CHAMPION ENTERPRISES INC
Form 10-Q
October 23, 2003

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FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

(Mark one)

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

For Quarterly period ended September 27, 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 [X] No [ ]

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

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

58,769,512 shares of the registrant s $1.00 par value Common Stock were outstanding as of October 17, 2003.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

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

	Unaudited Three Months Ended		Unaudited Nine Months Ended	
	September 27, 2003	September 28, 2002	September 27, 2003	September 28, 2002
Net sales	$310,934	$373,590	$849,384	$1,041,473
Cost of sales	271,117	329,342	728,044	892,510
Gross margin	39,817	44,248	121,340	148,963
Selling, general and administrative expenses	50,052	57,448	141,934	181,479
Goodwill impairment charges	34,183		34,183	97,000
Restructuring charges	20,100	31,600	20,100	36,500
Gain on debt retirement			(13,833)	(5,870)
Operating loss	(64,518)	(44,800)	(61,044)	(160,146)
Interest income	329	727	1,215	1,946
Interest expense	(6,783)	(7,695)	(20,713)	(20,777)
Loss from continuing operations before income taxes	(70,972)	(51,768)	(80,542)	(178,977)
Income tax expense (benefit)	450	(14,800)	(1,950)	67,900
Loss from continuing operations	(71,422)	(36,968)	(78,592)	(246,877)
Loss from discontinued operations, net of taxes	(9,674)	(1,967)	(20,902)	(3,195)
Net loss	$ (81,096)	$ (38,935)	$ (99,494)	$ (250,072)
Basic and diluted loss per share:				
Loss from continuing operations	$ (1.24)	$ (0.76)	$ (1.47)	$ (5.09)
Loss from discontinued operations	(0.17)	(0.04)	(0.37)	(0.06)
Basic and diluted loss per share	$ (1.41)	$ (0.80)	$ (1.84)	$ (5.15)
Weighted shares for basic and diluted EPS	57,498	49,154	56,260	48,796

See accompanying Notes to Consolidated Financial Statements.

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

	Unaudited September 27, 2003	December 28, 2002
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 144,796	$ 77,381
Restricted cash	522	32,450
Accounts receivable, trade	41,958	28,631
Inventories	110,944	111,332
Current assets of discontinued operations	1,650	2,015
Other current assets	15,072	88,959
Total current assets	314,942	340,768
PROPERTY, PLANT AND EQUIPMENT, at cost	230,961	256,838
Less-accumulated depreciation	131,797	129,709
	99,164	127,129
GOODWILL, net	126,501	161,336
OTHER NON-CURRENT ASSETS		
Restricted cash		18,443
Non-current assets of discontinued operations	70	57,498
Other non-current assets	21,693	22,917
Total other non-current assets	21,763	98,858
Total assets	$ 562,370	$ 728,091
LIABILITIES, REDEEMABLE CONVERTIBLE PREFERRED STOCK AND SHAREHOLDERS EQUITY (DEFICIT)		
CURRENT LIABILITIES		
Floor plan payable	$ 14,842	$ 17,147
Accounts payable	42,902	37,053
Accrued warranty obligations	44,548	43,139
Accrued volume rebates	30,590	35,010
Accrued compensation and payroll taxes	20,984	17,118
Accrued self-insurance	30,139	28,772
Short-term liabilities of discontinued operations	4,047	36,764
Other current liabilities	55,533	48,141
Total current liabilities	243,585	263,144
LONG-TERM LIABILITIES		
Long-term debt	290,510	341,612
Other long-term liabilities	51,416	56,754
	341,926	398,366

CONTINGENT LIABILITIES (Note 11)		
REDEEMABLE CONVERTIBLE PREFERRED STOCK, no par value, 5,000 shares authorized, 8.75 shares and 30.0 shares issued and outstanding, respectively	8,629	29,256
SHAREHOLDERS EQUITY (DEFICIT)		
Common stock, $1 par value, 120,000 shares authorized, 58,400 and 52,658 shares issued and outstanding, respectively	58,400	52,658
Capital in excess of par value	82,248	54,666
Accumulated deficit	(171,751)	(68,150)
Accumulated other comprehensive income (loss)	(667)	(1,849)
Total shareholders equity (deficit)	(31,770)	37,325
Total liabilities, preferred stock and shareholders equity (deficit)	$ 562,370	$728,091

See accompanying Notes to Consolidated Financial Statements.

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

	Unaudited Nine Months Ended	
	September 27, 2003	**September 28, 2002**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Loss from continuing operations	$ (78,592)	$ (246,877)
Adjustments to reconcile loss from continuing operations to net cash provided by (used for) operating activities:		
Depreciation and amortization	12,215	16,556
Gain on debt retirement	(13,833)	(5,870)
Goodwill impairment charges	34,183	97,000
Deferred income taxes		94,800
Fixed asset impairment charges, net of gains	15,347	26,622
Increase/decrease:		
Accounts receivable, trade	(13,327)	(20,665)
Refundable income taxes	60,920	(10,129)
Inventories	388	25,890
Cash collateral deposits	9,600	(13,392)
Accounts payable	5,849	10,828
Accrued liabilities	13,008	22,651
Other, net	11,088	4,034
Net cash provided by continuing operating activities	56,846	1,448
CASH FLOWS FROM DISCONTINUED OPERATIONS:		
Loss from discontinued operations	(20,902)	(3,195)
Decrease (increase) in net assets of discontinued operations	25,076	(16,222)
Net cash provided by (used for) discontinued operations	4,174	(19,417)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisitions and deferred purchase price payments	(3,882)	(3,500)
Additions to property, plant and equipment	(4,368)	(4,347)
Investments in and advances to unconsolidated subsidiaries	(446)	(2,084)
Proceeds on disposal of fixed assets	5,193	3,591
Net cash used for investing activities	(3,503)	(6,340)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Decrease in floor plan payable, net	(2,305)	(61,739)
Repayment of long-term debt	(480)	(738)
Proceeds from Senior Notes		145,821
Purchase of Senior Notes	(35,830)	(23,750)
Increase in deferred financing costs	(1,985)	(1,494)
Decrease (increase) in restricted cash	50,371	(35,701)
Preferred stock issued, net		23,810
Dividends paid on preferred stock	(937)	
Common stock issued, net	1,064	1,000
Net cash provided by financing activities	9,898	47,209

NET INCREASE IN CASH AND CASH EQUIVALENTS	67,415	22,900
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	77,381	69,456
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 144,796	$ 92,356

See accompanying Notes to Consolidated Financial Statements.

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CHAMPION ENTERPRISES, INC.

Consolidated Statement of Shareholders Equity (Deficit)
Unaudited Nine Months Ended September 27, 2003
(In thousands)

	Common stock Shares	Common stock Amount	Capital in excess of par value	Accumulated deficit	Accumulated other comprehensive income (loss)	Total	Total comprehensive income (loss)
Balance at December 28, 2002	52,658	$52,658	$54,666	$ (68,150)	$(1,849)	$ 37,325	
Net loss				(99,494)		(99,494)	$(99,494)
Preferred stock dividends				(619)		(619)	
Stock options and benefit plans	551	551	4,043			4,594	
Amortization of preferred stock issuance costs			(622)			(622)	
Preferred stock conversions	3,751	3,751	17,499			21,250	
Issuance for acquisition deferred purchase price payments	1,440	1,440	3,174			4,614	
Charge for induced conversion of preferred stock			3,488	(3,488)			
Foreign currency translation adjustments					1,182	1,182	1,182
Balance at September 27, 2003	58,400	$58,400	$82,248	$(171,751)	$ (667)	$(31,770)	$(98,312)

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 restructuring charges discussed in Note 2, the goodwill impairment charges discussed in Note 3 and the charge to retained earnings related to the induced conversion of the Series C Preferred Stock recorded in the first quarter 2003 and 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.

The Company exited its consumer finance business during the third quarter of 2003 and as a result reclassified that segment as discontinued operations for all periods presented.

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 loss, loss per share and stock-based compensation expense would have been the amounts indicated below:

	Three Months Ended	
	September 27, 2003	September 28, 2002
	(In thousands, except per share amounts)	
Net loss as reported	$ (81,096)	$ (38,935)
Net loss pro forma	(79,895)	(40,055)
Basic and diluted loss per share as reported	(1.41)	(0.80)
Basic and diluted loss per share pro forma	(1.39)	(0.83)
Stock-based employee compensation expense (income), net of related tax effects as reported	2,423	(311)
Stock-based employee compensation expense, net of related tax effects pro forma	$ 1,222	$ 809

	Nine Months Ended	
	September 27, 2003	September 28, 2002
	(In thousands, except per share amounts)	
Net loss as reported	$ (99,494)	$ (250,072)
Net loss pro forma	(99,497)	(252,493)
Basic and diluted loss per share as reported	(1.84)	(5.15)
Basic and diluted loss per share pro forma	(1.84)	(5.20)
Stock-based employee compensation expense, net of related tax effects as reported	2,696	6
Stock-based employee compensation expense, net of related tax effects pro forma	$ 2,699	$ 2,427

2. During the quarter ended September 27, 2003, the Company announced the closure of four manufacturing facilities, the relocation of one manufacturing facility and the closure of 35 retail sales centers and recorded $26.9 million of restructuring charges. During the quarter, the 35 retail sales centers ceased normal operations and 11 of those sales centers had been abandoned after the liquidation of inventory.

The remaining closures will be completed in the fourth quarter of 2003 as the inventory is liquidated and the sites are vacated. The four announced manufacturing closures ceased production in early October. The closure of the four facilities and relocation of one facility are expected to be substantially complete during the fourth quarter of 2003. In connection with these closures, the Company estimates additional

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restructuring charges totaling $2.3 million will be recorded in the fourth quarter of 2003, primarily comprised of lease termination and severance costs. All restructuring actions are expected to be substantially complete by the end of the fourth quarter of 2003.

For the year-to-date period, retail closures, including the 35 described above, total 38 or 32% of the sales centers the Company was operating at the beginning of 2003. For the year, manufacturing closures, including the four described above, total seven, or 19% of the manufacturing facilities operated at the beginning of the year.

During the quarter ended September 28, 2002, the Company closed 64 retail sales centers and seven manufacturing facilities and recorded $42.9 million of restructuring charges. During the nine months then ended, the Company closed 100 retail sales centers and ten manufacturing facilities. The 2002 restructuring charges also included $0.3 million of severance costs related to eliminating 19 employees from the corporate office staff and charges totaling $2.3 million related to the Company exiting its principal development operations.

Restructuring charges for the three and nine months ended September 27, 2003 and September 28, 2002 were as follows:

	Three Months Ended		Nine Months Ended	
	September 27, 2003	September 28, 2002	September 27, 2003	September 28, 2002
	(In thousands)			
Manufacturing charges:				
Fixed asset impairment charges	$15,100	$19,500	$15,100	$19,500
Inventory charges	1,000	1,500	1,000	1,500
Warranty costs	3,300	3,500	3,300	3,500
Severance costs	600	1,800	600	1,800
Other closing costs	600		600	
Total manufacturing charges	20,600	26,300	20,600	26,300
Retail charges:				
Fixed asset impairment charges	2,000	5,000	2,000	6,900
Inventory charges	4,600	6,300	4,600	6,300
Lease termination costs	200	1,800	200	3,000
Other closing costs	1,600	900	1,600	2,700
Total retail charges	8,400	14,000	8,400	18,900
Development charges:				
Severance costs		1,200		1,200
Asset impairment charges		1,100		1,100
Total development charges		2,300		2,300
Corporate office severance costs		300		300
Intercompany profit elimination	(2,100)		(2,100)	
Total restructuring charges	$26,900	$42,900	$26,900	$47,800

Restructuring charges incurred in 2003 were accounted for in accordance with SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities. Restructuring charges incurred prior to 2003 were accounted for 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).

Inventory charges, net of intercompany profit elimination, and warranty costs are included in cost of goods sold while fixed asset impairment charges, severance costs, lease termination charges and other closing costs are included in restructuring charges.

Fixed asset impairment charges for the announced manufacturing facility closures were primarily based on appraised values and the Company s estimates of net sales values. At September 27, 2003, the Company had 22 idle manufacturing facilities of which 13 were permanent closures and are for sale. A majority of the Company s idle manufacturing facilities are accounted for as long-lived assets to be held and used, including certain of those for sale, due to uncertainty of completing a sale within one year.

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Manufacturing inventory charges are for obsolescence related to the consolidation of product lines and models as a result of the four plant closings and the one plant relocation announced in the quarter, as well as the elimination of stock keeping units. Additional warranty costs were provided for due to expected higher costs to service homes after the closure of plants in certain areas. Manufacturing severance costs are related to the termination of substantially all the employees at the four manufacturing facility closures announced in the quarter and include a portion of payments required under the Worker Adjustment and Retraining Notification Act and severance payments to qualifying salaried employees. Approximately 600 employees have been or will be terminated at these four facilities.

Retail fixed asset impairment charges were determined based on net book value at the 35 closed sales centers and result from the planned abandonment of leasehold improvements. Retail inventory charges represent estimated losses resulting from the bulk sale of certain new home inventory and estimated lower of cost or market charges for inventory of land, park spaces and improvements at closed sales centers. For purposes of reconciling 2003 restructuring charges by segment, a credit (income) of $2.1 million resulted from the reduction in intercompany profit in inventory associated with the bulk sale of new home inventory mentioned above. Retail lease termination charges consist of accruals for future lease payments, net of estimated sublease income or settlements, for the termination of leases at vacated sales centers. Approximately 170 retail employees have been or will be terminated as a result of these 35 sales center closings.

The following table summarizes the changes in accrued restructuring costs during the nine months ended September 27, 2003.

	Reserve balance at December 28, 2002	Charges recorded	Costs paid or settled	Adjustments	Reserve balance at September 27, 2003
			(In thousands)		
Manufacturing accruals:					
Warranty costs	$2,938	$3,300	$(1,293)	$2,100	$ 7,045
Severance costs		600			600
Other closing costs		600	(265)		335
Total manufacturing	2,938	4,500	(1,558)	2,100	7,980
Retail accruals:					
Lease termination costs	2,549	200	(1,125)	(114)	1,510
Other closing costs		1,600	(412)		1,188
Total retail	2,549	1,800	(1,537)	(114)	2,698
Total restructuring reserves	$5,487	$6,300	$(3,095)	$1,986	$10,678

During the third quarter of 2003, the Company accrued additional warranty costs of $2.1 million for estimated additional costs for prior closures of manufacturing facilities.

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

	Nine Months Ended September 27, 2003			
	Manufacturing	Retail	Other	Total
		(In thousands)		
Balance at December 28, 2002	$126,403	$ 34,439	$ 494	$161,336
Impairment charges		(34,183)		(34,183)
Other changes	98	(256)	(494)	(652)
Balance at September 27, 2003	$126,501	$	$	$126,501

In the third quarter of 2003, as a result of the significant downsizing of its operations in reaction to ongoing reductions in industry sales and in accordance with SFAS No. 142, the Company performed a test for retail and manufacturing goodwill impairment using the income approach. Under this method, the fair value of the reporting unit is determined based on the present value of estimated future cash flows that the reporting unit is expected to generate over its remaining life. In applying this method, the Company was required to make estimates of future operating trends and judgments about discount rates and other variables. Actual future results could differ from these estimates. In applying the income approach, it assumed a cash flow

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period of five years, a discount rate of 12%, and a terminal value of the fifth year s estimated future cash flows for the next five years. 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 $34.2 million, which was recorded in the quarter ended September 27, 2003.

The $0.5 million decrease in other goodwill during the nine months ended September 27, 2003 was due to the sale of land, land improvements and certain other assets of a development company during the first quarter of 2003.

In the second quarter of 2002, as a result of the closure of 64 retail sales centers, the Company performed a test for goodwill impairment similar to that described above. 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.

4. In the quarter ended September 27, 2003, the Company decided to exit the consumer finance business. The Company s financial services segment operated as HomePride Finance Corp. (HPFC). HPFC stopped accepting new loan applications on July 31, 2003 and processed approved applications through September 30, 2003. The loss from discontinued operations related to HPFC is summarized below:

	Three Months Ended		Nine Months Ended	
	September 27, 2003	September 28, 2002	September 27, 2003	September 28, 2002
	(In thousands)			
Loss from operations	$(1,074)	$(1,967)	$(12,302)	$(3,195)
Loss on discontinuance	(8,600)		(8,600)	
Loss from discontinued operations	$(9,674)	$(1,967)	$(20,902)	$(3,195)

The loss on discontinuance included a goodwill impairment charge of $4.1 million as well as fixed asset impairment charges, severance costs and accruals for the estimated costs associated with the termination of operating leases and other contracts. Approximately 30 employees have been or will be terminated as a result of the discontinuance. Net revenues of the financial services business were $2.3 million for the nine months ended September 27, 2003 and $0.5 million for the nine months ended September 28, 2002. The loss from discontinued operations was net of income tax benefits of $1.3 million and $2.0 million for the three and nine months ended September 28, 2002, respectively.

At September 27, 2003, the current assets of the discontinued operations consisted of $1.1 million of loans receivable and $0.5 million of other assets. Non-current assets of discontinued operations consist primarily of fixed assets. The short-term liabilities of discontinued operations were primarily comprised of accrued severance costs and accrued contractual obligations.

During the quarter ended September 27, 2003, the Company sold loans receivable with a face value of $26.1 million for gross proceeds of approximately $24.3 million resulting in net cash of $14.3 million after reduction of associated short-term borrowings. During the nine months ended September 27, 2003, the Company sold loans with a face value of $85.8 million for gross proceeds of approximately $78.4 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 $26.2 million after reduction of associated short-term borrowings. During the three and nine months ended September 27, 2003, the Company originated $7.9 million and $35.8 million of loans, respectively.

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

	Nine Months Ended	
	September 27, 2003	September 28, 2002
	(In thousands)	
Statutory U.S. tax rate	$(28,200)	$ (62,500)
Increase (decrease) in rate resulting from		
Deferred tax valuation allowance	25,200	122,900
State taxes, net of federal tax effect	250	(3,700)
Nondeductible goodwill amortization and impairment charges		10,300
Other	800	900
Total income tax provision (benefit)	$ (1,950)	$ 67,900

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 has demonstrated their realizability through sustained profitability and/or from other factors. Current federal income tax regulations provide for a two-year carryback of net operating losses. The Company has no taxable income available during this carryback period and, as a result, any net operating losses incurred in 2003 will become tax loss carryforwards that will be available to offset certain future taxable income. The effective tax rate for the nine months ended September 27, 2003 differs from the 35% federal statutory rate primarily because of this 100% valuation allowance for deferred taxes 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. Upon 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 which was recorded in the first quarter of 2003 through a reduction in the related valuation allowance.

6. A summary of inventories by component follows:

	September 27, 2003	December 28, 2002
	(In thousands)	
New manufactured homes	$ 53,892	$ 55,846
Raw materials	26,710	27,097
Work-in-process	6,665	6,557
Other inventory	23,677	21,832
	$110,944	$111,332

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

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

	September 27, 2003	December 28, 2002
	(In thousands)	
Other current assets		

Refundable income taxes	$ 655	$ 61,100
Deposits	6,500	16,100
Other current assets	7,917	11,759
	$ 15,072	$ 88,959

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	September 27, 2003	December 28, 2002
	(In thousands)	
Other long-term liabilities		
Accrued self-insurance and warranty	$23,200	$23,200
Deferred portion of purchase price	4,000	10,000
Other long-term liabilities	24,216	23,554
	$51,416	$56,754

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

8. The Company s manufacturing operations provide retail homebuyers with a twelve-month warranty from the date of purchase. Estimated warranty costs are accrued as cost of sales at the time of sale. The warranty provision and reserves are based on estimates of the amounts necessary to settle existing and future claims for homes sold by the manufacturing operations as of the balance sheet date. The following table summarizes the changes in accrued product warranty obligations during the nine months ended September 27, 2003. A portion of warranty reserves was classified as other long-term liabilities in the consolidated balance sheet.

	Accrued Warranty Obligations
	(In thousands)
Reserves at December 28, 2002	$ 49,639
Warranty expense provided	45,963
Cash warranty payments	(44,554)
Reserves at September 27, 2003	$ 51,048

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

	September 27, 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	2,905	3,467
	$290,510	$341,612

During the nine months ended September 27, 2003 the Company purchased and retired $35.5 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 nine months ended September 28, 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 and certain ratios of earnings to fixed charges, as defined. Liquidity, as defined, consists of the majority of the Company s unrestricted cash and cash equivalents plus unused availability under the facility. Fixed charges, as defined, consist primarily of interest expense, capital expenditures, dividends paid in cash, required principal payments of debt and lease payments paid or accrued during the calculation period as well as cash losses under wholesale repurchase obligations. In addition, the facility contains covenants that limit the Company s ability to incur additional indebtedness and liens, sell assets and, if liquidity falls below $35 million, make certain investments, pay dividends and purchase or redeem its

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common stock. The line of credit is collateralized by accounts receivable, inventories, property, plant, and equipment, cash and other assets. As of September 27, 2003, facility availability was $67.4 million, letters of credit outstanding totaled $66.9 million, there were no borrowings outstanding and the Company s liquidity was $152.2 million, which 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 ofes New Roman" SIZE="2">The net decrease in cash and cash equivalents for the six months ended June 30, 2012 was primarily due to the investment of our cash reserves in certain government and government-backed securities, as previously noted.

The net increase in cash and cash equivalents of $3.9 million for the six months ended June 30, 2011 was primarily due to cash generated from our operating activities. Net income for the period was $2.9 million. In addition, our accounts payable and other current liabilities, net of the excess tax benefit generated by the exercise of nonqualified options in 2011, increased by $2.0 million from December 31, 2010, which had a favorable impact on our operating cash flows. Contributing to our increase in cash and cash equivalents was the cash proceeds received from the exercise of stock options during 2011 of $0.5 million. These increases were partially offset by scheduled debt payments of $1.3 million.

OFF-BALANCE SHEET ARRANGEMENTS

During the six months ended June 30, 2012 and 2011, we did not engage in any off-balance sheet arrangements.

Item 3: Quantitative and Qualitative Disclosure about Market Risk

Interest Rate Risk

We are exposed to market risk related to changes in interest rates on our revolving credit facility. We do not utilize derivative financial instruments or other market risk-sensitive instruments to manage exposure to interest rate changes. The main objective of our cash investment activities is to preserve principal while maximizing interest income through low-risk investments.

The interest rate related to borrowings under our revolving credit facility is a variable rate of LIBOR plus an Applicable Margin, as defined in the debt agreement (2.25% at June 30, 2012). As of June 30, 2012, we had outstanding borrowings of approximately $4.4 million under our revolving credit facility. If interest rates increased by 1.0%, our annual interest expense on our borrowings would increase by less than $0.1 million.

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Exchange Rate Risk

While we operate primarily in the United States, some of our research and development is performed abroad. As of June 30, 2012, our outstanding payables denominated in a foreign currency were less than $0.1 million.

Currently, we do not utilize financial instruments to hedge exposure to foreign currency fluctuations. We believe our exposure to foreign currency fluctuation is minimal as our purchases in foreign currency have a maximum exposure of 30 days based on invoice terms. Foreign currency exchange gains and losses were not significant for the six months ended June 30, 2012 and 2011. Neither a 10% increase nor decrease from current exchange rates would have a significant effect on our operating results or financial condition.

Item 4: Controls and Procedures

Our principal executive and principal financial officer evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of June 30, 2012. Based on that evaluation, our disclosure controls and procedures are considered effective to ensure that material information relating to us and our consolidated subsidiaries is made known to officers within these entities in order to allow for timely decisions regarding required disclosure.

PART II OTHER FINANCIAL INFORMATION

Item 1: Legal Proceedings

See Item 1A, Risk Factors, below for a discussion regarding legal proceedings, which is incorporated by reference herein.

Item 1a: Risk Factors

Information regarding risk factors appears on pages 17 through 31 in our Annual Report on Form 10-K for the year ended December 31, 2011 under the section titled Risk Factors. The following risk factor was included in our Form 10-K for the year ended December 31, 2011, and has been updated for recent developments:

Our strategy to secure and extend marketing exclusivity or patent rights may provide only limited protection from competition.

We seek to secure and extend marketing exclusivity for our products through a variety of means, including FDA exclusivity and patent rights. Additional barriers for competitors seeking to enter the market include the time and cost associated with the development, regulatory approval and manufacturing of a similar product formulation.

Acetadote is indicated to prevent or lessen hepatic (liver) injury when administered intravenously within eight to ten hours after ingesting quantities of acetaminophen that are potentially toxic to the liver. In April 2012, the United States Patent and Trademark Office (the USPTO) issued U.S. Patent number 8,148,356 (the Acetadote Patent) which is assigned to us. The claims of the Acetadote Patent encompass the new Acetadote formulation. Following its issuance, the Acetadote Patent was listed in the FDA Orange Book. The Acetadote Patent is scheduled to expire in May 2026 which time period includes a 270-day patent term adjustment granted by the USPTO. We also have additional patent applications relating to the uses of Acetadote which are pending with the USPTO and may or may not be issued.

Following the issuance of the Acetadote Patent, we received separate Paragraph IV certification notices from InnoPharma, Inc., Paddock Laboratories, LLC and Mylan Institutional LLC challenging the Acetadote Patent on the basis of non-infringement and/or invalidity. On May 17, 2012, we responded to the Paragraph IV certification notices by filing three separate lawsuits for infringement of the Acetedote Patent. The first lawsuit was filed against Mylan Institutional LLC and Mylan Inc. in the United States District Court for the Northern District of Illinois, Eastern Division. The second lawsuit was filed against InnoPharma, Inc. in the United States District Court for the District of Delaware. The third lawsuit was also filed in the United States District Court for the District of Delaware against Paddock Laboratories, LLC and Perrigo Company. On May 20, 2012, we received a fourth Paragraph IV certification notice from Sagent Agila LLC challenging the Acetadote Patent. On June 26, 2012, we filed a lawsuit for infringement of the Acetadote Patent against Sagent Agila LLC and Sagent Pharmaceuticals, Inc. in the United States District Court for the District of Delaware. On July 9, 2012, we received a Paragraph IV certification notice from Perrigo Company. We intend to vigorously defend and protect our Acetadote product and related intellectual property rights.

By statute, where the Paragraph IV certification is to a patent timely listed before an Abbreviated New Drug Application (ANDA) is filed, a company has 45 days to institute a patent infringement lawsuit during which period the FDA may not approve another application. In addition, such a lawsuit for patent infringement filed within such 45-day period may stay, or bar, the FDA from approving another product application for two and a half years or until a district court decision that is adverse to the asserted patents, whichever is earlier. On May 18, 2012, we requested the aforementioned bar or stay in connection with the filing of the three lawsuits on May 17, 2012. The aforementioned bar or stay may or may not be available to us with respect to the lawsuits.

On May 18, 2012, we also submitted a Citizen Petition to the FDA requesting that the FDA refrain from approving any applications for acetylcysteine injection that contain EDTA, based in part on the FDA s request that we evaluate the reduction or removal of EDTA from its original Acetadote formulation.

If we are unsuccessful in protecting our Acetadote intellectual property rights, our competitors may be able to introduce products into the marketplace that reduce the sales and market share of our Acetadote product which may require us to take measures such as reducing prices or increasing our marketing expense, any of which may result in a material adverse effect on our financial condition and results of operations.

We have a U.S. patent for Caldolor, and some related international patents, which are directed to ibuprofen solution formulations, methods of making the same, and methods of using the same, and which are related to our formulation and manufacture of Caldolor. Additionally, the active ingredient in Caldolor ibuprofen is in the public domain, and if a competitor were to develop a sufficiently distinct formulation, it could develop and seek FDA approval for another ibuprofen product that competes with Caldolor. Upon receipt of FDA approval in June 2009, we received three years of marketing exclusivity for Caldolor. Upon the expiration of our marketing exclusivity, a competitor with a generic form of injectable ibuprofen could enter the market.

While we consider patent protection when evaluating product acquisition opportunities, any products we acquire in the future may not have significant patent protection. Neither the USPTO nor the courts have a consistent policy regarding the breadth of claims allowed or the degree of protection afforded under many pharmaceutical patents. Patent applications in the U.S. and many foreign jurisdictions are typically not published until 18 months following the filing date of the first related application, and in some cases not at all. In addition, publication of discoveries in scientific literature often lags significantly behind actual discoveries. Therefore, neither we nor our licensors can be certain that we or they were the first to make the inventions claimed in our issued patents or pending patent applications, or that we or they were the first to file for protection of the inventions set forth in these patent applications. In addition, changes in either patent laws or in interpretations of patent laws in the U.S. and other countries may diminish the value of our intellectual property or narrow the scope of our patent protection. Furthermore, our competitors may independently develop similar technologies or duplicate technology developed by us in a manner that does not infringe our patents or other intellectual property. As a result of these factors, our patent rights may not provide any commercially valuable protection from competing products.

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

Purchases of Equity Securities

The following table summarizes the purchase of equity securities by the Company during the three months ended June 30, 2012:

Period	Total Number of Shares (or Units) Purchased	Average Price Paid per Share (or Unit)	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plan or Programs
April 1 April 30	103,500	$ 7.63	103,500	$ 4,475,544
May 1 May 31				4,475,544
June 1 June 30	67,900	6.28	67,900	4,049,143
Total	171,400		171,400	

Item 5: Other Information

In July 2012, we entered into the Third Amendment to Amended and Restated Lease Agreement (the Amendment) for the research facilities at Cumberland Emerging Technologies, Inc. The Amendment provides for an expansion of the leased premises from 6,718 rentable square feet to 14,151 square feet. The lease will terminate on April 30, 2018, with options to renew for two additional five-year periods.

In July 2012, we entered into an amendment to the manufacturing agreement with Bayer Healthcare LLC to extend the manufacturing agreement for Acetadote to September 2013. The amendment also establishes monthly minimum purchase requirements, which we expect to meet.

Item 6: Exhibits

No.	Description
10.24.1	Third Amendment to Amended and Restated Lease Agreement, dated July 3, 2012, by and between The Gateway to Nashville LLC and Cumberland Emerging Technologies, Inc.
10.25.1	Amendment Number 1 to the Manufacturing Agreement, effective January 19, 2009, between Cumberland Pharmaceuticals Inc. and Bayer Healthcare LLC
10.25.2	Amendment Number 2 to the Manufacturing Agreement, effective June 30, 2012 between Cumberland Pharmaceuticals Inc. and Bayer Healthcare LLC
31.1	Certification of Chief Executive Officer Pursuant to Rule 13-14(a) of the Securities Exchange Act of 1934 as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer Pursuant to Rule 13-14(a) of the Securities Exchange Act of 1934 as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Confidential treatment has been requested for portions of this exhibit. These portions have been omitted from the Registration Statement and submitted separately to the Securities and Exchange Commission.

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SIGNATURES

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

Cumberland Pharmaceuticals Inc.

Dated: August 9, 2012

By: */s/ A.J. Kazimi*
A. J. Kazimi
Chief Executive Officer

By: */s/ Rick S. Greene*
Rick S. Greene
Chief Financial Officer