April 1, 2006 certain of the Company s subsidiaries were guarantors of $4.8 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 April 1, 2006, the Company s potentially dilutive securities consisted of outstanding stock options and awards. During the three months ended April 2, 2005, the Company s potentially dilutive securities consisted of outstanding stock options and awards, convertible preferred stock, and a common stock warrant. 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. The amount of potentially dilutive securities that were excluded from the determination of diluted EPS

was approximately 0.3 million shares as of April 1, 2006 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 April 1, 2006	April 2, 2005 (Restated)
Numerator	(Dollars in thousands)	
Net income	$ 13,647	$ 2,651
Plus loss from discontinued operations	53	2,558
Less preferred stock dividend		(259)
Less amount allocated to participating securities holders		(337)
Income from continuing operations available to common shareholders for basic and diluted EPS	13,700	4,613
Loss from discontinued operations available to common shareholders for basic and diluted EPS	(53)	(2,558)
Income available to common shareholders for basic and diluted EPS	$ 13,647	$ 2,055
Denominator		
Shares for basic EPS-weighted average shares outstanding	76,081	72,547
Plus effect of dilutive securities		
Stock options and awards	1,219	798
Shares for diluted EPS	77,300	73,345

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 April 1, 2006	April 2, 2005 (Restated)
Net sales	(In thousands)	
Manufacturing	$ 331,651	$ 238,738
Retail	27,278	25,137
Less: intercompany	(12,400)	(19,600)
Consolidated net sales	$ 346,529	$ 244,275
Income from continuing operations before income taxes:		
Manufacturing segment income	$ 25,874	$ 11,194
Retail segment income	1,513	1,267
General corporate expenses	(9,617)	(8,144)
Mark-to-market credit for common stock warrant		3,800
Interest expense, net	(2,070)	(3,808)
Intercompany eliminations	(800)	1,200
Income from continuing operations before income taxes	$ 14,900	$ 5,509

11. Discontinued operations include the Company s traditional retail operations which were exited in 2005, and its former consumer finance business that was exited in 2003. For the three months ended April 2, 2005, revenues from discontinued retail operations were $18.9 million. Losses from discontinued operations for the three months ended April 1, 2006 and April 2, 2005 consist of the following:

	Three Months Ended	
	April 1, 2006	April 2, 2005
	(In thousands)	
Loss from retail operations	$ (48)	$ (2,548)
Loss from consumer finance business	(5)	(10)
Total loss from discontinued operations	$ (53)	$ (2,558)

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

	April 1, 2006	December 31, 2005
	(In thousands)	
Assets:		
Accounts receivable, trade	$ 96	$ 36
Inventories	796	1,279
Other current assets	370	521
Current assets of discontinued operations	$ 1,262	$ 1,836
Property, plant, and equipment, net	$ 334	$ 430
Other non-current assets	1,386	1,796
Non-current assets of discontinued		
Operations	$ 1,720	$ 2,226
Liabilities:		
Accounts payable	$ 349	$ 359
Other current liabilities	2,544	2,920
Current liabilities of discontinued operations	$ 2,893	$ 3,279

Loss from discontinued retail operations for the quarter ended April 2, 2005 included an operating loss of $1.6 million and a net loss of $1.0 million related to sales of retail businesses during the quarter and asset impairment charges related to a sale that was completed in April 2005. During the quarter ended April 2, 2005, the Company completed six transactions in which the assets and businesses of 22 of its retail sales centers were sold. The assets sold consisted primarily of new homes and other inventory. The total sale price included cash of approximately $19.6 million and the buyers assumption of certain liabilities totaling approximately $1.0 million. The Company recorded a loss of approximately $0.2 million from these transactions. In connection with one of these sales, the Company paid down $10.3 million of floor plan borrowings.

In connection with the sales of retail businesses during the first quarter of 2005, intercompany profit of $1.6 million was recognized in the consolidated statement of operations that is not classified as discontinued operations.

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.

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.

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	Three Months Ended April 1, 2006 (In thousands)
Balance at beginning of year	$ 4,330
Cash payments:	
Warranty costs	(551)
Other closing costs	(65)
Balance at April 1, 2006	$ 3,714
Period end balance comprised of:	
Warranty costs	$ 3,281
Other closing costs	433
	$ 3,714

The majority of 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.

14. On April 7, 2006, the Company acquired United Kingdom-based Calsafe Group (Holdings) Ltd. (Calsafe) and its operating subsidiary Caledonian Building Systems Limited (Caledonian), a leading modular manufacturer, for approximately $110 million. The transaction was financed through a combination of debt, via an approximate $80 million Sterling-denominated increase in Champion s credit facility, and cash. The final purchase price will ultimately be determined based upon the achievement of certain financial benchmarks over the three years and three quarters ending December 2009.

Caledonian constructs steel-framed modular buildings for use as prisons, residences and hotels, as well as military accommodations for the UK Ministry of Defence. The company recorded revenues of approximately $150 million over the last twelve months. Caledonian s steel-framed modular technology allows for multi-story construction, a key advantage over North American wood-framed construction techniques.

On April 7, 2006, concurrent with the closing of the acquisition of Calsafe, the Company entered into an Amended and Restated Credit Agreement (the "Restated Credit Agreement") with various financial institutions. The Restated Credit Agreement amended the terms of the Credit Agreement entered into on October 31, 2005 by (i) establishing an additional term loan, denominated in Pounds Sterling (the "Sterling Term Loan"), in the principal amount of £45 million (approximately $80 million), with the same maturity date and substantially the same terms as the existing term loan under the Credit Agreement; (ii) providing the Company the right from time to time to borrow incremental uncommitted term loans of up to an additional $100 million, which may be denominated in U.S. Dollars or Pounds Sterling; and (iii) amending certain restrictive covenants to permit the acquisition of Calsafe and provide increased flexibility for foreign acquisitions generally. The Restated Credit Agreement did not amend the financial covenants in the Credit Agreement. The interest rate for borrowings under the Sterling Term Loan is currently a UK LIBOR base rate plus 2.5% and customary mandatory costs. The maturity date for the Sterling Term Loan is October 31, 2012, unless as of February 3, 2009, more than $25 million in aggregate principal amount of our 7.625% Senior Notes due 2009 are outstanding, then the maturity date will be February 3, 2009. The Restated Credit Agreement continues to be secured equally and ratably with the Company s Senior Notes due 2009 by a first security interest in substantially all of the assets of our domestic operating subsidiaries.

15. Substantially all domestic operating subsidiaries of the Company are guarantors of the Term Loan due 2012 and the Senior Notes due 2009. The non-guarantor subsidiaries primarily include the Company s foreign operations, its development company and closed or discontinued retail and manufacturing 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 Term Loan due 2012. 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), as parent, as if it accounted for its 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 April 1, 2006

	Parent (In thousands)	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Consolidating Eliminations	Consolidated
Net sales	$	$ 341,465	$ 17,464	$ (12,400)	$ 346,529
Cost of sales		289,725	13,811	(11,300)	292,236
Gross margin		51,740	3,653	(1,100)	54,293
Selling, general, and administrative expenses	33	34,176	3,414	(300)	37,323
Operating (loss) income	(33)	17,564	239	(800)	16,970
Interest income	1,715	2,575	87	(2,836)	1,541
Interest expense	(1,715)	(4,732)		2,836	(3,611)
(Loss) income from continuing operations before income taxes	(33)	15,407	326	(800)	14,900
Income tax expense		200	1,000		1,200
(Loss) income from continuing operations	(33)	15,207	(674)	(800)	13,700
Loss from discontinued operations			(53)		(53)
(Loss) income before equity in income (loss) of consolidated subsidiaries	(33)	15,207	(727)	(800)	13,647
Equity in income (loss) of consolidated subsidiaries	14,480	(727)		(13,753)	
Net income (loss)	$ 14,447	$ 14,480	$ (727)	$ (14,553)	$ 13,647

CHAMPION ENTERPRISES, INC.

Condensed Consolidating Balance Sheet

As of April 1, 2006

	Parent	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Consolidating Eliminations	Consolidated
	(In thousands)				
Current assets					
Cash and cash equivalents	$	$ 123,391	$ 8,745	$	$ 132,136
Restricted cash		325			325
Accounts receivable, trade		46,704	619	(1,424)	45,899
Inventories		106,514	3,433	(3,200)	106,747
Current assets of discontinued operations			1,262		1,262
Other current assets		6,621	301		6,922
Total current assets		283,555	14,360	(4,624)	293,291
Property, plant, and equipment, net		91,907	4,160		96,067
Goodwill		170,838	832		171,670
Investment in consolidated subsidiaries	(7,079)	473,751	6,790	(473,462)	
Intercompany balances	250,566	(596,167)	9,379	336,222	
Non-current assets of discontinued operations			1,720		1,720
Other non-current assets	482	7,622	13,059		21,163
	$ 243,969	$ 431,506	$ 50,300	$ (141,864)	$ 583,911
Liabilities and Shareholders Equity					
Current liabilities					
Accounts payable	$	$ 39,486	$ 2,456	$ (1,046)	$ 40,896
Accrued warranty obligations		32,303	1,596		33,899
Accrued volume rebates		28,056	1,968		30,024
Current liabilities of discontinued operations			2,893		2,893
Other current liabilities	2,562	75,404	2,300		80,266
Total current liabilities	2,562	175,249	11,213	(1,046)	187,978
Long-term liabilities					
Long-term debt	89,273	112,145			201,418
Other long-term liabilities		31,289	94		31,383
	89,273	143,434	94		232,801
Shareholders equity					
Common stock	76,142	41	24	(65)	76,142
Capital in excess of par value	195,087	243,845	618,297	(862,142)	195,087
Accumulated deficit	(119,095)	(131,027)	(579,483)	721,389	(108,216)
Accumulated other comprehensive loss		(36)	155		119
Total shareholders equity	152,134	112,823	38,993	(140,818)	163,132
	$ 243,969	$ 431,506	$ 50,300	$ (141,864)	$ 583,911

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CHAMPION ENTERPRISES, INC.

Condensed Consolidating Statement of Cash Flows

For the Three Months Ended April 1, 2006

	Parent	Guarantor Subsidiaries (In thousands)	Non-guarantor Subsidiaries	Consolidating Eliminations	Consolidated
Net cash provided by (used for) operating activities	$ 3,367	$ 31,469	$ (8,183)	$ (21)	$ 26,632
Net cash provided by discontinued operations			550		550
Cash flows from investing activities					
Additions to property plant and equipment		(4,414)	(97)		(4,511)
Acquisition of Highland		(22,828)			(22,828)
Investments in and advances to consolidated subsidiaries	(3,989)	(2,695)	6,663	21	
Proceeds on disposal of fixed assets		4,103	517		4,620
Net cash (used for) provided by investing activities	(3,989)	(25,834)	7,083	21	(22,719)
Cash flows from financing activities					
Decrease in other long-term debt		(301)			(301)
Decrease in restricted cash		388			388
Common stock issued, net	622				622
Increase in deferred financing costs		(15)			(15)
Net cash used for financing activities	622	72			694
Net increase in cash and cash equivalents		5,707	(550)		5,157
Cash and cash equivalents at beginning of period		117,684	9,295		126,979
Cash and cash equivalents at end of period	$	$ 123,391	$ 8,745	$	$ 132,136

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CHAMPION ENTERPRISES, INC.

Condensed Consolidating Statement of Operations

For the Three Months Ended April 2, 2005

(Restated)

	Parent (In thousands)	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Consolidating Eliminations	Consolidated
Net sales	$	$ 252,472	$ 11,403	$ (19,600)	$ 244,275
Cost of sales		217,861	9,950	(20,800)	207,011
Gross margin		34,611	1,453	1,200	37,264
Selling, general, and administrative expenses	221	30,015	1,511		31,747
Mark-to-market credit for common stock warrant	(3,800)				(3,800)
Operating income (loss)	3,579	4,596	(58)	1,200	9,317
Interest income	1,715	2,353	112	(3,407)	773
Interest expense	(1,715)	(6,274)	1	3,407	(4,581)
Income from continuing operations before income taxes	3,579	675	55	1,200	5,509
Income tax expense			300		300
Income (loss) from continuing operations	3,579	675	(245)	1,200	5,209
Loss from discontinued operations			(2,558)		(2,558)
Income (loss) before equity in (loss) income of consolidated subsidiaries	3,579	675	(2,803)	1,200	2,651
Equity in (loss) income of consolidated subsidiaries	(2,128)	(2,803)		4,931	
Net income (loss)	$ 1,451	$ (2,128)	$ (2,803)	$ 6,131	$ 2,651

CHAMPION ENTERPRISES, INC.

Condensed Consolidating Balance Sheet

As of December 31, 2005

	Parent (In thousands)	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Consolidating Eliminations	Consolidated
Current assets					
Cash and cash equivalents	$	$ 117,684	$ 9,295	$	$ 126,979
Restricted cash		513	200		713
Accounts receivable, trade		51,996	9	(2,859)	49,146
Inventories		108,387	2,663	(2,400)	108,650
Current assets of discontinued operations			1,836		1,836
Other current assets		10,157	675		10,832
Total current assets		288,737	14,678	(5,259)	298,156
Property, plant, and equipment, net		86,484	4,689		91,173
Goodwill		153,337	837		154,174
Investment in consolidated subsidiaries	14,796	472,921	6,790	(494,507)	
Intercompany balances	210,222	(608,493)	62,031	336,240	
Non-current assets of discontinued operations			2,226		2,226
Other non-current assets	524	12,820	7,581		20,925
	$ 225,542	$ 405,806	$ 99,008	$ (163,702)	$ 566,654
Liabilities and Shareholders Equity					
Current liabilities					
Accounts payable	$	$ 29,547	$ 2,028	$ (2,460)	$ 29,115
Accrued warranty obligations					