CHAMPION INDUSTRIES INC
Form 10-Q
June 02, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

**FORM 10-Q**

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

For the quarterly period ended April 30, 2006

OR

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

For the transition period from _____to_____

Commission File No. 0-21084

**Champion Industries, Inc.**
(Exact name of Registrant as specified in its charter)

| West Virginia | 55-0717455 |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

2450-90 1st Avenue
P.O. Box 2968
Huntington, WV 25728
(Address of principal executive offices)
(Zip Code)

(304) 528-2700
(Registrant's telephone number, including area code)

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 ü No _____.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

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

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

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

| Class | Outstanding at April 30, 2006 |
|---|---|
| Common stock, $1.00 par value per share | 9,745,913 shares |

**Champion Industries, Inc.**

**INDEX**


| | Page No. |
|---|---|
| Part I. Financial Information | |
| Item 1. Financial Statements | |
| Consolidated Balance Sheets (Unaudited) | 3 |
| Consolidated Statements of Operations (Unaudited) | 5 |
| Consolidated Statements of Cash Flows (Unaudited) | 6 |
| Notes to Consolidated Financial Statements | 7 |
| Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations | 14 |
| Item 3. Quantitative and Qualitative Disclosure About Market Risk | 19 |
| Item 4. Controls and Procedures | 19 |
| Part II. Other Information | |
| Item 4. Submission of Matters to a Vote of Security Holders | 20 |
| Item 6. Exhibits | 20 |
| Signatures | 21 |

## PART I - FINANCIAL INFORMATION

### Item 1. Financial Statements

**Champion Industries, Inc. and Subsidiaries**
**Consolidated Balance Sheets**

| **ASSETS** | **April 30, 2006 (Unaudited)** | **October 31, 2005 (Audited)** |
|---|---|---|
| Current assets: | | |
| Cash and cash equivalents | **$ 1,699,245** | $ 3,661,622 |
| Accounts receivable, net of allowance of $1,353,000 and $1,410,000 | **22,451,112** | 19,300,453 |
| Inventories | **10,625,183** | 11,079,726 |
| Other current assets | **1,047,848** | 629,381 |
| Deferred income tax assets | **1,168,526** | 1,168,526 |
| Total current assets | **36,991,914** | 35,839,708 |
| | | |
| Property and equipment, at cost: | | |
| Land | **2,023,375** | 2,006,375 |
| Buildings and improvements | **8,464,316** | 8,368,720 |
| Machinery and equipment | **44,822,232** | 43,668,900 |
| Equipment under capital leases | **-** | 426,732 |
| Furniture and fixtures | **3,560,895** | 3,492,535 |
| Vehicles | **3,460,446** | 3,629,268 |
| | **62,331,264** | 61,592,530 |
| Less accumulated depreciation | **(44,486,614)** | (42,894,910 ) |
| | **17,844,650** | 18,697,620 |
| | | |
| Cash surrender value of officers' life insurance | **1,117,484** | 1,117,484 |
| Goodwill | **2,060,786** | 2,060,786 |
| Other intangibles, net of accumulated amortization | **3,516,799** | 3,697,368 |
| Other assets | **282,940** | 232,204 |
| | **6,978,009** | 7,107,842 |
| Total assets | **$ 61,814,573** | $ 61,645,170 |

See notes to consolidated financial statements.

**Champion Industries, Inc. and Subsidiaries**
**Consolidated Balance Sheets (continued)**

| LIABILITIES AND SHAREHOLDERS' EQUITY | April 30, 2006 (Unaudited) | October 31, 2005 (Audited) |
|---|---|---|
| Current liabilities: | | |
| Accounts payable | **$ 3,694,822** | $ 3,584,323 |
| Accrued payroll | **1,502,254** | 1,714,078 |
| Taxes accrued and withheld | **1,459,248** | 1,106,910 |
| Accrued income taxes | **785,595** | 681,763 |
| Accrued expenses | **1,104,254** | 987,228 |
| Current portion of long-term debt: | | |
| Notes payable | **1,743,974** | 1,667,797 |
| Capital lease obligations | **-** | 16,483 |
| Total current liabilities | **10,290,147** | 9,758,582 |
| | | |
| Long-term debt, net of current portion: | | |
| Notes payable, line of credit | **1,024,000** | 1,612,000 |
| Notes payable, term | **3,895,686** | 5,148,503 |
| Other liabilities | **388,665** | 388,930 |
| Deferred income tax liabilities | **3,714,351** | 3,984,934 |
| Total liabilities | **19,312,849** | 20,892,949 |
| Shareholders' equity: | | |
| Common stock, $1 par value, 20,000,000 shares authorized; 9,745,913 shares issued and outstanding | **9,745,913** | 9,745,913 |
| Additional paid-in capital | **22,297,670** | 22,297,670 |
| Retained earnings | **10,458,141** | 8,708,638 |
| Total shareholders' equity | **42,501,724** | 40,752,221 |
| Total liabilities and shareholders' equity | **$ 61,814,573** | $ 61,645,170 |

See notes to consolidated financial statements.

**Champion Industries, Inc. and Subsidiaries**
**Consolidated Statements of Operations**
(Unaudited)

| | Three Months Ended April 30, | | Six Months Ended April 30, | |
|---|---|---|---|---|
| | **2006** | **2005** | **2006** | **2005** |
| Revenues: | | | | |
| Printing | **$ 27,841,677** | **$ 24,384,970** | **$ 54,007,326** | **$ 48,821,591** |
| Office products and office furniture | **9,578,892** | **9,167,312** | **19,704,951** | **19,170,682** |
| Total revenues | **37,420,569** | **33,552,282** | **73,712,277** | **67,992,273** |
| | | | | |
| Cost of sales: | | | | |
| Printing | **19,155,034** | **17,866,111** | **37,705,574** | **35,637,374** |
| Office products and office furniture | **6,753,428** | **6,478,517** | **13,897,176** | **13,636,473** |
| Total cost of sales | **25,908,462** | **24,344,628** | **51,602,750** | **49,273,847** |
| Gross profit | **11,512,107** | **9,207,654** | **22,109,527** | **18,718,426** |
| | | | | |
| Selling, general and administrative expenses | **8,727,944** | **9,260,093** | **17,441,611** | **18,237,773** |
| Hurricane and relocation costs, net of recoveries | **(43,733)** | **-** | **(301,693)** | **-** |
| Income (loss) from operations | **2,827,896** | **(52,439)** | **4,969,609** | **480,653** |
| Other income (expense): | | | | |
| Interest income | **7,383** | **4,574** | **14,125** | **9,640** |
| Interest expense | **(168,828)** | **(133,938)** | **(340,570)** | **(271,303)** |
| Other | **3,042** | **13,011** | **2,928** | **75,685** |
| | **(158,403)** | **(116,353)** | **(323,517)** | **(185,978)** |
| Income (loss) before income taxes | **2,669,493** | **(168,792)** | **4,646,092** | **294,675** |
| Income tax (expense) benefit | **(1,091,079)** | **71,493** | **(1,922,000)** | **(128,848)** |
| Net income (loss) | **$ 1,578,414** | **$ (97,299)** | **$ 2,724,092** | **$ 165,827** |
| | | | | |
| Earnings (loss) per share | | | | |
| Basic | **$ 0.16** | **$ (0.01)** | **$ 0.28** | **$ 0.02** |
| Diluted | **$ 0.16** | **$ (0.01)** | **$ 0.28** | **$ 0.02** |
| | | | | |
| Weighted average shares outstanding: | | | | |
| Basic | **9,746,000** | **9,734,000** | **9,746,000** | **9,734,000** |
| Diluted | **9,947,000** | **9,734,000** | **9,889,000** | **9,803,000** |
| Dividends per share | **$ 0.05** | **$ 0.05** | **$ 0.10** | **$ 0.10** |

See notes to consolidated financial statements.

**Champion Industries, Inc. and Subsidiaries**
**Consolidated Statements of Cash Flows**
(Unaudited)

| | Six Months Ended April 30, | |
|---|---|---|
| | **2006** | **2005** |
| **Cash flows from operating activities:** | | |
| Net income | **$ 2,724,092** | $ 165,827 |
| Adjustments to reconcile net income to cash provided by operating activities: | | |
| Depreciation and amortization | **2,069,677** | 2,359,886 |
| Loss (gain) on sale of assets | **11,686** | (3,997) |
| Deferred income taxes | **(270,583)** | (120,674) |
| Increase in deferred compensation | **1,787** | 3,575 |
| Bad debt expense | **357,269** | 296,381 |
| Hurricane and relocation costs, net of recoveries | (301,693) | - |
| Changes in assets and liabilities: | | |
| Accounts receivable | **(3,430,251)** | 2,417,600 |
| Inventories | **260,370** | 410,147 |
| Other current assets | **(418,467)** | (210,920) |
| Accounts payable | **528,686** | (855,526) |
| Accrued payroll | **(211,824)** | (456,886) |
| Taxes accrued and withheld | **352,338** | 173,719 |
| Income taxes | **103,832** | (62,840) |
| Accrued expenses | **117,026** | 666,365 |
| Other liabilities | **(2,052)** | (16,110) |
| Net cash provided by operating activities | **1,891,893** | 4,766,547 |
| | | |
| **Cash flows from investing activities:** | | |
| Purchases of property and equipment | **(1,109,538)** | (1,588,388) |
| Proceeds from sales of property | **67,713** | 51,174 |
| Other assets | **(56,735)** | 76,830 |
| Net cash used in investing activities | **(1,098,560)** | (1,460,384) |
| | | |
| **Cash flows from financing activities:** | | |
| Borrowings on line of credit | **7,517,000** | 2,217,000 |
| Payments on line of credit | **(8,105,000)** | (2,717,000) |
| Proceeds from term debt | **80,010** | - |
| Principal payments on long-term debt | **(1,273,132)** | (855,400) |
| Dividends paid | **(974,588)** | (973,391) |
| Net cash used in financing activities | **(2,755,710)** | (2,328,791) |
| Net (decrease) increase in cash and cash equivalents | **(1,962,377)** | 977,372 |
| Cash and cash equivalents, beginning of period | **3,661,622** | 1,745,457 |
| Cash and cash equivalents, end of period | **$ 1,699,245** | $ 2,722,829 |

See notes to consolidated financial statements.

**Champion Industries, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Unaudited)**

**April 30, 2006**

**1. Basis of Presentation and Business Operations**

The foregoing financial information has been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") and rules and regulations of the Securities and Exchange Commission for interim financial reporting. The preparation of the financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates. In the opinion of management, the financial information reflects all adjustments (consisting of items of a normal recurring nature) necessary for a fair presentation of financial position, results of operations and cash flows in conformity with GAAP. These interim financial statements should be read in conjunction with the consolidated financial statements for the year ended October 31, 2005, and related notes thereto contained in Champion Industries, Inc.'s Form 10-K dated January 16, 2006. The accompanying interim financial information is unaudited. The results of operations for the period are not necessarily indicative of the results to be expected for the full year. The balance sheet information as of October 31, 2005 was derived from our audited financial statements.

Certain prior-year amounts have been reclassified to conform to the current year financial statement presentation.

**2. Earnings per Share**

Basic earnings per share is computed by dividing net income by the weighted average shares of common stock outstanding for the period and excludes any dilutive effects of stock options. Diluted earnings per share is computed by dividing net income by the weighted average shares of common stock outstanding for the period plus the shares that would be outstanding assuming the exercise of dilutive stock options. The dilutive effect of stock options was 201,000 and 143,000 shares for the three and six months ended April 30, 2006 and 0 and 69,000 shares for the three and six months ended April 2005.

**3. Inventories**

Inventories are principally stated at the lower of first-in, first-out cost or market. Manufactured finished goods and work in process inventories include material, direct labor and overhead based on standard costs, which approximate actual costs. The Company utilizes an estimated gross profit method for determining cost of sales in interim periods.

Inventories consisted of the following:

| | April 30, 2006 | October 31, 2005 |
|---|---|---|
| Printing: | | |
| Raw materials | **$ 2,239,937** | $ 2,198,882 |
| Work in process | **1,799,851** | 1,766,862 |
| Finished goods | **4,087,969** | 4,013,041 |
| Office products and office furniture | **2,497,426** | 3,100,941 |
| | **$ 10,625,183** | $ 11,079,726 |

**Champion Industries, Inc. and Subsidiaries**
**Notes to Consolidated Financial Statements (Unaudited) (continued)**

**4. Long-Term Debt**

Long-term debt consisted of the following:

| | April 30, 2006 | October 31, 2005 |
|---|---|---|
| Secured term note payable | **$ 2,154,978** | $ 3,024,861 |
| Installment notes payable to banks | **3,484,682** | 3,791,439 |
| Capital lease obligations | **-** | 16,483 |
| | **5,639,660** | 6,832,783 |
| Less current portion | **1,743,974** | 1,684,280 |
| Long-term debt, net of current portion | **$ 3,895,686** | $ 5,148,503 |

The Company has an unsecured revolving line of credit with a bank for borrowings to a maximum of $10,000,000 with interest payable monthly at the prime rate of interest. The line of credit expires in July 2008 and contains certain restrictive financial covenants. The Company had outstanding borrowings under this facility of approximately $1.0 million and $1.6 million at April 30, 2006 and October 31, 2005.

The Company has an unsecured revolving line of credit with a bank for borrowings to a maximum of $1,000,000 with interest payable monthly at the Wall Street Journal prime rate. The line of credit expires in April 2007 and contains certain financial covenants. There were no borrowings outstanding under this facility at April 30, 2006 and October 31, 2005.

There were no non-cash financing activities for the three and six months ended April 30, 2006 and 2005.

**5. Shareholders' Equity**

The Company paid a dividend of five cents per share on March 27, 2006 to stockholders of record on March 10, 2006. Also, the Company declared a dividend of five cents per share to be paid on June 26, 2006 to stockholders of record on June 9, 2006.

**Champion Industries, Inc. and Subsidiaries**
**Notes to Consolidated Financial Statements (Unaudited) (continued)**

**6. Commitments and Contingencies**

As of April 30, 2006 the Company had contractual obligations in the form of leases and debt as follows:

| | Payments Due by Fiscal Year | | | | | | |
|---|---|---|---|---|---|---|---|
| **Contractual Obligations** | **2006** | **2007** | **2008** | **2009** | **2010** | **Residual** | **Total** |
| Non-cancelable operating leases | $ 529,048 | $ 977,046 | $ 786,387 | $ 402,503 | $ 149,163 | $ 89,303 | $ 2,933,450 |
| Revolving line of credit | - | - | 1,024,000 | - | - | - | 1,024,000 |
| Term debt | 791,294 | 1,773,052 | 1,566,066 | 484,598 | 1,024,650 | - | 5,639,660 |
| Equipment purchase obligations | 1,515,150 | - | - | - | - | - | 1,515,150 |
| | $ 2,835,492 | $ 2,750,098 | $ 3,376,453 | $ 887,101 | $ 1,173,813 | $ 89,303 | $ 11,112,260 |

During the second quarter of 2006, the Company entered into a purchase commitment with an equipment manufacturer for the purchase of a printing press for $1,130,725. As a result of this commitment the Company paid this manufacturer a deposit of $127,575 during the second quarter of 2006. The Company also entered into a purchase commitment for pre-press equipment with a manufacturer for $642,000. As a result of this commitment the Company paid this manufacturer a deposit of $130,000 during the second quarter of 2006.

**7. Accounting for Stock-Based Compensation**

In December 2004, the FASB issued SFAS No. 123R (revised 2004), "*Share-Based Payment*." This statement revises SFAS No. 123, "*Accounting for Stock-Based Compensation*," and requires companies to expense the value of employee stock options and similar awards. The effective date of this standard initially was for interim and annual periods beginning after June 15, 2005. On April 14, 2005, the United States Securities and Exchange Commission amended the effective date of this standard to the beginning of a company's fiscal year that begins after June 15, 2005. Therefore, the effective date of this standard for the Company was November 1, 2005. Since the Company's outstanding employee stock options vested immediately in the year granted, the initial adoption of this standard had no effect on the Company's financial statements. However, the Company will be required to expense the fair value of the employee stock options when future options are granted or when existing options are modified or repurchased pursuant to the provisions of SFAS No. 123R.

The Company did not issue any employee stock options for the three and six months ended April 30, 2006 and 2005.

**Champion Industries, Inc. and Subsidiaries**
**Notes to Consolidated Financial Statements (Unaudited) (continued)**

| | Three Months Ended April 30 | | Six Months Ended April 30 | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| Net income (loss), as reported | $ 1,578,414 | $ (97,299) | $ 2,724,092 | $ 165,827 |
| Deduct: Total stock-based employee compensation expense determined under fair value method for all awards, net of related tax effects | — | — | — | — |
| Pro forma net income (loss) | $ 1,578,414 | $ (97,299) | $ 2,724,092 | $ 165,827 |
| Earnings (loss) per share: | | | | |
| Basic, as reported | $ 0.16 | $ (0.01) | $ 0.28 | $ 0.02 |
| Basic, pro forma | 0.16 | (0.01) | 0.28 | 0.02 |
| Diluted, as reported | $ 0.16 | $ (0.01) | $ 0.28 | $ 0.02 |
| Diluted, pro forma | 0.16 | (0.01) | 0.28 | 0.02 |

**8. Acquisitions**

On September 7, 2004, the Company acquired all the issued and outstanding capital stock of Syscan Corporation (“Syscan”), a West Virginia corporation, for a cash price of $3,500,000 and a contingent purchase price, dependent upon satisfaction of certain conditions, not to exceed the amount of $1,500,000.

The Williams Land Corporation has the option to put the 3000 Washington Street building occupied by Syscan to the Company for a price of $1.5 million and the Company has the option to purchase the building for $1.5 million at the conclusion of the five year lease term ending September 1, 2009. This option may be exercised no later than 60 days prior to the end of the lease and closing of said purchase cannot exceed 45 days from the end of the lease.

**9. Accounting for Costs Associated with Exit or Disposal Activities and Impact of Hurricane Katrina**

During the second quarter of 2005, the Company relocated its Chapman Printing Company Charleston division to a facility leased by the Company as a result of the acquisition of Syscan. The Company is currently evaluating its facility needs in Charleston, West Virginia and the future use, if any, of the building formerly occupied by the Chapman Printing Charleston division.

The Company moved its Dallas operations to an existing facility in Baton Rouge, Louisiana in August 2005. The Company is currently evaluating its options regarding the Dallas facility.

On August 29, 2005, Hurricane Katrina made landfall and subsequently caused extensive flooding and destruction along the coastal areas of the Gulf of Mexico, including New Orleans and other communities in Louisiana and Mississippi in which Champion conducts business. Operations in many of the Company's markets were disrupted by both the evacuation of large portions of the population as well as damage and/or lack of access to the Company's operating facility in New Orleans.

**Champion Industries, Inc. and Subsidiaries**
**Notes to Consolidated Financial Statements (Unaudited) (continued)**

The Company has filed insurance claims related to both actual and contingent losses. The Company received an advance to claim from an insurance company of $300,000 in February 2006. A second advance to claim of $200,000 was received in April 2006 and a check in the amount of $78,000 in full settlement of any and all claims was received in May 2006. The Company recorded all of the payments as insurance recoveries for the six months ended April 30, 2006.

The Company has categorized the costs associated with Hurricane Katrina as follows:
1.) Personnel costs representing costs associated with payment of personnel primarily in New Orleans during the time period the city was essentially shut down;
2.) Plant costs represent all facilities, equipment and inventory charges incurred as a result of the hurricane using the most current available information;
3.) The allowance for doubtful accounts charge represents accounts receivable specifically reserved based on a collectibility analysis performed by the Company using the most current available information for customers located in the New Orleans area;
4.) The relocation costs represent costs of closing the New Orleans production facility and associated costs of moving equipment.

The following table summarizes the cumulative costs incurred as of April 30, 2006 relating to Hurricane Katrina.

| | | |
|---|---|---|
| Personnel | $ | 88,423 |
| Plant | | 745,035 |
| Allowance for doubtful accounts | | 208,310 |
| Moving and relocation costs | | 255,215 |
| Total pre-tax hurricane expense | | 1,296,983 |
| Insurance recoveries | | 577,677 |
| Cumulative impact of Hurricane Katrina, net | $ | 719,306 |

The Company recorded costs of $1,020,999 for the three months ended October 31, 2005 and costs of $275,984 and recoveries of $577,677 for the six months ending April 30, 2006 relating to Hurricane Katrina.

The costs and recoveries associated with Hurricane Katrina are reflected in the consolidated statements of operations in the category “Hurricane and relocation costs, net of recoveries” and are part of the printing segment.

11

**Champion Industries, Inc. and Subsidiaries**
**Notes to Consolidated Financial Statements (Unaudited) (continued)**

**10. Industry Segment Information**

The Company operates principally in two industry segments organized on the basis of product lines: the production, printing and sale, principally to commercial customers, of printed materials (including brochures, pamphlets, reports, tags, continuous and other forms) and the sale of office products and office furniture including interior design services.

The table below presents information about reported segments for the three months ended April 30:

| 2006 Quarter 2 | Printing | Office Products & Furniture | Total |
|---|---|---|---|
| Revenues | $ 32,014,163 | $ 11,838,155 | $ 43,852,318 |
| Elimination of intersegment revenue | (4,172,486) | (2,259,263) | (6,431,749) |
| Consolidated revenues | $ 27,841,677 | $ 9,578,892 | $ 37,420,569 |
| Operating income | 2,220,966 | 606,930 | 2,827,896 |
| Depreciation & amortization | 979,864 | 39,672 | 1,019,536 |
| Capital expenditures | 793,197 | 81,920 | 875,117 |
| Identifiable assets | 51,534,191 | 10,280,382 | 61,814,573 |
| Goodwill | 1,774,344 | 286,442 | 2,060,786 |

| 2005 Quarter 2 | Printing | Office Products & Furniture | Total |
|---|---|---|---|
| Revenues | $ 27,812,058 | $ 11,276,457 | $ 39,088,515 |
| Elimination of intersegment revenue | (3,427,088) | (2,109,145) | (5,536,233) |
| Consolidated revenues | $ 24,384,970 | $ 9,167,312 | $ 33,552,282 |
| Operating income (loss) | (508,299) | 455,860 | (52,439) |
| Depreciation & amortization | 1,132,788 | 74,987 | 1,207,775 |
| Capital expenditures | 684,085 | 48,768 | 732,853 |
| Identifiable assets | 51,415,546 | 9,933,810 | 61,349,356 |
| Goodwill | 1,774,344 | 286,442 | 2,060,786 |

| 2006 Year to Date | Printing | Office Products & Furniture | Total |
|---|---|---|---|
| Revenues | $ 61,702,192 | $ 24,300,439 | $ 86,002,631 |
| Elimination of intersegment revenue | (7,694,866) | (4,595,488) | (12,290,354) |
| Consolidated revenues | $ 54,007,326 | $ 19,704,951 | $ 73,712,277 |
| Operating income | 3,668,714 | 1,300,895 | 4,969,609 |
| Depreciation & amortization | 1,994,962 | 74,715 | 2,069,677 |
| Capital expenditures | 1,005,440 | 104,098 | 1,109,538 |

| | | | |
|---|---|---|---|
| Identifiable assets | 51,534,191 | 10,280,382 | 61,814,573 |
| Goodwill | 1,774,344 | 286,442 | 2,060,786 |

**Champion Industries, Inc. and Subsidiaries**
**Notes to Consolidated Financial Statements (Unaudited) (continued)**

| 2005 Year to Date | Printing | Office Products & Furniture | Total |
|---|---|---|---|
| Revenues | $ 55,898,035 | $ 22,805,226 | $ 78,703,261 |
| Elimination of intersegment revenue | (7,076,444) | (3,634,544) | (10,710,988) |
| Consolidated revenues | $ 48,821,591 | $ 19,170,682 | $ 67,992,273 |
| | | | |
| Operating income (loss) | (666,646) | 1,147,299 | 480,653 |
| Depreciation & amortization | 2,205,242 | 154,644 | 2,359,886 |
| Capital expenditures | 1,466,833 | 121,555 | 1,588,388 |
| Identifiable assets | 51,415,546 | 9,933,810 | 61,349,356 |
| Goodwill | 1,774,344 | 286,442 | 2,060,786 |

A reconciliation of total segment revenues and of total segment operating income (loss) to consolidated income (loss) before income taxes, for the three and six months ended April 30, 2006 and 2005, is as follows:

| | Three months | | Six months | |
|---|---|---|---|---|
| | **2006** | **2005** | **2006** | **2005** |
| Revenues: | | | | |
| Total segment revenues | **$ 43,852,318** | **$ 39,088,515** | **$ 86,002,631** | **$ 78,703,261** |
| Elimination of intersegment revenue | **(6,431,749)** | **(5,536,233)** | **(12,290,354)** | **(10,710,988)** |
| Consolidated revenue | **$ 37,420,569** | **$ 33,552,282** | **$ 73,712,277** | **$ 67,992,273** |
| | | | | |
| Operating income (loss): | | | | |
| Total segment operating income (loss) | **$ 2,827,896** | **$ (52,439)** | **$ 4,969,609** | **$ 480,653** |
| Interest income | **7,383** | **4,574** | **14,125** | **9,640** |
| Interest expense | **(168,828)** | **(133,938)** | **(340,570)** | **(271,303)** |
| Other income | **3,042** | **13,011** | **2,928** | **75,685** |
| Consolidated income (loss) before income taxes | **$ 2,669,493** | **$ (168,792)** | **$ 4,646,092** | **$ 294,675** |
| | | | | |
| Identifiable assets: | | | | |
| Total segment identifiable assets | **$ 61,814,573** | **$ 61,349,356** | **$ 61,814,573** | **$ 61,349,356** |
| Elimination of intersegment assets | — | — | — | — |
| Total consolidated assets | **$ 61,814,573** | **$ 61,349,356** | **$ 61,814,573** | **$ 61,349,356** |

**11. Subsequent Event**

On May 21, 2006 a collective bargaining agreement covering 72 employees or approximately 10% of the Company's workforce, was ratified by the bargaining unit. The Company expects a final agreement to be signed during the third quarter of 2006 with an effective date of June 1, 2006 and expiring May 31, 2010. The previous collective bargaining agreement for this workforce expired on May 31, 2006.

**Champion Industries, Inc. and Subsidiaries**

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

**Results of Operations**

The following table sets forth, for the periods indicated, information derived from the Consolidated Statements of Operations as a percentage of total revenues.

| | Percentage of Total Revenues | | | |
|---|---|---|---|---|
| | Three Months Ended April 30, | | Six Months Ended April 30, | |
| | 2006 | 2005 | 2006 | 2005 |
| Revenues: | | | | |
| Printing | 74.4% | 72.7% | 73.3% | 71.8% |
| Office products and office furniture | 25.6 | 27.3 | 26.7 | 28.2 |
| Total revenues | 100.0 | 100.0 | 100.0 | 100.0 |
| | | | | |
| Cost of sales: | | | | |
| Printing | 51.2 | 53.3 | 51.2 | 52.4 |
| Office products and office furniture | 18.0 | 19.3 | 18.8 | 20.1 |
| Total cost of sales | 69.2 | 72.6 | 70.0 | 72.5 |
| Gross profit | 30.8 | 27.4 | 30.0 | 27.5 |
| Selling, general and administrative expenses | 23.3 | 27.6 | 23.7 | 26.8 |
| Hurricane and relocation costs, net of recoveries | (0.1) | - | (0.4) | - |
| Income (loss) from operations | 7.6 | (0.2) | 6.7 | 0.7 |
| Interest income | 0.0 | 0.0 | 0.0 | 0.0 |
| Interest expense | (0.5) | (0.4) | (0.4) | (0.4) |
| Other income | 0.0 | 0.1 | 0.0 | 0.1 |
| Income (loss) before taxes | 7.1 | (0.5) | 6.3 | 0.4 |
| Income tax (expense) benefit | (2.9) | 0.2 | (2.6) | (0.2) |
| Net income (loss) | 4.2% | (0.3)% | 3.7% | 0.2% |

The following table is a reconciliation of net income (loss) as reported to core net income (loss), which is defined as generally accepted accounting principles (GAAP) net income (loss) adjusted for insurance recoveries, net of expenses associated with Hurricane Katrina. The Company believes that events associated with Hurricane Katrina require additional disclosure and therefore, the Company has disclosed additional non-GAAP financial measures in an effort to make the quarterly financial statements more useful to investors.

| | Three Months Ended April 30, | | Six Months Ended April 30, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| Net income (loss) | $ 1,578,000 | $ (97,000) | $ 2,724,000 | $ 166,000 |
| Insurance recoveries, net of expenses | 26,000 | - | 176,000 | - |
| Core net income (loss) | $ 1,552,000 | $ (97,000) | $ 2,548,000 | $ 166,000 |

14

**Champion Industries, Inc. and Subsidiaries**

**Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**

**Three Months Ended April 30, 2006 Compared to Three Months Ended April 30, 2005**

*Revenues*

Total revenues increased 11.5% in the second quarter of 2006 compared to the same period in 2005 from $33.6 million to $37.4 million. Printing revenue increased 14.2% in the second quarter of 2006 to $27.8 million from $24.4 million in the second quarter of 2005. Office products and office furniture revenue increased 4.5% in the second quarter of 2006 to $9.6 million from $9.2 million in the second quarter of 2005. The increase in printing sales as well as office products and office furniture sales was primarily due to organic growth since there were no new acquisitions since the fourth quarter of 2004.

*Cost of Sales*

Total cost of sales increased 6.4% in the second quarter of 2006 to $25.9 million from $24.3 million in the first quarter of 2005. Printing cost of sales in the second quarter of 2006 increased $1.3 million over the prior year and decreased as a percentage of printing sales from 73.3% in 2005 to 68.8% in 2006. The printing gross margin dollar increase resulted from increased sales volume and was partially offset by lower cost of goods sold as percentage of sales resulting from lower material and outside purchase costs as a percentage of sales coupled with improved labor and overhead absorption. Office products and office furniture cost of sales increased in 2006 from 2005 levels due to increased sales and decreased as a percent of sales from 70.7% in 2005 to 70.5% in 2006.

*Operating Expenses*

In the second quarter of 2006, selling, general and administrative expenses decreased on a gross dollar basis to $8.7 million from $9.3 million in 2005, a decrease of $500,000 or 5.7%. As a percentage of total sales, the expenses decreased on a quarter to quarter basis in 2006 to 23.3% from 27.6% in 2005.

The decrease in selling, general and administrative expenses is primarily the result of $777,000 of legal settlements, accruals and expenses including $440,000 to settle a lawsuit in Mississippi that were present in the second quarter of 2005. In addition, the Company benefited from the consolidation of Chapman Printing Charleston and Syscan in 2005, the closing of the Company's facility in Jackson, Mississippi and the consolidation of the Company's New Orleans plant into the Company's Baton Rouge facility. These decreases were offset by additional costs associated with revenue growth of 11.5% for the second quarter of 2006 compared to the second quarter of 2005.

On August 29, 2005, Hurricane Katrina made landfall and subsequently caused extensive flooding and destruction along the coastal areas of the Gulf of Mexico, including New Orleans and other communities in Louisiana and Mississippi in which Champion conducts business. Operations in many of the Company's markets were disrupted by both the evacuation of large portions of the population as well as damage and/or lack of access to the Company's operating facility in New Orleans.

The Company has filed insurance claims related to both actual and contingent losses. The Company received an advance to claim payment from an insurance company of $300,000 in February 2006 and final settlement claims of $278,000 in April and May 2006. The Company recorded the $300,000 payment as an insurance recovery and related receivable at January 31, 2006. The Company recorded additional charges of approximately $42,000 in the first quarter of 2006 associated with Hurricane Katrina. The Company received a second advance to claim check in April

of 2006 in the amount of $200,000 and a full and final settlement of any and all claims check of $78,000 in May of 2006. The Company recorded the aggregate amount of these checks as an insurance recovery and the $78,000 as a related receivable at April 30, 2006. The Company incurred additional charges of $234,000, primarily related to additional inventory valuation reserves and costs associated with relocation in the second quarter of 2006.

The Company is currently unable to accurately assess the short and long term effects of Hurricane Katrina on its business and on the macro operating environment in the Gulf States in which the Company operates.

**Champion Industries, Inc. and Subsidiaries**

**Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**

*Income from Operations and Other Income and Expenses*

Income from operations increased in the second quarter of 2006 to $2.8 million from a loss of $(52,000) in the second quarter of 2005. This increase is the result of increased sales and gross profit and gross profit percent, coupled with a decrease in selling, general and administrative expenses (S,G & A) and a decrease in S,G & A as a percent of sales. Other expense (net), increased approximately $42,000 from 2005 to 2006 primarily due to increases in interest expense resulting from increased interest rates.

*Income Taxes*

The Company's effective income tax rate was 40.9% for the second quarter of 2006 and 42.4% for the second quarter of 2005. The decrease in income taxes as a percentage of income before taxes is primarily related to improved absorption regarding the nondeductibility of certain selling related expenses. The effective income tax rate approximates the combined federal and state, net of federal benefit, statutory income tax rate.

*Net Income*

Net income for the second quarter of 2006 was $1,578,000 compared to a net loss of $(97,000) in the second quarter of 2005. Basic and diluted earnings (loss) per share for the three months ended April 30, 2006 and 2005 were $0.16 and $(0.01). The Company reported core net income of $1,552,000 or $0.16 per share on a basic and diluted basis for the three months ended April 30, 2006. Core net income does not include the insurance recovery, net of expenses. (See Explanatory Table in "Results of Operations" section.)

**Six Months Ended April 30, 2006 Compared to Six Months Ended April 30, 2005**

*Revenues*

Total revenues increased 8.4% in the first six months of 2006 compared to the same period in 2005 to $73.7 million from $68.0 million. Printing revenue increased 10.6% in the six month period ended April 30, 2006 to $54.0 million from $48.8 million in the same period in 2005. Office products and office furniture revenue increased 2.8% in the six month period ended April 30, 2006 to $19.7 million from $19.2 million in the same period in 2005. The increase in printing sales as well as office products and office furniture sales was primarily due to organic growth since there were no new acquisitions since the fourth quarter of 2004.

*Cost of Sales*

Total cost of sales increased 4.7% in the six months ended April 30, 2006 to $51.6 million from $49.3 million in the six months ended April 30, 2005. Printing cost of sales increased 5.8% in the six months ended April 30, 2006 to $37.7 million from $35.6 million in the six months ended April 30, 2005. The increase in printing cost of sales was primarily due to the increase in printing sales noted above partially offset by gross margin improvement resulting from lower material and outside purchase costs as a percentage of sales coupled with improved labor and overhead absorption. Office products and office furniture cost of sales increased 1.9% in the six months ended April 30, 2006 to $13.9 million from $13.6 million in the six months ended April 30, 2005 and decreased as a percent of sales from 71.1% in 2005 to 70.5% in 2006. The increase in office products and office furniture cost of sales is attributable to an increase in office products and office furniture sales. The decrease in office products and office furniture cost of sales

as a percent of sales is reflective of wholesale pricing factors at Syscan for office supplies in 2005 mitigated via the office products consolidation during the second quarter of 2005 of which the benefits were fully reflected in the six months ended April 30, 2006, partially offset by higher furniture costs as a percent of furniture sales.

*Operating Expenses*

During the six months ended April 30, 2006 compared to the same period in 2005, selling, general and administrative expenses decreased as a percentage of sales to 23.7% from 26.8%. Total selling, general and administrative expenses (S,G & A) decreased $800,000. The decrease in selling, general and administrative expenses is primarily due to approximately $800,000 in legal related costs associated with various legal settlements, accruals, and expenses including a $440,000 settlement related to a Mississippi lawsuit, which were incurred during 2005.

**Champion Industries, Inc. and Subsidiaries**

**Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**

The decrease in S,G& A as a percent of sales is reflective of the $800,000 in legal costs not being present in the current year coupled with the consolidation of Chapman Printing Charleston and Syscan in 2005, the closing of the Company's facility in Jackson, Mississippi and the consolidation of the Company's New Orleans plant into the Company's Baton Rouge facility. These decreases were offset by additional costs associated with revenue growth of 8.4% for the second quarter of 2006 compared to the second quarter of 2005.

On August 29, 2005, Hurricane Katrina made landfall and subsequently caused extensive flooding and destruction along the coastal areas of the Gulf of Mexico, including New Orleans and other communities in Louisiana and Mississippi in which Champion conducts business. Operations in many of the Company's markets were disrupted by both the evacuation of large portions of the population as well as damage and/or lack of access to the Company's operating facility in New Orleans.

The Company has filed insurance claims related to both actual and contingent losses. The Company received an advance to claim payment from an insurance company of $300,000 in February 2006 and final settlement claims of $278,000 in April and May 2006. The Company recorded the $300,000 payment as an insurance recovery and related receivable at January 31, 2006. The Company recorded additional charges of approximately $42,000 in the first quarter of 2006 associated with Hurricane Katrina. The Company received a second advance to claim check in April of 2006 in the amount of $200,000 and a full and final settlement of any and all claims check of $78,000 in May of 2006. The Company recorded the aggregate amount of these checks as an insurance recovery and the $78,000 as a related receivable at April 30, 2006. The Company incurred additional charges of $234,000, primarily related to additional inventory valuation reserves and costs associated with relocation in the second quarter of 2006.

The Company is currently unable to accurately assess the short and long term effects of Hurricane Katrina on its business and on the macro operating environment in the Gulf States in which the Company operates.

*Income from Operations and Other Income and Expenses*

Income from operations increased 933.9% in the six month period ended April 30, 2006 to $5.0 million from $481,000 in the same period of 2005. This increase is the result of increased gross profit contribution due to increased sales and improved gross margins discussed above as well as decreases in S,G&A and a reduction of S,G&A as a percent of sales in 2006 compared to 2005. Other expense increased $138,000 to $324,000 in 2006 from $186,000 in 2005. This increase is primarily due to a $69,000 increase in interest expense resulting from higher interest rates for 2006 compared to 2005 and a reduction of other income of approximately $73,000.

*Income Taxes*

The Company's effective income tax rate was 41.4% for the six months ended April 30, 2006, down from 43.7% in the same period of 2005. The decrease in income taxes as a percentage of income before taxes is primarily related to improved absorption regarding the nondeductibility of certain selling related expenses. The effective income tax rate approximates the combined federal and state, net of federal benefit, statutory income tax rate and is partially impacted by the geographic profitability mix of our operations.

*Net Income*

Net income for the first six months of 2006 increased 1542.7% to $2.7 million from $166,000 in the same period of 2005 due to the reasons discussed above. Basic and diluted earnings per share for the six months ended April 30, 2006

and 2005, were $0.28 and 0.02. The Company reported core net income of $2,548,000 or $0.26 per share on a basic and diluted basis for the six months ended April 30, 2006. Core net income does not include the insurance recovery, net of expenses. (See Explanatory Table in "Results of Operations" section.)

**Inflation and Economic Conditions**

Management believes that the effect of inflation on the Company's operations has not been material and will continue to be immaterial for the foreseeable future. The Company does not have long-term sales and purchase contracts; therefore, to the extent permitted by competition, it has the ability to pass through to the customer most cost increases resulting from inflation, if any.

**Champion Industries, Inc. and Subsidiaries**

**Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**

**Seasonality**

Historically, the Company has experienced a greater portion of its profitability in the second and fourth quarters than in the first and third quarters. The second quarter generally reflects increased orders for printing of corporate annual reports and proxy statements. A post-Labor Day increase in demand for printing services and office products coincides with the Company's fourth quarter.

**Liquidity and Capital Resources**

Net cash provided by operations for the six months ended April 30, 2006, was $1.9 million compared to net cash provided by operations of $4.8 million during the same period in 2005. This change in net cash from operations is due primarily to timing changes in assets and liabilities primarily related to an increase in accounts receivable in 2006 compared to a decrease in accounts receivable in 2005.

Net cash used in investing activities for the six months ended April 30, 2006 was $1.1 million compared to $1.5 million during the same period in 2005. The net cash used in investing activities during the first six months of 2006, primarily relates to equipment and vehicle purchases including mail service equipment upgrades, software purchases in the office products and office furniture segment, press additions and upgrades and numerous information technology related expenditures. The net cash used in investing activities during the first six months of 2005 primarily related to vehicle and equipment additions including pre-press expenditures at two of the Company's sheetfed plants and print on demand expenditures.

Net cash used in financing activities for the six months ended April 30, 2006 was $2.8 million compared to $2.3 million during the same period in 2005. This change is primarily due to net payments on the Company's term debt of $1.3 million compared with net payments on the Company's term debt of approximately $900,000 in 2005.

The Company's off balance sheet arrangements at April 30, 2006 relate to the Syscan acquisition and are associated with potential contingent purchase price consideration of $1.5 million payable in October 2006 and a put option from Williams Land Corporation to sell a building to the Company for $1.5 million. This option may be exercised no later than 60 days prior to the end of the lease and closing of said purchase cannot exceed 45 days from the end of the lease. The lease term concludes effective September 1, 2009.

Working capital on April 30, 2006 was $26.7 million, an increase of $600,000 from October 31, 2005. Management believes that working capital and operating ratios remain at acceptable levels.

During the second quarter of 2006, the Company entered into a purchase commitment with an equipment manufacturer for the purchase of a printing press for $1,130,725. As a result of this commitment the Company paid this manufacturer a deposit of $127,575. The Company also entered into a purchase commitment for pre-press equipment with a manufacturer for $642,000. As a result of this commitment the Company paid this manufacturer a deposit of $130,000.

The Company expects that the combination of funds available from working capital, borrowings available under the Company's credit facilities and anticipated cash flows from operations will provide sufficient capital resources for the foreseeable future. In the event the Company seeks to accelerate internal growth or make acquisitions beyond these sources, additional financing would be necessary.

18

**Champion Industries, Inc. and Subsidiaries**

**Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**

**Environmental Regulation**

The Company is subject to the environmental laws and regulations of the United States, and the states in which it operates, concerning emissions into the air, discharges into the waterways and the generation, handling and disposal of waste materials. The Company's past expenditures relating to environmental compliance have not had a material effect on the Company. These laws and regulations are constantly evolving, and it is impossible to predict accurately the effect they may have upon the capital expenditures, earnings, and competitive position of the Company in the future. Based upon information currently available, management believes that expenditures relating to environmental compliance will not have a material impact on the financial position of the Company.

**Special Note Regarding Forward-Looking Statements**

Certain statements contained in this Form 10-Q, including without limitation statements including the word "believes," "anticipates," "intends," "expects" or words of similar import, constitute "forward-looking statements" within the meaning o section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements of the Company expressed or implied by such forward-looking statements. Such factors include, among others, general economic and business conditions, general economic and business conditions in the Company's market areas affected by Hurricane Katrina, changes in business strategy or development plans and other factors referenced in this Form 10-Q , including without limitations under the captions "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Business." The Company disclaims any obligation to update any such factors or to publicly announce the results of any revisions to any of the forward-looking statements contained herein to reflect future events or developments.

**ITEM 3. Quantitative and Qualitative Disclosure About Market Risk**

The Company does not have any significant exposure relating to market risk.

**ITEM 4. Controls and Procedures**

Company management, including the Chief Executive Officer, Chief Operating Officer and Chief Financial Officer, has conducted an evaluation of the effectiveness of disclosure controls and procedures pursuant to Exchange Act Rule 13a-15c as of the end of the period covered by this quarterly report. Based on that evaluation, the Chief Executive Officer, Chief Operating Officer and Chief Financial Officer concluded that the disclosure controls and procedures are effective in ensuring that all material information required to be filed in this quarterly report has been made known to them in a timely fashion. There were no changes in internal controls over financial reporting during the last fiscal quarter that have materially affected or are reasonably likely to materially affect the Company's internal controls over financial reporting.

## PART II - OTHER INFORMATION

### Item 4. Submission of Matters to a Vote of Security Holders

At the annual meeting of shareholders held March 20, 2006, the following matters were voted upon:

a) Fixing the number of directors at seven (7) and election of the following nominees as directors, with votes "for" and "withheld," as well as broker non-votes, as follows:

| Director | Votes "For" | Votes "Withheld" | Broker Non-votes |
|---|---|---|---|
| Louis J. Akers | 9,152,764 | 182,108 | -0- |
| Philip E. Cline | 9,295,014 | 39,858 | -0- |
| Harley F. Mooney, Jr. | 9,315,607 | 19,265 | -0- |
| A. Michael Perry | 9,320,407 | 14,465 | -0- |
| Marshall T. Reynolds | 9,321,807 | 13,065 | -0- |
| Neal W. Scaggs | 9,295,054 | 39,818 | -0- |
| Glenn W. Wilcox, Sr. | 9,320,407 | 14,465 | -0- |

### Item 6. Exhibits

a) Exhibits:

| | | |
|---|---|---|
| (31.1) | Principal Executive Officer Certification Pursuant to Section 302 of the Sarbanes-Oxley act of 2002 - Marshall T. Reynolds | Exhibit 31.1 Page Exhibit 31.1-p1 |
| (31.2) | Principal Financial Officer Certification Pursuant to Section 302 of the Sarbanes-Oxley act of 2002 - Todd R. Fry | Exhibit 31.2 Page Exhibit 31.2-p1 |
| (31.3) | Principal Operating Officer Certification Pursuant to Section 302 of the Sarbanes-Oxley act of 2002 - Toney K. Adkins | Exhibit 31.3 Page Exhibit 31.3-p1 |
| (32) | Marshall T. Reynolds, Todd R. Fry and Toney K. Adkins Certification Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley act of 2002 | Exhibit 32 Page Exhibit 32-p1 |

**Signatures**

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

CHAMPION INDUSTRIES, INC.

| | |
|---|---|
| Date: June 2, 2006 | /s/ Marshall T. Reynolds<br>Marshall T. Reynolds<br>Chief Executive Officer |
| Date: June 2, 2006 | /s/ Toney K. Adkins<br>Toney K. Adkins<br>President and Chief Operating Officer |
| Date: June 2, 2006 | /s/ Todd R. Fry<br>Todd R. Fry<br>Senior Vice President and Chief Financial Officer |