

CHAMPION INDUSTRIES INC
Form 10-Q
March 11, 2011
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended January 31, 2011

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 No. 0-21084

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

West Virginia
(State or other jurisdiction of
incorporation or organization)

55-0717455
(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 No .

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No .

Edgar Filing: CHAMPION INDUSTRIES INC - Form 10-Q

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No .

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

| Class | Outstanding at January 31, 2011 |
|--|---------------------------------|
| Common stock, \$1.00 par value per share | 9,987,913 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 Shareholders' Equity (Unaudited) | 6 |
| Consolidated Statements of Cash Flows (Unaudited) | 7 |
| Notes to Consolidated Financial Statements | 8 |
| Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations | 16 |
| Item 3. Quantitative and Qualitative Disclosure About Market Risk | 20 |
| Item 4. Controls and Procedures | 20 |
| Part II. Other Information | |
| Item 1A. Risk Factors | 21 |
| Item 6. Exhibits | 21 |
| Signatures | 22 |

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

Champion Industries, Inc. and Subsidiaries
Consolidated Balance Sheets

| ASSETS | January 31, 2011 (Unaudited) | October 31, 2010 (Audited) |
|--|------------------------------------|----------------------------------|
| Current assets: | | |
| Accounts receivable, net of allowance of \$1,099,000 and \$1,297,000 | \$ 18,163,402 | \$ 18,133,748 |
| Inventories | 9,288,266 | 9,690,333 |
| Income tax refund | - | 36,293 |
| Other current assets | 1,375,938 | 652,178 |
| Deferred income tax assets | 1,144,519 | 1,144,519 |
| Total current assets | 29,972,125 | 29,657,071 |
| Property and equipment, at cost: | | |
| Land | 2,016,148 | 2,016,148 |
| Buildings and improvements | 11,860,349 | 11,843,376 |
| Machinery and equipment | 55,095,709 | 55,025,237 |
| Furniture and fixtures | 4,188,751 | 4,171,194 |
| Vehicles | 3,308,978 | 3,266,898 |
| | 76,469,935 | 76,322,853 |
| Less accumulated depreciation | (54,731,538) | (53,949,280) |
| | 21,738,397 | 22,373,573 |
| Goodwill | 15,332,283 | 15,332,283 |
| Deferred financing costs | 1,161,643 | 1,267,174 |
| Other intangibles, net of accumulated amortization | 5,085,082 | 5,195,361 |
| Trademark and masthead | 10,001,812 | 10,001,812 |
| Deferred tax asset, net of current portion | 8,370,151 | 8,370,151 |
| Other assets | 35,270 | 36,561 |
| | 39,986,241 | 40,203,342 |
| Total assets | \$ 91,696,763 | \$ 92,233,986 |

See notes to consolidated financial statements.

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

| LIABILITIES AND SHAREHOLDERS' EQUITY | January 31, 2011 (Unaudited) | October 31, 2010 (Audited) |
|---|------------------------------------|----------------------------------|
| Current liabilities: | | |
| Negative book cash balances | \$ 2,202,315 | \$ 1,013,713 |
| Accounts payable | 3,328,994 | 4,116,087 |
| Deferred revenue | 904,295 | 720,549 |
| Accrued payroll and commissions | 1,491,551 | 2,115,922 |
| Taxes accrued and withheld | 1,040,198 | 1,125,726 |
| Accrued expenses | 1,983,246 | 1,930,327 |
| Accrued income taxes | 29,612 | - |
| Current portion of long-term debt: | | |
| Notes payable | 5,519,903 | 5,484,842 |
| Total current liabilities | 16,500,114 | 16,507,166 |
| Long-term debt, net of current portion: | | |
| Line of credit | 11,101,742 | 10,425,496 |
| Notes payable | 40,594,312 | 41,873,500 |
| Other liabilities | 5,100 | 5,550 |
| Total liabilities | 68,201,268 | 68,811,712 |
| Shareholders' equity: | | |
| Common stock, \$1 par value, 20,000,000 shares authorized; 9,987,913 shares issued and outstanding | 9,987,913 | 9,987,913 |
| Additional paid-in capital | 22,768,610 | 22,768,610 |
| Retained deficit | (9,261,028) | (9,334,249) |
| Total shareholders' equity | 23,495,495 | 23,422,274 |
| Total liabilities and shareholders' equity | \$ 91,696,763 | \$ 92,233,986 |

See notes to consolidated financial statements.

Edgar Filing: CHAMPION INDUSTRIES INC - Form 10-Q

Champion Industries, Inc. and Subsidiaries

Consolidated Statements of Operations
(Unaudited)

| | Three Months Ended January 31, | |
|---|-----------------------------------|---------------|
| | 2011 | 2010 |
| Revenues: | | |
| Printing | \$ 19,558,178 | \$ 19,749,471 |
| Office products and office furniture | 8,339,302 | 8,261,714 |
| Newspaper | 4,007,675 | 4,376,061 |
| Total revenues | 31,905,155 | 32,387,246 |
| Cost of sales and newspaper operating costs: | | |
| Printing | 15,120,842 | 14,721,374 |
| Office products and office furniture | 6,099,486 | 5,931,021 |
| Newspaper cost of sales and operating costs | 2,175,222 | 2,128,606 |
| Total cost of sales and newspaper operating costs | 23,395,550 | 22,781,001 |
| Gross profit | 8,509,605 | 9,606,245 |
| Selling, general and administrative expenses | 7,216,662 | 8,716,644 |
| Restructuring charges | 220,658 | - |
| Income from operations | 1,072,285 | 889,601 |
| Other income (expenses): | | |
| Interest expense | (968,822) | (1,569,812) |
| Other | 16,681 | 304,581 |
| | (952,141) | (1,265,231) |
| Income (loss) before income taxes | 120,144 | (375,630) |
| Income tax (expense) benefit | (46,923) | 162,944 |
| Net income (loss) | \$ 73,221 | \$ (212,686) |
| Income (loss) per share | | |
| Basic | \$ 0.01 | \$ (0.02) |
| Diluted | \$ 0.01 | \$ (0.02) |
| Weighted average shares outstanding: | | |
| Basic | 9,988,000 | 9,988,000 |
| Diluted | 9,988,000 | 9,988,000 |
| Dividends per share | \$ - | \$ - |

See notes to consolidated financial statements.

Champion Industries, Inc. and Subsidiaries
Consolidated Statements of Shareholders' Equity
(Unaudited)

| | Common Stock | | Additional | Retained | Other | Total |
|----------------------------|--------------|--------------|--------------------|----------------|-----------------------|---------------|
| | Shares | Amount | Paid-In Capital | Deficit | Comprehensive Loss | |
| Balance, October 31, 2010 | 9,987,913 | \$ 9,987,913 | \$ 22,768,610 | \$ (9,334,249) | \$ - | \$ 23,422,274 |
| Comprehensive income: | | | | | | |
| Net Income | - | - | - | 73,221 | - | 73,221 |
| Total comprehensive income | - | - | - | 73,221 | - | 73,221 |
| Balance, January 31, 2011 | 9,987,913 | \$ 9,987,913 | \$ 22,768,610 | \$ (9,261,028) | \$ - | \$ 23,495,495 |

See notes to consolidated financial statements.

Champion Industries, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

January 31, 2011

1. Basis of Presentation, Business Operations and Recent Accounting Pronouncements

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, 2010, and related notes thereto contained in Champion Industries, Inc.'s Form 10-K filed January 28, 2011. 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, 2010 was derived from our audited financial statements.

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. There was no dilutive effect of stock options for the three months ended January 31, 2011 and 2010.

3. Accounts Receivable, Allowance for Doubtful Accounts and Revenue Recognition

Accounts Receivable: Accounts receivable are stated at the amount billed to customers. Accounts receivable are ordinarily due 30 days from the invoice date. The Company encounters risks associated with sales and the collection of the associated accounts receivable. As such, the Company records a monthly provision for accounts receivable that are considered to be uncollectible. In order to calculate the appropriate monthly provision, the Company primarily utilizes a historical rate of accounts receivable written off as a percentage of total revenue. This historical rate is applied to the current revenues on a monthly basis. The historical rate is updated periodically based on events that may change the rate such as a significant increase or decrease in collection performance and timing of payments as well as the calculated total exposure in relation to the allowance. Periodically, the Company compares the identified credit risks with the allowance that has been established using historical experience and adjusts the allowance accordingly.

Revenue Recognition: Revenues are recognized when products are shipped or ownership is transferred and when services are rendered to customers. The Company acts as a principal party in sales transactions, assumes title to products and assumes the risks and rewards of ownership including risk of loss for collection, delivery or returns. The Company typically recognizes revenue for the majority of its products upon shipment to the customer and transfer of title. Under agreements with certain customers, custom forms may be stored by the Company for future delivery. In these situations, the Company may receive a logistics and warehouse management fee for the services provided. In these cases, delivery and bill schedules are outlined with the customer and product revenue is recognized when manufacturing is complete and the product is received into the warehouse, title transfers to the customer, the order is invoiced and there is reasonable assurance of collectability. Since the majority of products are customized, product returns are not significant. Therefore, the Company records sales on a gross basis. Advertising revenues are recognized, net of agency commissions, in the period when advertising is printed or placed on websites. Circulation

revenues are recognized when purchased newspapers are distributed. Amounts received from customers in advance of revenue recognized are recorded as deferred revenue.

Champion Industries, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited) (continued)

4. 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:

| | January 31, 2011 | October 31, 2010 |
|--------------------------------------|---------------------|---------------------|
| Printing and newspaper: | | |
| Raw materials | \$ 2,543,686 | \$ 2,897,036 |
| Work in process | 1,149,234 | 1,130,291 |
| Finished goods | 3,262,605 | 3,451,815 |
| Office products and office furniture | 2,332,741 | 2,211,191 |
| | \$ 9,288,266 | \$ 9,690,333 |

5. Long-Term Debt

Long-term debt consisted of the following:

| | January 31, 2011 | October 31, 2010 |
|--|---------------------|---------------------|
| Installment notes payable to banks & shareholder | \$ 4,281,237 | \$ 4,300,364 |
| Term loan facility with syndicate of banks | 41,832,978 | 43,057,978 |
| | 46,114,215 | 47,358,342 |
| Less current portion | 5,519,903 | 5,484,842 |
| Long-term debt, net of current portion | \$ 40,594,312 | \$ 41,873,500 |

Champion Industries, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited) (continued)

On December 29, 2009, the Company, Marshall T. Reynolds, Fifth Third Bank, as Administrative Agent for lenders under the Company's Credit Agreement dated September 14, 2007, and the other lenders entered into a Forbearance Agreement. The Forbearance Agreement, among other provisions, required Marshall T. Reynolds to lend to the Company \$3,000,000 in exchange for a subordinated unsecured promissory note in like amount, payment of principal and interest on which is prohibited until payment of all liabilities under the Credit Agreement. The subordinated unsecured promissory note, bearing interest at a floating Wall Street Journal prime rate and maturing September 14, 2014, and a debt subordination agreement, both dated December 29, 2009, were executed and delivered, and Mr. Reynolds advanced \$3,000,000 to the Company. The \$3,000,000 was applied to a prepayment of \$3,000,000 of the Company's loans. The Forbearance Agreement expired on March 31, 2010 and the Company entered into a Second Amendment and Waiver to Credit Agreement.

On March 31, 2010, the Company, Fifth Third Bank, as a Lender, L/C Issuer and Administrative Agent for Lenders (the "Administrative Agent") and the other Lenders party to Champion's Credit Agreement dated September 14, 2007 (the "Credit Agreement") entered into a Second Amendment and Waiver to Credit Agreement ("the "Second Amendment"). All conditions precedent to the effectiveness of the Second Amendment were satisfied on April 6, 2010. The Company has pledged substantially all of the assets of the Company as collateral for the indebtedness under the Credit Agreement.

In the Second Amendment the Administrative Agent and Lenders waived any default or event of default arising from Champion's previously disclosed violations of provisions of the Credit Agreement. The Second Amendment amended various provisions of the Credit Agreement, including but not limited to:

- a \$17,000,000 revolving credit facility with a sublimit of up to \$3,000,000 for letters of credit and \$3,000,000 for swing line loans. Outstanding borrowings, thereunder, may not exceed the sum of (1) up to 85% of eligible receivable plus (b) up to the lesser of \$6,000,000 or 50% of eligible inventory.
 - at the Company's option, interest at a LIBOR Rate, so long as no default exists.
 - post-default increase in interest rate of 2%.
 - amendment of various financial covenants.
 - fixed charge coverage ratio is required to be 1.0:1.0 through January 31, 2011; 1.1:1.0 through January 31, 2012 and 1.20:1.00 thereafter
- leverage ratio shall not be greater than 6.5:1.00 at April 30, 2010 with 0.5:1.00 step-downs quarterly through April 30, 2011 and 0.25:1.00 quarterly step-downs through April 30, 2012.
- minimum EBITDA pursuant to a quarterly build up commencing with the three months ended April 30, 2010 of \$2,700,000, the six months ended July 31, 2010 of \$5,400,000, the nine months ended October 31, 2010 of \$8,900,000 and the twelve months ended January 31, 2011 of \$11,800,000, thereafter varying quarterly step-ups culminating in twelve months trailing EBITDA of \$14,300,000 at October 31, 2012.
- maximum capital expenditures are limited to \$2,000,000 per fiscal year for the years ended October 31, 2010 and 2011 and \$2,500,000 thereafter.
- enhanced reporting by the Company to Administrative Agent, including monthly reports and conference calls, quarterly reports by the Company's independent auditors of restructuring charges and organizational expense reductions.
- application of the Company's income tax refunds applied to reduce indebtedness under the Credit Agreement.
 - Restrictions on payment of dividends based on various covenant compliance thresholds.

The Company was in compliance with the covenants of its credit agreements at January 31, 2011 as set forth in the filing by the Company of the applicable compliance certificate for such period. Failure to maintain compliance with financial covenants as required by our credit facility could result in default and acceleration of amounts due under those facilities. The Company is required to maintain a minimum of \$750,000 of compensating balances with the Administrative Agent under the terms of its Credit Agreement.

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

As required by the Second Amendment, the Company, Marshall T. Reynolds and the Administrative Agent entered into a Contribution Agreement and Cash Collateral Security Agreement dated March 31, 2010 (the "Contribution Agreement") pursuant to which Mr. Reynolds deposited \$2,500,000 as cash collateral with the Administrative Agent, which the Administrative Agent may withdraw upon an event of default under the Credit Agreement.

Mr. Reynolds has granted the Administrative Agent a first priority security interest in the cash collateral.

Amounts drawn down by the Administrative Agent will be applied to repayment of the Company's obligations under the Credit Agreement. The Contribution Agreement expires upon the earliest of (i) full drawdown of the \$2,500,000 deposited, (ii) repayment in full of all obligations under the Credit Agreement and termination of all commitments thereunder and (iii) the Administrative Agent's determination that the Company has achieved a fixed charge coverage ratio of at least 1.2 to 1.0 as of the last day of two consecutive fiscal quarters of the Company.

In connection with the Contribution Agreement, the Company executed and delivered to Mr. Reynolds a Subordinated Promissory Note in amount of \$2,500,000, payment of principal and interest on which is prohibited prior to January 31, 2011, and thereafter only with the Administrative Agent's consent. The Subordinated Promissory Note bears interest at the Wall Street Journal prime rate (3.25% at inception and at January 31, 2011), matures September 14, 2014 and is unsecured.

The Company had borrowed under its \$17.0 million line of credit approximately \$11.1 million at January 31, 2011. Pursuant to the terms of the Second Amendment, the Company's borrowing base certificate as submitted to the Administrative Agent reflected minimum excess availability of \$4.3 million as of January 31, 2011. The minimum excess availability is subject to a \$1.0 million reserve and may be adjusted by the Administrative Agent.

The Company is required to make certain mandatory payments on its credit facilities related to (1) net proceeds received from a loss subject to applicable thresholds, (2) equity proceeds and (3) effective January 31, 2009, and continuing each year thereafter under the terms of the agreement the Company is required to prepay its credit facilities by 75% of excess cash flow for its most recently completed fiscal year. The excess cash flow for purposes of this calculation is defined as the difference (if any) between (a) EBITDA for such period and (b) federal, state and local income taxes paid in cash during such period plus capital expenditures during such period not financed with indebtedness plus interest expense paid in cash during such period plus the aggregate amount of scheduled payments made by the Company and its Subsidiaries during such period in respect of all principal on all indebtedness (whether at maturity, as a result of mandatory sinking fund redemption, or otherwise), plus restricted payments paid in cash by the Company during such period in compliance with the Credit Agreement. The Company had no prepayment obligation due under its prepayment obligation for fiscal 2009 and 2010 that would have been payable January 2010 and 2011 pursuant to the applicable calculations of the Second Amendment to the Credit Agreement.

The Company may incur costs in 2011 related to facility consolidations, employee termination costs and other restructuring related activities. These costs may be incurred, in part, as a response to the Company's efforts to overcome the impact of the global economic crisis.

The non-cash financing and investing activities for the three months ended January 31, 2011 and 2010 related primarily to equipment and vehicle purchases of \$136,000 in 2011 and \$103,000 in 2010.

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

6. Commitments and Contingencies

As of January 31, 2011 the Company had contractual obligations in the form of leases and debt as follows:

| Contractual Obligations | Payments Due by Fiscal Year | | | | | | Residual | Total |
|---------------------------------|-----------------------------|---------------|---------------|--------------|------------|----------|---------------|-------|
| | 2011 | 2012 | 2013 | 2014 | 2015 | | | |
| Non-cancelable operating leases | \$ 926,431 | \$ 1,042,154 | \$ 1,036,454 | \$ 887,296 | \$ 313,052 | \$ 5,620 | \$ 4,211,007 | |
| Revolving line of credit | - | 11,101,742 | - | - | - | - | 11,101,742 | |
| Term debt | 4,158,224 | 5,402,893 | 33,483,083 | 3,070,015 | - | - | 46,114,215 | |
| | \$ 5,084,655 | \$ 17,546,789 | \$ 34,519,537 | \$ 3,957,311 | \$ 313,052 | \$ 5,620 | \$ 61,426,964 | |

Champion Industries, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited) (continued)

7. Industry Segment Information

The Company operates principally in three 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), the sale of office products and office furniture including interior design services and publication of The Herald-Dispatch daily newspaper in Huntington, West Virginia, with a total daily and Sunday circulation of approximately 23,000 and 29,000, respectively.

Our financial reporting systems present various data which is used to operate and measure our operating performance, including internal statements of operations which are prepared on a basis inconsistent with GAAP. Therefore, the segment reporting may not necessarily be consistent with GAAP reporting. Furthermore, because of our integrated business structure, operating costs included in one segment may benefit other segments, as a result of this structure these segments are not specifically designed to measure operating income or loss directly related to the products or services included in each segment.

The identifiable assets are reflective of non-GAAP assets reported on the Company's internal balance sheets and are typically adjusted for negative book cash balances, taxes, and other items excluded for segment reporting. The total assets reported on the Company's balance sheet as of January 31, 2011 and 2010 are \$91,696,763 and \$97,945,559. The identifiable assets reported above represent \$81,124,296 and \$86,408,270 at January 31, 2011 and 2010.

The table below presents information about reported segments for the three months ended January 31:

| 2011 Quarter 1 | Printing | Office Products & Furniture | Newspaper | Total |
|-------------------------------------|---------------|-----------------------------------|--------------|---------------|
| Revenues | \$ 21,082,580 | \$ 9,993,003 | \$ 4,007,675 | \$ 35,083,258 |
| Elimination of intersegment revenue | (1,524,402) | (1,653,701) | - | (3,178,103) |
| Consolidated revenues | \$ 19,558,178 | \$ 8,339,302 | \$ 4,007,675 | \$ 31,905,155 |
| Operating income (loss) | (109,653) | 345,729 | 836,209 | 1,072,285 |
| Depreciation & amortization | 692,329 | 33,872 | 284,129 | 1,010,330 |
| Capital expenditures | 252,212 | 17,557 | 16,973 | 286,742 |
| Identifiable assets | 39,222,493 | 6,660,642 | 35,241,161 | 81,124,296 |
| Goodwill | 2,226,837 | 1,230,485 | 11,874,961 | 15,332,283 |

| 2010 Quarter 1 | Printing | Office Products and Furniture | Newspaper | Total |
|-------------------------------------|---------------|-------------------------------------|--------------|---------------|
| Revenues | \$ 22,396,030 | \$ 9,892,392 | \$ 4,376,061 | \$ 36,664,483 |
| Elimination of intersegment revenue | (2,646,559) | (1,630,678) | - | (4,277,237) |

Edgar Filing: CHAMPION INDUSTRIES INC - Form 10-Q

| | | | | |
|-----------------------------|---------------|--------------|--------------|---------------|
| Consolidated revenues | \$ 19,749,471 | \$ 8,261,714 | \$ 4,376,061 | \$ 32,387,246 |
| Operating income (loss) | (494,561) | 369,251 | 1,014,911 | 889,601 |
| Depreciation & amortization | 786,190 | 37,833 | 393,618 | 1,217,641 |
| Capital expenditures | 181,079 | 4,046 | 25,341 | 210,466 |
| Identifiable assets | 42,942,206 | 6,987,433 | 36,478,631 | 86,408,270 |
| Goodwill | 2,226,837 | 1,230,485 | 11,874,961 | 15,332,283 |

Edgar Filing: CHAMPION INDUSTRIES INC - Form 10-Q

Champion Industries, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited) (continued)

A reconciliation of total segment revenues and of total segment operating income to consolidated income (loss) before income taxes, for the three months ended January 31, 2011 and 2010, is as follows:

| | Three months ended January 31, | |
|---|--------------------------------|----------------------|
| | 2011 | 2010 |
| Revenues: | | |
| Total segment revenues | \$ 35,083,258 | \$ 36,664,483 |
| Elimination of intersegment revenue | (3,178,103) | (4,277,237) |
| Consolidated revenue | \$ 31,905,155 | \$ 32,387,246 |
| Operating Income: | | |
| Total segment operating income | \$ 1,072,285 | \$ 889,601 |
| Interest income | - | - |
| Interest expense | (968,822) | (1,569,812) |
| Other income | 16,681 | 304,581 |
| Consolidated income (loss) before income taxes | \$ 120,144 | \$ (375,630) |
| Identifiable assets: | | |
| Total segment identifiable assets | \$ 81,124,296 | \$ 86,408,270 |
| Assets not allocated to a segment | 10,572,467 | 11,537,289 |
| Total consolidated assets | \$ 91,696,763 | \$ 97,945,559 |

8. Fair Value of Financial Instruments, Derivative Instruments and Hedging Activities

The Company manages exposure to changes in market interest rates. The Company's use of derivative instruments is limited to highly effective fixed and floating interest rate swap agreements used to manage well-defined interest rate risk exposures. The Company monitors its positions and the credit ratings of its counterparties and does not anticipate non-performance by the counterparties. Interest rate swap agreements are not entered into for trading purposes.

At September 28, 2007, the Company was party to an interest rate swap agreement which terminated on October 29, 2010. The swap agreement was with a major financial institution and aggregated \$25 million in notional principal amount representing approximately \$20.6 million of outstanding notional principal at January 31, 2010. This swap agreement effectively converted \$25 million of variable interest rate debt to fixed rate debt. The swap agreement required the Company to make fixed interest payments based on an average effective rate of 4.78% and receive variable interest payments from its counterparties based on one-month LIBOR (actual rate of 0.23% at January 31, 2010). In the three months ended January 31, 2010 the Company recorded as a component of other income \$284,000, related to its hedging arrangement, or \$170,000 net of income tax. Due to the termination of LIBOR borrowing eligibility from the Administrative Agent the Company recorded a loss in 2009 from ineffectiveness in its hedging arrangement.

There is a fair value hierarchy for those instruments measured at fair value that distinguishes between assumptions based on market data (observable inputs) and our own assumptions (unobservable inputs). The hierarchy consists of three levels:

Level 1 - Quoted market prices in active markets for identical assets or liabilities

Level 2 - Inputs other than Level 1 inputs that are either directly or indirectly observable; and

Level 3 - Unobservable inputs developed using estimates and assumptions developed by the Company, which reflect those that a market participant would use.

Our interest bearing debt is primarily composed of a revolving line of credit and term loan facility with a syndicate of banks. The Company believes the carrying amount of these facilities approximates fair value due to these facilities carrying a variable interest rate based on recent market conditions.

Cash and cash equivalents consist principally of cash on deposit with banks. All highly liquid investments with an original maturity of three months or less. The Company's cash deposits in excess of federally insured amounts are primarily maintained at a large well-known financial institution.

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

The carrying amounts of the Company's accounts receivable, accounts payable, accrued payrolls and commissions, taxes accrued and withheld and accrued expenses approximates fair value due to their short-term nature.

The Company's interest rate swap derivative liability is based on third party valuation models, and is therefore classified as having level 2 inputs as of January 31, 2010. The interest rate swap agreement expired on October 29, 2010; and therefore there is no balance at January 31, 2011.

| Fair Value Measurements as of January 31, 2011 and 2010 | | | | |
|--|---------|------------|---------|------------|
| Liabilities: | Level 1 | Level 2 | Level 3 | Total |
| Interest rate swap at (2011) | \$ - | \$ - | \$ - | \$ - |
| Interest rate swap at (2010) | \$ - | \$ 678,814 | \$ - | \$ 678,814 |

9. Restructuring of Operations

In fiscal 2010 and the first quarter of fiscal 2011, the Company recorded charges related to a restructuring and profitability enhancement plan; and to respond to the fluid nature the economic crisis has had on the Company. This plan was implemented to effectuate certain key initiatives and was an integral component of the Second Amendment and Waiver to the Credit Agreement (Second Amendment). These actions were taken to comply with the provisions and targeted covenants of the Second Amendment and to address the impact of the global economic crisis on the Company. The Company may incur additional costs in future periods to address the ongoing and fluid nature of the economic crisis. The amount of future charges are currently not estimable by the Company.

The plan was implemented to address several key initiatives including streamlining production and administrative operations, headcount reductions and an overall response to the global economic crisis. The aggregate pre-tax charge resulting from these actions was \$2.1 million (\$1.2 million after tax or \$0.12 per share on a basic and diluted basis). The charges were comprised of \$1.3 million associated with excess facility and maintenance costs primarily related to operating leases, inventory related costs of \$200,000 and costs associated with streamlining production and personnel related separation costs of \$565,000. The costs associated with the restructuring and profitability enhancement plan are primarily recorded in the restructuring charges line item as part of operating income. Inventory is recorded as a component of cost of sales.

The following information summarizes the costs incurred with respect to restructuring, integration and asset impairment charges during the three months ended January 31, 2011 and 2010, as well as the cumulative total of such costs representing fiscal 2010 and the first quarter of 2011, respectively, and such costs are included as a component of the printing segment:

| | Three Months Ended January 31, 2011 | Three Months Ended January 31, 2010 | Cumulative Total |
|-------------------------|--|--|------------------|
| Occupancy related costs | \$ 123,553 | \$ - | \$ 1,296,728 |

Edgar Filing: CHAMPION INDUSTRIES INC - Form 10-Q

| | | | |
|--|------------|------|--------------|
| Costs incurred to streamline production, personnel and other | 97,105 | - | 564,726 |
| Inventory | 28,851 | - | 200,380 |
| Total | \$ 249,509 | \$ - | \$ 2,061,834 |

The activity pertaining to the Company's accruals related to restructuring and other charges since October 31, 2010, including additions and payments made are summarized below:

| | Occupancy related costs | Costs incurred to streamline production, personnel and other | Total |
|-----------------------------|-------------------------|--|--------------|
| Balance at October 31, 2010 | \$1,037,548 | \$ 8,462 | \$ 1,046,010 |
| 2011 expenses | 123,553 | 97,105 | 220,658 |
| Paid in 2011 | (88,291) | (79,413) | (167,704) |
| Balance at January 31, 2011 | \$1,072,810 | \$26,154 | \$ 1,098,964 |

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.

| | Three Months Ended January 31 | | | |
|---|-------------------------------|--------------|-----------------|---------------|
| | 2011 | | 2010 | |
| | (\$ In thousands) | | | |
| Revenues: | | | | |
| Printing | \$ 19,558 | 61.3% | \$ 19,749 | 61.0 % |
| Office products and office furniture | 8,339 | 26.1 | 8,262 | 25.5 |
| Newspaper | 4,008 | 12.6 | 4,376 | 13.5 |
| Total revenues | 31,905 | 100.0 | 32,387 | 100.0 |
| Cost of sales and newspaper operating costs: | | | | |
| Printing | 15,121 | 47.4 | 14,721 | 45.4 |
| Office products and office furniture | 6,099 | 19.1 | 5,931 | 18.3 |
| Newspaper cost of sales and operating costs | 2,175 | 6.8 | 2,129 | 6.6 |
| Total cost of sales and newspaper operating costs | 23,395 | 73.3 | 22,781 | 70.3 |
| Gross profit | 8,510 | 26.7 | 9,606 | 29.7 |
| Selling, general and administrative expenses | 7,216 | 22.6 | 8,717 | 26.9 |
| Restructuring charges | 221 | 0.7 | - | - |
| Income from operations | 1,073 | 3.4 | 889 | 2.8 |
| Interest expense | (969) | (3.0) | (1,570) | (4.9) |
| Other income | 16 | 0.0 | 305 | 0.9 |
| Income (loss) before taxes | 120 | 0.4 | (376) | (1.2) |
| Income tax (expense) benefit | (47) | (0.2) | 163 | 0.5 |
| Net income (loss) | \$ 73 | 0.2% | \$ (213) | (0.7)% |

Champion Industries, Inc. and Subsidiaries

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

Three Months Ended January 31, 2011 Compared to Three Months Ended January 31, 2010

Revenues

Total revenues decreased 1.5% in the first quarter of 2011 compared to the same period in 2010, to \$31.9 million from \$32.4 million. Printing revenue decreased 1.0% in the first quarter of 2011, to \$19.6 million, from \$19.7 million in the first quarter of 2010. Office products and office furniture revenue increased 0.9% in the first quarter of 2011 with approximately \$8.3 million in revenue for the first quarter 2011 and 2010. The Company recorded newspaper revenues from the Herald-Dispatch of approximately \$4.0 million, consisting of advertising revenue of approximately \$3.1 million and \$0.9 million in circulation revenues for the first quarter of 2011. This compares to newspaper revenues of approximately \$4.4 million, consisting of advertising revenue of approximately \$3.4 million and \$1.0 million in circulation revenues for the first quarter of 2010. The decrease in newspaper revenues is primarily associated with a decrease in advertising revenues which we believe is reflective of macro-industry dynamics coupled with the residual effect of the global economic crisis.

Cost of Sales

Total cost of sales increased 2.7% in the first quarter of 2011, to \$23.4 million from \$22.8 million in the first quarter of 2010. Printing cost of sales in the first quarter of 2011 increased \$0.4 million over the prior year and increased as a percent of printing sales to 77.3% in 2011 from 74.5% in 2010. The increase in printing cost of sales as a percentage of printing sales is primarily related to higher material costs as a percent of printing sales. Office products and office furniture cost of sales increased in 2011 from 2010 levels to \$6.1 million in the first quarter of 2011, from \$5.9 million in the first quarter of 2010, and increased as a percent of sales to 73.1% in 2011 from 71.8% in 2010. Newspaper cost of sales and operating costs increased to \$2.2 million in the first quarter of 2011, from \$2.1 million in the first quarter of 2010, and as a percent of newspaper sales were 54.3% for the three months ended January 31, 2011 compared with 48.6% for the three months ended January 31, 2010.

Operating Expenses

In the first quarter of 2011, selling, general and administrative expenses (S,G&A) decreased on a gross dollar basis to \$7.2 million from \$8.7 million in 2010, a decrease of \$1.5 million. As a percentage of total sales, the expenses decreased on a quarter to quarter basis in 2011 to 22.6% from 26.9% in 2010. The decrease in S,G&A as a percent of sales was primarily reflective of additional cost reduction initiatives implemented in 2010 of which a full quarter's benefit was reflected in the first quarter of 2011. These initiatives were initiated by the Company in response to the global economic crisis.

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 first quarter of 2011 to \$1.1 million from \$0.9 million in the first quarter of 2010. This increase is the result of improved operating results primarily from the Company's printing segment. These improved results were partially offset by restructuring related charges of approximately \$250,000, of which \$29,000 is reflected as a component of cost of goods sold and \$221,000 is reflected as restructuring charges. These charges were incurred, in part, as a response to the global economic crisis. These additional costs were incurred as a result of the ongoing and fluid nature of the economic crisis and its related impact on our operations.

Other expenses (net), decreased approximately \$0.3 million from 2010 to 2011 primarily due to decreases in interest expense, resulting from lower rates primarily associated with the expiration of an interest rate swap contract in the fourth quarter of 2010. This decrease was partially offset by a decrease in other income in 2011, due to other income in 2010 resulting from a hedging arrangement.

Income Taxes

The Company's effective income tax rate was an expense of 39.1% in the first quarter of 2011 and a benefit of 43.4% for the first quarter of 2010. The effective income tax rate approximates the combined federal and state, net of federal benefit, statutory income tax rate.

Net Income (loss)

Net loss for the first quarter of 2010 was (\$213,000) compared to a net income of \$73,000 in the first quarter of 2011. Basic and diluted income (loss) per share for the three months ended January 31, 2011 and 2010 were \$0.01 and (\$0.02).

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 contracts; therefore, to the extent permitted by competition, it has the ability to pass through to its customers most cost increases resulting from inflation, if any. In addition, the Company is not particularly energy dependent; therefore, an increase in energy costs should not have a significant impact on the Company.

Our operating results depend on the relative strength of the economy on both a regional and national basis. Recessionary conditions applicable to the economy as a whole and specifically to our core business segments, have had a significant adverse impact on the Company's business. A continuing or a deepening of the recessionary conditions we are experiencing could significantly affect our revenue categories.

Seasonality

Our business is subject to seasonal fluctuations that we expect to continue to be reflected in our operating results in future periods. 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.

On a historical basis The Herald-Dispatch's first and third calendar quarters of the year tended to be the weakest because advertising volume is at its lowest levels following the holiday season and a seasonal slowdown in the summer months. Correspondingly, on a historical basis the fourth calendar quarter followed by the second calendar quarter tended to be the strongest quarters. The fourth calendar quarter included heavy holiday season advertising. Other factors that affect our quarterly revenues and operating results may be beyond our control, including changes in the pricing policies of our competitors, the hiring and retention of key personnel, wage and cost pressures, distribution costs, changes in newsprint prices and general economic factors.

Champion Industries, Inc. and Subsidiaries
Management's Discussion and Analysis of Financial Condition
and Results of Operations (continued)

Liquidity and Capital Resources

Net cash (used in) operations for the three months ended January 31, 2011, was (\$0.4) million compared to net cash provided by operations of \$3.0 million during the same period in 2010. This change in net cash from operations is due primarily to timing changes in assets and liabilities.

Net cash used in investing activities for the three months ended January 31, 2011 was \$125,000 compared to \$97,000 during the same period in 2010. The net cash used in investing activities during the first three months of 2011 and 2010 primarily related to the purchase of equipment and vehicles.

Net cash provided by (used in) financing activities for the three months ended January 31, 2011 was \$0.5 million provided by financing activities compared to (\$4.1) million used in financing activities during the same period in 2010. In 2010, the Company was required to make higher principal payments on indebtedness related to the terms of the Forbearance Agreement. In 2011, the Company generated additional cash flow from financing activities associated primarily with net borrowings on the line of credit and an increase in negative book cash balances.

Working capital on January 31, 2011 was \$13.5 million and at October 31, 2010 was \$13.1 million.

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 of 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, 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

(a) Evaluation of Disclosure Controls and Procedures. Under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, we evaluated the effectiveness of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended. Based upon that evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls were effective as of the end of the period covered by this quarterly report.

(b) Changes in Internal Controls. There have been no changes in our internal controls over financial reporting that occurred during the first three months of fiscal year 2011 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

PART II - OTHER INFORMATION

Item 1A. Risk Factors

There were no material changes in risk factors from disclosures previously reported in our annual report on Form 10-K for the fiscal year ended October 31, 2010.

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: March 11, 2011

/s/ Marshall T. Reynolds
Marshall T. Reynolds
Chief Executive Officer

Date: March 11, 2011

/s/ Toney K. Adkins
Toney K. Adkins
President and Chief Operating Officer

Date: March 11, 2011

/s/ Todd R. Fry
Todd R. Fry
Senior Vice President and Chief Financial
Officer