CHAMPION ENTERPRISES INC
Form 10-Q
November 05, 2008

Table of Contents

FORM 10-Q
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

(Mark one)

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

For Quarterly period ended September 27, 2008

OR

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

For the transition period from __________ to __________

Commission file number 1-9751
CHAMPION ENTERPRISES, INC.
(Exact name of registrant as specified in its charter)

Michigan	38-2743168
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

755 W. Big Beaver Rd., Suite 1000,
Troy, MI 48084
(Address of principal executive offices)

Registrant s telephone number, including area code: (248) 614-8200

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 þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No þ

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

77,786,706 shares of the registrant s $1.00 par value Common Stock were outstanding as of October 30, 2008.

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION
- Item 1. Financial Statements
- Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations
- Item 3. Quantitative and Qualitative Disclosures About Market Risk
- Item 4. Controls and Procedures

PART II. OTHER INFORMATION
- Item 1A. Risk Factors.
- Item 6. Exhibits and Reports on Form 8-K

SIGNATURES
EX-31.1
EX-31.2
EX-32.1

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

CHAMPION ENTERPRISES, INC.

Condensed Consolidated Statements of Operations

(In thousands, except per share amounts)

	Unaudited Three Months Ended		Unaudited Nine Months Ended	
	September 27, 2008	September 29, 2007	September 27, 2008	September 29, 2007
Net sales	$ 259,450	$ 357,698	$ 845,332	$ 947,855
Cost of sales	228,373	296,802	735,225	803,074
Gross margin	31,077	60,896	110,107	144,781
Selling, general and administrative expenses	32,635	40,082	104,953	112,608
Restructuring charges			9,471	1,121
Foreign currency transaction losses	76		1,851	
Amortization of intangible assets	2,346	1,454	7,197	4,273
Operating (loss) income	(3,980)	19,360	(13,365)	26,779
Interest income	751	1,298	3,115	3,345
Interest expense	(4,848)	(5,151)	(15,174)	(14,961)
(Loss) income before income taxes	(8,077)	15,507	(25,424)	15,163
Income tax expense	153,444	2,582	153,231	2,019
Net (loss) income	$ (161,521)	$ 12,925	$ (178,655)	$ 13,144
Basic (loss) income per share	$ (2.08)	$ 0.17	$ (2.30)	$ 0.17
Weighted shares for basic EPS	77,794	77,062	77,668	76,804
Diluted (loss) income per share	$ (2.08)	$ 0.17	$ (2.30)	$ 0.17
Weighted shares for diluted EPS	77,794	77,848	77,668	77,616

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

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

	Unaudited September 27, 2008	December 29, 2007
ASSETS		
Current assets		
Cash and cash equivalents	$ 92,760	$ 135,408
Short-term investments	6,950	
Accounts receivable, trade	71,537	89,646
Inventories	71,059	90,782
Deferred tax assets	654	29,746
Other current assets	7,166	14,827
Total current assets	250,126	360,409
Property, plant and equipment		
Land and improvements	30,710	30,970
Buildings and improvements	118,812	129,002
Machinery and equipment	90,152	89,742
	239,674	249,714
Less-accumulated depreciation	133,889	132,730
	105,785	116,984
Goodwill	337,249	360,610
Amortizable intangible assets, net of accumulated amortization	81,473	72,541
Deferred tax assets		87,983
Other non-current assets	21,118	23,696
	$ 795,751	$ 1,022,223
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities		
Short-term portion of debt	$ 43,716	$ 25,884
Accounts payable	111,707	119,390
Accrued volume rebates	20,631	29,404
Accrued warranty obligations	23,223	29,246
Accrued compensation and payroll taxes	18,038	25,168
Accrued self-insurance	24,583	27,539
Other current liabilities	30,907	61,695
Total current liabilities	272,805	318,326
Long-term liabilities		

Long-term debt	319,364	342,897
Deferred tax liabilities	37,852	7,065
Other long-term liabilities	33,868	34,089
	391,084	384,051
Contingent liabilities (Note 7)		
Shareholders equity		
Common stock, $1 par value, 120,000 shares authorized, 77,794 and 77,346 shares issued and outstanding, respectively	77,794	77,346
Capital in excess of par value	202,505	203,708
Accumulated other comprehensive income	6,581	15,155
Retained earnings (accumulated deficit)	(155,018)	23,637
Total shareholders equity	131,862	319,846
	$ 795,751	$ 1,022,223

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

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

	Unaudited Nine Months Ended	
	September 27, 2008	September 29, 2007
Cash flows from operating activities:		
Net (loss) income	$ (178,655)	$ 13,144
Adjustments to reconcile net (loss) income to net cash (used for) provided by operating activities:		
Depreciation and amortization	17,540	15,036
Stock-based compensation	346	2,235
Change in deferred taxes	144,526	(4,420)
Fixed asset impairment charges	7,000	245
Insurance proceeds	5,791	
Compensation portion of earn-out payment	(5,884)	
Gain on disposal of fixed assets	(235)	(633)
Foreign currency transaction losses	1,851	
Increase/decrease:		
Accounts receivable	14,587	(53,107)
Inventories	19,861	20,979
Accounts payable	(2,649)	53,114
Accrued liabilities	(37,428)	(9,047)
Other, net	768	(2,407)
Net cash (used for) provided by operating activities	(12,581)	35,139
Cash flows from investing activities:		
Proceeds on disposal of fixed assets	2,850	3,640
Purchase of short-term investments	(10,000)	
Redemption of short-term investments	3,050	
Additions to property, plant and equipment	(11,421)	(5,494)
Distributions from unconsolidated affiliates		884
Acquisitions and related payments	(8,892)	
Net cash used for investing activities	(24,413)	(970)
Cash flows from financing activities:		
Payments on debt	(27,107)	(1,577)
Proceeds from revolver debt	25,000	
Decrease in restricted cash		15
Common stock issued, net	437	2,294

Net cash (used for) provided by financing activities	(1,670)	732
Cash provided by discontinued operations	93	285
Effect of exchange rate changes on cash and cash equivalents	(4,077)	5,888
Net (decrease) increase in cash and cash equivalents	(42,648)	41,074
Cash and cash equivalents at beginning of period	135,408	70,208
Cash and cash equivalents at end of period	$ 92,760	$ 111,282

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

CHAMPION ENTERPRISES, INC.
Condensed Consolidated Statement of Shareholders Equity
Unaudited Nine Months Ended September 27, 2008
(In thousands)

	Common stock		Capital in excess of	Retained earnings (Accumulated	Accumulated other comprehensive income	
	Shares	Amount	par value	deficit)	(loss)	Total
Balance at December 29, 2007	77,346	$77,346	$203,708	$ 23,637	$ 15,155	$ 319,846
Net loss				(178,655)		(178,655)
Stock compensation plans	448	448	(1,203)			(755)
Foreign currency translation adjustments					(12,872)	(12,872)
Net investment hedge, net of income taxes					4,298	4,298
Balance at September 27, 2008	77,794	$77,794	$202,505	$(155,018)	$ 6,581	$ 131,862

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

CHAMPION ENTERPRISES, INC.
Notes to Condensed Consolidated Financial Statements
(Unaudited)

NOTE 1 Summary of Significant Accounting Policies

The Condensed Consolidated Financial Statements are unaudited, but in the opinion of management include all adjustments necessary for a fair statement of the results of the interim periods. All such adjustments are of a normal recurring nature, except for the provision during the quarter ended September 27, 2008, of a valuation allowance for 100% of the Company s U.S. deferred tax assets which resulted in recording income tax expense of $150.8 million. See additional discussion in Note 3. Financial results of the interim periods are not necessarily indicative of results that may be expected for any other interim period or for the fiscal year. The balance sheet as of December 29, 2007 was derived from audited financial statements but does not include all disclosures required by accounting principles generally accepted in the United States.

For a description of significant accounting policies used by Champion Enterprises, Inc. (Champion or 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 29, 2007.

The Company operates in three segments. The North American manufacturing segment (the manufacturing segment) consists of 28 manufacturing facilities as of September 27, 2008 that primarily construct factory-built manufactured and modular houses throughout the U.S. and in western Canada. The international manufacturing segment (the international segment) consists of five facilities currently operated by Caledonian Building Systems Limited (Caledonian) and a subsidiary in the United Kingdom, that manufacture steel-framed modular buildings for prisons, military accommodations, hotels, residential units and other commercial applications. The retail segment currently operates 14 retail sales offices that sell manufactured houses to consumers throughout California.

NOTE 2 Acquisitions

The Company made one acquisition during 2007 and one acquisition during the first quarter of 2008. Results of operations for these acquisitions are included in the Company s consolidated results for periods subsequent to their respective acquisition dates.

On February 29, 2008, the Company acquired 100% of the capital stock of United Kingdom based ModularUK Building Systems Limited (ModularUK) for a nominal initial cash payment and the assumption of approximately $4.2 million of debt, resulting in intangible assets totaling approximately $3.9 million. The results of operations of ModularUK are included in the Company s results from operations and in its international segment for periods subsequent to its acquisition date.

On December 21, 2007, the Company acquired substantially all of the assets and the business of western Canada-based SRI Homes Inc. (SRI) for cash payments of approximately $96.2 million, a note payable of $24.0 million (CAD) ($24.5 million USD at acquisition date) and assumption of the operating liabilities of the business. The results of operations of SRI are included in the Company s results from operations and in its manufacturing segment for periods subsequent to its acquisition date. The following is a summary of amortizable intangible assets and goodwill arising from the SRI acquisition, together with amortization periods and initial amortization expense, translated at the exchange rate on the acquisition date.

	Cost (In thousands)	Expected useful life (In years)	Initial annual amortization (In thousands)
Goodwill	$ 47,607		
Amortizable intangible assets:			

Customer relationships	$	42,330	14	$	3,024
Trade names		6,955	15		464
Employee agreements		302	3		101
Favorable leases		493	1		493
	$	50,080		$	4,082

ModularUK is not material to the Company. The following table presents unaudited proforma combined results as if the Company had acquired SRI on January 1, 2007, instead of the actual acquisition date of December 21, 2007:

	Three Months Ended September 29, 2007 Unaudited	Nine Months Ended September 29, 2007 Unaudited
Net sales (in thousands)	$ 383,567	$ 1,022,427
Net income (in thousands)	15,333	19,331
Diluted income per share	$ 0.20	$ 0.25

The proforma results include amortization of amortizable intangible assets acquired and valued in the SRI acquisition. The proforma results are not necessarily indicative of what actually would have occurred if the SRI acquisition had been completed as of the beginning of the periods presented nor are they necessarily indicative of future consolidated results. For more detail on the SRI acquisition, please refer to Note 2 of Notes to Consolidated Financial Statements in the Company s Annual Report on Form 10-K for the year ended December 29, 2007.

NOTE 3 Income Taxes

During the quarter ended September 27, 2008, the Company provided a valuation allowance for 100% of its U.S. deferred tax assets. SFAS No. 109 Accounting for Income Taxes, 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. SFAS No. 109 further states forming a conclusion that a valuation allowance is not needed is difficult when there is negative evidence such as cumulative losses in recent years, and places considerably more weight on historical results and less weight on future projections. Although the Company had U.S. pretax income in 2005 and 2006 totaling approximately $71 million, it expects to have cumulative U.S. pretax losses exceeding $60 million for the years 2006 through 2008. Current conditions in the housing and credit markets and the general economy in the U.S. continue to present significant challenges to returning the Company s U.S. operations to profitability. In the absence of specific favorable factors, application of SFAS No. 109 requires a valuation allowance for deferred tax assets in a tax jurisdiction when a company has cumulative financial accounting losses over several years. Accordingly, after consideration of these factors, the Company recorded a non-cash tax charge of approximately $150.8 million to provide a valuation allowance for 100% of its U.S. deferred tax assets.

The tax provisions for the three and nine months ended September 27, 2008, also included foreign income tax expense of $2.6 million and $10.0 million, respectively related to the Company s operations in Canada and the United Kingdom.

During periods when the Company has a valuation allowance for 100% of its U.S. deferred tax assets, the Company s income tax provisions will be comprised of income taxes on results of its foreign operations and no tax provision or benefit for its U.S. results except for state income taxes payable in cash and a deferred tax expense related to amortization of certain goodwill for tax purposes.

The primary difference between the effective tax rate for the three and nine months ended September 29, 2007 and the 35% U.S. federal statutory rate related to the use of an annual estimated effective global tax rate of 18.8% and the inclusion of certain non-recurring items. The income tax provision for the three and nine months ended September 29, 2007, included a $0.6 million tax benefit for the effect on deferred tax liabilities of a UK income tax rate reduction that became effective April 1, 2008, and a $0.2 million tax expense for certain differences between the filed U.S. federal tax return and the U.S. tax provision for 2006. The income tax provision for the nine months ended September 29, 2007, also included a $0.5 million tax benefit from the settlement of a tax uncertainty during the period. As a result of these items, the effective income tax rates for the three and nine months ended September 29, 2007, were 16.7% and 13.3%, respectively. The annual estimated effective global tax rate for 2007, excluding effects of non-recurring items, was determined after consideration of both the estimated annual pretax results and the related statutory tax rates for the three countries and the various states in which the Company operates.

As of December 29, 2007, the Company had available U.S. federal net operating loss carryforwards of approximately $233 million for tax purposes to offset certain future federal taxable income. These loss carryforwards expire in 2023 through 2027. As of December 29, 2007, the Company had available state net operating loss carryforwards of approximately $211 million for tax purposes to offset future state taxable income. These loss carryforwards expire in 2016 through 2027.

The Company and its subsidiaries are subject to income taxes in the U.S. federal jurisdiction and various state and foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state and foreign tax examinations by tax authorities for years prior to 2003.

Included in the balance sheet at September 27, 2008 and December 29, 2007 are tax accruals of approximately $0.5 million and $0.6 million, respectively, for uncertain tax positions, including $0.2 million of accrued interest and penalties. Realization of any of the related unrecognized tax benefits would result in recording a tax benefit. The Company classifies interest and penalties as a component of income tax expense.

NOTE 4 Inventories, Long-Term Construction Contracts and Other Current Liabilities

Table of Contents

A summary of inventories by component is as follows:

	September 27, 2008	December 29, 2007
	(In thousands)	
New manufactured homes	**$ 18,102**	$ 20,235
Raw materials	**32,084**	38,725
Work-in-process	**8,040**	8,617
Other inventory	**12,833**	23,205
Total inventory	**$ 71,059**	$ 90,782

Other inventory consists of payments made by the retail segment for rights to park spaces in manufactured housing communities and related improvements.

Accounts receivable-trade at September 27, 2008 and December 29, 2007 included uncollected billings of $3.2 million and $22.4 million, respectively, and unbilled revenue of $32.6 million and $37.2 million, respectively, under long-term construction contracts of the Company s international segment. Unbilled revenue at September 27, 2008 and December 29, 2007 includes retention amounts totaling $5.7 million and $2.8 million, respectively. Other current liabilities at September 27, 2008 and December 29, 2007 include cash receipts in excess of revenue recognized under these construction contacts of $5.7 million and $9.2 million, respectively and also includes customer deposits of $6.5 million and $9.7 million, respectively, primarily in the manufacturing segment.

NOTE 5 Product Warranty

The Company s manufacturing segment generally provides the retail homebuyer or the builder/developer with a twelve-month warranty from the date of purchase. Estimated warranty costs are accrued as cost of sales primarily at the time of the manufacturing sale. Warranty provisions and reserves are based on estimates of the amounts necessary to settle existing and future claims for homes sold by the manufacturing operations as of the balance sheet date. The non-current portion of warranty reserves were classified as other long-term liabilities in the condensed consolidated balance sheets. The following table summarizes the changes in accrued product warranty obligations during the nine months ended September 27, 2008 and September 29, 2007.

	Nine Months Ended	
	September 27, 2008	September 29, 2007
	(In thousands)	
Reserves at beginning of period	**$ 35,746**	$ 36,923
Warranty expense provided	**22,603**	30,926
Reserve adjustment for closed plants		(600)
Cash warranty payments	**(28,626)**	(33,010)
Reserves at end of period	**29,723**	34,239
Less non-current portion	**(6,500)**	(6,500)
Total	**$ 23,223**	$ 27,739

NOTE 6 Debt

Long-term debt consisted of the following:

	September 27, 2008	December 29, 2007
	(In thousands)	
Convertible Senior Notes due 2037	**$ 180,000**	$ 180,000
Sterling Term Loan due 2012	**80,946**	88,386
Term Loan due 2012	**55,750**	55,750
Revolving line of credit	**25,000**	
Obligations under industrial revenue bonds	**12,430**	12,430
7.625% Senior Notes due May 2009	**6,716**	6,716
Other debt	**2,238**	971
Total	**363,080**	344,253
Less: current portion of long-term debt	**(43,716)**	(1,356)
Long-term debt	**$ 319,364**	$ 342,897

The Company has a senior secured credit agreement (the Credit Agreement) with various financial institutions under which the Sterling Term Loan and the Term Loan were issued. The Sterling Term Loan is denominated in pounds Sterling. The Credit Agreement also provides the Company with a revolving line of credit (Revolver) in the amount of $40 million and a $60 million letter of credit facility. During the quarter ended September 27, 2008, the Company borrowed $25.0 million on the Revolver. The Credit Agreement is secured by a first security interest in substantially all of the assets of the domestic operating subsidiaries of the Company. As of September 27, 2008, letters of credit issued under the facility totaled $55.7 million. The maturity date for the revolving line of credit is October 31, 2010. The maturity date for each of the Term Loan, the Sterling Term Loan and the letter of credit facility is October 31, 2012. The Credit Agreement also contains affirmative and negative covenants requiring certain maximum senior leverage ratio, minimum interest coverage ratio and minimum fixed charge ratio, all as defined in the Credit Agreement.

The interest rate for borrowings under the Term Loan was a LIBOR based rate of 2.47% at September 27, 2008 plus 3.25%. The interest rate for borrowings under the Sterling Term Loan was a U.K. LIBOR based rate of 5.36% at September 27, 2008 plus 3.25%. The interest rate for borrowings under the Revolver was a U.S. prime based rate of 5.00% at September 27, 2008 plus 2.25%. As of September 27, 2008, the letter of credit facility was subject to a 3.35% annual fee and the unused portion of the Revolver was subject to an annual fee of 0.75%.

As of June 28, 2008, the Company was in compliance with all Credit Agreement covenants. However, as a result of deteriorating operating results throughout 2008, including the third quarter, the Company would not have been in compliance with certain of its debt covenants as of September 27, 2008. During October 2008, an amendment to the Credit Agreement (the Amendment) was completed. The Amendment covers the period from September 27, 2008 through January 2, 2010 (the Company s 2009 fiscal year end) and provides for, among other things, changes to certain covenants in exchange for certain repayments and prepayments, as well as revised pricing.

During the period covered by the Amendment, the maximum senior leverage ratio, minimum interest coverage ratio and minimum fixed charge ratio covenants have been eliminated in exchange for new covenants requiring minimum quarter-end liquidity and minimum twelve-month EBITDA. Pursuant to the Amendment, in October 2008 the Company repaid $10.0 million of the Revolver loan and prepaid $13.1 million and $10.4 million of borrowings under the Sterling Term Loan and the Term Loan, respectively. During the Amendment period, the interest rates for borrowings under the Sterling Term Loan, the Term Loan and the Revolver were increased to LIBOR plus 6.5%, with a LIBOR floor for the Term Loan of 3.25%. Interest of LIBOR plus 5.0% is payable in cash and payment of the remaining interest of 1.5% may be paid in kind (deferred and added to the respective loan balances). In addition, the Amendment revised the letter of credit facility annual fee to 6.6%, of which 1.5% may be paid in kind.

The Amendment provides for interest rate reductions on all remaining borrowings under the Credit Agreement and a reduction of fees for the letter of credit facility if the Company makes additional term loan prepayments during the Amendment period. For aggregate prepayments between $10 and $20 million the interest rate will be reduced to LIBOR plus 5.5% (of which 0.5% percent may be paid in kind); for aggregate prepayments between $20 and $30 million the interest rate will be reduced to LIBOR plus 5.0%; and for aggregate prepayments of $30 million or more the interest rate will be reduced to LIBOR plus 4.5%. Those respective aggregate prepayments will result in reducing the letter of credit annual fee to 5.6%, 5.1% and 4.6%, respectively.

The Amendment also reduced the letter of credit facility by $16.5 million by canceling approximately $4.3 million of unused capacity and moving approximately $12.2 million of outstanding undrawn letters of credit to the Revolver. As a result, while the total size of the Company s Revolver remains at $40 million, its unused capacity now stands at approximately $12.8 million.

The Amendment requires quarterly principal payments for the Term Loan and the Sterling Term Loan totaling $5.0 million for 2009. Thereafter the Credit Agreement requires quarterly principal payments for the Term Loan and the Sterling Term Loan totaling approximately $1.4 million annually.

The following table summarizes the maximum Senior Leverage Ratio, minimum Interest Coverage Ratio and minimum Fixed Charge Ratio that the Company is required to maintain under the Credit Agreement for periods after January 2, 2010:

Fiscal Quarter	Maximum Senior Leverage Ratio	Minimum Interest Coverage Ratio	Minimum Fixed Charge Ratio
First quarter of 2010 Third quarter of 2010	2.75:1	2.50:1	1.25:1
Fourth quarter of 2010 Third quarter of 2011	2.50:1	2.75:1	1.25:1
Fourth quarter of 2011 Second quarter of 2012	2.25:1	3.00:1	1.25:1