

CHAMPION ENTERPRISES INC

Form 10-Q

August 11, 2003

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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 June 28, 2003

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

38-2743168

(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer
Identification No.)

2701 Cambridge Court, Suite 300
Auburn Hills, MI 48326

(Address of principal executive offices)

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

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

Yes 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.

57,323,990 shares of the registrant's \$1.00 par value Common Stock were outstanding as of August 1, 2003.

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Item 1. Financial Statements.

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

	Unaudited Three Months Ended		Unaudited Six Months Ended	
	June 28, 2003	June 29, 2002	June 28, 2003	June 29, 2002
Net revenues	\$ 296,102	\$ 361,506	\$ 540,627	\$ 667,883
Cost of sales	246,471	301,300	456,927	563,168
Selling, general and administrative expenses	43,219	65,793	91,882	124,031
Financial services operating costs	2,977	1,927	6,444	1,927
Loss on finance loans sold or held for sale	278		5,689	
Goodwill impairment charges		97,000		97,000
Restructuring charges		4,900		4,900
Gain on debt retirement	(7,130)	(5,870)	(13,833)	(5,870)
Total costs and expenses	285,815	465,050	547,109	785,156
Operating income (loss)	10,287	(103,544)	(6,482)	(117,273)
Interest income	339	601	886	1,219
Interest expense	(7,249)	(7,648)	(15,152)	(13,083)
Income (loss) before income taxes	3,377	(110,591)	(20,748)	(129,137)
Income tax expense (benefit)	350	88,700	(2,350)	82,000
Net income (loss)	\$ 3,027	\$ (199,291)	\$ (18,398)	\$ (211,137)
Basic earnings (loss) per share	\$ 0.05	\$ (4.10)	\$ (0.40)	\$ (4.36)
Weighted shares for basic EPS	56,757	48,729	55,641	48,617
Diluted earnings (loss) per share	\$ 0.05	\$ (4.10)	\$ (0.40)	\$ (4.36)
Weighted shares for diluted EPS	61,624	48,729	55,641	48,617

See accompanying Notes to Consolidated Financial Statements.

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CHAMPION ENTERPRISES, INC.
Consolidated Balance Sheets
(In thousands, except par value)

	<u>Unaudited June 28, 2003</u>	<u>December 28, 2002</u>
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 129,436	\$ 77,381
Restricted cash	1,062	33,857
Accounts receivable, trade	46,090	28,631
Inventories	120,534	111,352
Finance loans held for sale, net	17,854	
Other current assets	16,983	89,547
	<u>331,959</u>	<u>340,768</u>
FINANCE LOANS HELD FOR INVESTMENT, net		52,043
	<u>252,234</u>	<u>257,513</u>
PROPERTY, PLANT AND EQUIPMENT, at cost		
Less-accumulated depreciation	132,772	129,869
	<u>119,462</u>	<u>127,644</u>
GOODWILL, net	165,045	165,437
	<u>23,496</u>	<u>18,443</u>
OTHER NON-CURRENT ASSETS		
Restricted cash		18,443
Other non-current assets	23,496	23,756
	<u>23,496</u>	<u>42,199</u>
Total assets	<u>\$ 639,962</u>	<u>\$ 728,091</u>
LIABILITIES, REDEEMABLE CONVERTIBLE PREFERRED STOCK AND SHAREHOLDERS EQUITY		
CURRENT LIABILITIES		
Floor plan payable	\$ 19,453	\$ 17,147
Accounts payable	46,032	37,615
Short-term borrowings	7,000	
Warehouse proceeds structured as collateralized borrowings	10,024	35,565
Accrued warranty obligations	40,660	43,139
Accrued volume rebates	28,949	35,010
Accrued compensation and payroll taxes	16,092	17,569
Accrued self-insurance	28,068	28,772
Other current liabilities	47,711	48,327
	<u>243,989</u>	<u>263,144</u>
LONG-TERM LIABILITIES		
Long-term debt	290,652	341,612
Other long-term liabilities	53,140	56,754

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	343,792	398,366
CONTINGENT LIABILITIES (Note 11)		
REDEEMABLE CONVERTIBLE PREFERRED STOCK, no par value, 5,000 shares authorized, 13.75 shares and 30.0 shares issued and outstanding, respectively		
	13,568	29,256
SHAREHOLDERS' EQUITY		
Common stock, \$1 par value, 120,000 shares authorized, 56,777 and 52,658 shares issued and outstanding, respectively		
	56,777	52,658
	72,978	54,666
	(90,491)	(68,150)
	(651)	(1,849)
	38,613	37,325
	\$ 639,962	\$ 728,091

See accompanying Notes to Consolidated Financial Statements.

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CHAMPION ENTERPRISES, INC.
Consolidated Statements of Cash Flows
(In thousands)

	Unaudited Six Months Ended	
	June 28, 2003	June 29, 2002
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$ (18,398)	\$ (211,137)
Adjustments to reconcile net loss to net cash provided by (used for) operating activities:		
Depreciation and amortization	8,495	11,563
Gain on debt retirement	(13,833)	(5,870)
Loss on finance loans sold or held for sale	5,689	
Goodwill impairment charges		97,000
Deferred income taxes		94,800
Fixed asset impairment charge (gain on sale)	(1,765)	1,900
Increase/decrease:		
Accounts receivable, trade	(17,459)	(21,929)
Refundable income taxes	60,749	4,671
Inventories	(9,182)	819
Cash collateral deposits	9,600	(12,850)
Accounts payable	8,417	19,753
Accrued liabilities	(8,704)	1,100
Other, net	7,021	1,950
	30,630	(18,230)
Originations of finance loans held for sale	(27,905)	
Proceeds on sale of finance loans	53,837	
Principal receipts on finance loans held for sale	1,673	
	58,235	(18,230)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisitions and deferred purchase price payments	(3,882)	(8,050)
Originations of finance loans held for investment		(6,145)
Additions to property, plant and equipment	(3,068)	(2,857)
Investments in and advances to unconsolidated subsidiaries	(343)	(1,139)
Proceeds on disposal of fixed assets	5,076	3,069
	(2,217)	(15,122)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Increase (decrease) in floor plan payable, net	2,306	(60,174)
Proceeds from short-term borrowings	7,000	
Repayment of long-term debt	(326)	(440)
Proceeds from Senior Notes		145,821
Purchase of Senior Notes	(35,830)	(23,750)
Proceeds from warehouse facility	17,987	2,103
Repayment of warehouse facility	(43,528)	
Increase in deferred financing costs	(2,342)	(3,266)

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Decrease (increase) in restricted cash	51,238	(35,572)
Preferred stock issued, net		23,810
Dividends paid on preferred stock	(768)	
Common stock issued, net	300	1,000
	<u> </u>	<u> </u>
Net cash provided by (used for) financing activities	(3,963)	49,532
	<u> </u>	<u> </u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	52,055	16,180
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	77,381	69,456
	<u> </u>	<u> </u>
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 129,436	\$ 85,636
	<u> </u>	<u> </u>

See accompanying Notes to Consolidated Financial Statements.

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CHAMPION ENTERPRISES, INC.
 Consolidated Statement of Shareholders' Equity
 Unaudited Six Months Ended June 28, 2003
 (In thousands)

	Common stock		Capital in excess of par value	Accumulated deficit	Accumulated other comprehensive income (loss)		Total comprehensive income (loss)
	Shares	Amount			Total		
Balance at December 28, 2002	52,658	\$ 52,658	\$ 54,666	\$ (68,150)	\$ (1,849)	\$ 37,325	
Net loss				(18,398)		(18,398)	\$ (18,398)
Preferred stock dividend				(455)		(455)	
Stock options and benefit plans	280	280	361			641	
Amortization of preferred stock issuance costs			(562)			(562)	
Preferred stock conversions	2,869	2,869	13,381			16,250	
Issuance for acquisition deferred purchase price payments	970	970	1,644			2,614	
Charge for induced conversion of preferred stock			3,488	(3,488)			
Foreign currency translation adjustments					1,198	1,198	1,198
Balance at June 28, 2003	<u>56,777</u>	<u>\$ 56,777</u>	<u>\$ 72,978</u>	<u>\$ (90,491)</u>	<u>\$ (651)</u>	<u>\$ 38,613</u>	<u>\$ (17,200)</u>

See accompanying Notes to Consolidated Financial Statements.

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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 presentation of the results of the interim period. All such adjustments are of a normal recurring nature except for the following two adjustments which were recorded in the first quarter of 2003: the lower of cost or market provision recorded upon the reclassification of finance loans to held for sale as discussed in Note 13 and the charge to retained earnings related to the induced conversion of the Series C Preferred Stock as discussed in Note 10. 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 December 28, 2002 was derived from audited financial statements.

For a description of significant accounting policies used by Champion Enterprises, Inc. (the Company) in the preparation of its consolidated financial statements, please refer to Note 1 of Notes to Consolidated Financial Statements in the Company s Annual Report on Form 10-K for the year ended December 28, 2002.

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 the amounts indicated below:

	Three Months Ended	
	June 28, 2003	June 29, 2002
	(In thousands, except per share amounts)	
Net income (loss) as reported	\$ 3,027	\$ (199,291)
Net income (loss) pro forma	2,542	(200,236)
Basic and diluted earnings (loss) per share as reported	0.05	(4.10)
Basic and diluted earnings (loss) per share pro forma	0.04	(4.12)
Stock-based employee compensation cost, net of related tax effects as reported	187	171
Stock-based employee compensation cost, net of related tax effects pro forma	\$ 672	\$ 1,116

	Six Months Ended	
	June 28, 2003	June 29, 2002
	(In thousands, except per share amounts)	
Net loss as reported	\$ (18,398)	\$ (211,137)
Net loss pro forma	(19,602)	(212,438)
Basic and diluted loss per share as reported	(0.40)	(4.36)
Basic and diluted loss per share pro forma	(0.42)	(4.39)
Stock-based employee compensation cost, net of related tax effects as reported	273	317
Stock-based employee compensation cost, net of related tax effects pro forma	\$ 1,477	\$ 1,618

2. In July 2003, the Company engaged the performance improvement group of AlixPartners LLC to perform a review for potential improvements to the Company s operating performance. The study includes looking at all aspects of the Company s operations and may

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result in the closing of additional manufacturing facilities and retail sales centers during the third and fourth quarters of 2003. Any such closures would likely result in fixed asset impairment charges, severance costs and other charges and would trigger an evaluation of goodwill that could result in goodwill impairment charges.

In July 2003, the Company decided to discontinue its consumer finance operation and various exit strategies are being evaluated. The Company currently estimates that it will record charges not to exceed \$12 million in the third quarter of 2003, including a non-cash charge of approximately \$5 million primarily reflecting the impairment of goodwill.

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In July 2003, certain of the Company's executive officers terminated employment with the Company. These terminations will result in certain charges which will be recorded in the third quarter of 2003, although the amounts have not yet been determined.

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

	Six Months Ended	
	June 28, 2003	June 29, 2002
	(In thousands)	
Statutory U.S. tax rate	\$ (7,300)	\$ (45,200)
Increase (decrease) in rate resulting from		
Deferred tax valuation allowance	4,300	120,000
State taxes, net of federal tax effect		(3,700)
Nondeductible goodwill amortization and impairment charges		10,300
Other	650	600
Total income tax provision (benefit)	\$ (2,350)	\$ 82,000

Beginning with the quarter ended June 29, 2002, the Company has provided a 100% valuation allowance for its deferred tax assets. Deferred tax assets will continue to require a 100% valuation allowance until the Company can demonstrate their realizability through sustained profitability and/or from other factors. Current federal income tax regulations provide for a two-year carryback period for net operating losses. The Company has no taxable income available in this carryback period. Therefore, any net operating losses incurred in 2003 will become tax loss carryforwards that will be available to offset future taxable income. The effective tax rate for the six months ended June 28, 2003 differs from the 35% federal statutory rate primarily because of the 100% valuation allowance for deferred taxes resulting from tax loss carryforwards in the period, partially offset by a \$3.0 million tax benefit for a reduction in the valuation allowance, as discussed below.

The amount of net deferred tax assets, the 100% valuation allowance and the expected tax refund related to the 2002 federal income tax return were estimated at December 28, 2002, based on year-end estimates of the tax deductibility of certain costs and charges. As a result of the completion and filing of the 2002 federal income tax return in April 2003, the Company received tax refunds totaling \$63.5 million in the second quarter 2003. These refunds exceeded by approximately \$3.0 million the estimate made as of December 28, 2002, resulting in a \$3.0 million reduction of deferred tax assets during 2003. As a result, during the first quarter of 2003, a tax benefit of \$3.0 million was recorded for the related reduction in the 100% valuation allowance.

4. A summary of inventories by component follows:

	June 28, 2003	December 28, 2002
	(In thousands)	
New manufactured homes	\$ 64,112	\$ 55,866
Raw materials	25,513	27,097
Work-in-process	6,099	6,557
Other inventory	24,810	21,832
	\$ 120,534	\$ 111,352

Other inventory consists of pre-owned manufactured homes, land and park spaces and improvements.

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5. A summary of other current assets and other long-term liabilities by component follows:

	June 28, 2003	December 28, 2002
(In thousands)		
Other current assets		
Refundable income taxes	\$ 351	\$ 61,100
Deposits	6,500	16,100
Other current assets	10,132	12,347
	\$ 16,983	\$ 89,547

	June 28, 2003	December 28, 2002
(In thousands)		
Other long-term liabilities		
Accrued self-insurance and warranty	\$ 23,200	\$ 23,200
Deferred portion of purchase price	6,000	10,000
Other long-term liabilities	23,940	23,554
	\$ 53,140	\$ 56,754

Deposits consist of cash collateral deposited for surety bonds and insurance purposes.

6. The change in the carrying amount of goodwill follows:

	Six Months Ended June 28, 2003			
	Manufacturing	Retail	Other	Total
(In thousands)				
Balance at December 28, 2002	\$ 126,403	\$ 34,439	\$ 4,595	\$ 165,437
Other changes	102		(494)	(392)
Balance at June 28, 2003	\$ 126,505	\$ 34,439	\$ 4,101	\$ 165,045

The decrease in other goodwill during the six months ended June 28, 2003 was due to the sale of land, land improvements and certain other assets of a development company during the first quarter of 2003. At June 28, 2003, other goodwill of \$4.1 million was related to the Company's consumer finance operation. As discussed in Note 2, in July 2003 the Company decided to discontinue its consumer finance operation which will result in the recording of a 100% impairment charge in the third quarter of 2003.

In the second quarter 2002, as a result of the significant downsizing of the Company's retail operations in reaction to continuing challenging industry conditions and in accordance with SFAS No. 142, the Company performed a test for goodwill impairment. The results of this impairment test indicated that the implied fair value of the retail goodwill was less than its carrying value, resulting in a non-cash, pretax impairment charge of \$97 million.

7. During the quarter ended June 29, 2002 the Company recorded restructuring charges totaling \$4.9 million for fixed asset impairments and lease termination and other costs related to the closure of 34 retail sales centers.

8. The Company's manufacturing operations provide the retail homebuyer with a twelve-month warranty from the date of consumer 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 six months ended June 28, 2003. A portion of warranty reserves was classified as other long-term liabilities in the consolidated balance sheet.

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	Accrued Warranty Obligations
	(In thousands)
Reserves at December 28, 2002	\$ 49,639
Warranty expense provided	27,841
Cash warranty payments	(30,320)
Reserves at June 28, 2003	\$ 47,160

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

	June 28, 2003	December 28, 2002
	(In thousands)	
7.625% Senior Notes due 2009	\$ 134,450	\$ 170,000
11.25% Senior Notes due 2007	135,010	150,000
Obligations under industrial revenue bonds	18,145	18,145
Other debt	3,047	3,467
	\$ 290,652	\$ 341,612

During the quarter ended June 28, 2003 the Company purchased and retired \$22.7 million of the Senior Notes due 2009 for cash payments of \$15.3 million, resulting in pretax gains totaling \$7.1 million. During the six months ended June 28, 2003 the Company purchased and retired \$35.6 million of the Senior Notes due 2009 and \$15 million of the Senior Notes due 2007 for cash payments of \$35.8 million, resulting in pretax gains totaling \$13.8 million. During the quarter ended June 29, 2002, the Company purchased and retired \$30 million of its Senior Notes due 2009 for cash payments of \$23.8 million, resulting in a pretax gain of \$5.9 million.

In January 2003, Champion Home Builders Co. (CHB), a wholly-owned subsidiary of the Company, entered into a three-year, \$75 million revolving credit facility to be used in support of letters of credit and for general corporate purposes. Under this facility, letter of credit fees range from 2.5% to 3.5% annually on letters of credit issued and borrowings bear interest at either the prime interest rate plus up to 0.5% or the Eurodollar rate plus 2.5% to 3.5%. In addition, there is an annual fee of \$0.1 million plus 0.375% of the unused portion of the facility. Availability under the credit facility is subject to a borrowing base calculated as percentages of eligible accounts receivable, inventory and fixed assets. 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 (EBITDA) and certain ratios of EBITDA 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 and 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, property, plant, and equipment, cash and other assets. As of June 28, 2003, availability under the facility was \$72 million, letters of credit totaling \$61.9 million and borrowings of \$7.0 million were outstanding under the facility and the Company's liquidity was in excess of \$35 million such that no financial covenants were in effect.

During the first quarter of 2003 substantially all of the former fully cash collateralized letters of credit were terminated, resulting in the release to the Company of restricted cash totaling \$49.8 million. Additionally, \$9.6 million of cash deposits were released to the Company upon replacing cash collateral for surety bonds with letters of credit under the new credit facility.

In April 2003, the Company completed an amendment and renewal of the \$150 million warehouse facility that expired in April 2003 at a reduced size of \$75 million. The warehouse facility is maintained for a consolidated third party special purpose entity to support the

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Company's consumer finance operations. In July 2003, borrowings under the warehouse facility were substantially repaid through the proceeds from the sale of loans with a face value totaling \$16.4 million. As discussed in Note 2, in July the Company decided to discontinue its consumer finance operation. As a result the warehouse facility is expected to be terminated during the third quarter of 2003.

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The Company has two floor plan facilities with total availability of \$21 million of which \$17.8 million was outstanding at June 28, 2003. A \$15 million floor plan financing facility contains a covenant requiring the maintenance of a minimum of \$35 million of liquidity, as defined in the \$75 million revolving credit facility, at each fiscal month end. In the event of non-compliance with this covenant, the lender could terminate the credit line and cause the debt to become immediately due and payable. As of June 28, 2003, the Company had approximately \$13.7 million outstanding under this facility and was in compliance with the covenant.

10. At June 28, 2003 redeemable convertible preferred stock consisted of Series B-1 with a carrying value and a redemption value of \$5.0 million and Series C with a carrying value of \$8.6 million and a redemption value of \$8.75 million. Both Series have a 5% annual dividend that is payable quarterly, at the Company's option, in cash or common stock. The Series C is carried net of issuance costs, which are being amortized by charges to paid-in-capital over a period of two years through April 2004.

The rights and preferences of the Series B-1 preferred stock provide for, among other things, mandatory redemption on March 29, 2004. Such redemption may be made for either common stock or cash, at the Company's option. Optional redemptions may be made by the holder only for common stock and are subject to a common stock floor price of \$5.66 per share. The holder has the right to purchase an additional \$12 million of Series B-1 preferred stock until December 31, 2004.

The Series C preferred stock has a seven-year term expiring April 2, 2009. During the first quarter of 2003, the terms of the Series C preferred stock were amended to accelerate the modification of the conversion price to \$5.66 and the preferred shareholder agreed to convert \$16.25 million of the Series C cumulative convertible preferred stock by March 12, 2003. Upon conversion, 2.9 million shares of common stock were issued. This amendment to the preferred stock terms was accounted for as an induced conversion, resulting in a charge to retained earnings of \$3.5 million during the first quarter of 2003.

In connection with the issuance of the Series C preferred stock in 2002, the Company issued the preferred shareholder a warrant which currently is exercisable based on approximately 2.2 million shares at a strike price of \$10.77 per share. Annually, on April 2 of each year, the warrant strike price increases by \$0.75 per share. The warrant expires on April 2, 2009 and is exercisable only on a non-cash, net basis, whereby the warrant holder would receive shares of common stock as payment for the net gain upon exercise.

11. As is customary in the manufactured housing industry, 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, 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 June 28, 2003 was estimated to be approximately \$265 million, without reduction for the resale value of the homes. This amount compares to approximately \$240 million at the beginning of the year and approximately \$270 million a year earlier. Losses under repurchase obligations are determined by the difference between the repurchase price and the estimated net proceeds from the resale of the homes. Repurchase losses incurred on homes repurchased totaled \$0.3 million and \$0.6 million for the three and six months ended June 28, 2003, respectively, and \$0.2 million and \$0.5 million for the three and six months ended June 29, 2002, respectively. During the first quarter 2003, wholesale repurchase reserves were increased \$3.2 million in connection with the extension of repurchase terms to 24 months for certain national lenders and for the negative effects of market conditions on the Company's largest independent retailer. During the second quarter of 2003, the Company agreed to extend both repurchase terms and the timing of required principal curtailment payments by this independent retailer to respective floor plan lenders resulting in a slightly higher repurchase exposure to the Company for a longer period of time.

At June 28, 2003 the Company was contingently obligated for approximately \$62.2 million under letters of credit, primarily comprised of \$14.1 million to support insurance reserves, \$18.4 million to support long-term debt and \$27.7 million to secure surety bonds. Champion was also contingently obligated for \$35.8 million under surety bonds, generally to support insurance, and license and service bonding requirements. 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 June 28, 2003 Champion was contingently liable for up to \$7.5 million under an unconditional guaranty of a \$75 million warehouse facility of a consolidated third party special purpose entity. The warehouse

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facility supported Champion's finance company's operation. This facility is expected to be terminated in the third quarter of 2003 as a result of the Company's decision to discontinue its consumer finance operation as discussed in Note 2.

At June 28, 2003 certain of the Company's subsidiaries were guarantors of \$5.7 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 which arise in the ordinary course of its business.

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

12. The Company's potential dilutive securities consist of outstanding stock options, deferred purchase price obligations, convertible preferred stock and warrants. Dilutive securities were not considered in determining the denominator for diluted earnings per share (EPS) in either six-month period presented and for the three months ended June 29, 2002 because the effect on the net loss would have been antidilutive. Convertible preferred stock was not included as dilutive securities in the quarter ended June 28, 2003 because preferred stock dividends were more dilutive. A reconciliation of the numerators and denominators used in the Company's basic and diluted EPS calculations follows:

	Three Months Ended		Six Months Ended	
	June 28, 2003	June 29, 2002	June 28, 2003	June 29, 2002
Numerator				
Net income (loss)	\$ 3,027	\$ (199,291)	\$ (18,398)	\$ (211,137)
Less: preferred stock dividend	(169)	(563)	(455)	(813)
Less: charge to retained earnings for induced conversion of preferred stock			(3,488)	
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Income (loss) available to common shareholders for basic and diluted EPS	\$ 2,858	\$ (199,854)	\$ (22,341)	\$ (211,950)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Denominator				
Shares for basic EPS weighted average shares outstanding	56,757	48,729	55,641	48,617
Plus: effect of dilutive securities				
Deferred purchase price payment	4,811			
Stock options	56			
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Shares for diluted EPS	61,624	48,729	55,641	48,617
	<u> </u>	<u> </u>	<u> </u>	<u> </u>

13. The Company's financial services segment operates as HomePride Finance Corp. (HPFC). HPFC structures sales of originated consumer loans to the warehouse facility as collateralized financing transactions under generally accepted accounting principles. As a result, the Company's consolidated balance sheet reflects the related consumer loans as finance loans receivable, and reflects proceeds from the sales of consumer loans into the warehouse facility as collateralized borrowings.

Finance loans receivable were held for investment at December 28, 2002, and were stated at the aggregate remaining unpaid principal balances, plus deferred loan origination costs, less deferred loan origination fees and allowance for loan losses. The finance loans receivable balance was reclassified to held for sale during the quarter ended March 29, 2003 upon the Company's decision to sell the majority of its finance loans through whole loan sales. As a result, for the three and six months ended June 28, 2003, the Company recorded \$0.3 million and \$5.7 million, respectively, of charges to value its finance loans receivable at the lower of cost or market. During the quarter ended June 28, 2003, the Company sold loans with a face value of \$59.7 million for approximately \$54.1 million, which was comparable to the carrying value of the loans, net of the lower of cost or market reserve. The sale of the loans provided net cash of \$11.9 million after paying down \$42.2 million of warehouse line borrowings. Subsequent to quarter end, in July 2003, the

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Company sold loans with a face value of \$16.4 million for approximately \$15.6 million. The sale of these loans provided net cash of \$5.6 million after paying down \$10.0 million of warehouse line borrowings.

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As discussed in Note 2, in July 2003 the Company decided to discontinue its consumer finance operation.

14. The Company evaluates the performance of its manufacturing and retail segments based on earnings (loss) before interest, income taxes and general corporate expenses (EBIT), excluding goodwill impairment charges. Financial services revenues consist of interest income and other income earned on the consumer loans. Financial services loss consists of financial services revenues less operating costs, interest expense for the warehouse facility and losses on finance loans sold or held for sale. Reconciliations of segment revenues to consolidated net revenues and segment earnings (loss) to income (loss) before income taxes follow:

	Three Months Ended	
	June 28, 2003	June 29, 2002
	(In thousands)	
Net revenues		
Manufacturing net sales	\$ 263,067	\$ 313,699
Retail net sales	67,040	96,607
Financial services revenues	449	
Less: intercompany sales	(34,454)	(48,800)
Consolidated net revenues	<u>\$ 296,102</u>	<u>\$ 361,506</u>
Income (loss) before income taxes		
Manufacturing EBIT	\$ 13,003	\$ 10,426
Retail EBIT	(737)	(13,802)
Financial services loss	(2,877)	(1,927)
General corporate expenses	(6,449)	(7,111)
Gain on debt retirement	7,130	5,870
Goodwill impairment charges		(97,000)
Intercompany eliminations	146	
Net interest expense, excluding financial services	(6,839)	(7,047)
Income (loss) before income taxes	<u>\$ 3,377</u>	<u>\$ (110,591)</u>
	Six Months Ended	
	June 28, 2003	June 29, 2002
	(In thousands)	
Net revenues		
Manufacturing net sales	\$ 472,264	\$ 580,351
Retail net sales	128,161	176,732
Financial services revenues	2,177	
Less: intercompany sales	(61,975)	(89,200)
Consolidated net revenues	<u>\$ 540,627</u>	<u>\$ 667,883</u>
Income (loss) before income taxes		
Manufacturing EBIT	\$ 6,157	\$ 11,729
Retail EBIT	(3,420)	(21,880)
Financial services loss	(10,245)	(1,927)
General corporate expenses	(13,721)	(14,065)
Gain on debt retirement	13,833	5,870

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Goodwill impairment charges	(97,000)	
Intercompany eliminations	625	
Net interest expense, excluding financial services	(13,977)	(11,864)
	\$ (20,748)	\$ (129,137)
Loss before income taxes	\$ (20,748)	\$ (129,137)

Retail floor plan interest expense not charged to retail EBIT totaled \$0.5 million and \$0.9 million for the three and six months ended June 28, 2003 and \$0.9 million and \$2.3 million for the three and six months ended June 29, 2002, respectively. Financial services interest expense on warehouse borrowings charged to financial services loss totaled \$70,000 and \$289,000 for the three and six months ended June 28, 2003. Financial services loss for the three and six months ended June 28, 2003 included a lower of cost or market loss of \$0.3 million and \$5.7 million, respectively, for finance loans sold or held for sale.

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For the three and six months ended June 29, 2002, retail EBIT included \$1.9 million of non-cash fixed asset impairment charges and \$3.0 million of lease termination and other costs associated with closures of retail sales centers.

15. In June 2002, the Financial Accounting Standards Board (FASB) issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities, which requires recognition of a liability for a cost associated with an exit or disposal activity when the liability is incurred rather than recognized at the date of an entity's commitment to an exit plan as previously required in accordance with Emerging Issues Task Force (EITF) Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). SFAS No. 146 also establishes that fair value is the objective for initial measurement of the liability. The provisions of SFAS No. 146 are effective for exit or disposal activities that are initiated after December 31, 2002. The adoption of SFAS No. 146 by the Company at the beginning of fiscal 2003 had no significant impact on the Company's financial statements for the three and six months ended June 28, 2003. In future periods, SFAS No. 146 may impact the manner in which the Company reports certain restructuring activities, including lease termination costs, employee severance and other exit activities. These charges will generally be recognized when the liability is incurred.

In December 2002, the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation-Transition and Disclosure-an amendment of FASB Statement No. 123, which provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, Statement No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The adoption by the Company of SFAS No. 148 in the first quarter of 2003 impacted interim disclosure requirements and requires the Company to choose among alternative implementation methods if the Company were to adopt SFAS No. 123 and change to the fair value method of accounting for stock-based compensation.

In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity, which requires that an issuer of certain types of financial instruments with characteristics of both liabilities and equity classify the financial instruments as liabilities. The following three types of financial instruments are required to be reported as liabilities by the issuer: (i) mandatorily redeemable instruments, (ii) forward purchase contracts, written put options, and other financial instruments in the form of shares that either obligate or may obligate the issuer to settle its obligations for cash or by transferring other assets, and (iii) certain financial instruments that include an obligation that (1) the issuer may or must settle by issuing a variable number of its equity shares and (2) has a monetary value at inception that (a) is fixed, (b) is tied to a market index or other benchmark or (c) varies inversely with the fair value of the equity shares. Historically, these types of instruments have been reported as liabilities, equity or between liabilities and equity. The provisions of SFAS No. 150 are effective for instruments entered into or modified after May 15, 2003 and pre-existing instruments as of the beginning of the Company's fiscal 2003 third quarter. The adoption of SFAS No. 150 by the Company in the third quarter of 2003 is expected to have no significant impact on the Company's financial statements.

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

Separate financial statements for each guarantor subsidiary are not included in this filing because each guarantor subsidiary is wholly-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 June 28, 2003

	<u>Parent</u>	<u>CHB</u>	<u>Guarantor Subsidiaries</u>	<u>Non-guarantor Subsidiaries</u>	<u>Consolidating Eliminations</u>	<u>Consolidated</u>
	(In thousands)					
Net revenues	\$	\$ 60,793	\$ 257,802	\$ 11,961	\$ (34,454)	\$ 296,102
Cost of sales		52,233	219,856	8,982	(34,600)	246,471
Selling, general and administrative expenses		9,603	32,100	1,516		43,219
Financial services operating costs			1,421	684	872	2,977
Loss on finance loans sold or held for sale			(117)		395	278
Gain on debt retirement	(7,130)					(7,130)
Total costs and expenses	(7,130)	61,836	253,260	11,182	(33,333)	285,815
Operating income (loss)	7,130	(1,043)	4,542	779	(1,121)	10,287
Interest income	2,780	2,951	385	9	(5,786)	339
Interest expense	(2,780)	(3,874)	(6,249)	(132)	5,786	(7,249)
Income (loss) before income taxes	7,130	(1,966)	(1,322)	656	(1,121)	3,377
Income tax expense (benefit)	403	(9,521)	10,423	(955)		350
Loss before equity in income (loss) of consolidated subsidiaries	6,727	7,555	(11,745)	1,611	(1,121)	3,027
Equity in income (loss) of consolidated subsidiaries	(2,579)	(10,134)			12,713	
Net income (loss)	\$ 4,148	\$ (2,579)	\$ (11,745)	\$ 1,611	\$ 11,592	\$ 3,027

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CHAMPION ENTERPRISES, INC.
Condensed Consolidating Statement of Operations
For the Six Months Ended June 28, 2003

	<u>Parent</u>	<u>CHB</u>	<u>Guarantor Subsidiaries</u>	<u>Non-guarantor Subsidiaries</u>	<u>Consolidating Eliminations</u>	<u>Consolidated</u>
	(In thousands)					
Net revenues	\$	\$ 109,935	\$ 470,506	\$ 22,161	\$ (61,975)	\$ 540,627
Cost of sales		97,258	406,120	16,149	(62,600)	456,927
Selling, general and administrative expenses		20,481	68,640	2,761		91,882
Financial services operating costs			4,342	1,445	657	6,444
Loss on finance loans sold or held for sale			3,533		2,156	5,689
Gain on debt retirement	(12,555)	(1,278)				(13,833)
Total costs and expenses	(12,555)	116,461	482,635	20,355	(59,787)	547,109
Operating income (loss)	12,555	(6,526)	(12,129)	1,806	(2,188)	(6,482)
Interest income	5,886	5,944	911	98	(11,953)	886
Interest expense	(5,886)	(7,856)	(12,870)	(493)	11,953	(15,152)
Income (loss) before income taxes	12,555	(8,438)	(24,088)	1,411	(2,188)	(20,748)
Income tax expense (benefit)	403	(9,521)	7,423	(655)		(2,350)
Loss before equity in income (loss) of consolidated subsidiaries	12,152	1,083	(31,511)	2,066	(2,188)	(18,398)
Equity in income (loss) of consolidated subsidiaries	(28,362)	(29,445)			57,807	
Net income (loss)	\$ (16,210)	\$ (28,362)	\$ (31,511)	\$ 2,066	\$ 55,619	\$ (18,398)

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CHAMPION ENTERPRISES, INC.
Condensed Consolidating Balance Sheet
As of June 28, 2003

	<u>Parent</u>	<u>CHB</u>	<u>Guarantor Subsidiaries</u>	<u>Non-guarantor Subsidiaries</u>	<u>Consolidating Eliminations</u>	<u>Consolidated</u>
(In thousands)						
Assets						
Current assets						
Cash and cash equivalents	\$	\$ 118,334	\$ 1,125	\$ 9,977	\$	\$ 129,436
Restricted cash		310	200	552		1,062
Accounts receivable, trade		10,486	38,614	4,090	(7,100)	46,090
Inventories		10,951	109,955	1,878	(2,250)	120,534
Finance loans held for sale, net			4,813	12,740	301	17,854
Other current assets		9,302	90,282	470	(83,071)	16,983
Total current assets		149,383	244,989	29,707	(92,120)	331,959
Property, plant and equipment, net		29,147	88,167	2,148		119,462
Goodwill, net			164,324	721		165,045
Investment in consolidated subsidiaries	85,346	369,501	135,130	6,871	(596,848)	
Other non-current assets	1,418	10,382	2,485	9,211		23,496
	\$ 86,764	\$ 558,413	\$ 635,095	\$ 48,658	\$ (688,968)	\$ 639,962
Liabilities, Redeemable Convertible Preferred Stock and Shareholders Equity						
Current liabilities						
Floor plan payable	\$	\$	\$ 19,358	\$ 95	\$	\$ 19,453
Accounts payable		10,354	33,806	1,872		46,032
Short-term borrowings		7,000				7,000
Warehouse proceeds structured as collateralized borrowings				10,024		10,024
Accrued warranty obligations		5,978	33,932	750		40,660
Accrued volume rebates		7,608	20,058	1,383	(100)	28,949
Other current liabilities	1,315	125,685	46,799	1,353	(83,281)	91,871
Total current liabilities	1,315	156,625	153,953	15,477	(83,381)	243,989
Long-term liabilities						
Long-term debt	134,450	142,474	13,704	24		290,652
Other long-term liabilities		36,073	16,941	126		53,140
	134,450	178,547	30,645	150		343,792
Intercompany balances	(96,601)	(102,926)	533,449	1,826	(335,748)	
Redeemable convertible preferred stock	13,568					13,568
Shareholders equity						

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Common stock	56,777	1	59	4	(64)	56,777
Capital in excess of par value	72,978	613,336	273,218	33,723	(920,277)	72,978
Accumulated deficit	(95,723)	(287,170)	(356,229)	(1,871)	650,502	(90,491)
Accumulated other comprehensive income (loss)				(651)		(651)
Total shareholders equity	34,032	326,167	(82,952)	31,205	(269,839)	38,613
	\$ 86,764	\$ 558,413	\$ 635,095	\$ 48,658	\$ (688,968)	\$ 639,962

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CHAMPION ENTERPRISES, INC.
Condensed Consolidating Statement of Cash Flows
For the Six Months Ended June 28, 2003

	<u>Parent</u>	<u>CHB</u>	<u>Guarantor Subsidiaries</u>	<u>Non-guarantor Subsidiaries</u>	<u>Consolidating Eliminations</u>	<u>Consolidated</u>
	(In thousands)					
Net cash provided by (used for) operating activities:	\$ 2,213	\$ 76,825	\$ (22,583)	\$ 1,780	\$	\$ 58,235
Cash flows from investing activities:						
Acquisitions and deferred purchase price payments			(3,882)			(3,882)
Additions to property and equipment		(418)	(2,455)	(195)		(3,068)
Investments in and advances to unconsolidated subsidiaries				(343)		(343)
Investments in and advances to consolidated subsidiaries	20,854	(67,913)	26,231	20,828		
Proceeds on disposal of fixed assets		694	2,782	1,600		5,076
Net cash provided by (used for) investing activities	20,854	(67,637)	22,676	21,890		(2,217)
Cash flows from financing activities:						
Increase (decrease) in floor plan payable, net			2,594	(288)		2,306
Proceeds from short-term borrowings		7,000				7,000
Repayment of long-term debt		(83)	(198)	(45)		(326)
Purchase of Senior Notes	(22,599)	(13,231)				(35,830)
Proceeds from warehouse facility				17,987		17,987
Repayment of warehouse facility				(43,528)		(43,528)
Increase in deferred financing costs		(2,342)				(2,342)
Decrease in restricted cash		49,174	549	1,515		51,238
Dividends paid on preferred stock	(768)					(768)
Common stock issued, net	300					300
Net cash provided by (used for) financing activities	(23,067)	40,518	2,945	(24,359)		(3,963)
Net increase (decrease) in cash and cash equivalents		49,706	3,038	(689)		52,055
Cash and cash equivalents at beginning of period		68,628	(1,913)	10,666		77,381
Cash and cash equivalents at end of period	\$	\$ 118,334	\$ 1,125	\$ 9,977	\$	\$ 129,436



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CHAMPION ENTERPRISES, INC.
Condensed Consolidating Statement of Operations
For the Three Months Ended June 29, 2002

	<u>Parent</u>	<u>CHB</u>	<u>Guarantor Subsidiaries</u>	<u>Non-guarantor Subsidiaries</u>	<u>Consolidating Eliminations</u>	<u>Consolidated</u>
	(In thousands)					
Net revenues	\$	\$ 74,508	\$ 326,463	\$ 9,335	\$ (48,800)	\$ 361,506
Cost of sales		63,994	278,544	7,562	(48,800)	301,300
Selling, general and administrative expenses		13,421	50,315	2,057		65,793
Financial services operating costs			1,927			1,927
Goodwill impairment charges			97,000			97,000
Restructuring charges			4,900			4,900
Gain on debt retirement	(5,870)					(5,870)
Total costs and expenses	(5,870)	77,415	432,686	9,619	(48,800)	465,050
Operating income (loss)	5,870	(2,907)	(106,223)	(284)		(103,544)
Interest income	3,329		299	33	(3,060)	601
Interest expense	(3,329)	(3,179)	(4,151)	(49)	3,060	(7,648)
Income (loss) before income taxes	5,870	(6,086)	(110,075)	(300)		(110,591)
Income tax expense	2,230	10,537	72,524	3,409		88,700
Income (loss) before equity in income (loss) of consolidated subsidiaries	3,640	(16,623)	(182,599)	(3,709)		(199,291)
Equity in income (loss) of consolidated subsidiaries	(202,931)	(186,308)			389,239	
Net loss	\$ (199,291)	\$ (202,931)	\$ (182,599)	\$ (3,709)	\$ 389,239	\$ (199,291)

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CHAMPION ENTERPRISES, INC.
Condensed Consolidating Statement of Operations
For the Six Months Ended June 29, 2002

	<u>Parent</u>	<u>CHB</u>	<u>Guarantor Subsidiaries</u>	<u>Non-guarantor Subsidiaries</u>	<u>Consolidating Eliminations</u>	<u>Consolidated</u>
	(In thousands)					
Net revenues	\$	\$ 139,845	\$ 600,614	\$ 16,624	\$ (89,200)	\$ 667,883
Cost of sales		121,975	516,776	13,617	(89,200)	563,168
Selling, general and administrative expenses		29,024	90,803	4,204		124,031
Financial services operating costs			1,927			1,927
Goodwill impairment charges			97,000			97,000
Restructuring charges			4,900			4,900
Gain on debt retirement	(5,870)					(5,870)
Total costs and expenses	(5,870)	150,999	711,406	17,821	(89,200)	785,156
Operating income (loss)	5,870	(11,154)	(110,792)	(1,197)		(117,273)
Interest income	7,193		832	205	(7,011)	1,219
Interest expense	(7,193)	(3,201)	(9,585)	(115)	7,011	(13,083)
Income (loss) before income taxes	5,870	(14,355)	(119,545)	(1,107)		(129,137)
Income tax expense	2,230	7,467	69,203	3,100		82,000
Income (loss) before equity in income (loss) of consolidated subsidiaries	3,640	(21,822)	(188,748)	(4,207)		(211,137)
Equity in income (loss) of consolidated subsidiaries	(214,777)	(186,308)			401,085	
Net loss	\$ (211,137)	\$ (208,130)	\$ (188,748)	\$ (4,207)	\$ 401,085	\$ (211,137)

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CHAMPION ENTERPRISES, INC.
Condensed Consolidating Balance Sheet
As of December 28, 2002

	<u>Parent</u>	<u>CHB</u>	<u>Guarantor Subsidiaries</u>	<u>Non-guarantor Subsidiaries</u>	<u>Consolidating Eliminations</u>	<u>Consolidated</u>
(In thousands)						
Assets						
Current assets						
Cash and cash equivalents	\$	\$ 68,628	\$ (1,913)	\$ 10,666	\$	\$ 77,381
Restricted cash		31,041	749	2,067		33,857
Accounts receivable, trade		8,802	26,280	749	(7,200)	28,631
Inventories		10,677	100,048	2,377	(1,750)	111,352
Other current assets		80,742	87,733	1,459	(80,387)	89,547
		<u>199,890</u>	<u>212,897</u>	<u>17,318</u>	<u>(89,337)</u>	<u>340,768</u>
Finance loans held for investment, net			3,294	46,448	2,301	52,043
Property, plant and equipment, net		30,435	94,211	2,998		127,644
Goodwill, net			164,324	1,113		165,437
Investment in consolidated subsidiaries	131,970	405,726	108,593	8,364	(654,653)	
Restricted cash		18,443				18,443
Other non-current assets	1,949	9,435	3,460	8,912		23,756
	<u>\$ 133,919</u>	<u>\$ 663,929</u>	<u>\$ 586,779</u>	<u>\$ 85,153</u>	<u>\$ (741,689)</u>	<u>\$ 728,091</u>
Liabilities, Redeemable Convertible Preferred Stock and Shareholders Equity						
Current liabilities						
Floor plan payable	\$	\$	\$ 16,764	\$ 383	\$	\$ 17,147
Accounts payable		8,529	27,763	1,423	(100)	37,615
Warehouse proceeds structured as collateralized borrowings				35,565		35,565
Accrued warranty obligations		6,172	36,406	561		43,139
Accrued volume rebates		10,328	23,449	1,333	(100)	35,010
Other current liabilities	2,102	119,420	50,358	3,075	(80,287)	94,668
		<u>2,102</u>	<u>144,449</u>	<u>42,340</u>	<u>(80,487)</u>	<u>263,144</u>
Long-term liabilities						
Long-term debt	170,000	157,547	13,996	69		341,612
Other long-term liabilities		35,637	21,003	114		56,754
		<u>170,000</u>	<u>34,999</u>	<u>183</u>		<u>398,366</u>
Intercompany balances	(99,193)	(28,233)	462,564	609	(335,747)	
Redeemable convertible preferred stock	29,256					29,256
Shareholders equity						

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Common stock	52,658	1	60	3	(64)	52,658
Capital in excess of par value	54,666	613,336	259,134	47,804	(920,274)	54,666
Accumulated deficit	(75,570)	(258,808)	(324,718)	(3,937)	594,883	(68,150)
Accumulated other comprehensive income (loss)				(1,849)		(1,849)
Total shareholders equity	31,754	354,529	(65,524)	42,021	(325,455)	37,325
	\$ 133,919	\$ 663,929	\$ 586,779	\$ 85,153	\$ (741,689)	\$ 728,091

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CHAMPION ENTERPRISES, INC.
Condensed Consolidating Statement of Cash Flows
For the Six Months Ended June 29, 2002

	<u>Parent</u>	<u>CHB</u>	<u>Guarantor Subsidiaries</u>	<u>Non-guarantor Subsidiaries</u>	<u>Consolidating Eliminations</u>	<u>Consolidated</u>
(In thousands)						
Net cash provided by (used for) operating activities:	\$ (9,609)	\$ (2,734)	\$ (7,389)	\$ 1,502	\$	\$ (18,230)
Cash flows from investing activities:						
Acquisitions and deferred purchase price payments			(8,050)			(8,050)
Originations of loans held for sale			(6,145)			(6,145)
Additions to property and equipment		(362)	(2,359)	(136)		(2,857)
Investments in and advances to unconsolidated subsidiaries				(1,139)		(1,139)
Investments in and advances to consolidated subsidiaries	(51,762)	(33,134)	81,711	3,185		
Proceeds on disposal of fixed assets			3,069			3,069
Net cash provided by (used for) investing activities	(51,762)	(33,496)	68,226	1,910		(15,122)
Cash flows from financing activities:						
Increase (decrease) in floor plan payable, net			(60,251)	77		(60,174)
Payment of long-term debt		(25)	(389)	(26)		(440)
Proceeds from Senior Notes		145,821				145,821
Purchase of Senior Notes	(23,750)					(23,750)
Proceeds from warehouse borrowings			2,103			2,103
Increase in deferred financing costs		(1,466)	(1,800)			(3,266)
Increase in restricted cash		(34,943)	(624)	(5)		(35,572)
Preferred stock issued, net	23,810					23,810
Common stock issued, net	1,000					1,000
Net cash provided by (used for) financing activities	1,060	109,387	(60,961)	46		49,532
Net increase (decrease) in cash and cash equivalents	(60,311)	73,157	(124)	3,458		16,180
Cash and cash equivalents at beginning of period	60,311	(249)	3,006	6,388		69,456
Cash and cash equivalents at end of period	\$	\$ 72,908	\$ 2,882	\$ 9,846	\$	\$ 85,636

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

CHAMPION ENTERPRISES, INC.

Results of Operations
Three and Six Months Ended June 28, 2003
versus the Three and Six Months Ended June 29, 2002

During 2003, our revenues and operating results continued to be affected by challenging industry conditions including limited availability of consumer financing and floor plan inventory financing, high levels of homes repossessed from consumers and an uncertain economic outlook. Since the industry downturn began in mid-1999 we have closed 34 manufacturing facilities, including two consolidated in the second quarter 2003 and one in the first quarter of 2003, and since mid-2000 we have closed 239 retail sales locations to eliminate under-performing operations and rationalize our operations and capacity for industry conditions.

According to data reported by the Institute for Building Technology and Safety (formerly the National Conference of States on Building Codes and Standards), U.S. industry wholesale shipments of HUD code homes for the first half of 2003 declined 26% from shipments in the comparable 2002 period. Based on data reported by Statistical Surveys, Inc. and our estimates, we believe that industry retail sales of new homes in the first five months of 2003 dropped approximately 20% from prior year levels.

Consolidated

	Three Months Ended		% Change
	June 28, 2003	June 29, 2002	
	(Dollars in millions)		
Net revenues			
Manufacturing net sales	\$ 263.1	\$ 313.7	(16%)
Retail net sales	67.0	96.6	(31%)
Less: intercompany sales	(34.5)	(48.8)	
Total net sales	295.6	361.5	(18%)
Financial services revenues	0.5		
Total net revenues	\$ 296.1	\$ 361.5	(18%)
Gross margin (net sales less cost of sales)	\$ 49.2	\$ 60.2	(18%)
Selling, general and administrative expenses (SG&A)	43.2	65.8	(34%)
Financial services operating costs	3.0	1.9	
Loss on finance loans sold or held for sale	0.3		
Gain on debt retirement	(7.1)	(5.9)	
Goodwill impairment charges		97.0	
Restructuring charges		4.9	
Operating income (loss)	\$ 10.3	\$ (103.5)	110%
Gross margin as a percent of net sales	16.6%	16.7%	
SG&A as a percent of net sales	14.6%	18.2%	
Operating income (loss) as a percent of net revenues	3.5%	(28.6%)	

Six Months Ended

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	<u>June 28, 2003</u>	<u>June 29, 2002</u>	<u>% Change</u>
(Dollars in millions)			
Net revenues			
Manufacturing net sales	\$ 472.3	\$ 580.4	(19%)
Retail net sales	128.1	176.7	(27%)
Less: intercompany sales	(62.0)	(89.2)	
	<u>538.4</u>	<u>667.9</u>	(19%)
Total net sales	538.4	667.9	(19%)
Financial services revenues	2.2		
	<u>540.6</u>	<u>667.9</u>	(19%)
Total net revenues	\$ 540.6	\$ 667.9	(19%)

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	Six Months Ended		% Change
	June 28, 2003	June 29, 2002	
	(Dollars in millions)		
Gross margin (net sales less cost of sales)	\$ 81.5	\$ 104.7	(22%)
Selling, general and administrative expenses	91.9	124.1	(26%)
Financial services operating costs	6.4	1.9	
Loss on finance loans sold or held for sale	5.7		
Gain on debt retirement	(13.8)	(5.9)	
Goodwill impairment charges		97.0	
Restructuring charges		4.9	
Operating loss	\$ (6.5)	\$ (117.3)	94%
Gross margin as a percent of net sales	15.1%	15.7%	
SG&A as a percent of net sales	17.1%	18.6%	
Operating loss as a percent of net revenues	(1.2%)	(17.6%)	

Net sales for the quarter and year to date periods ended June 28, 2003 decreased from the same periods in 2002 due primarily to operating fewer retail sales centers and manufacturing facilities and decreasing manufacturing and retail sales volumes, partially offset by sales price increases in both the manufacturing and retail segments. At June 28, 2003, we were operating 34 manufacturing facilities and 115 sales centers compared to 46 manufacturing facilities and 208 sales centers at June 29, 2002. Sales in the first half of 2003 were affected by industry conditions including limited availability of consumer financing and floor plan inventory financing, continuing high levels of industry consumer repossessions and an uncertain economic outlook.

Gross margin for the three months ended June 28, 2003 declined \$11.0 million from the comparable quarter of 2002, which was due to lower sales volumes in 2003 versus 2002. Gross margin as a percent of sales for the quarter was comparable to the prior year quarter. Gross margin dollars for the six months ended June 28, 2003 declined \$23.2 million from the comparable period of 2002 primarily due to the \$129 million decline in consolidated net sales. Gross margin as a percent of sales for the six-month period declined versus the prior year six-month period due to manufacturing inefficiencies from lower manufacturing production volumes in the first quarter of 2003, partially offset by increased wholesale and retail average sales prices.

Second quarter 2003 selling, general and administrative expenses (SG&A) declined by \$22.6 million or 34% primarily due to the reduction in sales and the operation of 26% fewer manufacturing facilities and 45% fewer sales centers. The current quarter SG&A decreased as a percentage of sales compared to the second quarter 2002 due to eliminating the SG&A at under-performing plants and sales centers as a result of their closure during 2002. SG&A for the six-month period ended June 28, 2003 decreased 26% versus the prior year, primarily due to the same factors that affected the second quarter as discussed above. SG&A for the three and six months in 2003 also included gains of \$0.8 and \$1.8 million, respectively, from the sale of idled manufacturing facilities and a retail sales center. Year-to-date 2003 SG&A also included an increase in the wholesale repurchase reserve totaling \$3.2 million in connection with the extension of repurchase terms to 24 months for certain national floor plan lenders and for the negative effects of market conditions on our largest independent retailer. During the second quarter of 2003, the Company agreed to extend both repurchase terms and the timing of required principal curtailment payments by this independent retailer to respective floor plan lenders resulting in a slightly higher repurchase exposure to the Company for a longer period of time.

Finance loans receivable were held for investment at December 28, 2002, and were stated at the aggregate remaining unpaid principal balances, plus deferred loan origination costs, less deferred loan origination fees and allowance for loan losses. During 2003, finance loans receivable were reclassified to held for sale upon the Company's decision to sell the majority of its finance loans to reduce borrowings on the warehouse line and generate cash. As a result, during the three and six months ended June 28, 2003, we recorded \$0.3 million and \$5.7 million, respectively, for losses on finance loans sold or held for sale. In the second quarter 2003, we sold loans with a face value of \$59.7 million for approximately \$54.1 million, comparable to the carrying value of the loans, net of the lower of cost or market reserve. The sale of loans provided net cash of \$11.9 million after paying down \$42.2 million of warehouse line borrowings.

For the three months ended June 28, 2003, operating results included a gain on extinguishment of debt totaling \$7.1 million as we purchased and retired \$22.7 million of our Senior Notes due 2009 for \$15.3 million. For the six months then ended, the gain on extinguishment of debt totaled \$13.8 million for the purchase and retirement of \$35.6 million of our Senior Notes due 2009 and \$15.0 million of our Senior Notes due 2007 for total payments of

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\$35.8 million. In the second quarter 2002, the Company purchased and retired \$30.0 million of our Senior Notes due 2009 for approximately \$23.8 million and recognized a gain of \$5.9 million. During the quarter ended June 29, 2002, we re-evaluated our goodwill and deferred tax assets and as a result recorded pretax non-cash charges of \$97 million for retail goodwill impairments and \$120 million for a deferred tax asset valuation allowance. The operating loss for the three and six months ended June 29, 2002 also included \$1.9 million for fixed asset impairment charges and \$3.0 million for lease termination and other costs related to the closing of 34 retail sales centers in the second quarter 2002.

Manufacturing Operations

We evaluate the performance of our manufacturing segment based on earnings (loss) before interest, income taxes and general corporate expenses (EBIT), excluding goodwill impairment charges.

	Three Months Ended		
	June 28, 2003	June 29, 2002	% Change
Net sales (in millions)	\$ 263.1	\$ 313.7	(16%)
EBIT (in millions)	\$ 13.0	\$ 10.4	25%
EBIT margin %	4.9%	3.3%	
Homes sold	6,925	9,124	(24%)
Floors sold	13,131	16,778	(22%)
Multi-section mix	85%	80%	
Average home price	\$ 36,500	\$ 33,000	11%

	Six Months Ended		
	June 28, 2003	June 29, 2002	% Change
Net sales (in millions)	\$ 472.3	\$ 580.4	(19%)
EBIT (in millions)	\$ 6.2	\$ 11.7	(48%)
EBIT margin %	1.3%	2.0%	
Homes sold	12,596	16,869	(25%)
Floors sold	23,849	31,213	(24%)
Multi-section mix	84%	81%	
Average home price	\$ 36,100	\$ 33,100	9%
Manufacturing facilities at period end	34	46	(26%)

Manufacturing net sales for the quarter ended June 28, 2003 decreased 16% compared to the second quarter of 2002 as a result of selling 24% fewer homes, partially offset by an 11% increase in the average selling price. With the closure of two manufacturing facilities during the second quarter, we were operating 26% fewer facilities at the end of the second quarter 2003 versus 2002. For the quarter ended June 28, 2003, our shipments of HUD code homes declined 27% from shipments a year earlier and our shipments of non-HUD code homes were comparable to shipments in the second quarter of 2002. Manufacturing sales for the six months ended June 28, 2003 decreased 19% compared to the same period last year due to a 25% decrease in the number of homes sold partially offset by a 9% increase in average home selling price. Year-to-date manufacturing sales volume was affected by operating fewer manufacturing facilities, a reduced number of Company-owned retail sales centers and industry conditions, including the effects of limited availability of consumer financing and floor plan inventory financing, high levels of homes repossessed from consumers and an uncertain economic outlook.

Manufacturing EBIT in the second quarter of 2003 increased \$2.6 million or 25% from the prior year period despite the \$50.6 million decline in segment sales. The reduction in manufacturing gross margin dollars as a result of lower sales and operating fewer plants was offset by the reduction in SG&A costs resulting from the closure of under-performing plants in 2002 and 2003. Additionally, during the quarter gross margin as a percent of sales improved slightly and a gain of \$0.7 was realized from the sale of one idle facility. Manufacturing EBIT for the six months ended June 28, 2003 declined \$5.6 million from the same period in 2002 primarily due to the poor results in the first quarter of 2003 which were affected by inefficiencies from lower production volumes and a \$3.2 million increase in wholesale repurchase reserves in connection with the extension of repurchase terms to 24 months for certain national lenders and for the negative effects of market conditions on our largest independent retailer. Year-to-date 2003 results were also affected by an increase in the average sales price per home and a gain of \$1.6 million

from the sale of two idle manufacturing facilities.

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 housing at June 28, 2003 totaled

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approximately \$48 million at the 34 plants then operated, compared to \$26 million at 46 plants at June 29, 2002. A majority of the year-over-year increase in unfilled orders was concentrated in four geographic areas.

Retail Operations

We evaluate the performance of our retail segment based on EBIT, excluding goodwill impairment charges.

	Three Months Ended		
	June 28, 2003	June 29, 2002	% Change
Total net sales (in millions)	\$ 67.0	\$ 96.6	(31%)
EBIT (in millions)	\$ (0.7)	\$ (13.8)	95%
EBIT margin %	(1.1%)	(14.3%)	
New homes sold	821	1,430	(43%)
Pre-owned homes sold	292	376	(22%)
Total homes sold	1,113	1,806	(38%)
% Champion-produced new homes sold	93%	96%	
New home multi-section mix	85%	78%	
Average new home price	\$ 75,400	\$ 62,600	20%
Average number of new homes sold per sales center per month	2.3	2.1	10%
Average number of new homes sold per sales center per month - 115 ongoing locations	2.3	2.6	(12%)

	Six Months Ended		
	June 28, 2003	June 29, 2002	% Change
Total net sales (in millions)	\$ 128.1	\$ 176.7	(27%)
EBIT (in millions)	\$ (3.4)	\$ (21.9)	84%
EBIT margin %	(2.7%)	(12.4%)	
New homes sold	1,598	2,624	(39%)
Pre-owned homes sold	600	723	(17%)
Total homes sold	2,198	3,347	(34%)
% Champion-produced new homes sold	95%	95%	
New home multi-section mix	84%	78%	
Average new home price	\$ 73,900	\$ 62,100	19%
Average number of new homes sold per sales center per month	2.3	1.9	21%
Average number of new homes sold per sales center per month - 115 ongoing locations	2.3	2.4	(4%)
Average number of new homes in inventory per sales center at period end	14.7	14.4	2%
Sales centers at period end	115	208	(45%)

Retail sales for the three and six months ended June 28, 2003 decreased 31% and 27%, respectively, versus the same periods last year due to a decline in new home sales, partially offset by a higher average selling price. The decrease in net sales and homes sold is due to operating fewer sales centers. During the second quarter we operated an average of 117 sales centers, 48% lower than the average of 225 sales centers operated in the second quarter of 2002. The average number of new homes sold per sales center per month during the second quarter of 2003 and year-to-date period increased versus last year primarily due to the closure of under-performing locations during 2002. The decrease in the average number of new homes sold per sales center per month during the second quarter of 2003 for ongoing locations reflects the continuing difficult market conditions and limited consumer financing availability. The 20% increase in average new home selling price resulted from the sale of a greater proportion of higher-priced, multi-section homes and homes with more add-ons, improvements and accessories.

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Retail EBIT for the three and six months ended June 28, 2003 improved by \$13.1 million and \$18.5 million, respectively, compared to the same periods in 2002, primarily due to the closure of under-performing sales centers in 2002. In addition, 2002 results included restructuring charges of \$1.9 million for fixed asset impairment charges and \$3.0 million for lease termination and other costs related to the closing of 34 retail sales centers. Gross profit during the quarter and year-to-date period declined approximately \$5.9 million and \$9.4 million, respectively, due to the reduction in sales volume, while SG&A declined approximately \$14.1 million and \$23.0 million, respectively, due to operating fewer sales centers in 2003.

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Financial Services

During the three and six months ended June 28, 2003, the financial services segment originated \$12.7 million and \$27.9 million of loans, respectively. The segment's operating results include losses of \$0.3 million and \$5.7 million, respectively, for the three and six months ended June 28, 2003 on finance loans sold or loans held for sale marked to market value.

Finance loans receivable, which were classified as held for investment at December 28, 2002, were reclassified to held for sale in the first quarter of 2003 upon the Company's decision to sell the majority of its finance loans to reduce borrowings on the warehouse line and generate cash. In the second quarter 2003, we sold loans with a face amount of \$59.7 million for approximately \$54.1 million, comparable to the carrying value of the loans, net of the lower of cost or market reserve. The sale of loans provided net cash of \$11.9 million after paying down \$42.2 million of warehouse line borrowings. Subsequent to quarter end, in July 2003, we sold loans with a face value of \$16.4 million for approximately \$15.6 million. The sale of these loans provided net cash of \$5.6 million after paying down \$10.0 million of warehouse line borrowings.

As discussed below in Strategic Initiatives and Subsequent Events, in July 2003 the Company decided to discontinue its consumer finance operation. Charges not to exceed \$12 million are expected to be incurred in connection with the closure but are not expected to adversely affect the Company's cash flows.

Restructuring Charges

During the six months ended June 28, 2003 we closed three manufacturing facilities, three retail sales centers and one finance segment administrative office but incurred no significant restructuring costs. As of June 28, 2003, accrued but unpaid restructuring costs totaled \$1.9 million compared to \$2.5 million at December 28, 2002, primarily for lease commitments at retail locations closed in 2002.

Interest Expense

Interest expense decreased by \$0.4 million for the three months ended June 28, 2003 versus the same period last year primarily due to reduced debt under our Senior Notes due 2007 and 2009. Interest expense for the six months ended June 28, 2003 increased by \$2.1 million versus the same period last year, primarily due to our 11.25% Senior Notes due 2007 which were issued in April 2002, partially offset by reduced debt under our Senior Notes due to repurchases and reduced levels of floor plan borrowings.

Income Taxes

We began providing a 100% valuation allowance for our deferred tax assets in the quarter ended June 29, 2002. Deferred tax assets will continue to require a 100% valuation allowance until the Company can demonstrate their realizability through sustained profitability and/or from other factors. Current federal income tax regulations provide for a two-year carryback period for net operating losses. The Company has no taxable income available in this carryback period. Therefore, any net operating losses incurred in 2003 will become tax loss carryforwards that will be available to offset future taxable income. The effective tax rate for the six months ended June 28, 2003 differs from the 35% federal statutory rate primarily because of the 100% valuation allowance for deferred taxes which offsets any deferred tax benefits resulting from tax loss carryforwards in the period, partially offset by a \$3.0 million tax benefit for a reduction in the valuation allowance, as discussed below. The effective tax rate for the six months ended June 2002 differed from the federal statutory rate primarily because of the valuation allowance for deferred taxes, state income taxes and non-deductible items.

The amount of net deferred tax assets, the 100% valuation allowance and the expected tax refund related to the 2002 federal income tax return were estimated at December 28, 2002, based on year-end estimates of the tax deductibility of certain costs and charges. As a result of the completion and filing of the 2002 federal income tax return in April 2003, the Company received tax refunds totaling \$63.5 million in the second quarter of 2003. These refunds exceeded by approximately \$3.0 million the estimate made as of December 28, 2002, resulting in a \$3.0 million reduction of deferred tax assets during the quarter ended March 29, 2003. As a result, during the quarter ended March 29, 2003, a tax benefit of \$3.0 million was recorded for the related reduction in the 100% valuation allowance.

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Contingent Repurchase Obligations

We are contingently obligated under repurchase agreements with certain lending institutions that provide wholesale floor plan financing to our independent retailers. We use information which is 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 retail inventory financing sources, the estimate of our contingent repurchase obligation may not be precise. At June 28, 2003 we estimate our contingent repurchase obligation was approximately \$265 million, without reduction for the resale value of the homes. For the six months ended June 28, 2003, we paid \$3.4 million and incurred losses of \$0.6 million from the repurchase of 94 homes. In the same period last year, we paid \$2.9 million and incurred losses of \$0.5 million from the repurchase of 100 homes. Our estimated contingent repurchase obligation has been declining during this downturn due to reduced sales and inventory at our independent retailers and due to an estimated 50% of independent retailer inventory being financed at local banks, with whom we do not always enter into repurchase agreements. During the first quarter of 2003, wholesale repurchase reserves were increased \$3.2 million in connection with the extension of repurchase terms to 24 months for certain national floor plan lenders and for the negative effects of market conditions on our largest independent retailer. During the second quarter of 2003, the Company agreed to extend both repurchase terms and the timing of required principal curtailment payments by this independent retailer to respective floor plan lenders resulting in a slightly higher repurchase exposure to the Company for a longer period of time.

Liquidity and Capital Resources

Unrestricted cash balances totaled \$129.4 million at June 28, 2003. For the six months ended June 28, 2003, net cash of \$30.6 million was provided by operations (including \$63.7 million from income tax refunds), \$53.8 million was provided from the sale of finance loans receivable, \$51.2 million was provided by decreases in our restricted cash balances, \$18.0 million of net proceeds from sales of consumer loans into the warehouse facility, \$7.0 million of short-term borrowings under our credit facility and \$5.1 million of proceeds from the sale of two closed manufacturing facilities, a retail sales center and one development operation. Expenditures during the period included \$43.5 million to repay the warehouse facility for finance loans sold, \$35.8 million for the repurchase of Senior Notes, \$27.9 million to originate consumer loans, \$3.9 million for acquisition related payments, \$3.1 million for capital improvements and \$2.3 million for deferred financing costs.

During 2003, accounts receivable increased by \$17.5 million, inventories increased by \$9.2 million and accounts payable increased by \$8.4 million primarily due to year-end levels generally being low due to seasonality, holidays and vacations. Other current assets decreased primarily due to the receipt of \$63.7 million in income tax refunds and the release of \$9.6 million of cash collateral deposits previously provided for surety bond requirements.

During the six months ended June 28, 2003, the following transactions were completed:

We finalized a \$75 million revolving credit facility.

We purchased and retired \$35.6 million of our Senior Notes due 2009 and \$15.0 million of our Senior Notes due 2007 for total payments of \$35.8 million.

We sold finance loans with a face value of approximately \$59.7 million for approximately \$54.1 million at which time warehouse line borrowings were reduced by \$42.2 million. We received net proceeds of \$11.9 million after the warehouse line pay down and payment of certain expenses.

We amended and renewed our warehouse facility that supports our finance company's operations. The renewed facility is for \$75 million and has a one-year term and revised terms. This facility is expected to be terminated in the third quarter of 2003 as a result of our decision to discontinue our consumer finance operation.

We received tax refunds totaling \$63.5 million from the filing of our 2002 federal income tax return and the carryback of the 2002 net operating loss.

Subsequent to quarter end, in July 2003, we sold finance loans with a face value of approximately \$16.4 million for approximately \$15.6 million at which time warehouse line borrowings were reduced by \$10.0 million. The net proceeds from this transaction were \$5.6 million, after pay down of the warehouse line and payment of certain expenses.

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In January 2003, we finalized a committed three-year, \$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 liquidity, as defined, falls below \$35 million, to maintain certain levels of earnings before interest, taxes, depreciation, amortization, non-cash restructuring costs and gains from extinguishment of Senior Notes (EBITDA) and certain ratios of EBITDA 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 and cash losses under wholesale repurchase obligations. The financial covenants that are required in the event that our liquidity falls below \$35 million are as follows:

Period	Required EBITDA	Required ratio of EBITDA to fixed charges
6 months ended June 28, 2003	\$14.5 million	0.437 to 1
9 months ended September 27, 2003	\$32.4 million	0.663 to 1
12 months ended January 3, 2004	\$45.2 million	1.0 to 1
Each 12 month period ending on a fiscal quarter end thereafter	\$45.2 million	1.0 to 1

For the six months ended June 28, 2003, our EBITDA was a negative \$8.1 million and our ratio of EBITDA to fixed charges was a negative 0.29 to 1. At June 28, 2003 our liquidity was \$133 million and we expect, over the next 12 months, to maintain liquidity at or in excess of the \$35 million threshold. Thus, while our operating results may continue to be below the required levels of EBITDA and ratios of EBITDA to fixed charges, these covenant requirements are not expected to be in effect.

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. As of June 28, 2003, availability under the facility was \$71.8 million, there were \$61.9 million of letters of credit and \$7.0 million of borrowings outstanding under the facility and liquidity was in excess of \$35 million such that no financial covenants were in effect. We expect to utilize availability under this facility principally for letters of credit.

Upon completion of our \$75 million credit facility, substantially all of the fully cash collateralized letters of credit were terminated, resulting in the release to the Company of restricted cash of \$49.8 million that had been held as collateral. Additionally, \$9.6 million of cash deposits were released to the Company upon replacing cash collateral for surety bonds with letters of credit under the new credit facility.

Our two issuances of Senior Notes continue to trade at discounts to their respective face values. We continuously evaluate the most efficient use of our capital, including without limitation, purchasing, refinancing or otherwise retiring our outstanding indebtedness, debt exchanges, restructuring of obligations, financings, and issuances of securities, whether in the open market or by other means and to the extent permitted by our financing arrangements. We will evaluate any such transactions in light of then existing market conditions. The amounts involved in any such transactions, individually or in the aggregate, may be material.

In April 2003, the Company completed an amendment and renewal of the \$150 million warehouse facility that expired in April 2003 at a reduced size of \$75 million. The warehouse facility is maintained for a consolidated third party special purpose entity to support the Company's consumer finance operations. In July 2003, borrowings under the warehouse facility were substantially repaid through the proceeds from the sale of loans with a face value totaling \$16.4 million. As discussed in Strategic Initiatives and Subsequent Events, in July the Company decided to discontinue its consumer finance operation. As a result the warehouse facility is expected to be terminated during the third quarter of 2003.

We have two floor plan facilities with total availability of \$21 million, of which \$17.8 million was outstanding at June 28, 2003. A \$15 million floor plan financing facility contains a covenant requiring the maintenance of \$35 million of liquidity, as defined in the revolving credit facility, at each fiscal month end. If we were to be out of compliance with this covenant, the lender could terminate the credit line and cause the debt to become immediately due and payable. As of June 28, 2003, we had approximately \$13.7 million outstanding under this facility and were in compliance with the covenant.

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We plan to spend less than \$10 million in 2003 on capital expenditures. We do not plan to pay cash dividends on our common stock in the near term.

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Contingent liabilities and obligations

We had significant contingent liabilities and obligations at June 28, 2003, including estimated wholesale repurchase obligations totaling approximately \$265 million (without reduction for the resale value of the homes), surety bonds and letters of credit totaling \$98 million and guarantees by certain of our consolidated subsidiaries of \$5.7 million of debt of unconsolidated subsidiaries. In addition, as of June 28, 2003, the Company was contingently liable for up to \$7.5 million under an unconditional guaranty of a consolidated third party special purpose entity's \$75 million warehouse facility to support our finance company's operations. At June 28, 2003, \$10.0 million was outstanding under the warehouse facility, which was reflected in our consolidated balance sheet.

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 claims which 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 June 28, 2003, our unrestricted cash balances totaled \$129.4 million and we had unused availability of \$2.9 million on our \$75 million credit facility and \$3.2 million of unused availability under our two floor plan lines. In July, 2003 we received net proceeds of \$5.6 million from the sale of finance loans with a face value of \$16.4 million. Therefore, total cash available from these sources was approximately \$140 million. This level of cash availability is projected to be substantially in excess of cash needed to operate our businesses for the next 12 months. In the event one or more of our capital resources were to become unavailable, we would revise our operating strategies accordingly.

Strategic Initiatives and Subsequent Events

In July 2003, we engaged the performance improvement group of AlixPartners LLC to perform a review for potential improvements to our operating performance. The study includes looking at all aspects of the Company's operations and may result in the closing of additional manufacturing facilities and retail sales centers during the third and fourth quarters of 2003. Any such closures would likely result in fixed asset impairment charges, severance costs and other charges and would trigger an evaluation of goodwill that could result in goodwill impairment charges.

In July 2003, we decided to discontinue our consumer finance operation. While we are evaluating various exit strategies we currently estimate that we will record charges not to exceed \$12 million in the third quarter of 2003, including a non-cash charge of approximately \$5 million primarily reflecting the impairment of goodwill.

In July 2003, certain of our executive officers terminated employment with the Company. These terminations will result in certain charges which will be recorded in the third quarter of 2003, although the amounts have not yet been determined.

Critical Accounting Policies

The preparation of financial statements in conformity with generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Assumptions and estimates of future earnings and cash flow are used in the periodic analyses of the recoverability of goodwill, deferred tax assets, and property, plant and equipment. Historical experience and trends are used to estimate reserves, including reserves for self-insured risks, warranty costs and wholesale repurchase losses. Following is a description of each accounting policy requiring significant judgments and estimates:

Goodwill

We test for goodwill impairment in accordance with Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Other Intangible Assets . We evaluate each reporting unit's fair value versus its carrying value in the fourth quarter of each year or more frequently if events or changes in circumstances indicate that the carrying value may exceed the fair value of the reporting unit. When estimating a unit's fair value, we

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calculate the present value of future cash flows based on forecasted sales volumes, the number of retail sales centers and homebuilding facilities in operation, current industry and economic conditions, historical results and inflation. Significant changes in the estimates and assumptions used in calculating the fair value of goodwill or differences between estimates and actual results could result in additional impairment charges in the future.

Income Taxes: Deferred Tax Assets and Income Tax Refunds

Deferred tax assets and liabilities are determined based on temporary differences between the financial statement balances and the tax bases of assets and liabilities using enacted tax rates in effect in the years in which the differences are expected to reverse. We periodically evaluate the realizability of our deferred tax assets based on the requirements established in SFAS No. 109, Accounting for Income Taxes, which requires the recording of a valuation allowance when it is more likely than not that some portion or all of the deferred tax assets will not be realized. We incurred pretax losses in 2002, 2001 and 2000. Additionally, the manufactured housing industry continues to be challenged by limited availability of consumer and floor plan financing, high industry consumer repossession levels and an uncertain economic outlook, resulting in a continued decline in manufacturing shipments and retail sales. After consideration of these factors, beginning in the second quarter of 2002, we have provided a 100% valuation allowance against our deferred tax assets. Deferred tax assets will continue to require a 100% valuation allowance until the Company can demonstrate their realizability through sustained profitability and/or from other factors. The valuation allowance will be reversed to income in future periods to the extent that the related deferred tax assets are realized as a reduction of taxes otherwise payable on any future earnings or a portion or all of the valuation allowance is otherwise no longer required.

Because provisions in the tax law allowed us to receive a carryback refund for taxable losses incurred in 2002, in determining the amount of the deferred tax asset valuation allowance at December 28, 2002 we had to estimate the current tax deductibility of certain costs and charges. Differences between those estimates and actual values determined during the preparation of the income tax return, which was filed in April 2003, were reflected as a \$3.0 million tax benefit in results of operations in the quarter ended March 29, 2003.

Tax refunds of \$63.5 million were received during the second quarter of 2003 from the filing of our 2002 federal income tax return and the carryback of the 2002 net operating loss. Due to the size of the tax refund, we expect that our 2002 federal tax return will be audited by the Internal Revenue Service. The outcome of the expected audit of the 2002 federal tax return is not possible to predict. We have evaluated the need for tax reserves based on current and prior year tax filings and in 2002 increased our tax reserves by recording a \$12 million allowance for tax adjustments.

Property, Plant and Equipment

The recoverability of long-lived assets is evaluated whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable, primarily based on estimated selling prices, appraised values or projected undiscounted cash flows. Our cash flow estimates are based on historical results adjusted for estimated current industry trends, the economy and operating conditions. Additionally, we use estimates of fair market values to establish impairment reserves for permanently closed facilities that are held for sale. A significant change in these estimates and assumptions could have a material adverse impact on future operating results.

Reserves for Self-Insured Risks

We are self-insured for a significant portion of our workers' compensation, general and products liability, auto liability, health and property insurance. Under our current self-insurance programs, we are generally responsible for up to \$500,000 per claim for workers' compensation and automobile liability claims, up to \$1.5 million per claim for product liability and general liability claims and up to \$2.0 million per claim for property insurance claims including business interruption losses. We maintain excess liability insurance with outside insurance carriers to minimize our risks related to catastrophic claims. Under our current self-insurance program we are responsible for 100% of health insurance claims. Estimated insurance costs are accrued for incurred claims and claims incurred but not yet reported. Factors considered in estimating our insurance reserves are the nature of outstanding claims including the severity of the claims, estimated costs to settle existing claims, loss history, and inflation, as well as estimates provided by our outside insurance broker and carrier, and third party actuaries. A significant change in the factors described above could have a material adverse impact on future operating results.

Warranty Reserves

Our manufacturing operations provide the retail homebuyer with a twelve-month warranty. Estimated warranty costs are accrued as cost of sales at the time of sale. Our warranty

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reserve is based on estimates of the amounts necessary to settle existing and future claims on homes sold by the manufacturing operations as of the balance sheet date. Factors used to calculate the warranty obligation are the estimated number of homes still under warranty, including homes in retailer inventories and homes purchased by consumers still within the twelve-month warranty period, and the historical average costs incurred to service a home. A significant change in these factors could have a material adverse impact on future operating results.

Wholesale Repurchase Reserves

The majority of our manufacturing sales to independent retailers are made pursuant to repurchase agreements with the providers of floor plan financing. Potential losses under repurchase obligations are determined by calculating the difference between the repurchase price and the estimated net resale value of the homes. Probable losses under repurchase agreements are accrued based on the historical number of homes repurchased, the cost of such repurchases and the historical losses incurred as well as the current inventory levels held at our independent retailers. In addition, we monitor the risks associated with our independent retailers and consider these risks in our evaluation of the wholesale repurchase reserves. A significant change in any of these factors could have a material adverse impact on future operating results.

Impact of Recently Issued Accounting Pronouncements

In June 2002, the Financial Accounting Standards Board (FASB) issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities, which requires recognition of a liability for a cost associated with an exit or disposal activity when the liability is incurred rather than recognized at the date of an entity's commitment to an exit plan as previously required in accordance with Emerging Issues Task Force (EITF) Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). SFAS No. 146 also establishes that fair value is the objective for initial measurement of the liability. The provisions of SFAS No. 146 are effective for exit or disposal activities that are initiated after December 31, 2002. The adoption by the Company at the beginning of fiscal 2003 had no significant impact on the Company's financial statements for the six months ended June 28, 2003. In future periods, SFAS No. 146 may impact the manner in which the Company reports certain restructuring activities, including lease termination costs, employee severance and other exit activities. These charges will generally be recognized when the liability is incurred.

In December 2002, the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation-Transition and Disclosure-an amendment of FASB Statement No. 123, which provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, Statement No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The adoption by the Company of SFAS No. 148 in the first quarter of 2003 impacted interim disclosure requirements and requires the Company to choose among alternative implementation methods if the Company were to adopt SFAS No. 123 and change to the fair value method of accounting for stock-based compensation.

In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity, which requires that an issuer of certain types of financial instruments with characteristics of both liabilities and equity classify the financial instruments as liabilities. The following three types of financial instruments are required to be reported as liabilities by the issuer: (i) mandatorily redeemable instruments, (ii) forward purchase contracts, written put options, and other financial instruments in the form of shares that either obligate or may obligate the issuer to settle its obligations for cash or by transferring other assets, and (iii) certain financial instruments that include an obligation that (1) the issuer may or must settle by issuing a variable number of its equity shares and (2) has a monetary value at inception that (a) is fixed, (b) is tied to a market index or other benchmark or (c) varies inversely with the fair value of the equity shares. Historically, these types of instruments have been reported as liabilities, equity or between liabilities and equity. The provisions of SFAS No. 150 are effective for instruments entered into or modified after May 15, 2003 and pre-existing instruments as of the beginning of the Company's fiscal 2003 third quarter. The adoption of SFAS No. 150 by the Company in the third quarter of 2003 is expected to have no significant impact on the Company's financial statements.

Forward Looking Statements

Certain statements contained in this Report, including our plans and beliefs regarding availability of liquidity and financing, anticipated capital expenditures, outlook for the manufactured housing industry in particular and the economy in general, availability of wholesale and consumer financing and characterization of and our ability

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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 of June 28, 2003, we had long-term debt of \$290.7 million, floor plan payable of \$19.5 million and warehouse borrowings of a consolidated third party entity of \$10.0 million. 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 manufactured housing industry;

place us at a competitive disadvantage to competitors with less indebtedness; and

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

In addition, our 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 enable us 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 which could restrict our operations.

General industry conditions *As a result of the current downturn in the manufactured housing industry, we have experienced a decline in sales and incurred operating losses and costs for the closures or consolidations of existing operations, fixed asset impairment charges and goodwill impairment charges. If industry conditions do not improve, our sales could decline further and our operating results and cash flows could suffer.*

Since mid-1999 the manufactured housing industry has experienced declining manufacturing shipments, tightened consumer credit standards, excess retail locations and inventory, reduced availability of consumer financing, high levels of homes repossessed from consumers, higher interest rates on manufactured housing loans relative to those generally available to site-built homebuyers, a reduced number of consumer and floor plan lenders and reduced floor plan availability in the industry. Based on reports published by the Institute for Building Technology and Safety (formerly the National Conference of States on Building Codes and Standards), industry wholesale shipments of manufactured housing decreased 26% in the first half of 2003 versus 2002, 13% from 2001 to 2002 and 23% from 2000 to 2001. Based on data reported by Statistical Surveys, Inc. and other sources, we estimate that industry retail sales of new homes declined 20% for the first five months of 2003, 9% in 2002 versus 2001 and 25% from 2000 to 2001. In addition, we estimate approximately 4,500 retail locations, or approximately 50% of industry locations, and 160 manufacturing facilities, or approximately 47% of industry manufacturing facilities, have closed since mid-1999. Largely as a result of these industry conditions, since mid-1999 we have closed 34 homebuilding facilities in an attempt to return to profitability. Since June 2000, we have closed 239 retail sales locations. In 2000 through 2002 we reported net losses totaling \$431 million, including goodwill impairment charges totaling \$287 million, a valuation allowance of 100% of our deferred tax assets totaling \$102.3 million in 2002, and restructuring charges totaling \$55.3 million in 2002. In the first half of 2003, we reported a net loss of \$18.4 million. If the current downturn in the industry continues, our sales could decline further, our operating

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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 goodwill impairment charges.

Common stock and Senior Notes values *Our common stock price is currently depressed and may continue to be depressed, experience further decline in value or be highly volatile given current industry and economic conditions. Our Senior Notes are trading at discounts to face value and may continue to trade at discounts or further decline in value.*

Our Company's closing common stock price was \$27.38 on December 31, 1998, before the industry downturn began in mid-1999. The trading value per share of our stock has ranged from \$1.65 to \$12.85 during 2002 and the first half of 2003, and closed at \$4.11 on June 27, 2003. Additionally, our two issuances of Senior Notes continue to trade 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 our common stock and Senior Notes market prices in the future.

Fluctuations in operating results *The cyclical and seasonal nature of the manufactured housing market causes our revenues and operating results to fluctuate. We expect this fluctuation 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:

- 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 economic, demographic and seasonal factors, our revenues and operating results fluctuate, and we expect them to 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 *Tightened 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 or unavailable, 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 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 ABS market. As a result, consumer finance companies have curtailed their industry lending and some have exited the manufactured housing market. In October 2002 Conseco Finance Corp. (Conseco), one of the historically largest consumer lenders in the manufactured housing industry, discontinued providing financing for the industry and filed a petition for bankruptcy in December 2002. On March 14, 2003 the bankruptcy court approved the sale of Conseco's assets to CFN Investment Holdings LLC and a unit of General Electric Co. Additionally, in recent months the industry has seen an increasing number of traditional real estate mortgage lenders discontinue financing for manufactured housing or tighten terms as a result of, in part, increasing pressure from traditional buyers of those loans, primarily

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Fannie Mae and Freddie Mac. Fannie Mae has issued revised lending standards for manufactured houses, effective August 2003, which, among other things, increased interest rates, tightened terms and restricted eligibility requirements for buyers of manufactured houses. In addition, the revised standards defined new and tightened existing standards for appraisals of manufactured housing properties subject to such financing.

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

Floor plan financing availability *Reduced number of floor plan lenders and reduced amount of credit allowed to industry retailers may result in lower inventory levels and lower sales at our independent retailers and fewer sales centers, which could also affect our level of manufacturing shipments to these retailers. As a result, our sales could decline further and 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. The number of floor plan lenders and their lending limits affect the availability of wholesale financing to retailers. During the past five years several major national floor plan lenders have exited the industry or curtailed their floor plan operations while a smaller number of national lenders and a large number of local and regional banks have entered the market or expanded their floor plan operations. During 2002, the industry's two largest floor plan lenders, who recently provided as much as approximately 45% of the industry's wholesale financing, exited the business. At June 28, 2003, our independent retailers had approximately \$38 million of floor plan loans for Champion-built homes outstanding with these two national floor plan lenders. The remaining floor plan lenders or new floor plan lenders entering the industry may change the terms of their loans as compared to the traditional terms of industry floor plan loans. These changes could include higher interest rates, smaller advance rates, earlier or more significant principal payments or longer repurchase periods for the manufacturers. Therefore, industry retailers may be faced with tightened floor plan terms and weaker retailers may not qualify for floor plan financing at all. 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. Retail sales to consumers at our independent retailers could also be affected by reduced retail inventory levels or a reduced number of sales centers. As a result we could experience manufacturing sales declines 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 may 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 flow.*

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, 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 amount of any damage to the home and any missing appliances. We estimate our contingent repurchase obligation at June 28, 2003 was approximately \$265 million, before factoring in the resale value of the homes. As of June 28, 2003, our largest independent retailer, a nationwide retailer, had approximately \$22.6 million of inventory subject to repurchase for up to 30 months. As of June 28, 2003 our next 24 largest independent retailers had an aggregate of approximately \$49 million of inventory subject to repurchase, with individual amounts ranging from approximately \$0.8 million to \$5.4 million per retailer. During the first half of 2003, we paid \$3.4 million and incurred losses of \$0.6 million under repurchase agreements related to 94 homes. At June 28, 2003, our independent retailers had approximately \$11 million of floor plan loans for Champion-built homes under repurchase obligation with two national floor plan lenders who exited the industry in 2002. We may be required to honor some or all of our contingent repurchase obligations in the future, which would result in reduced cash flows and additional losses.

At June 28, 2003, we had contingent debt obligations related to surety bonds totaling \$35.8 million and letters of credit totaling \$62.2 million. At June 28, 2003, we also had guarantees by certain of our consolidated subsidiaries of \$5.7 million of debt of unconsolidated subsidiaries. In addition, at June 28, 2003, the Company was contingently liable for up to \$7.5 million under an unconditional guaranty of a consolidated third party special purpose entity's \$75 million warehouse facility used to support our finance company's operations. If we were required to fund a material amount of these contingent obligations, we would have reduced cash flows and could incur additional losses.

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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 2002, approximately 77% 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 one or more of our markets, sales in those markets could decline and our operating results and cash flows could suffer.

Effect on liquidity *Current industry conditions and our recent operating results have limited our sources of capital. If this situation does not improve and if we are unable to locate alternative sources of capital, we may be unable to expand or maintain our business.*

We depend on our cash balances, cash flows from operations, revolving credit facility, and floor plan facilities to finance our operating requirements, capital expenditures and other needs. The downturn in the manufactured housing industry, combined with our recent operating results and other changes, have decreased sources of financing and required us to collateralize a portion of our surety bond and insurance program needs.

If our cash balances, cash flows from operations, and availability under our revolving credit facility and floor plan facilities are insufficient to finance our operations and alternative capital is not available or if surety bonds become unavailable to us, we may not be able to expand our business or maintain our existing operations, or we may need to curtail or limit our existing operations.

As of June 28, 2003, we had surety bonds totaling \$20.8 million as collateral for our self-insurance program and \$15.0 million for general operating purposes. We are required to provide collateral in support of our surety bond programs, resulting in total collateral of \$27.7 million in letters of credit at June 28, 2003. If our current surety bond provider were to terminate these programs, we would seek alternative providers. The inability to retain our current 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.

Discontinuance of our consumer finance operation *We face risks of loss related to the discontinuance of our consumer finance operation, including risks associated with liquidation of existing finance loans, goodwill impairment charges, and other charges in connection with the exit of this segment.*

In July 2003, the Company decided to discontinue its consumer finance operation. We face risks of loss related to the discontinuance of this business. Total finance loans to be liquidated are projected to have a face value totaling an estimated \$10 to 12 million. Our decision to exit the finance segment may impact the proceeds we receive from the liquidation of the remaining finance loans or may cause us to bear a larger portion of the risk of loss on the financing agreements. Estimated charges in connection with the decision to exit the finance business include non-cash charges of approximately \$5 million, reflecting primarily the impairment of goodwill, and other charges totaling up to \$7 million.

Competition *The manufactured 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 manufactured housing industry is highly competitive at both the manufacturing and retail levels, with competition based upon several factors, including price, product features, reputation for service and quality, merchandising, terms of retailer promotional programs and the terms of consumer financing. Numerous companies produce manufactured homes in our markets. A number of our manufacturing competitors also have their own retail distribution systems and consumer finance operations. In addition, there are many independent manufactured 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 into 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

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in this environment, our retail sales and manufacturing shipments could be reduced. As a result, our growth could be limited, our sales could decline and our operating results and cash flows could suffer.

Recently, a well capitalized institutional investor purchased one of our major competitors, a vertically integrated company. It is not possible to estimate the impact of this transaction on us or the industry.

Zoning *If the manufactured 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 location 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.

Certain elements of our business strategy may not succeed *Our business strategy may not adequately address the issues currently facing our company and the manufactured housing industry or correctly identify future trends in the industry. Any failure of our business strategy could cause our sales to decline and our operating results and cash flows to suffer.*

Since mid-1999, retail sales and manufacturing shipments of new manufactured homes have decreased as a result of high consumer repossession levels, tightened consumer credit standards, excess retail locations and inventory, a reduced number of consumer lenders in the industry, higher interest rates on consumer loans and a reduced number of floor plan lenders in the industry. As a result, our sales have declined, we have experienced operating losses and we have closed a significant number of manufacturing facilities and retail sales centers. We are implementing strategies designed to address these issues. These strategies may not be successful because the reasons for the decline in demand or future trends in the industry may not be correctly identified, and our operating results may not improve. In addition, factors beyond our control, such as increased competition, reductions in consumer demand or continued economic downturn, may offset any improved operating results that are attributable to our strategy. Any failure of our business strategy could cause our sales to decline and our operating results and cash flows to suffer or cause us to incur additional and potentially substantial losses to close and liquidate operations or lines of business which are unsuccessful.

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

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

- incur additional indebtedness, contingent liabilities and liens;
- issue additional preferred stock;
- pay dividends or make other distributions on our common stock;
- redeem or repurchase common stock and redeem, repay or repurchase subordinated debt;
- make investments in subsidiaries that are not restricted subsidiaries;
- enter into joint ventures;
- use assets as security in other transactions;

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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.

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

The debt incurrence covenant in the indenture governing the Senior Notes due 2007 currently limits additional debt to: i) a working capital line of credit up to a borrowing base equal to 60% of otherwise unencumbered inventories and 75% of otherwise unencumbered accounts receivable; ii) warehouse financing meeting certain parameters up to \$200 million; iii) other debt up to \$30 million; and iv) ordinary course indebtedness and contingent obligations that includes non-speculative hedging obligations, floor plan financing, letters of credit, surety bonds, bankers acceptances, repurchase agreements related to retailer floor plan financing and guaranties of additional debt otherwise permitted to be incurred. The resulting effect at June 28, 2003, when combined with limits in our Senior Notes due 2009, was a working capital line of credit limit of approximately \$90 million of which no more than approximately \$85 million of cash borrowings could be secured debt.

We also have a \$15 million floor plan financing facility that contains a covenant requiring the maintenance of \$35 million of liquidity, as defined in the revolving credit facility, at each month end. If we were to be out of compliance with this covenant, the lender could terminate the credit line and cause the debt to become immediately due and payable. As of June 28, 2003, we had approximately \$13.7 million outstanding under this facility and we were in compliance with the covenant.

In January 2003, we finalized a committed three-year, \$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 the Company, only in the event that its liquidity, as defined, falls below \$35 million, to maintain certain levels of EBITDA and certain ratios of EBITDA to fixed charges, as defined in the agreement. 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. As of June 28, 2003, \$61.9 million of letters of credit and \$7.0 million of borrowings were outstanding on this line and the Company was in compliance with all applicable covenants. However, had the financial covenants been applicable as of the end of the quarter, the Company would not have been in compliance.

Potential Dilution *Outstanding preferred stock that is convertible into common stock and redeemable for common stock (and in some cases, at the Company's option, for cash), a warrant to acquire common stock and a deferred purchase price obligation that is payable, at the Company's option, in cash or common stock, could result in potential dilution and impair the price of our common stock.*

At June 28, 2003, there was \$5 million of Series B-1 cumulative convertible preferred stock outstanding which is convertible into common stock at a rate of \$13.85 per share. The preferred shareholder has the right, through March 29, 2004, to redeem this preferred stock for common stock at the then common stock price, subject to a floor price of \$5.66 per share. We have the mandatory obligation to redeem any remaining outstanding Series B-1 preferred stock on March 29, 2004, for cash or common stock, at our option. The preferred shareholder has the right until December 31, 2004 to purchase an additional \$12 million of Series B preferred stock. From July 3, 2003 until its maturity on July 3, 2008, the holder will have the right to redeem the additional \$12 million of Series B preferred stock in common stock at the then market price or in cash at our option. The conversion rate for any future issuance of this preferred stock would be 120% of the market value of the common stock at the time of purchase (subject to certain limitations) but could not be less than \$7.50 per share.

At June 28, 2003 there was \$8.75 million of Series C preferred stock outstanding which is convertible into common stock at a rate of \$5.66 per share. Commencing March 29, 2004, the preferred shareholder has the right to redeem this preferred stock for common stock, and, at our option, partially for cash.

We pay a quarterly dividend on the preferred stock at a rate of 5% per annum. The dividend is payable in cash or shares of our common stock, at our option. The number of shares issuable in payment of these dividends depends on the market value of the common stock at the time of issuance (subject to certain limitations). As a result,

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assuming we elected to pay any dividend in shares of common stock, the preferred shareholder would receive a greater number of shares of common stock in payment of those dividends if our common stock price decreases.

At June 28, 2003 we had a warrant outstanding which was exercisable based on approximately 2.2 million shares of common stock at a strike price of \$10.77 per share. Beginning on April 2, 2003, the warrant strike price began to increase annually by \$0.75 per share. The warrant expires on April 2, 2009. The warrant is exercisable only on a non-cash, net basis, whereby the warrant holder would receive shares of common stock as payment for the net gain upon exercise.

As of June 28, 2003, we had outstanding \$14 million of a deferred purchase price obligation which is payable in quarterly installments of \$2 million through January 3, 2005. Quarterly installments may be made in cash or shares of common stock, at our option. The number of shares to be issued in any quarterly payment depends on the availability of registered shares of common stock and the market value of the common stock at the time of issuance. As a result, assuming we elected to pay any quarterly installment in shares of common stock, the recipients would receive a greater number of shares of common stock in payment of those installments if our common stock price decreases. In January and April 2003, we issued 970,000 shares of common stock and paid \$1.4 million in cash as payment for the quarterly installments then due and in July 2003, we issued 470,000 shares of common stock for that quarterly installment.

To the extent that the preferred shareholder elects to convert the preferred stock into common stock or redeem the preferred stock for common stock or we elect to make preferred dividend payments or the deferred purchase price obligation payments in common stock, our then existing common shareholders would experience dilution in their percentage ownership interests. If the remaining \$8.75 million of outstanding Series C preferred stock were converted at its conversion price of \$5.66 per share, the remaining \$5 million of Series B-1 preferred stock were redeemed at its current redemption floor of \$5.66 per share, the \$12 million of additional Series B preferred stock were assumed to be issued and converted at 120% of the June 27, 2003 market price, at a minimum of \$7.50 per share, and the remaining \$12 million deferred purchase price obligation were assumed to be paid in common stock using the June 27, 2003 market price, together with the 470,000 shares of common stock that were issued in July 2003 for deferred purchase price payments, dilution of approximately 11.6% would occur based on the number of shares of common stock outstanding on June 28, 2003.

The additional shares of common stock that could be available for sale upon conversion or redemption of the preferred stock, as dividends on the preferred stock or in payment of the deferred purchase price obligation 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 preferred shareholder or the recipients of the deferred purchase price payments, 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, the terms of which may result in additional potential dilution.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk.

The Company's floor plan borrowings, obligations under industrial revenue bonds and borrowings under the warehouse facility are subject to variable rates of interest based on the U.S. prime interest rate, short-term tax exempt rate indices and LIBOR, respectively. Without consideration of the minimum rate of interest on certain of the floor plan borrowings, a 100 basis point increase in the underlying interest rates would result in additional annual interest cost of approximately \$0.5 million, assuming average related debt of \$47.6 million, the amount of outstanding borrowings at June 28, 2003.

Item 4. Controls and Procedures.

Within the 90 days prior to the date of this report, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including its Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Rule 13a-15 of the Securities Exchange Act of 1934. Based upon that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective to cause material information required to be disclosed by the Company in the reports that it files or submits 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. There have been no significant changes in the Company's internal controls or in other factors which could significantly affect internal controls subsequent to the date the Company carried out its evaluation.

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Item 2. Changes in Securities and Use of Proceeds.

On January 2, 2003, April 1, 2003 and July 1, 2003 the Company issued 641,613 shares, 328,405 shares and 469,695 shares of its common stock, respectively, in connection with the \$2.0 million quarterly installment payments under convertible promissory notes issued June 21, 2001. These notes represent a deferred purchase price obligation of the Company. During the quarter ended March 29, 2003, the Company issued 2,868,794 shares of its common stock to the holder of the Company's Series C cumulative convertible preferred stock in conversion of \$16.25 million of such preferred stock. 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 4. Submission of Matters to a Vote of Security Holders.

On April 29, 2003 the Registrant held its 2003 Annual Meeting of Shareholders at which the following matters were submitted to a vote of security holders with results as follows:

1. Election of Directors

<u>Nominee</u>	<u>Votes For</u>	<u>Votes Withheld</u>
Robert W. Anestis	45,676,900	2,339,614
Eric S. Belsky	45,677,920	2,338,594
Selwyn Isakow	45,676,620	2,339,894
Brian D. Jellison	45,677,525	2,338,989
G. Michael Lynch	45,675,845	2,340,669
George R. Mrkonic	45,656,960	2,359,554
Walter R. Young	45,624,305	2,392,209

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

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

<u>Exhibit No</u>	<u>Description</u>
31.1	Certification of Chief Executive Officer of Registrant, dated August 11, 2003, relating to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 28, 2003.
31.2	Certification of Chief Financial Officer of Registrant, dated August 11, 2003, relating to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 28, 2003.
32.1	Certification of Chief Executive Officer and Chief Financial Officer of Registrant, dated August 11, 2003, 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 June 28, 2003.

(b) Current reports on Form 8-K

- 1) April 16, 2003. Press release filed under Item 5 announcing Champion Enterprises, Inc. first quarter 2003 results with condensed consolidated financial information.

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- 2) April 16, 2003. Champion Enterprises filed under Item 5 that it entered into the Amended and Restated Receivables Purchase Agreement by and among GSS HomePride Corp., HomePride Finance Corp., The CIT Group/Sales Financing, Inc., Greenwich Funding Corp, the financial institutions named therein, and Credit Suisse First Boston, New York Branch.
- 3) June 12, 2003. Press release filed under Item 5 announcing the resignation of Abdul H. Rajput, President of HomePride Finance Corp.

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- 4) June 30, 2003. Press release filed under Item 5 announcing that Albert A. Koch was to be named Chairman of the Board and interim president and Chief Executive Officer of the Company.
- 5) July 3, 2003. Champion Enterprises filed under Item 5 that it entered into a letter agreement with AP Services, LLC pursuant to which AP Services will provide interim management services to the Company. On June 30, 2003, the Company also entered into a letter agreement with AlixPartners, LLC pursuant to which AlixPartners would provide financial and operational consulting services to the Company.
- 6) July 16, 2003. Press release filed under Item 5 announcing Champion Enterprises, Inc. second quarter 2003 results with condensed consolidated financial information.
- 7) July 21, 2003. Press release filed under Item 5 announcing that Philip Surles was retiring as Chief Operating Officer of the Company and that the Chief Operating Officer position at the Company will be eliminated effective with Mr. Surles' retirement.
- 8) July 31, 2003. Press release filed under Item 5 announcing that the Company has discontinued operations at HomePride Finance Corp., its manufactured housing loan origination business.

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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: August 11, 2003

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