

CHAMPION ENTERPRISES INC

Form 10-Q

April 22, 2005

**FORM 10-Q**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

(Mark one)

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

**For Quarterly period ended April 2, 2005**

**OR**

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

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

Commission file number 1-9751

**CHAMPION ENTERPRISES, INC.**

(Exact name of registrant as specified in its charter)

Michigan  
(State or other jurisdiction of incorporation or  
organization)

38-2743168  
(I.R.S. Employer

Identification No.)

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2701 Cambridge Court, Suite 300

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

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

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

Yes  No

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

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

75,685,743 shares of the registrant's \$1.00 par value Common Stock were outstanding as of April 22, 2005.

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**PART I. FINANCIAL INFORMATION**

## Item 1. Financial Statements.

CHAMPION ENTERPRISES, INC.  
Consolidated Statements of Operations  
(In thousands, except per share amounts)

|   | <b>Unaudited<br/>Three Months Ended<br/>April 2, 2005</b> | <b>April 3, 2004</b> |
|---|---|----------------------|
| <b>Net sales</b>  | \$ 244,275  | \$ 206,734           |
| Cost of sales   | 207,011   | 179,277              |
| <b>Gross margin</b>   | 37,264  | 27,457               |
| Selling, general, and administrative expenses                       | 31,669  | 28,243               |
| Mark-to-market (credit) charge for common stock warrant             | (3,800 )  | 5,100                |
| Loss on debt retirement   |   | 3,226                |
| <b>Operating income (loss)</b>                                      | 9,395   | (9,112 )             |
| Interest income   | 773   | 232                  |
| Interest expense  | (4,581 )  | (5,062 )             |
| <b>Income (loss) from continuing operations before income taxes</b> | 5,587   | (13,942 )            |
| Income tax expense  | 300   | 300                  |
| <b>Income (loss) from continuing operations</b>                     | 5,287   | (14,242 )            |
| Loss from discontinued operations, net of taxes                     | (2,558 )  | (81 )                |
| <b>Net income (loss)</b>  | \$ 2,729  | \$ (14,323 )         |
| <b>Basic income (loss) per share (Note 9):</b>                      |   |                      |
| Income (loss) from continuing operations                            | \$ 0.06   | \$ (0.21 )           |
| Loss from discontinued operations                                   | (0.03 )   |                      |
| Basic income (loss) per share                                       | \$ 0.03   | \$ (0.21 )           |
| Weighted shares for basic EPS                                       | 72,547  | 68,103               |
| <b>Diluted income (loss) per share (Note 9):</b>                    |   |                      |
| Income (loss) from continuing operations                            | \$ 0.06   | \$ (0.21 )           |
| Loss from discontinued operations                                   | (0.03 )   |                      |
| Diluted income (loss) per share                                     | \$ 0.03   | \$ (0.21 )           |
| Weighted shares for diluted EPS                                     | 73,345  | 68,103               |

See accompanying Notes to Consolidated Financial Statements.



CHAMPION ENTERPRISES, INC.

## Consolidated Balance Sheets

(In thousands, except par value)

|  | <b>Unaudited</b> |                 |
|--|------------------|-----------------|
|  | April 2, 2005    | January 1, 2005 |
| <b>ASSETS</b>  |                  |                 |
| <b>Current assets</b>  |                  |                 |
| Cash and cash equivalents  | \$ 142,119       | \$ 142,266      |
| Restricted cash  | 4,694            | 529             |
| Accounts receivable, trade   | 34,245           | 22,119          |
| Inventories  | 83,869           | 71,616          |
| Current assets of discontinued operations  | 14,751           | 35,463          |
| Other current assets   | 13,003           | 13,535          |
| Total current assets   | 292,681          | 285,528         |
| Property, plant and equipment  | 196,344          | 207,216         |
| Less-accumulated depreciation  | 118,345          | 126,259         |
|  | 77,999           | 80,957          |
| Goodwill   | 126,583          | 126,591         |
| Non-current assets of discontinued operations  | 6,478            | 7,747           |
| Other non-current assets   | 15,726           | 16,219          |
|  | \$ 519,467       | \$ 517,042      |
| <b>LIABILITIES, REDEEMABLE CONVERTIBLE PREFERRED STOCK, AND SHAREHOLDERS' EQUITY</b>                                     |                  |                 |
| <b>Current liabilities</b>   |                  |                 |
| Accounts payable   | \$ 28,664        | \$ 13,819       |
| Accrued warranty obligations   | 32,691           | 33,551          |
| Accrued volume rebates   | 27,345           | 30,234          |
| Accrued compensation and payroll taxes   | 14,238           | 19,659          |
| Accrued self-insurance   | 26,684           | 25,988          |
| Current liabilities of discontinued operations   | 9,051            | 21,411          |
| Other current liabilities  | 36,094           | 31,696          |
| Total current liabilities  | 174,767          | 176,358         |
| <b>Long-term liabilities</b>   |                  |                 |
| Long-term debt   | 200,710          | 200,758         |
| Long-term liabilities of discontinued operations   | 417              | 432             |
| Other long-term liabilities  | 40,492           | 41,444          |
|  | 241,619          | 242,634         |
| <b>Contingent liabilities (Note 8)</b>   |                  |                 |
| <b>Redeemable convertible preferred stock,</b>   |                  |                 |
| <b>no par value, 5,000 shares authorized, 21 shares</b>  |                  |                 |
| <b>and 21 shares issued and outstanding, respectively</b>  | 20,750           | 20,750          |
| <b>Shareholders' equity</b>  |                  |                 |
| Common stock, \$1 par value, 120,000 shares authorized,<br>72,583 and 72,358 shares issued and outstanding, respectively | 72,583           | 72,358          |
| Capital in excess of par value   | 166,821          | 164,377         |
| Accumulated deficit  | (156,905)        | (159,375)       |
| Accumulated other comprehensive loss   | (168)            | (60)            |
| Total shareholders' equity   | 82,331           | 77,300          |
|  | \$ 519,467       | \$ 517,042      |

See accompanying Notes to Consolidated Financial Statements.



CHAMPION ENTERPRISES, INC.

## Consolidated Statements of Cash Flows

(In thousands)

|  | <b>Unaudited<br/>Three Months Ended<br/>April 2, 2005</b> | <b>April 3, 2004</b> |
|--|---|----------------------|
| <b>Cash flows from operating activities</b>  |   |                      |
| Income (loss) from continuing operations   | \$ 5,287  | \$ (14,242 )         |
| Adjustments to reconcile income (loss) from continuing operations to net cash used for |   |                      |
| continuing operating activities:   |   |                      |
| Depreciation   | 2,539   | 2,670                |
| Loss on debt retirement  |   | 3,226                |
| Mark-to-market (credit) charge for common stock warrant                                | (3,800 )  | 5,100                |
| (Gain) loss on disposal of fixed assets, net   | (1,595 )  | 37                   |
| Increase/decrease  |   |                      |
| Accounts receivable  | (12,126 )   | (17,944 )            |
| Refundable income taxes  |   | 277                  |
| Inventories  | (12,253 )   | (13,631 )            |
| Accounts payable   | 14,845  | 6,520                |
| Accrued liabilities  | (1,814 )  | (5,018 )             |
| Other, net   | 3,825   | 501                  |
| Net cash used for continuing operating activities                                      | (5,092 )  | (32,504 )            |
| <b>Cash flows from discontinued operations</b>   |   |                      |
| Loss from discontinued operations  | (2,558 )  | (81 )                |
| Proceeds from sales of retail businesses   | 19,568  |                      |
| Decrease (increase) in net assets of discontinued operations                           | (9,995 )  | (3,355 )             |
| Net cash provided by (used for) discontinued operations                                | 7,015   | (3,436 )             |
| <b>Cash flows from investing activities</b>  |   |                      |
| Additions to property, plant and equipment   | (2,468 )  | (1,880 )             |
| Proceeds on disposal of fixed assets   | 4,746   | 223                  |
| Investments in and advances to unconsolidated subsidiaries                             | (55 )   | (58 )                |
| Net cash provided by (used for) investing activities                                   | 2,223   | (1,715 )             |
| <b>Cash flows from financing activities</b>  |   |                      |
| Decrease in floor plan payable, net  |   | (29 )                |
| Decrease in long-term debt   | (51 )   | (5,813 )             |
| (Increase) decrease in restricted cash   | (4,165 )  | 1,710                |
| Preferred stock issued, net  |   | 12,000               |
| Common stock issued, net   | 182   | 1,611                |
| Dividends paid on preferred stock  | (259 )  | (112 )               |
| Net cash (used for) provided by financing activities                                   | (4,293 )  | 9,367                |
| Net decrease in cash and cash equivalents  | (147 )  | (28,288 )            |
| Cash and cash equivalents at beginning of period                                       | 142,266   | 145,868              |
| Cash and cash equivalents at end of period   | \$ 142,119  | \$ 117,580           |

See accompanying Notes to Consolidated Financial Statements.





CHAMPION ENTERPRISES, INC.

Consolidated Statement of Shareholders' Equity

Unaudited Three Months Ended April 2, 2005

(In thousands)

|   | Common stock<br>Shares | Amount    | Capital in excess of<br>par value | Accumulated<br>deficit | Accumulated other<br>comprehensive<br>income (loss) | Total        |
|---|------------------------|-----------|-----------------------------------|------------------------|---|--------------|
| Balance at<br>January 1,<br>2005  | 72,358                 | \$ 72,358 | \$ 164,377                        | \$ (159,375)           | ) \$ (60)   | ) \$ 77,300  |
| Net income  |                        |           |                                   | 2,729                  |   | 2,729        |
| Preferred<br>stock<br>dividends   |                        |           |                                   | (259)                  | )   | (259)        |
| Stock<br>options and<br>benefit plans<br>Issuance for<br>acquisition<br>deferred<br>purchase<br>price<br>payments | 54<br>171              | 54<br>171 | 615<br>1,829                      |                        |   | 669<br>2,000 |
| Foreign<br>currency<br>translation<br>adjustments   |                        |           |                                   |                        | (108)   | ) (108)      |
| Balance at<br>April 2,<br>2005  | 72,583                 | \$ 72,583 | \$ 166,821                        | \$ (156,905)           | ) \$ (168)  | ) \$ 82,331  |

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.

During the quarter ended April 2, 2005, the Company sold 22 of its retail sales centers and committed to a plan to dispose of the remainder of its retail operations except for its Advantage Homes operation in California. As a result the remaining non-Advantage operations were classified as held for sale. For the periods reported, retail operations, excluding Advantage Homes, 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.

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.

Certain amounts reported in previous periods have been reclassified to conform to the 2005 presentation.

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:

|   | <b>Three Months Ended</b>                       |                          |
|---|---|--------------------------|
|   | <b>April 2,<br/>2005</b>                        | <b>April 3,<br/>2004</b> |
|   | <b>(In thousands, except per share amounts)</b> |                          |
| Net income (loss) as reported               | \$ 2,729  | \$ (14,323 )             |
| Net income (loss) pro forma                 | 2,618   | (14,460 )                |
| Basic income (loss) per share as reported   | 0.03  | (0.21 )                  |
| Diluted income (loss) per share as reported | 0.03  | (0.21 )                  |
| Basic income (loss) per share pro forma     | 0.03  | (0.21 )                  |
| Diluted income (loss) per share pro forma   | 0.03  | (0.21 )                  |

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|  |          |        |
|--|----------|--------|
| Stock-based employee compensation expense,<br>net of related tax effects as reported | 1,107    | 145    |
| Stock-based employee compensation expense, net of<br>related                         |          |        |
| tax effects pro forma  | \$ 1,218 | \$ 282 |

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 the fiscal year 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 April 2, 2005. 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 for closures of manufacturing plants and retail sales centers.

|                                  | <b>Three Months Ended April 2, 2005</b> |  |                 |              |
|----------------------------------|---|--|-----------------|--------------|
|                                  | <b>2004</b>                             |  | <b>Prior</b>    |              |
|                                  | <b>Closures</b>                         |  | <b>Closures</b> | <b>Total</b> |
|                                  | <b>(In thousands)</b>                   |  |                 |              |
| Balance at beginning of year     | \$ 810                                  |  | \$ 3,611        | \$ 4,421     |
| Cash payments:                   |   |  |                 |              |
| Warranty costs                   |   |  | (211 )          | (211 )       |
| Other closing costs              | (421 )                                  |  | (51 )           | (472 )       |
| Reversals credited to earnings:  |   |  |                 |              |
| Warranty costs                   |   |  |                 |              |
| Other closing costs              | (190 )                                  |  |                 | (190 )       |
| Balance at April 2, 2005         | \$ 199                                  |  | \$ 3,349        | \$ 3,548     |
| Period end balance comprised of: |   |  |                 |              |
| Warranty costs                   | \$                                      |  | \$ 2,381        | \$ 2,381     |
| Other closing costs              | 199                                     |  | 968             | 1,167        |
|                                  | \$ 199                                  |  | \$ 3,349        | \$ 3,548     |

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 other closing costs during the three months ended April 2, 2005 consisted of an adjustment to accruals for employee severance.

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

|   | <b>Three Months Ended<br/>April 2, 2005<br/>(In thousands)</b> | <b>April 3, 2004</b> |
|---|--|----------------------|
| Statutory U.S. tax rate                     | \$ 2,000   | \$ (4,900 )          |
| (Decrease) increase in rate resulting from: |  |                      |
| Warrant mark-to-market and other permanent  | (1,200 )   | 1,900                |
| Deferred tax valuation allowance            | (800 )   | 3,000                |
| Foreign and state taxes                     | 300  | 300                  |
| Total income tax expense                    | \$ 300   | \$ 300               |

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 future federal taxable income. These loss carryforwards expire in 2023 and 2024.

4. A summary of inventories by component follows:

|                        | <b>April 2, 2005<br/>(In thousands)</b> | <b>January 1, 2005</b> |
|------------------------|---|------------------------|
| New manufactured homes | \$ 26,190                               | \$ 18,749              |
| Raw materials          | 31,297                                  | 30,908                 |
| Work-in-process        | 9,443                                   | 7,166                  |
| Other inventory        | 16,939                                  | 14,793                 |
|                        | \$ 83,869                               | \$ 71,616              |

Other inventory consists of pre-owned manufactured homes, 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 at the time of sale. The warranty provision 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 2, 2005. A portion of warranty reserves was classified as other long-term liabilities in the consolidated balance sheet.

|                                  | <b>Accrued Warranty Obligations<br/>2005<br/>(In thousands)</b> | <b>2004</b> |
|----------------------------------|---|-------------|
| Reserves at beginning of quarter | \$ 40,051   | \$ 47,058   |
| Warranty expense provided        | 12,579  | 12,564      |
| Cash warranty payments           | (13,439 )   | (14,271 )   |
| Reserve at end of quarter        | \$ 39,191   | \$ 45,351   |



6. Long-term debt by component consisted of the following:

|  | <b>April 2, 2005</b><br><b>(In thousands)</b> | <b>January 1, 2005</b> |
|--|---|------------------------|
| 7.625% Senior Notes due 2009               | \$ 89,273                                     | \$ 89,273              |
| 11.25% Senior Notes due 2007               | 97,510  | 97,510                 |
| Obligations under industrial revenue bonds | 12,430  | 12,430                 |
| Other debt                                 | 1,497   | 1,545                  |
|  | <b>\$ 200,710</b>                             | <b>\$ 200,758</b>      |

During the three months ended April 3, 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.

CHB 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 April 2, 2005, there were \$60.3 million of letters of credit issued under the facility, there were no borrowings outstanding and the Company's liquidity, as defined, was \$132.5 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 April 2, 2005 redeemable convertible preferred stock consisted of \$8.75 million of Series C and \$12 million of Series B-2 with mandatory redemption dates of April 2, 2009 and July 3, 2008, respectively. Both Series had a 5% annual dividend that was payable quarterly, at the Company's option, in cash or common stock.

In connection with the issuance of the Series C preferred stock in 2002, the Company issued to the preferred shareholder a warrant, which was exercisable based on approximately 2.2 million shares at a strike price of \$12.27 per share at April 2, 2005. 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. During the three months ended April 2, 2005 and April 3, 2004, as a result of changes in the Company's common stock price, the Company recorded a mark-to-market credit of \$3.8 million and a charge of \$5.1 million, respectively, for the change in estimated fair value of the warrant.

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 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.





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 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 \$0.1 million for both the three months ended April 2, 2005 and April 3, 2004.

At April 2, 2005 the Company was contingently obligated for approximately \$60.6 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 \$31.8 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 April 2, 2005 certain of the Company's subsidiaries were guarantors of \$5.5 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. At the end of the quarter, the Company's potentially dilutive securities in 2005 and 2004 consisted of outstanding stock options and awards, convertible preferred stock, a common stock warrant, and, in 2004, 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. Additionally, outstanding stock options and awards and deferred purchase price obligations were not considered in determining the denominator for diluted EPS for the three months ended April 3, 2004 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:

|   | <b>Three Months Ended<br/>April 2, 2005<br/>(In thousands)</b> | <b>April 3, 2004</b> |
|---|--|----------------------|
| Numerator:  |  |                      |
| Net income (loss)   | \$ 2,729   | \$ (14,323 )         |
| Plus loss from discontinued operations  | 2,558  | 81                   |
| Less preferred stock dividends  | (259 )   | (160 )               |
| Less amount allocated to participating securities holders   | (343 )   |                      |
| Income (loss) from continuing operations available to common shareholders for basic and diluted EPS | 4,685  | (14,402 )            |
| Loss from discontinued operations   | (2,558 )   | (81 )                |
| Less amount allocated to participating securities.  | -  | -                    |
| Loss from discontinued operations available to common shareholders for basic and diluted EPS        | (2,558 )   | (81 )                |
| Income (loss) available to common shareholders for basic and diluted EPS                            | \$ 2,127   | \$ (14,483 )         |
| Denominator:  |  |                      |
| Shares for basic EPS - weighted average shares outstanding  | 72,547   | 68,103               |
| Plus effect of dilutive securities  |  |                      |
| Stock options and awards  | 798  |                      |
| Shares for diluted EPS  | 73,345   | 68,103               |

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:

|   | <b>Three Months Ended<br/>April 2, 2005<br/>(In thousands)</b> |  | <b>April 3, 2004</b> |
|---|--|--|----------------------|
| <b>Net sales</b>  |  |  |                      |
| Manufacturing   | \$ 238,738   |  | \$ 209,856           |
| Retail  | 25,137   |  | 19,478               |
| Less: intercompany  | (19,600 )  |  | (22,600 )            |
| Consolidated net sales  | \$ 244,275   |  | \$ 206,734           |
| <br>  |  |  |                      |
| Income (loss) from continuing operations before income taxes: |  |  |                      |
| Manufacturing segment income                                  | \$ 11,190  |  | \$ 4,654             |
| Retail segment income   | 1,267  |  | 783                  |
| General corporate expenses                                    | (8,062 )   |  | (6,023 )             |
| Mark-to-market credit (charge) for common stock warrant       | 3,800  |  | (5,100 )             |
| Loss on debt retirement                                       |  |  | (3,226 )             |
| Interest expense, net   | (3,808 )   |  | (4,830 )             |
| Intercompany eliminations                                     | 1,200  |  | (200 )               |
| Income (loss) from continuing operations before income taxes  | \$ 5,587   |  | \$ (13,942 )         |

11. Discontinued operations include the Company's retail operations, excluding Advantage Homes, and its former consumer finance business that was exited in 2003. For the three months ended April 2, 2005 and April 3, 2004, revenues from discontinued retail operations were \$18.9 million and \$30.4 million, respectively. (Loss) income from discontinued operations for the quarters ended April 2, 2005 and April 3, 2004 consist of the following:

|  | <b>Three Months Ended<br/>April 2, 2005<br/>(In thousands)</b> |  | <b>April 3, 2004</b> |
|--|--|--|----------------------|
| Loss from retail operations                  | \$ (2,548 )  |  | \$ (1,237 )          |
| (Loss) income from consumer finance business | (10 )  |  | 1,156                |
| Total loss from discontinued operations      | \$ (2,558 )  |  | \$ (81 )             |

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

|  | April 2, 2005<br>(In thousands) | January 1, 2005 |
|--|---------------------------------|-----------------|
| Assets:  |                                 |                 |
| Accounts receivable, trade                     | \$ 167                          | \$ 598          |
| Inventories                                    | 13,507                          | 33,964          |
| Other current assets                           | 1,077                           | 901             |
| Current assets of discontinued operations      | \$ 14,751                       | \$ 35,463       |
| Property, plant, and equipment, net            | \$ 3,851                        | \$ 5,064        |
| Other non-current assets                       | 2,627                           | 2,683           |
| Non-current assets of discontinued operations  | \$ 6,478                        | \$ 7,747        |
| Liabilities:                                   |                                 |                 |
| Floor plan payable                             | \$ 1,568                        | \$ 11,835       |
| Accounts payable                               | 1,134                           | 2,043           |
| Other current liabilities                      | 6,349                           | 7,533           |
| Current liabilities of discontinued operations | \$ 9,051                        | \$ 21,411       |
| Long-term debt                                 | \$ 417                          | \$ 432          |

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 22 retail sales centers had sales of \$10.4 million for the three months ended April 2, 2005. The assets sold consisted primarily of new homes and other inventory. The total sale price was 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.

On April 15 2005, the Company sold the assets and business of eight retail sales centers for cash of \$1.6 million, the buyer's assumption of certain liabilities totaling \$0.3 million and the buyer's pay down of floor plan borrowings of \$1.6 million. The assets sold consisted primarily of inventory of new and pre-owned homes. During the quarter ended April 2, 2005 the Company recorded impairment charges of approximately \$0.8 million related to the assets sold.

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

Income from discontinued consumer finance business for the three months ended April 3, 2004 consisted primarily of a favorable adjustment from the settlement of remaining contractual obligations.

12. During the first quarter of 2004, the Company purchased and retired \$27.0 million of its Senior Notes in exchange for 3.9 million shares of Company common stock. In addition, during the three months ended April 2, 2005 and April 3, 2004, the Company issued 171,000 shares and 276,000 shares of common stock, respectively, in payment of deferred purchase price obligations of \$2.0 million each.

13. 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



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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.

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CHAMPION ENTERPRISES, INC.

Condensed Consolidating Statement of Operations

For the Three Months Ended April 2, 2005

|   | Parent  | CHB<br>(In thousands) | Guarantor<br>Subsidiaries | Non-guarantor<br>Subsidiaries | Consolidating<br>Eliminations | Consolidated |
|---|---------|-----------------------|---------------------------|-------------------------------|-------------------------------|--------------|
| Net sales   | \$      | \$ 74,808             | \$ 178,513                | \$ 9,954                      | \$ (19,000)                   | ) \$ 244,275 |
| Cost of sales   |         | 64,396                | 154,438                   | 8,377                         | (20,200)                      | ) 207,011    |
| Gross margin  |         | 10,412                | 24,075                    | 1,577                         | 1,200                         | 37,264       |
| Selling, general<br>and                                 |         |                       |                           |                               |                               |              |
| Administrative<br>expenses                              | 110     | 10,026                | 20,205                    | 1,328                         |                               | 31,669       |
| Mark-to-market<br>credit for<br>common stock<br>warrant | (3,800) | )                     |                           |                               |                               | (3,800)      |
| Operating<br>income                                     | 3,690   | 386                   | 3,870                     | 249                           | 1,200                         | 9,395        |
| Interest income   | 1,715   | 1,692                 | (2,747)                   | ) 91                          | 22                            | 773          |
| Interest<br>expense                                     | (1,715) | ) (2,783)             | ) (83)                    | )                             |                               | (4,581)      |
| Income (loss)<br>from                                   |         |                       |                           |                               |                               |              |
| continuing<br>operations                                |         |                       |                           |                               |                               |              |
| before income<br>taxes                                  | 3,690   | (705)                 | ) 1,040                   | 340                           | 1,222                         | 5,587        |
| Income tax<br>expense                                   |         |                       | 50                        | 250                           |                               | 300          |
| Income (loss)<br>from                                   |         |                       |                           |                               |                               |              |
| continuing<br>operations                                | 3,690   | (705)                 | ) 990                     | 90                            | 1,222                         | 5,287        |
| Loss from<br>discontinued                               |         |                       |                           |                               |                               |              |
| operations, net<br>of taxes                             |         |                       | (2,262)                   | ) (274)                       | ) (22)                        | ) (2,558)    |
| Income (loss)<br>before equity                          | 3,690   | (705)                 | ) (1,272)                 | ) (184)                       | ) 1,200                       | 2,729        |



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in income of  
consolidated

subsidiaries  
Equity in (loss)  
income of

consolidated

|              |          |    |        |      |        |      |       |      |                |
|--------------|----------|----|--------|------|--------|------|-------|------|----------------|
| subsidiaries | (2,161   | )  | (1,456 | )    |        |      | 3,617 |      |                |
| Net income   |          |    |        |      |        |      |       |      |                |
| (loss)       | \$ 1,529 | \$ | (2,161 | ) \$ | (1,272 | ) \$ | (184  | ) \$ | 4,817 \$ 2,729 |

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CHAMPION ENTERPRISES, INC.

## Condensed Consolidating Balance Sheet

As of April 2, 2005

|   | Parent -<br>(In thousands) | CHB        | Guarantor<br>Subsidiaries | Non-guarantor<br>Subsidiaries | Consolidating<br>Eliminations | Consolidated |
|---|----------------------------|------------|---------------------------|-------------------------------|-------------------------------|--------------|
| <b>Assets</b>   |                            |            |                           |                               |                               |              |
| Current assets  |                            |            |                           |                               |                               |              |
| Cash and cash equivalents   | \$                         | \$ 120,731 | \$ 4,155                  | \$ 17,231                     | \$ 2                          | \$ 142,119   |
| Restricted cash   |                            | 4,460      | 234                       |                               |                               | 4,694        |
| Accounts receivable, trade  |                            | 11,948     | 22,631                    | 1,586                         | (1,920)                       | 34,245       |
| Inventories   |                            | 17,536     | 66,279                    | 2,854                         | (2,800)                       | 83,869       |
| Current assets of   |                            |            |                           |                               |                               |              |
| discontinued operations   |                            |            | 14,751                    |                               |                               | 14,751       |
| Other current assets  |                            | 8,554      | 4,302                     | 447                           | (300)                         | 13,003       |
| Total current assets  |                            | 163,229    | 112,352                   | 22,118                        | (5,018)                       | 292,681      |
| Property, plant, and equipment,   |                            |            |                           |                               |                               |              |
| net   |                            | 26,373     | 49,290                    | 2,336                         |                               | 77,999       |
| Goodwill  |                            |            | 125,783                   | 800                           |                               | 126,583      |
| Investment in consolidated  |                            |            |                           |                               |                               |              |
| subsidiaries  | 5,787                      | 309,960    | 163,724                   | 6,791                         | (486,262)                     |              |
| Non-current assets of   |                            |            |                           |                               |                               |              |
| discontinued  |                            |            |                           |                               |                               |              |
| operations  |                            |            | 5,687                     | 791                           |                               | 6,478        |
| Other non-current assets  | 650                        | 2,653      | 4,604                     | 7,819                         |                               | 15,726       |
|   | \$ 6,437                   | \$ 502,215 | \$ 461,440                | \$ 40,655                     | \$ (491,280)                  | \$ 519,467   |
| <b>Liabilities, Redeemable Convertible Preferred Stock, and Shareholders Equity</b> |                            |            |                           |                               |                               |              |
| Current liabilities   |                            |            |                           |                               |                               |              |
| Accounts payable  | \$                         | \$ 9,342   | \$ 18,035                 | \$ 1,287                      | \$                            | \$ 28,664    |
| Accrued warranty  |                            |            |                           |                               |                               |              |
| obligations   |                            | 7,660      | 24,277                    | 754                           |                               | 32,691       |
| Accrued volume rebates  |                            | 8,983      | 17,666                    | 1,993                         | (1,297)                       | 27,345       |
| Current liabilities of  |                            |            |                           |                               |                               |              |
| discontinued operations   |                            |            | 9,051                     |                               |                               | 9,051        |
| Other current liabilities   | 2,656                      | 24,981     | 48,466                    | 1,113                         | (200)                         | 77,016       |
| Total current liabilities   | 2,656                      | 50,966     | 117,495                   | 5,147                         | (1,497)                       | 174,767      |
| Long-term liabilities   |                            |            |                           |                               |                               |              |
| Long-term debt  | 89,273                     | 104,879    | 6,558                     |                               |                               | 200,710      |
| Long-term liabilities of  |                            |            |                           |                               |                               |              |
| discontinued operations   |                            |            | 417                       |                               |                               | 417          |
| Other long-term liabilities   | 5,000                      | 8,125      | 27,249                    | 118                           |                               | 40,492       |
|   | 94,273                     | 113,004    | 34,224                    | 118                           |                               | 241,619      |

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|                                |            |            |            |           |               |            |
|--------------------------------|------------|------------|------------|-----------|---------------|------------|
| Intercompany balances          | (182,962 ) | 59,508     | 457,553    | 4,658     | (338,757 )    |            |
| Redeemable convertible         |            |            |            |           |               |            |
| preferred stock                | 20,750     |            |            |           |               | 20,750     |
| Shareholders' equity           |            |            |            |           |               |            |
| Common stock                   | 72,583     | 1          | 62         | 3         | (66 )         | 72,583     |
| Capital in excess of par value | 166,821    | 613,336    | 323,527    | 32,526    | (969,389 )    | 166,821    |
| Accumulated deficit            | (167,684 ) | (334,600 ) | (471,367 ) | (1,683 )  | 818,429       | (156,905 ) |
| Accumulated other              |            |            |            |           |               |            |
| comprehensive loss             |            |            | (54 )      | (114 )    |               | (168 )     |
| Total shareholders'            |            |            |            |           |               |            |
| equity                         | 71,720     | 278,737    | (147,832 ) | 30,732    | (151,026 )    | 82,331     |
|                                | \$ 6,437   | \$ 502,215 | \$ 461,440 | \$ 40,655 | \$ (491,280 ) | \$ 519,467 |

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CHAMPION ENTERPRISES, INC.

Condensed Consolidating Statement of Cash Flows

For the Three Months Ended April 2, 2005

|  | Parent<br>(In thousands) | CHB      | Guarantor<br>Subsidiaries | Non-guarantor<br>Subsidiaries | Consolidating<br>Eliminations | Consolidated |
|--|--------------------------|----------|---------------------------|-------------------------------|-------------------------------|--------------|
| Net cash (used for)<br>provided                            |                          |          |                           |                               |                               |              |
| by continuing operating                                    |                          |          |                           |                               |                               |              |
| activities   | \$ (2,187 )              | \$ 8,978 | \$ (16,359 )              | \$ 5,141                      | \$ (665 )                     | \$ (5,092 )  |
| Net cash provided by (used<br>for) discontinued operations |                          |          | 7,289                     | (274 )                        |                               | 7,015        |
| Cash flows from investing                                  |                          |          |                           |                               |                               |              |
| activities   |                          |          |                           |                               |                               |              |
| Additions to property,<br>plant,<br>and equipment          |                          | (382 )   | (1,874 )                  | (212 )                        |                               | (2,468 )     |
| Investments in and<br>advances                             |                          |          |                           |                               |                               |              |
| to unconsolidated  |                          |          |                           |                               |                               |              |
| subsidiaries   |                          |          |                           | (55 )                         |                               | (55 )        |
| Investments in and<br>advances                             |                          |          |                           |                               |                               |              |
| to consolidated subsidiaries                               | 2,264                    | (4,235 ) | 7,131                     | (5,346 )                      | 186                           |              |
| Proceeds on disposal of<br>fixed                           |                          |          |                           |                               |                               |              |
| assets   |                          | 144      | 4,206                     | 396                           |                               | 4,746        |
| Net cash provided by (used<br>for) investing activities    | 2,264                    | (4,473 ) | 9,463                     | (5,217 )                      | 186                           | 2,223        |
| Cash flows from financing                                  |                          |          |                           |                               |                               |              |
| Activities   |                          |          |                           |                               |                               |              |
| Decrease in long-term debt                                 |                          |          | (51 )                     |                               |                               | (51 )        |
| Increase in restricted cash                                |                          | (4,151 ) | (14 )                     |                               |                               | (4,165 )     |
| Common stock issued, net                                   | 182                      |          |                           |                               |                               | 182          |
| Dividends paid on preferred                                |                          |          |                           |                               |                               |              |
| stock  | (259 )                   |          |                           |                               |                               | (259 )       |

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Net cash used for financing

activities (77 ) (4,151 ) (65 ) (4,293 )

Net increase (decrease) in cash

and cash equivalents 354 328 (350 ) (479 ) (147 )

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 \$ \$ 120,731 \$ 4,155 \$ 17,231 \$ 2 \$ 142,119

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CHAMPION ENTERPRISES, INC.

Condensed Consolidating Statement of Operations

For the Three Months Ended April 3, 2004

|   | Parent<br>(In thousands) | CHB       | Guarantor<br>Subsidiaries | Non-guarantor<br>Subsidiaries | Consolidating<br>Eliminations | Consolidated |
|---|--------------------------|-----------|---------------------------|-------------------------------|-------------------------------|--------------|
| Net sales   | \$                       | \$ 59,495 | \$ 160,803                | \$ 9,036                      | \$ (22,600 )                  | \$ 206,734   |
| Cost of sales   |                          | 52,920    | 141,428                   | 7,329                         | (22,400 )                     | 179,277      |
| Gross margin  |                          | 6,575     | 19,375                    | 1,707                         | (200 )                        | 27,457       |
| Selling, general<br>and<br>administrative<br>expenses                       |                          | 4,042     | 22,769                    | 1,432                         |                               | 28,243       |
| Mark-to-market<br>charge for<br>common stock<br>warrant                     | 5,100                    |           |                           |                               |                               | 5,100        |
| Loss on debt<br>retirement  | 462                      | 2,696     | 68                        |                               |                               | 3,226        |
| Operating<br>(loss) income  | (5,562 )                 | (163 )    | (3,462 )                  | 275                           | (200 )                        | (9,112 )     |
| Interest income   | 2,068                    | 1,970     | 213                       | 19                            | (4,038 )                      | 232          |
| Interest<br>expense   | (2,068 )                 | (2,974 )  | (4,057 )                  | (1 )                          | 4,038                         | (5,062 )     |
| (Loss) income<br>from<br>continuing<br>operations<br>before income<br>taxes | (5,562 )                 | (1,167 )  | (7,306 )                  | 293                           | (200 )                        | (13,942 )    |
| Income tax<br>expense   |                          | 50        | 50                        | 200                           |                               | 300          |
| (Loss) income<br>from<br>continuing<br>operations                           | (5,562 )                 | (1,217 )  | (7,356 )                  | 93                            | (200 )                        | (14,242 )    |
| Loss from<br>discontinued<br>operations, net<br>of taxes                    |                          |           | (66 )                     | (15 )                         |                               | (81 )        |

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(Loss) income  
before equity in

income of  
consolidated

|                  |            |   |           |   |           |   |       |           |   |            |   |
|------------------|------------|---|-----------|---|-----------|---|-------|-----------|---|------------|---|
| subsidiaries     | (5,562     | ) | (1,217    | ) | (7,422    | ) | 78    | (200      | ) | (14,323    | ) |
| Equity in (loss) |            |   |           |   |           |   |       |           |   |            |   |
| income of        |            |   |           |   |           |   |       |           |   |            |   |
| consolidated     |            |   |           |   |           |   |       |           |   |            |   |
| subsidiaries     | (8,561     | ) | (7,344    | ) |           |   |       | 15,905    |   |            |   |
| Net (loss)       |            |   |           |   |           |   |       |           |   |            |   |
| income           | \$ (14,123 | ) | \$ (8,561 | ) | \$ (7,422 | ) | \$ 78 | \$ 15,705 |   | \$ (14,323 | ) |

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CHAMPION ENTERPRISES, INC.

Condensed Consolidating Balance Sheet

As of January 1, 2005

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



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

CHAMPION ENTERPRISES, INC.

Condensed Consolidating Statement of Cash Flows

For the Three Months Ended April 3, 2004

|   | Parent<br>(In thousands) | CHB          | Guarantor<br>Subsidiaries | Non-guarantor<br>Subsidiaries | Consolidating<br>Eliminations | Consolidated |
|---|--------------------------|--------------|---------------------------|-------------------------------|-------------------------------|--------------|
| Net cash provided by (used for) continuing operating activities | \$ 7,042                 | \$ (25,489 ) | \$ (14,439 )              | \$ 196                        | \$ 186                        | \$ (32,504 ) |
| Net cash used for discontinued operations                       |                          |              | (3,421 )                  | ((15 )                        |                               | (3,436 )     |
| Cash flows from investing activities                            |                          |              |                           |                               |                               |              |
| Additions to property plant and equipment                       |                          | (422 )       | (1,385 )                  | (73 )                         |                               | (1,880 )     |
| Investments in and advances to unconsolidated subsidiaries      |                          |              |                           | (58 )                         |                               | ((58 )       |
| Investments in and advances to consolidated subsidiaries        | (20,541 )                | 5,454        | 14,970                    | 257                           | (140 )                        |              |
| Proceeds on disposal of fixed assets                            |                          |              | 180                       | 43                            |                               | 223          |
| Net cash (used for) provided by investing activities            | (20,541 )                | 5,032        | 13,765                    | 169                           | (140 )                        | (1,715 )     |
| Cash flows from financing activities                            |                          |              |                           |                               |                               |              |
| Decrease in floor plan  |                          |              |                           | (29 )                         |                               | (29 )        |

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|  |        |            |          |           |       |            |  |
|--|--------|------------|----------|-----------|-------|------------|--|
| payable, net   |        |            |          |           |       |            |  |
| Decrease in long-term debt                           |        |            | (5,813 ) |           |       | (5,813 )   |  |
| Decrease in restricted cash                          |        | (6,112 )   | 7,822    |           |       | 1,710      |  |
| Preferred stock issued, net                          | 12,000 |            |          |           |       | 12,000     |  |
| Common stock issued, net                             | 1,611  |            |          |           |       | 1,611      |  |
| Dividends paid on preferred stock                    | (112 ) |            |          |           |       | (112 )     |  |
| Net cash provided by (used for)                      |        |            |          |           |       |            |  |
| financing activities                                 | 13,499 | (6,112 )   | 2,009    | (29 )     |       | 9,367      |  |
| Net (decrease) increase in cash and cash equivalents |        | (26,569 )  | (2,086 ) | 321       | 46    | (28,288 )  |  |
| Cash and cash equivalents at beginning of period     |        | 129,072    | 3,824    | 12,972    |       | 145,868    |  |
| Cash and cash equivalents at end of period           | \$     | \$ 102,503 | \$ 1,738 | \$ 13,293 | \$ 46 | \$ 117,580 |  |

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

CHAMPION ENTERPRISES, INC.

## **Results of Operations**

**Three Months Ended April 2, 2005**

**versus the Three Months Ended April 3, 2004**

### **Overview**

We are a leading producer of factory-built housing in the U.S. As of April 2, 2005, we operated 29 homebuilding facilities in 14 states and two provinces in western Canada. As of April 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. Our homes are also sold through 18 Company-owned sales locations in California operated as Advantage Homes. In addition, at April 2, 2005 our homes were sold through 18 sales centers in 9 states that are classified as discontinued operations.

Our pretax income from continuing operations for the first quarter of 2005 was \$5.6 million, an improvement of \$19.5 million over 2004. Improvement in our results is attributable to improved manufacturing pricing and purchasing, production efficiencies, and our restructuring actions in 2004 and prior years to eliminate under-performing operations. As a result of changes in our common stock share price, included in income from continuing operations in 2005 is a credit of \$3.8 million for the change in estimated fair value of an outstanding common stock warrant for 2.2 million shares, compared to a charge of \$5.1 million in 2004. Additionally, results in 2005 include gains of \$1.5 million from the sale of three idle plants and results in 2004 included a loss on debt retirement of \$3.2 million.

During the quarter ended April 2, 2005, we sold 22 retail sales centers and committed to a plan to dispose of the remainder of our retail operations, excluding Advantage Homes. As a result, our retail operations, excluding Advantage Homes, have been classified as discontinued operations for the periods presented. On April 15, 2005 we sold an additional eight retail sales centers, leaving ten remaining locations that we expect to dispose of in the next several months.

We continue to focus on matching our manufacturing capacity to industry and local market conditions, improving or eliminating under-performing manufacturing facilities, and exiting the retail business, except for Advantage Homes. We continually review our manufacturing capacity and will make further adjustments as deemed necessary. During 2005, we plan to divest of our remaining traditional retail sales centers. After the completion of those planned divestitures, our continuing retail operations will consist of Advantage Homes, which currently operates 18 sales offices specializing in selling homes for the redevelopment of manufactured housing communities in California.



**Consolidated Results Continuing Operations**

|   | <b>Three Months Ended</b>    |                      | <b>%</b>      |    |
|---|------------------------------|----------------------|---------------|----|
|   | <b>April 2, 2005</b>         | <b>April 3, 2004</b> | <b>Change</b> |    |
|   | <b>(Dollars in millions)</b> |                      |               |    |
| Net sales   |                              |                      |               |    |
| Manufacturing   | \$ 238.8                     | \$ 209.8             | 14            | %  |
| Retail  | 25.1                         | 19.5                 | 29            | %  |
| Less: Intercompany                                      | (19.6 )                      | (22.6 )              |               |    |
| Total net sales   | \$ 244.3                     | \$ 206.7             | 18            | %  |
| Gross margin  | \$ 37.3                      | \$ 27.4              | 36            | %  |
| Selling, general and administrative expenses ( SG&A )   | 31.7                         | 28.2                 | 12            | %  |
| Mark to market (credit) charge for common stock warrant | (3.8 )                       | 5.1                  | (175          | %) |
| Loss on debt retirement                                 |                              | 3.2                  |               |    |
| Operating income (loss)                                 | \$ 9.4                       | \$ (9.1 )            |               |    |
| As a percent of net sales                               |                              |                      |               |    |
| Gross margin  | 15.3                         | %                    | 13.3          | %  |
| SG&A  | 13.0                         | %                    | 13.7          | %  |
| Operating income (loss)                                 | 3.8                          | %                    | (4.4          | %) |

Net sales for the quarter ended April 2, 2005 increased from the comparable period in 2004 due primarily to sales price increases in the manufacturing segment. Gross margin for the three months ended April 2, 2005 increased \$9.8 million from the comparable period of 2004. Manufacturing gross margin increased significantly due to improved pricing and purchasing, as well as production efficiencies in part due to operating a number of our plants with stronger backlogs in 2005 and the closure of under-performing plants in 2004 and prior years. SG&A for the three months ended April 2, 2005 increased by \$3.4 million from the comparable period of 2004 primarily due to increases in the manufacturing and retail segments related to increased sales and increased general corporate expenses due to compensation programs and information technology projects.

During the three months ended April 2, 2005, as a result of changes in the Company's common stock price, the Company recorded mark-to-market credits of \$3.8 million for the decrease in estimated fair value of an outstanding common stock warrant. During the three months ended April 3, 2004, the Company recorded mark-to-market charges of \$5.1 million for the increase in estimated fair value of the outstanding common stock warrant. On April 18, 2005, the Company repurchased and subsequently cancelled the common stock warrant in exchange for a cash payment of \$4.5 million.

During the three months ended April 3, 2004, operating results included a net loss of \$3.2 million for the purchase and retirement of \$27.0 million of Senior Notes in exchange for 3.9 million shares of Company common stock.

## Manufacturing Operations

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

| c   | Three Months Ended |               | % Change |    |
|---|--------------------|---------------|----------|----|
|   | April 2, 2005      | April 3, 2004 |          |    |
| Manufacturing segment net sales (in millions) | \$ 238.8           | \$ 209.8      | 14       | %  |
| Manufacturing segment income (in millions)    | \$ 11.2            | \$ 4.7        | 140      | %  |
| Manufacturing segment margin %                | 4.7                | 2.2           |          | %  |
| HUD-code home shipments                       | 4,014              | 4,122         | (3       | %) |
| Modular and Canadian code home shipments      | 976                | 883           | 11       | %) |
| Total homes sold                              | 4,990              | 5,005         | (0       | %) |
| Floors sold                                   | 9,609              | 9,724         | (1       | %) |
| Multi-section mix                             | 87                 | 87            |          | %  |
| Average home price                            | \$ 44,600          | \$ 40,500     | 10       | %  |
| Manufacturing facilities at period end        | 29                 | 30            | (3       | %) |

Manufacturing net sales for the quarter ended April 2, 2005 increased compared to the same period of 2004 primarily from higher average home selling prices and greater delivery revenues. We operated one less manufacturing facility during the first quarter of 2005 versus 2004. Average manufacturing selling prices increased in 2005 as compared to 2004 as a result of price increases, which, in part, offset rising material costs, and product mix, as well as increased sales of higher priced modular homes.

Manufacturing segment income for the three months ended April 2, 2005 increased over the comparable period of 2004 by \$6.5 million on increased sales while operating one less plant. The improvement in our manufacturing operations is attributable to improved pricing and purchasing, production efficiencies driven, in part, by operating a number of our plants with stronger backlogs, and our restructuring actions in 2004 and prior years to eliminate under-performing operations. In addition, manufacturing segment income in the first quarter of 2005 included net gains of \$1.5 million from the sale of three idle plants.

Although retailer orders can be cancelled at any time without penalty, and unfilled orders are not necessarily an indication of future business, our unfilled manufacturing orders for homes at April 2, 2005 totaled approximately \$86 million at the 29 plants operated, compared to \$50 million at 30 plants at April 3, 2004.

## Retail Operations

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

|  | Three Months Ended |   |               |      |     |
|--|--------------------|---|---------------|------|-----|
|  | April 2, 2005      |   | April 3, 2004 | %    |     |
| Retail segment net sales (in millions) | \$ 25.1            |   | \$ 19.5       | 29   | %   |
| Retail segment income (in millions)    | \$ 1.3             |   | \$ 0.8        | 62   | %   |
| Retail segment margin %                | 5.0                | % | 4.0           |      | %   |
| New homes retail sold                  | 150                |   | 129           | 16   | %   |
| Pre-owned homes retail sold.           | 190                |   | 304           | (38) | (%) |
| Total homes retail sold.               | 340                |   | 433           | (21) | (%) |
| % Champion-produced new homes sold     | 81                 | % | 78            |      | %   |
| New home multi-section mix             | 96                 | % | 97            |      | %   |
| Average new home retail price          | \$ 165,000         |   | \$ 148,000    | 11   | %   |
| Sales centers at end of period         | 18                 |   | 14            | 29   | %   |

Retail sales for the three months ended April 2, 2005 increased versus the comparable period last year due to selling more homes from the operation of a greater number of sales centers, and from an increased average selling price. The increased average home selling price resulted from the sale of homes with more add-ons, improvements, and amenities. Additionally, retail prices have increased to offset higher prices from the manufacturers due to rising material costs. Retail segment income for the three months ended April 2, 2005 improved by \$0.5 million compared to the same period in 2004 primarily due to increased sales.

### Discontinued Operations

During the quarter ended April 2, 2005, the Company sold 22 of its retail sales centers and committed to a plan to dispose of the remainder of its retail operations except for its Advantage Homes operation in California. As a result the remaining non-Advantage operations were classified as held for sale. For the periods reported, retail operations, excluding Advantage Homes, 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.

Loss from discontinued retail operations for the quarter ended April 2, 2005 consisted of 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 an asset impairment charge for a sale of eight lots that was completed in April 2005.

Loss from discontinued operations for the quarter ended April 3, 2004 consisted of an operating loss of \$1.3 million from discontinued retail operations, partially offset by income from the consumer finance business of \$1.2 million that resulted from a favorable adjustment from the settlement of contractual obligations.



*Restructuring Charges*

We did not incur any significant restructuring charges during the three months ended April 2, 2005 and April 3, 2004. As of April 2, 2005, accrued but unpaid restructuring costs totaled \$3.5 million compared to \$4.4 million at January 1, 2005, primarily consisting of warranty reserves for closed manufacturing plants.

*Interest Income and Interest Expense*

Interest income in 2005 was \$0.5 million higher than in 2004 due to higher cash balances and increased

interest rates. Interest expense in 2005 was \$0.5 million lower than in 2004 due to debt reduction during 2004. Since the beginning of 2003, we have reduced indebtedness by more than \$180 million.

## Income Taxes

We currently provide a 100% valuation allowance for our deferred tax assets. As of January 1, 2005, the Company had net operating losses for tax purposes totaling approximately \$120 million that are available to offset certain future taxable income. Income tax expense for the quarters ended April 2, 2005 and April 3, 2004 consisted of foreign and state income taxes.

## Liquidity and Capital Resources

Unrestricted cash balances totaled \$142.1 million at April 2, 2005. During 2005, net cash of \$5.1 million was used for continuing operating activities, including \$9.5 million used to increase working capital. During the period, inventories, accounts receivable, and accounts payable increased by \$12.3 million, \$12.1 million, and \$14.8 million, respectively, as a result of typical seasonal factors in our business leading into the beginning of our traditionally stronger selling months. Cash provided during the period included \$4.7 million from the disposal of fixed assets primarily from the sale of three idle plants. Additionally, net cash of \$10.0 million was provided by the sale of retail businesses that included a \$10.3 million pay down of related floorplan borrowings. Cash used during the period included \$4.2 million to fund restricted cash and \$2.5 million for capital expenditures.

We have a committed \$75 million revolving credit facility for letters of credit and general corporate purposes that expires in January 2006. Availability under this facility is determined by a monthly borrowing base calculation based on percentages of accounts receivable, inventories, fixed assets, and, if necessary, cash on deposit. As of April 2, 2005, there were \$60.3 million of letters of credit issued under the facility and there were no borrowings outstanding. We expect to continue to utilize this facility principally for letters of credit. The facility contains financial covenants that become effective only in the event that our liquidity, as defined, falls below \$35 million. These covenants include required earnings, as defined, of \$45.2 million and a required ratio of earnings to fixed charges, as defined, of 1.0 to 1.0 for each 12-month period ending on a fiscal quarter. For the twelve months ended April 2, 2005, our earnings, as defined, were \$59.7 million and our ratio of earnings to fixed charges was 1.7 to 1.0. At April 2, 2005, our liquidity, as defined, was \$132.5 million, which was in excess of \$35 million such that these financial covenants were not in effect. We expect to maintain liquidity at or in excess of the \$35 million threshold over the next twelve months.

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

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

The debt incurrence covenant in the indenture governing the Senior Notes due 2007 currently limits additional debt to: i) a working capital line of credit up to a borrowing base equal to 60% of otherwise unencumbered inventories and 75% of otherwise unencumbered accounts receivable;

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ii) warehouse financing meeting certain parameters up to \$200 million; iii) other debt up to \$30 million; and iv) ordinary course indebtedness and contingent obligations including non-speculative hedging obligations, floor plan financing, letters of credit, surety bonds, bankers acceptances, repurchase agreements related to retailer floor plan financing and guarantees of additional debt otherwise permitted to be incurred. The resulting effect at April 2, 2005, when combined with limits in our Senior Notes due 2009, was a working capital line of credit limit of approximately \$83 million of which no more than approximately \$32 million of cash borrowings could be secured debt, as defined.

We expect to spend less than \$13 million on capital expenditures during the remainder of 2005. We do not

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plan to pay cash dividends on our common stock in the near term.

### ***Contingent Liabilities and Obligations***

We had significant contingent liabilities and obligations at April 2, 2005, including surety bonds and letters of credit totaling \$92.4 million, guarantees by certain of our consolidated subsidiaries of \$5.5 million of debt of unconsolidated subsidiaries, and estimated wholesale repurchase obligations.

We are contingently obligated under repurchase agreements with certain lending institutions that provide floor plan financing to our independent retailers. We use information, which is generally available only from the primary national floor plan lenders, to estimate our contingent repurchase obligations. With the exit of certain national floor plan lenders from the industry and the shift to alternative inventory financing sources, this estimate of our contingent repurchase obligation may not be precise. We estimate our contingent repurchase obligation as of April 2, 2005 was approximately \$250 million, without reduction for the resale value of the homes. As of April 2, 2005, our largest independent retailer, a nationwide retailer, had approximately \$9.7 million of inventory subject to repurchase for up to 24 months from date of invoice. As of April 2, 2005 our next 24 largest independent retailers had an aggregate of approximately \$50.4 million of inventory subject to repurchase for up to 24 months from date of invoice, with individual amounts ranging from approximately \$0.8 million to \$4.8 million per retailer. For the three months ended April 2, 2005, we paid \$0.6 million to repurchase 16 homes and recorded related losses of \$0.1 million. In the same period last year, we paid \$0.4 million and incurred losses of \$0.1 million related to the repurchase of 13 homes.

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

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

### ***Summary of Liquidity and Capital Resources***

At April 2, 2005, our unrestricted cash balances totaled \$142.1 million and we had no unused availability under our \$75 million credit facility. Our credit facility expires in January 2006. We expect to obtain an amendment to the current credit facility during 2005 that would extend the facility for up to two additional years. For the next two years, we expect cash flow from operating activities to fund capital expenditures. In addition, we have less than \$2.0 million of scheduled debt payments due in 2005 and 2006. Therefore, the level of cash availability is projected to be substantially in excess of cash needed to operate our businesses for the next two years. In the event one or more of our capital resources were to become unavailable, we would revise our operating strategies accordingly.

### **Critical Accounting Policies**

For information regarding critical accounting policies, see **Critical Accounting Policies** in Item 7 of Part II of the our Form 10-K for 2004.

*Impact of Recently Issued Accounting Pronouncements*

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

*Forward Looking Statements*

Certain statements contained in this Report, including our plans and beliefs regarding availability of

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

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

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

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

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

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

***General industry conditions*** *As a result of the downturn in the manufactured housing industry which began in 1999, during the period beginning in 2000 through 2003 we experienced a decline in sales and incurred operating losses and costs for the closures or consolidations of operations, fixed asset impairment charges and goodwill impairment charges. If industry conditions deteriorate further, our sales could decline further and our operating results and cash flows could suffer.*

From mid-1999 through 2004 the manufactured housing industry experienced declining manufacturing shipments and retail sales. Tightened consumer credit standards, reduced availability of consumer financing, high levels of homes repossessed from consumers, higher interest rates

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

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goodwill impairment charges.

***Common stock and Senior Notes values*** *Our common stock price has been volatile and may continue to be volatile given current industry and economic conditions. Our Senior Notes have traded at significant discounts to face value and may trade at discounts in the future.*

The trading value per share of our stock has ranged from \$6.36 to \$12.25 during 2004 and 2005. Additionally, our two issuances of Senior Notes have traded at discounts to their respective face values. The market prices of our common stock and Senior Notes are affected by many factors including: general economic and market conditions, interest rates, current manufactured housing industry forecasts, Champion's and our competitors' operating results, our ability to pay our debt obligations, consumer and wholesale financing availability, the market's perception of our strategies and the overall market fluctuations unrelated to our Company or the manufactured housing industry. All of these factors may adversely impact the market prices of our common stock and Senior Notes in the future.

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

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

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

interest rates;  
population and employment trends;  
income levels;

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

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

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

The consumers who buy our homes have historically secured consumer financing from third party lenders. The availability, terms and costs of consumer financing depend on the lending practices of financial institutions, governmental regulations and economic and other conditions, all of which are beyond our control. A consumer seeking to finance the purchase of a manufactured home without land will generally pay a higher



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interest rate and have a shorter loan term than a consumer seeking to finance the purchase of land and the home. Manufactured home consumer financing is at times more difficult to obtain than financing for site-built homes. Since 1999, consumer lenders have tightened the credit underwriting standards and loan terms and increased interest rates for loans to purchase manufactured homes, which have reduced lending volumes and caused our sales to decline.

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

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

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

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

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

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

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

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

During 2004, approximately 78% of our manufacturing shipments of homes were made to independent retail locations throughout the United States and western Canada. As is common in the industry, independent retailers may sell manufactured homes produced by competing manufacturers. We may not be able to establish relationships with new independent retailers or maintain good relationships with independent retailers that sell our homes. Even if we do establish and maintain relationships with independent retailers, these retailers are not obligated to sell our manufactured homes exclusively, and may choose to sell our competitors' homes instead. The independent retailers with whom we have relationships can cancel these relationships on short notice. In addition, these retailers may not remain financially solvent as they are subject to the same industry, economic, demographic and seasonal trends that we face. If we do not establish and maintain relationships with solvent independent retailers in the markets we serve, sales in those markets could decline and our operating results and cash flows could suffer.

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

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

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We have a significant amount of surety bonds representing collateral for our casualty insurance programs and for general operating purposes. We are required to provide collateral to support our surety bond programs in the form of letters of credit or cash. For additional detail and information concerning the amounts of our surety bonds and letters of credit, see Note 8 of Notes to Consolidated Financial Statements in Item 1 of this Report. The inability to retain our current surety bond provider or obtain alternative bonding sources could require us to post cash collateral, reduce the amount of cash available for our operations or cause us to curtail or limit existing operations.

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

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

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

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

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

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

***Restrictive covenants*** *The terms of our debt place operating restrictions on us and our subsidiaries and contain various financial performance and other covenants with which we must remain in compliance. If we do not remain in compliance with these covenants, certain of our debt facilities could be terminated and the amounts outstanding thereunder could become immediately due and payable.*

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

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

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

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

***Potential Dilution - Outstanding preferred stock at April 2, 2005 that was convertible into common stock and redeemable for common stock (and in some cases, at our option, for cash) and other potential capital or debt reduction transactions could result in potential dilution and impair the price of our common stock.***

At April 2, 2005 there were \$8.75 million of Series C preferred stock outstanding, which was convertible into common stock at a rate of \$5.66 per share, and \$12 million of Series B-2 preferred stock outstanding, which was convertible into common stock at a rate of \$7.92 per share. On April 18, 2005, the preferred shareholder converted this preferred stock into 3.1 million shares of common stock.

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

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To the extent that we decide to further reduce debt obligations through the issuance of common shares, our then existing common shareholders would experience dilution in their percentage ownership interests. The additional shares of common stock that could be available for sale may have a negative impact on the market price of our common stock. In addition, sale of substantial amounts of our common stock in the public market by the former preferred shareholder or the exchangers of Senior Notes, or the perception that these sales might occur, could depress the price of our common stock. Such selling shareholders may determine the timing, structure and terms of any disposition of our common stock, all of which could affect the market price of our common stock.

We may seek additional sources of capital and financing in the future or issue securities in connection with retiring our outstanding indebtedness, the terms of which may result in additional potential dilution.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Our obligations under industrial revenue bonds are subject to variable rates of interest based on short-term tax-exempt rate indices and LIBOR. A 100 basis point increase in the underlying interest rates would result in additional annual interest cost of approximately \$124,000, assuming average related debt of \$12.4 million, the amount of outstanding borrowings at April 2, 2005.

Item 4. Controls and Procedures.

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15 of the Securities Exchange Act of 1934. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective to cause material information required to be disclosed by the Company in the reports that we file or submit under the Securities Exchange Act of 1934 to be recorded, processed, summarized and reported within the time periods specified in the Commission's rules and forms. During the quarter ended April 2, 2005, there were no changes in our internal control over financial reporting which materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. The Company is in the process of implementing a new enterprise resource planning ( ERP ) system for its manufacturing operations. The completion of the ERP system implementation is targeted for the first half of 2006. Management does not currently believe that this will adversely affect the Company's internal control over financial reporting.



**PART II. OTHER INFORMATION**

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

On January 3, 2005, we issued 171,136 shares of our common stock in connection with the final \$2.0 million quarterly installment payment under convertible promissory notes issued June 21, 2001. These notes represented a deferred purchase price obligation of the Company. Although these shares of common stock were issued in private placements in reliance on the exemption from registration contained in Section 4(2) of the Securities Exchange Act of 1933, such shares of common stock have been registered for resale under the Securities Exchange Act of 1933, pursuant to effective registration statements.

Item 6. Exhibits.

The following exhibits are filed as part of this report:

| <u>Exhibit No.</u> | <u>Description</u>   |
|--------------------|--|
| 10.1               | Second Amendment dated January 24, 2005 to the Loan and Security Agreement, filed as Exhibit 99.1 to the Company's Current Report on Form 8-K dated January 24, 2005 and incorporated herein by reference.   |
| 10.2               | 2005 Cash Incentive Compensation Arrangement Summary.  |
| 31.1               | Certification of Chief Executive Officer dated April 22, 2005, relating to the Registrant's Quarterly Report on Form 10-Q for the quarter ended April 2, 2005.   |
| 31.2               | Certification of Chief Financial Officer dated April 22, 2005, relating to the Registrant's Quarterly Report on Form 10-Q for the quarter ended April 2, 2005.   |
| 32.1               | Certification of Chief Executive Officer and Chief Financial Officer of the Registrant, dated April 22, 2005, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, relating to the Registrant's Quarterly Report on Form 10-Q for the quarter ended April 2, 2005. |



**SIGNATURES**

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

CHAMPION ENTERPRISES, INC.

By:

/s/ PHYLLIS A. KNIGHT  
Phyllis A. Knight  
Executive Vice President and

Chief Financial Officer  
(Principal Financial Officer)

And:

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

Dated: April 22, 2005

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