Financial Review

Mohawk Industries, Inc. and Subsidiaries

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SELECTED FINANCIAL DATA

Mohawk Industries, Inc. and Subsidiaries

(In thousands, except per share data)

	2004[h]	2003	2002[i]
Statement of earnings data:			
Net sales	$5,880,372	4,999,381	4,516,957
Cost of sales	4,259,531	3,605,579	3,247,865
Gross profit	1,620,841	1,393,802	1,269,092
Selling, general and administrative expenses	985,251	851,773	747,027
Restructuring costs [a]	–	–	–
Carrying value reduction of property, plant and equipment and other assets [b]	–	–	–
Class action legal settlement [c]	–	–	–
Compensation expense for stock option exercises [d]	–	–	–
Operating income	635,590	542,029	522,065
Interest expense [e]	53,392	55,575	68,972
Acquisition costs – World Merger [f]	–	–	–
Other expense (income), net	4,809	(1,980)	9,464
	58,201	53,595	78,436
Earnings before income taxes	577,389	488,434	443,629
Income taxes	208,767	178,285	159,140
Net earnings	$ 368,622	310,149	284,489
Basic earnings per share [g]	$ 5.53	4.68	4.46
Weighted-average common shares outstanding [g]	66,682	66,251	63,723
Diluted earnings per share [g]	$ 5.46	4.62	4.39
Weighted-average common and dilutive potential common shares outstanding [g]	67,557	67,121	64,861
Balance sheet data:			
Working capital	$ 968,923	592,310	640,846
Total assets	4,403,118	4,163,575	3,596,743
Short-term note payable	–	–	–
Long-term debt (including current portion)	891,341	1,012,413	820,427
Stockholders' equity	2,666,337	2,297,801	1,982,879

(a) During 1996, the Company recorded pre-tax restructuring costs of $0.7 million related to certain mill closings whose operations have been consolidated into other Mohawk facilities.

(b) During 1996, the Company recorded a charge of $3.1 million arising from the write-down of property, plant and equipment to be disposed of related to the closing of a manufacturing facility in 1996 and a revision in the estimate of fair value of certain property, plant and equipment based on current market conditions related to mill closings in 1995. During 1997, the Company recorded a charge of $5.5 million arising from a revision in the estimated fair value of certain property, plant and equipment held for sale based on current appraisals and other market information related to a mill closing in 1995. During 1998, the Company recorded a charge of $2.9 million for the write-down of assets to be disposed of relating to the acquisition of World.

(c) The Company recorded a one-time charge of $7.0 million in 2000, reflecting the settlement of two class-action lawsuits.

(d) A charge of $2.6 million was recorded in 1997 for income tax reimbursements to be made to certain executives related to the exercise of stock options granted in 1988 and 1989 in connection with the Company's 1988 leveraged buyout.

2001	2000	1999	1998	1997	1996
3,441,267	3,400,905	3,208,813	2,846,646	2,519,340	2,322,682
2,583,669	2,556,772	2,414,312	2,156,195	1,953,110	1,804,107
857,598	844,133	794,501	690,451	566,230	518,575
530,441	527,018	499,704	441,355	389,889	373,120
–	–	–	–	–	700
–	–	–	2,900	5,500	3,060
–	7,000	–	–	–	–
–	–	–	–	2,600	–
327,157	310,115	294,797	246,196	168,241	141,695
29,787	38,044	32,632	31,023	36,474	39,772
–	–	–	17,700	–	–
5,954	4,442	2,266	2,667	338	4,586
35,741	42,486	34,898	51,390	36,812	44,358
291,416	267,629	259,899	194,806	131,429	97,337
102,824	105,030	102,660	79,552	51,866	40,395
188,592	162,599	157,239	115,254	79,563	56,942
3.60	3.02	2.63	1.91	1.33	0.96
52,418	53,769	59,730	60,393	59,962	59,310
3.55	3.00	2.61	1.89	1.32	0.95
53,141	54,255	60,349	61,134	60,453	59,899
449,361	427,192	560,057	438,474	389,378	390,889
1,768,485	1,795,378	1,682,873	1,405,486	1,233,361	1,226,959
–	–	–	–	–	21,200
308,433	589,828	596,065	377,089	402,854	486,952
948,551	754,360	692,546	611,059	493,841	409,616

(e) In December 2002, the Company discontinued hedge accounting for its interest rate swap. The impact of discontinuing the hedge was to increase interest expense by approximately $10.7 million.

(f) The Company recorded a one-time charge of $17.7 million in 1998 for transaction expenses related to the World merger.

(g) The Board of Directors declared a 3-for-2 stock split on October 23, 1997, which was paid on December 4, 1997, to holders of record on November 4, 1997. Earnings per share and weighted-average common share data have been restated to reflect the split.

(h) In 2004, the Company reclassified certain prior period financial statement balances to conform to current presentations to include sales distribution costs in selling, general and administrative costs rather than cost of sales and certain freight allowances in cost of sales.

(i) In 2002, the Company adopted the provisions of Financial Accounting Standards Board SFAS No. 142 "Goodwill and Other Intangible Assets" which required the Company to cease amortizing goodwill and evaluate such goodwill and indefinite intangibles for impairment.

Overview

The Company is a leading producer of floor covering products for residential and commercial applications in the United States with net sales in 2004 in excess of $5.8 billion. The Company is the second largest carpet and rugs manufacturer, and a leading manufacturer, marketer and distributor of ceramic tile and natural stone, in the United States. The Company has two reporting segments, the Mohawk segment and the Dal-Tile segment. The Mohawk segment distributes its product lines, which include carpet, rugs, pad, ceramic tile, hardwood, resilient and laminate through its network of approximately 52 regional distribution centers and satellite warehouses using its fleet of company-operated trucks, common carrier or rail transportation. The segment product lines are purchased by independent floor covering retailers, home centers, mass merchandisers, department stores, independent distributors, commercial dealers and commercial end users. The Dal-Tile segment product lines include ceramic tile, porcelain tile and stone products distributed through approximately 244 company-operated sales service centers and regional distribution centers using primarily common carriers and rail transportation. The segment product lines are purchased by tile specialty dealers, tile contractors, floor covering retailers, commercial end users, independent distributors and home centers.

The primary categories of the United States floor covering industry include carpet and rugs (63%), ceramic tile (12%), hardwood (10%), resilient and rubber (9%) and laminate (6%). Compound average growth rates for all categories, except the resilient and rubber category, for the period from 1998 through 2003 have met or exceeded the growth rates (measured in sales dollars) for both the gross domestic product of the United States and housing starts over the same period. During this period, the compound average growth rate was 3.0% for carpet and rugs, 7.0% for ceramic tile, 1.2% for resilient and rubber, 20.9% for laminate, and 7.9% for hardwood.

The Company reported net earnings of $368.6 million and EPS of $5.46, for 2004, up 19% compared to net earnings of $310.1 million and $4.62 EPS for 2003. The improvement in net earnings and EPS resulted from strong internal sales growth from both the Mohawk and Dal-Tile segments, improved manufacturing efficiencies, better leveraging of selling, general and administrative costs and the Lees Carpet acquisition, offset by higher raw material and energy costs. In addition, the Company has implemented multiple price increases within the Mohawk segment during 2004 to offset increases in raw material and energy prices. The Company has received formal notice of further cost increases to be implemented during the first quarter of 2005, and believes the continuing high level of commodity costs could continue to impact raw material costs in the future. The Company believes these costs will stabilize over the long-term but the short-term trend of these costs is uncertain.

On March 20, 2002, the Company acquired all of the outstanding capital stock of Dal-Tile International Inc. ("Dal-Tile"), a leading manufacturer and distributor of ceramic tile in the United States, for approximately $1,469 million in stock and cash. The transaction was accounted for using the purchase method of accounting and, accordingly, the results of operations of Dal-Tile have been included in the Company's consolidated financial statements since that date. The primary reason for the acquisition was to expand the Company's presence in the ceramic tile and stone markets.

On November 10, 2003, the Company acquired the assets and assumed certain liabilities of the commercial carpet division of Burlington Industries, Inc., known as Lees Carpet, from W.L. Ross & Company for approximately $350 million in cash. The results of operations for Lees Carpet have been included with the Mohawk segment results and in the Company's consolidated financial statements since that date. The primary reason for the acquisition was to expand the Company's presence in the commercial carpet market.

Results of Operations

Following are the results of operations for the last three years:

	For the Years Ended December 31,					
	2004		2003		2002	
	(In thousands)					
Statement of earnings data:						
Net sales	$ 5,880,372	100.0%	4,999,381	100.0%	4,516,957	100.0%
Cost of sales	4,259,531	72.4%	3,605,579	72.1%	3,247,865	71.9%
Gross profit	1,620,841	27.6%	1,393,802	27.9%	1,269,092	28.1%
Selling, general and administrative expenses	985,251	16.8%	851,773	17.0%	747,027	16.5%
Operating income	635,590	10.8%	542,029	10.9%	522,065	11.6%
Interest expense	53,392	0.9%	55,575	1.1%	68,972	1.5%
Other expense (income), net	4,809	0.1%	(1,980)	0.0%	9,464	0.2%
	58,201	1.0%	53,595	1.1%	78,436	1.7%
Earnings before income taxes	577,389	9.8%	488,434	9.8%	443,629	9.8%
Income taxes	208,767	3.6%	178,285	3.6%	159,140	3.5%
Net earnings	$ 368,622	6.3%	310,149	6.2%	284,489	6.2%

Year Ended December 31, 2004, as Compared with Year Ended December 31, 2003

Net sales for the year ended December 31, 2004, were $5,880.4 million, reflecting an increase of $881.0 million, or approximately 17.6%, over the $4,999.4 million reported for the year ended December 31, 2003. The increased net sales are primarily attributable to strong internal sales growth from both the Mohawk and Dal-Tile segments. The Mohawk segment recorded net sales of $4,368.8 million in 2004 compared to $3,730.8 million in 2003, representing an increase of $638.0 million or approximately 17.1%. The increase was attributable to strong internal growth in all product categories and the Lees Carpet acquisition. The Dal-Tile segment recorded net sales of $1,511.5 million in 2004, reflecting an increase of $243.0 million or 19.2%, over the $1,268.5 million reported in the year ended December 31, 2003. The increase was mostly attributable to strong internal growth in all product categories with stone and floor tile reflecting the strongest growth.

Quarterly net sales and the percentage changes in net sales by quarter for 2004 versus 2003 were as follows (dollars in thousands):

	2004	2003	Change
First quarter	$1,389,725	1,083,422	28.3%
Second quarter	1,485,897	1,245,870	19.3
Third quarter	1,529,651	1,301,547	17.5
Fourth quarter	1,475,099	1,368,542	7.8
Total year	$5,880,372	4,999,381	17.6%

Sales in the first and fourth quarters of 2004 were impacted by a shift of four days from the fourth to the first quarter when compared to 2003.

Gross profit was $1,620.8 million (27.6% of net sales) for 2004 and $1,393.8 million (27.9% of net sales) for 2003. The reduction in percentage was primarily attributable to increased raw material costs, energy costs, transportation costs, and higher import costs.

Selling, general and administrative expenses for 2004 were $985.3 million (16.8% of net sales) compared to $851.8 million (17.0% of net sales) for 2003. The reduction in percentage was attributable to better leveraging of selling, general and administrative expenses.

Operating income for 2004 was $635.6 million (10.8% of net sales) compared to $542.0 million (10.9% of net sales) in 2003. Operating income attributable to the Mohawk segment was $424.3 million (9.7% of segment net sales) in 2004 compared to $364.0 million (9.8% of segment net sales) in 2003. The percentage decrease in operating income was attributable to the higher raw material costs, energy costs and transportation costs. Operating income attributable to the Dal-Tile segment was $219.8 million (14.5% of segment net sales) in 2004, compared to $187.2 million (14.8% of segment net sales) in 2003. The decrease in operating income as a percentage of net sales is primarily attributable to higher energy costs, import costs and transportation costs.

Interest expense for 2004 was $53.4 million compared to $55.6 million in 2003. The decrease in interest expense was attributable to a larger benefit from a fair value adjustment related to an interest rate swap during 2004 when compared to 2003.

Income tax expense was $208.8 million, or 36.2% of earnings before income taxes for 2004 compared to $178.3 million, or 36.5% of earnings before income taxes for 2003. The improved rate was a result of the utilization of tax credits.

Year Ended December 31, 2003, as Compared with Year Ended December 31, 2002

Net sales for the year ended December 31, 2003, were $4,999.4 million, reflecting an increase of $482.4 million, or approximately 10.7%, over the $4,517.0 million reported in the year ended December 31, 2002. The increased net sales were attributable to the acquisition of Dal-Tile and Lees Carpet and internal growth. The Mohawk segment recorded net sales of $3,730.8 million in 2003 compared to $3,618.8 million in 2002, representing an increase of $112.0 million or approximately 3.0%. The growth was attributable to the Lees Carpet acquisition and internal growth of product lines. The Dal-Tile segment recorded net sales of $1,268.5 million in 2003, reflecting an increase of $370.4 million or 41.2% over the $898.2 million reported in the year ended December 31, 2002. The Dal-Tile results are not included in the Company's consolidated financial statements prior to the March 20, 2002 acquisition. However, when the Dal-Tile net sales for the year ended December 31, 2003, are compared to the Dal-Tile pro forma net sales of $1,134.2 million for the year ended December 31, 2002 (derived by combining Dal-Tile net sales of $236.0 million prior to the March 20, 2002 acquisition date, after reclassifications to conform to Mohawk's presentation, with reported Dal-Tile net sales of $898.2 million for the period ending December 31, 2002), an increase of approximately 11.8% for the period was realized. The growth was primarily attributable to growth within residential products. The Company believes this pro forma net sales information will be useful to investors because it allows investors to compare the results of the two periods.

Quarterly net sales and the percentage changes in net sales by quarter for 2003 versus 2002 were as follows (dollars in thousands):

	2003	2002	Change
First quarter	$1,083,422	865,336	25.2%
Second quarter	1,245,870	1,226,504	1.6
Third quarter	1,301,547	1,222,943	6.4
Fourth quarter	1,368,542	1,202,174	13.8
Total year	$4,999,381	4,516,957	10.7%

Gross profit was $1,393.8 million (27.9% of net sales) for 2003 and $1,269.1 million (28.1% of net sales) for 2002. The reduction in percentage was primarily attributable to a change in the selling mix, increased raw material costs, higher energy costs, higher import costs and start-up costs related to the new Dal-Tile manufacturing facility.

Selling, general and administrative expenses for 2003 were $851.8 million (17.0% of net sales) compared to $747.0 million (16.5% of net sales) for 2002. The increased percentage was primarily attributable to the acquisition of Dal-Tile, which has higher selling, general and administrative expenses than the Mohawk segment.

Operating income for 2003 was $542.0 million (10.8% of net sales) compared to $522.1 million (11.6% of net sales) in 2002. Operating income attributable to the Mohawk segment was $364.0 million (9.8% of segment net sales) in 2003 compared to $390.9 million (10.8% of segment net sales) in 2002. The percentage decrease in operating income was attributable to the higher raw material and energy costs and a change in the selling mix. Operating income attributable to the Dal-Tile segment was $187.2 million (14.8% of segment net sales) in 2003, compared to $139.9 million (15.6% of segment net sales) in 2002. The decrease in operating income as a percentage of net sales is primarily attributable to a change in product mix, higher import prices and start-up costs of a new manufacturing facility. On a pro forma combined basis, the Dal-Tile segment operating income was $171.7 million (15.1% of pro forma segment net sales) for 2002 (derived by combining Dal-Tile operating income of $31.8 million prior to the March 20, 2002 acquisition, after reclassifications to conform to Mohawk's presentation, with reported Dal-Tile operating income of $139.9 million for the period ended December 31, 2002). The Company believes that presentation of this pro forma combined operating income information will be useful to investors because it allows investors to compare the results between the two periods.

Interest expense for 2003 was $55.6 million compared to $69.0 million in 2002. The decrease in interest expense was attributable to lower average debt levels during 2003 when compared to 2002, offset by an increase in the average borrowing rate due to a change in the mix of fixed and variable rate debt in 2003 when compared to 2002. Additionally, interest expense for 2002 included $10.7 million related to the write-off of an interest rate swap previously accounted for as a cash flow hedge.

Income tax expense was $178.3 million, or 36.5% of earnings before income taxes for 2003 compared to $159.1 million, or 35.9% of earnings before income taxes for 2002. The change in tax rate resulted from the use of fewer available tax credits in 2003 when compared to 2002.

Liquidity and Capital Resources

The Company's primary capital requirements are for working capital, capital expenditures and acquisitions. The Company's capital needs are met primarily through a combination of internally generated funds, bank credit lines, term and senior notes, the sale of receivables and credit terms from suppliers.

Cash flows generated by operations for 2004 were $242.8 million compared to $309.4 million for 2003. The decrease was primarily attributable to an increase in accounts receivable, which increased from $573.5 million at the beginning of 2004 to $660.7 million at December 31, 2004 and inventories, which increased from $832.4 million at the beginning of 2004 to $1,018.0 million at December 31, 2004. The increases were primarily attributable to strong internal sales growth within both the Mohawk and Dal-Tile segments.

Net cash used in investing activities in 2004 was $121.6 million compared to $498.8 million for 2003. The decrease was primarily attributable to lower capital expenditures and lower expenditures related to acquisitions. Capital expenditures were incurred primarily to modernize, add and expand manufacturing and distribution facilities and equipment. Capital expenditures, including $1,116.8 million for acquisitions, have totaled $1,450.0 million over the past three years. Capital spending during 2005 for both the Mohawk and Dal-Tile segments combined, excluding acquisitions, is expected to range from $230 million to $270 million, and will be used primarily to purchase equipment and to add manufacturing and distribution capacity.

Net cash used in financing activities for 2004 was $121.2 million compared to cash provided in 2003 of $189.4 million. The primary reason for the change was a reduction in debt levels in 2004, when compared to 2003.

On September 29, 2004, the Company amended its five-year revolving credit facility with interest rates of either (i) LIBOR plus 0.4% to 1.4%, depending upon the Company's performance measured against certain financial ratios, or (ii) the base rate plus 0-0.5% depending upon the Company's performance measured against certain financial ratios. The facility was increased from $200 million to $300 million. The increase in the facility replaces the $100 million 364-day facility, which expired during the third quarter of 2004. The credit agreement contains customary financial and other covenants. The Company must pay an annual facility fee ranging from .15% to .50% of the total credit commitment, depending upon the Company's performance measured against specific coverage ratios, under the revolving credit line.

The Company believes that its available credit facilities at December 31, 2004 are adequate to support its operations and working capital requirements. At December 31, 2004, the Company had credit facilities of $300 million under its revolving credit line and $50 million under various short-term uncommitted credit lines. All of these lines are unsecured. At December 31, 2004, a total of approximately $234.1 million was available under both the credit facility and uncommitted credit lines compared to $237.3 million available under both the credit facility and uncommitted credit lines at December 31, 2003. The amount used under both the credit facility and uncommitted credit lines at December 31, 2004, consisted of $37.7 million under the Company's five-year revolving credit facility and unsecured credit lines, $55.6 million standby letters of credit guaranteeing the Company's industrial revenue bonds and $22.6 million standby letters of credit related to various insurance contracts and foreign vendor commitments.

The Company has an on-balance sheet trade accounts receivable securitization agreement (the "Securitization Facility"). The Securitization Facility allows the Company to borrow up to $350 million based on available accounts receivable. At December 31, 2004, the Company had $90 million outstanding secured by approximately $825.8 million of trade receivables compared to $182 million secured by approximately $649 million of trade receivables at December 31, 2003. During the third quarter of 2004, the Company extended the term of its Securitization Facility until August 2005 and amended certain representations and warranties.

The Company's Board of Directors has authorized the repurchase of up to 15 million shares of the Company's outstanding common stock. For the year ended December 31, 2004, a total of approximately 250,000 shares of the Company's common stock was purchased at an aggregate cost of approximately $18.4 million. Since the inception of the program in 1999, a total of approximately 11.2 million shares has been repurchased at an aggregate cost of approximately $311.5 million. All of these repurchases have been financed through the Company's operations and banking arrangements.

The outstanding checks in excess of cash represent trade payables checks that have not yet cleared the bank. When the checks clear the bank, they are funded by the revolving credit facility. This policy does not impact any liquid assets on the consolidated balance sheets.

The following is a summary of the Company's future minimum payments under contractual obligations as of December 31, 2004 (in thousands):

	Payments due by period						
	2005	2006	2007	2008	2009	Thereafter	Total
Long-term debt	$191,341	–	300,000	–	–	400,000	891,341
Estimated interest payments(1)	55,337	48,300	34,463	28,800	28,800	65,964	261,664
Operating leases	81,803	67,656	50,934	39,980	31,133	61,786	333,292
Purchase commitments(2)	81,809	57,693	52,280	49,723	1,775	–	243,280
	$410,290	173,649	437,677	118,503	61,708	527,750	1,729,577

(1) For fixed rate debt, the Company calculated interest based on the applicable rates and payment dates. For variable rate debt, the Company estimated average outstanding balances for the respective periods and applied interest rates in effect at December 31, 2004 to these balances. The interest payments associated with the Company's interest rate swap were based on the difference between the fixed rate and the forward yield curve.

(2) Includes commitments for natural gas, foreign currency, and raw material purchases.

Critical Accounting Policies

In preparing the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, the Company must make decisions which impact the reported amounts of assets, liabilities, revenues and expenses, and related disclosures. Such decisions include the selection of appropriate accounting principles to be applied and the assumptions on which to base accounting estimates. In reaching such decisions, the Company applies judgment based on its understanding and analysis of the relevant circumstances and historical experience. Actual amounts could differ from those estimated at the time the consolidated financial statements are prepared.

The Company's significant accounting policies are described in Note 1 to the consolidated financial statements included elsewhere in this report. Some of those significant accounting policies require the Company to make subjective or complex judgments or estimates. Critical accounting policies are defined as those that are both most important to the portrayal of a company's financial condition and results and require management's most difficult, subjective, or complex judgment, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods.

The Company believes the following accounting policies require it to use judgments and estimates in preparing its consolidated financial statements and represent critical accounting policies.

- Accounts receivable and revenue recognition. Revenues are recognized when goods are shipped and legal title passes to the customer. The Company provides allowances for expected cash discounts, returns, claims, and doubtful accounts based upon historical bad debt and claims experience and periodic evaluation of specific customer accounts and the aging of accounts receivable. If the financial condition of the Company's customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

- Inventories are stated at the lower of cost or market (net realizable value). Cost is determined using the last-in, first-out method (LIFO) for approximately 80% of the inventory within the Mohawk segment, which matches current costs with current revenues, and the first-in, first-out method (FIFO), which is used to value inventory within the Dal-Tile segment and inventory not valued under the LIFO method in the Mohawk segment. Inventories on hand are compared against anticipated future usage, which is a function of historical usage and anticipated future selling price, in order to evaluate obsolescence, excessive quantities, and expected sales below cost. Actual results could differ from assumptions used to value obsolete, excessive inventory or inventory expected to be sold below cost and additional reserves may be required.

- Goodwill and indefinite life intangible assets are subject to annual impairment testing. The impairment tests are based on determining the fair value of the specified reporting units and indefinite life intangible assets based on management judgments and assumptions using estimated future cash flows. These judgments and assumptions could materially change the value of the specified reporting units and indefinite life intangible assets and, therefore, could materially impact the Company's consolidated financial statements. Intangible assets with definite lives are amortized over their useful lives. The useful life of a definite intangible asset is based on assumptions and judgments made by management at the time of acquisition. Changes in these judgments and assumptions that could include a loss of customers, a change in the assessment of future operations or a prolonged economic downturn could materially change the value of the definite-lived intangible assets and, therefore, could materially impact the Company's financial statements.

- Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which the temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in the tax rates is recognized in earnings in the period that includes the enactment date. Additionally, taxing jurisdictions could retroactively disagree with the Company's tax treatment of certain items, and some historical transactions have income tax effects going forward. Accounting rules require these future effects to be evaluated using current laws, rules and regulations, each of which can change at any time and in an unpredictable manner.

- Environmental and legal accruals are estimates based on judgments made by the Company relating to ongoing environmental and legal proceedings, as disclosed in the Company's consolidated financial statements. In determining whether a liability is probable and reasonably estimable, the Company consults with its internal experts. The Company believes that the amounts recorded in the accompanying financial statements are based on the best estimates and judgments available to it.

Recent Accounting Pronouncements

In December 2004, the FASB issued FASB Staff Position 109-1, "Application of FASB Statement No. 109, "Accounting for Income Taxes" ("SFAS No. 109") to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004" ("FSP 109-1"). The American Jobs Creation Act of 2004 (the "Jobs Act") provides a tax deduction for income from qualified domestic production activities. FSP 109-1 provides the treatment for the deduction as a special deduction as described in SFAS No. 109. The Company is currently evaluating the effect that the manufacturer's deduction will have on future results. FSP 109-1 is effective prospectively as of January 1, 2005.

In December 2004, the FASB issued FASB Staff Position 109-2, "Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004" ("FSP 109-2"), which provides guidance under SFAS No. 109 with respect to recording the potential impact of the repatriation provisions of the Jobs Act on enterprises' income tax expense and deferred tax liability. The Jobs Act was enacted on October 22, 2004. FSP 109-2 states that an enterprise is allowed time beyond the financial reporting period of enactment to evaluate the effect of the Jobs Act on its plan for reinvestment or repatriation of foreign earnings for purposes of applying FASB Statement No. 109. The Company has not yet completed evaluating the impact of the repatriation provisions and has not adjusted its tax expense or deferred tax liability to reflect the repatriation provisions of the Jobs Act.

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs – An Amendment of ARB No. 43, Chapter 4" ("SFAS 151"). SFAS 151 amends the guidance in ARB No. 43, Chapter 4, "Inventory Pricing," to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). Among other provisions, the new rule requires that items such as idle facility expense, excessive spoilage, double freight, and re-handling costs be recognized as current-period charges regardless of whether they meet the criterion of "so abnormal" as stated in ARB No. 43. Additionally, SFAS 151 requires that the allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS 151 is effective for fiscal years beginning after June 15, 2005. The Company is currently evaluating SFAS 151 and does not expect it to have a material impact on the Company's consolidated financial statements.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123R"), which replaces SFAS No. 123, "Accounting for Stock-Based Compensation," ("SFAS 123") and supercedes APB Opinion No. 25, "Accounting for Stock Issued to Employees." SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values beginning with the first interim or annual period after June 15, 2005. Transition may be accomplished using either the prospective or retrospective methods. The Company currently measures compensation costs related to share-based payments under APB Opinion No. 25. The Company is currently evaluating the transition methods under SFAS 123R and will begin expensing stock options in the third quarter of 2005.

Impact of Inflation

Inflation affects the Company's manufacturing costs, distribution costs and operating expenses. The carpet and tile industry has experienced significant inflation in the prices of raw materials and fuel-related costs beginning in the first quarter of 2004. For the period from 1999 through 2004 the carpet and tile industry experienced moderate inflation in the prices of raw materials and fuel-related costs. In the past, the Company has generally passed along these price increases to its customers and has been able to enhance productivity to offset increases in costs resulting from inflation in both the United States and Mexico.

Seasonality

The Company is a calendar year-end company and its results of operations for the first quarter tend to be the weakest. The second, third and fourth quarters typically produce higher net sales and operating income. These results are primarily due to consumer residential spending patterns for floor covering, which historically have decreased during the first two months of each year following the holiday season.

Certain Factors Affecting the Company's Performance

In addition to the other information provided in the Company's Annual Report, the following risk factors should be considered when evaluating an investment in shares of Common Stock.

If any of the events described in these risks were to occur, it could have a material adverse effect on the Company's business, financial condition and results of operations.

The floor covering industry is sensitive to changes in general economic conditions, such as consumer confidence and income, corporate and government spending, interest rate levels and demand for housing. A prolonged decline in construction activity or spending for replacement floor covering products could have a material adverse effect on the Company's business.

The U.S. floor covering industry is highly dependent on construction activity, including new construction, remodeling and replacement which are cyclical in nature. Although the impact of a decline in new construction activity is typically accompanied by an increase in remodeling and replacement activity, a prolonged decline in residential or commercial construction activity could have a material adverse effect on the Company's business. Additionally, economic changes that result in a prolonged decline in spending for remodeling and replacement activities could have a material adverse effect on the Company's business.

The U.S. construction industry has experienced significant downturns in the past, which have adversely affected suppliers to the industry. The industry could experience similar downturns in the future, which could have a negative impact on the Company's business.

The Company faces intense competition in its industry, which could decrease demand for its products and could have a material adverse effect on its profitability.

The industry is highly competitive. The Company faces competition from a number of manufacturers and independent distributors. Some of its competitors may be larger and have greater resources and access to capital. Maintaining the Company's competitive position may require: substantial investments in its product development efforts, manufacturing facilities, distribution network and sales and marketing activities. Competitive pressures may also result in decreased demand for its products. Any of these factors could have a material adverse effect on the Company.

A failure to identify suitable acquisition candidates, to complete acquisitions and to integrate successfully the acquired operations could have a material adverse effect on the Company's business.

As part of its business strategy, the Company intends to pursue acquisitions of complementary businesses. Although it regularly evaluates acquisition opportunities, it may not be able to successfully identify suitable acquisition candidates; obtain sufficient financing on acceptable terms to fund acquisitions; complete acquisitions; or profitably manage acquired businesses.

Acquired operations may not achieve expected performance levels and may involve a number of special risks, including among others an inability to successfully integrate acquired operations and the diversion of management resources.

The Company may be unable to obtain raw materials on a timely basis, which could have a material adverse effect on its business.

The principal raw materials used in the Company's manufacturing operations include: nylon, polyester and polypropylene resins and fibers and carpet backings, which are used exclusively in its carpet and rugs business; talc, clay, nepheline syenite and various glazes, including frit (ground glass), zircon and stains, which are used exclusively in its ceramic tile business; and other materials. The Company has a single source supplier for all of its nepheline syenite requirements. An extended interruption in the supply of these or other raw materials used in the Company's business or in the supply of suitable substitute materials would disrupt the Company's operations, which could have a material adverse effect on its business.

The Company may be unable to pass on to its customers increases in the costs of raw materials and energy, which could have a material adverse effect on its profitability.

The prices of raw materials and energy costs vary with market conditions. Although the Company generally attempts to pass on increases in the costs of raw materials and energy costs to its customers, the Company's ability to do so is dependent upon the rate and magnitude of any increase, competitive pressures and market conditions for its products. There have been in the past, and may be in the future, periods of time during which increases in these costs cannot be recovered. During such periods of time, there could be a material adverse effect on the Company's profitability.

The Company has been, and in the future may be, subject to claims and liabilities under environmental, health and safety laws and regulations, which could be significant.

The Company's operations are subject to various environmental, health and safety laws and regulations, including those governing air emissions, wastewater discharges, and the use, storage, treatment and disposal of hazardous materials. The applicable requirements under these laws are subject to amendment, to the imposition of new or additional requirements and to changing interpretations of agencies or courts. The Company could incur material expenditures to comply with new or existing regulations, including fines and penalties.

The nature of the Company's operations, including the potential discovery of presently unknown environmental conditions, exposes the Company to the risk of claims under environmental, health and safety laws and regulations. The Company could incur material costs or liabilities in connection with such claims.

Changes in international trade laws and in the business, political and regulatory environment in Mexico could have a material adverse effect on the Company's business.

The Company's Monterrey, Mexico manufacturing facility represents a significant portion of the Company's total manufacturing capacity for ceramic tile. Accordingly, an event that has a material adverse impact on the Company's Mexican operations could have a material adverse effect on the tile operations as a whole. The business, regulatory and political environments in Mexico differ from those in the United States, and the Company's Mexican operations are exposed to legal, currency, tax, political, and economic risks specific to Mexico.

The Company could face increased competition as a result of the General Agreement on Tariffs and Trade ("GATT") and the North American Free Trade Agreement ("NAFTA").

The Company is uncertain what effect reduced import duties under GATT may have on its operations, although these reduced rates may stimulate additional competition from manufacturers that export ceramic tile to the United States.

Although NAFTA lowers the tariffs imposed on the Company's ceramic tile manufactured in Mexico and sold in the United States and will eliminate such tariffs entirely on January 1, 2008, it may also stimulate competition in the United States and Canada from manufacturers located in Mexico.

Forward-Looking Information

Certain of the statements in this Annual Report, particularly those anticipating future performance, business prospects, growth and operating strategies, proposed acquisitions, and similar matters, and those that include the words "believes," "anticipates," "forecast," "estimates" or similar expressions constitute "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended. For those statements, Mohawk claims the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. There can be no assurance that the forward-looking statements will be accurate because they are based on many assumptions, which involve risks and uncertainties. The following important factors could cause future results to differ: changes in industry conditions; competition; raw material prices; energy costs; timing and level of capital expenditures; integration of acquisitions; introduction of new products; rationalization of operations; and other risks identified in Mohawk's SEC reports and public announcements.

Quantitative and Qualitative Disclosures about Market Risk

Financial exposures are managed as an integral part of the Company's risk management program, which seeks to reduce the potentially adverse effect that the volatility of the exchange rate and natural gas markets may have on its operating results. The Company does not regularly engage in speculative transactions, nor does it regularly hold or issue financial instruments for trading purposes.

Natural Gas Risk Management

The Company uses a combination of natural gas futures contracts and long-term supply agreements to manage unanticipated changes in natural gas prices. The contracts are based on forecasted usage of natural gas measured in Million British Thermal Units ("MMBTU").

The Company has designated the natural gas futures contracts as cash flow hedges. The outstanding contracts are valued at market with the offset applied to other comprehensive income, net of applicable income taxes and any hedge ineffectiveness.

Any gain or loss is reclassified from other comprehensive income and recognized in cost of goods sold in the same period or periods during which the hedged transaction affects earnings. At December 31, 2004, the Company had natural gas contracts that mature from January 2005 to March 2005 with an aggregate notional amount of approximately 1 million MMBTU's. The fair value of these contracts was a liability of $1.3 million. At December 31, 2003, the Company had natural gas contracts that matured from January 2004 to December 2004 with an aggregate notional amount of approximately 3.9 million MMBTU's. The fair value of these contracts was an asset of $3.6 million. The offset to these assets is recorded in other comprehensive income, net of applicable income taxes. The ineffective portion of the derivative is recognized directly in the cost of goods sold within the consolidated statements of earnings and was not significant for the periods reported. The amount that the Company anticipates will be reclassified out of accumulated other comprehensive income in the next twelve months is a loss of approximately $1.3 million.

The Company's natural gas long-term supply agreements are accounted for under the normal purchases provision within SFAS No. 133 and its amendments. At December 31, 2004, the Company had normal purchase commitments of approximately 1.9 million MMBTU's for periods maturing from January 2005 through March 2006. The contracted value of these commitments was approximately $9.9 million and the fair value of these commitments was approximately $11.9 million, at December 31, 2004. At December 31, 2003, the Company had normal purchase commitments of approximately 3.1 million MMBTU's. The contracted value of these commitments was approximately $13.8 million and the fair value of these commitments was approximately $17.0 million.

Foreign Currency Rate Management

The Company enters into foreign exchange forward contracts to hedge foreign denominated costs associated with its operations in Mexico. The objective of these transactions is to reduce volatility of exchange rates where these operations are located by fixing a portion of their costs in U.S. currency. Accordingly, these contracts have been designated as cash flow hedges. Gains and losses are reclassified from other comprehensive income and recognized in cost of goods sold in the same period or periods during which the hedged transaction affects earnings. The Company had forward contracts to purchase approximately 145.3 million Mexican pesos at December 31, 2003. The aggregate U.S. dollar value of these contracts at December 31, 2003 was approximately $12.7 million. The contracts are marked to market in other current liabilities with the offset to other comprehensive income, net of applicable income taxes. Unrealized losses at December 31, 2003 were not significant. The Company had no forward contracts outstanding at December 31, 2004.

CONSOLIDATED STATEMENTS OF EARNINGS

Mohawk Industries, Inc. and Subsidiaries

	Years Ended December 31, 2004, 2003 and 2002		
	2004	2003	2002
	($ in thousands, except per share data)		
Net sales	$5,880,372	4,999,381	4,516,957
Cost of sales	4,259,531	3,605,579	3,247,865
Gross profit	1,620,841	1,393,802	1,269,092
Selling, general and administrative expenses	985,251	851,773	747,027
Operating income	635,590	542,029	522,065
Other expense (income):			
Interest expense	53,392	55,575	68,972
Other expense	9,731	6,252	13,455
Other income	(4,922)	(8,232)	(3,991)
	58,201	53,595	78,436
Earnings before income taxes	577,389	488,434	443,629
Income taxes	208,767	178,285	159,140
Net earnings	$ 368,622	310,149	284,489
Basic earnings per share	$ 5.53	4.68	4.46
Weighted-average common shares outstanding	66,682	66,251	63,723
Diluted earnings per share	$ 5.46	4.62	4.39
Weighted-average common and dilutive potential common shares outstanding	67,557	67,121	64,861

CONSOLIDATED BALANCE SHEETS

Mohawk Industries, Inc. and Subsidiaries

	December 31, 2004 and 2003	
	2004	2003
	($ in thousands, except per share data)	
ASSETS		
Current assets:		
Receivables	$ 660,650	573,500
Inventories	1,017,983	832,415
Prepaid expenses	49,381	43,043
Deferred income taxes	55,311	84,260
Total current assets	1,783,325	1,533,218
Property, plant and equipment, net	905,332	919,085
Goodwill	1,377,349	1,368,700
Other intangible assets	322,646	325,339
Other assets	14,466	17,233
	$4,403,118	4,163,575
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	$ 191,341	302,968
Accounts payable and accrued expenses	623,061	637,940
Total current liabilities	814,402	940,908
Deferred income taxes	191,761	183,669
Long-term debt, less current portion	700,000	709,445
Other long-term liabilities	30,618	31,752
Total liabilities	1,736,781	1,865,774
Stockholders' equity:		
Preferred stock, $.01 par value; 60 shares authorized; no shares issued	–	–
Common stock, $.01 par value; 150,000 shares authorized; 77,514 and 77,050 shares issued in 2004 and 2003, respectively	775	770
Additional paid-in capital	1,058,537	1,035,733
Retained earnings	1,910,383	1,541,761
Accumulated other comprehensive (loss) income	(2,441)	2,313
	2,967,254	2,580,577
Less treasury stock at cost; 10,755 and 10,515 shares in 2004 and 2003, respectively	300,917	282,776
Total stockholders' equity	2,666,337	2,297,801
	$4,403,118	4,163,575

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME

Mohawk Industries, Inc. and Subsidiaries

Years Ended December 31, 2004, 2003 and 2002

(In thousands)	Common stock Shares	Common stock Amount	Additional paid–in capital	Retained earnings	Accumulated other comprehensive income (loss)	Treasury stock Shares	Treasury stock Amount	Total stockholders' equity
Balances at December 31, 2001	61,408	$614	$ 197,247	$ 947,123	$(2,837)	(8,715)	$(193,596)	$ 948,551
Stock options exercised	2,056	20	50,165	–	–	–	–	50,185
Purchase of Dal-Tile	12,907	129	750,558	–	–	–	–	750,687
Purchase of treasury stock	–	–	–	–	–	(1,371)	(64,034)	(64,034)
Grant to employee profit sharing plan	–	–	3,040	–	–	72	282	3,322
Grant to executive incentive plan	–	–	77	–	–	8	176	253
Tax benefit from exercise of stock options	–	–	5,463	–	–	–	–	5,463
Comprehensive Income:								
Discontinued hedge on interest rate swap	–	–	–	–	6,768	–	–	6,768
Unrealized loss on hedge instruments net of taxes	–	–	–	–	(2,805)	–	–	(2,805)
Net earnings	–	–	–	284,489	–	–	–	284,489
Total Comprehensive Income								288,452
Balances at December 31, 2002	76,371	763	1,006,550	1,231,612	1,126	(10,006)	(257,172)	1,982,879
Stock options exercised	679	7	18,283	–	–	–	–	18,290
Purchase of treasury stock	–	–	–	–	–	(593)	(27,839)	(27,839)
Grant to employee profit sharing plan	–	–	2,080	–	–	72	1,929	4,009
Grant to executive incentive plan	–	–	63	–	–	12	306	369
Tax benefit from exercise of stock options	–	–	8,757	–	–	–	–	8,757
Comprehensive Income:								
Currency translation adjustment	–	–	–	–	47	–	–	47
Unrealized gain on hedge instruments net of taxes	–	–	–	–	1,140	–	–	1,140
Net earnings	–	–	–	310,149	–	–	–	310,149
Total Comprehensive Income								311,336
Balances at December 31, 2003	77,050	770	1,035,733	1,541,761	2,313	(10,515)	(282,776)	2,297,801
Stock options exercised	464	5	14,952	–	–	–	–	14,957
Purchase of treasury stock	–	–	–	–	–	(250)	(18,413)	(18,413)
Grant to executive incentive plan and other	–	–	307	–	–	10	272	579
Tax benefit from exercise of stock options	–	–	7,545	–	–	–	–	7,545
Comprehensive Income:								
Currency translation adjustment	–	–	–	–	(1,675)	–	–	(1,675)
Unrealized loss on hedge instruments net of taxes	–	–	–	–	(3,079)	–	–	(3,079)
Net earnings	–	–	–	368,622	–	–	–	368,622
Total Comprehensive Income								363,868
Balances at December 31, 2004	77,514	775	1,058,537	1,910,383	(2,441)	(10,755)	(300,917)	2,666,337

CONSOLIDATED STATEMENTS OF CASH FLOWS

Mohawk Industries, Inc. and Subsidiaries

	Years Ended December 31, 2004, 2003 and 2002		
	2004	2003	2002
		(in thousands)	
Cash flows from operating activities:			
Net earnings	$ 368,622	310,149	284,489
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation and amortization	123,088	106,615	101,942
Deferred income taxes	38,700	34,775	22,137
Tax benefit on stock options exercised	7,545	8,757	5,463
Loss on sale of property, plant and equipment	3,037	3,267	2,762
Changes in assets and liabilities, net of effects of acquisitions:			
Receivables	(85,417)	(47,443)	34,657
Inventories	(179,765)	(104,964)	(15,215)
Accounts payable and accrued expenses	(25,241)	(2,769)	117,039
Other assets and prepaid expenses	(6,598)	(5,592)	(13,111)
Other liabilities	(1,134)	6,595	9,347
Net cash provided by operating activities	242,837	309,390	549,510
Cash flows from investing activities:			
Additions to property, plant and equipment	(106,601)	(114,631)	(111,934)
Acquisitions	(14,998)	(384,121)	(717,638)
Net cash used in investing activities	(121,599)	(498,752)	(829,572)
Cash flows from financing activities:			
Net change in revolving line of credit	(3,981)	37,299	(29,491)
Proceeds from issuance of senior notes	–	–	700,000
Proceeds from bridge credit facility	–	–	600,000
Repayment of bridge credit facility	–	–	(600,000)
Net change in asset securitization borrowings	(92,000)	182,000	(125,000)
Payments on term loans	(25,034)	(26,492)	(32,208)
Redemption of acquisition indebtedness	–	–	(202,564)
Payments of other debt	(57)	(821)	(1,307)
Change in outstanding checks in excess of cash	3,290	6,925	(15,519)
Acquisition of treasury stock	(18,413)	(27,839)	(64,034)
Common stock transactions	14,957	18,290	50,185
Net cash (used in) provided by financing activities	(121,238)	189,362	280,062
Net change in cash	–	–	–
Cash, beginning of year	–	–	–
Cash, end of year	$ –	–	–

Note 1
SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of Presentation

The consolidated financial statements include the accounts of Mohawk Industries, Inc. and its subsidiaries (the "Company" or "Mohawk"). All significant intercompany balances and transactions have been eliminated in consolidation.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(b) Accounts Receivable and Revenue Recognition

The Company is principally a carpet, rug and ceramic tile manufacturer and sells carpet, rugs, ceramic tile, natural stone, hardwood, resilient and laminate flooring products throughout the United States principally for residential and commercial use. The Company grants credit to customers, most of whom are retail-flooring dealers and commercial end users, under credit terms that are customary in the industry.

Revenues are recognized when goods are shipped, which is when the legal title passes to the customer. The Company provides allowances for expected cash discounts, returns, claims and doubtful accounts based upon historical bad debt and claims experience and periodic evaluations of specific customer accounts.

(c) Inventories

Inventories are stated at the lower of cost or market (net realizable value). Cost is determined using the last-in, first-out (LIFO) method, which matches current costs with current revenues, for approximately 80% of the inventories within the Mohawk segment and the first-in, first-out (FIFO) method for the Dal-Tile segment and the remaining inventories within the Mohawk segment.

(d) Property, Plant and Equipment

Property, plant and equipment are stated at cost, including capitalized interest. Depreciation is calculated on a straight-line basis over the estimated remaining useful lives, which are 25-35 years for buildings and improvements, 5-15 years for machinery and equipment, the shorter of the estimated useful life or life of the lease for leasehold improvements and 3-7 years for furniture and fixtures.

(e) Goodwill and Other Intangible Assets

In accordance with the provisions of Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets" the Company tests goodwill and other intangible assets with indefinite lives for impairment on an annual basis (or on an interim basis if an event occurs that might reduce the fair value of the reporting unit below its carrying value). The Company conducts testing for impairment during the fourth quarter of its fiscal year. Intangible assets that do not have indefinite lives are amortized based on average lives.

(f) Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry-forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

(G) Financial Instruments

The Company's financial instruments consist primarily of receivables, accounts payable, accrued expenses and long-term debt. The carrying amount of receivables, accounts payable and accrued expenses approximates their fair value because of the short-term maturity of such instruments. The carrying amount of the Company's floating rate debt approximates its fair value. Interest rates that are currently available to the Company for issuance of long-term debt with similar terms and remaining maturities are used to estimate the fair value of the Company's long-term debt. The estimated fair value of the Company's long-term debt at December 31, 2004 and 2003 was $961,120 and $1,095,590, compared to a carrying amount of $891,341 and $1,012,413, respectively.

(H) Derivative Instruments

Accounting for Derivative Instruments and Hedging Activities requires the Company to recognize all derivatives on the consolidated balance sheet at fair value. Derivatives that are not hedges must be adjusted to fair value through earnings. If the derivative is a hedge, depending on the nature of the hedge, changes in its fair value are either offset against the change in fair value of assets, liabilities, or firm commitments through earnings or recognized in other comprehensive income until the hedged item is recognized in earnings. The Company engages in activities that expose it to market risks, including the effects of changes in interest rates, exchange rates and natural gas prices. Financial exposures are managed as an integral part of the Company's risk management program, which seeks to reduce the potentially adverse effect that the volatility of the interest rate, exchange rate and natural gas markets may have on operating results. The Company does not regularly engage in speculative transactions, nor does it regularly hold or issue financial instruments for trading purposes.

The Company formally documents all hedging instruments and hedging items, as well as its risk management objective and strategy for undertaking hedged items. This process includes linking all derivatives that are designated as fair value and cash flow hedges to specific assets or liabilities on the consolidated balance sheet or to forecasted transactions. The Company also formally assesses, both at inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair value or cash flows of hedged items. When it is determined that a derivative is not highly effective, the derivative expires or is sold, terminated, or exercised, or the derivative is discontinued because it is unlikely that a forecasted transaction will occur, the Company discontinues hedge accounting for that specific hedge instrument.

(I) Advertising Costs and Vendor Consideration

Advertising and promotion expenses are charged to earnings during the period in which they are incurred. Advertising and promotion expenses included in selling, administrative, and general expenses were $31,474 in 2004, $26,990 in 2003 and $31,829 in 2002.

Vendor consideration, generally cash, is classified as a reduction of net sales, unless specific criteria are met regarding goods or services that the vendor may receive in return for this consideration. The Company makes various payments to customers, including slotting fees, advertising allowances, buy-downs and co-op advertising. All of these payments reduce gross sales with the exception of co-op advertising. Co-op advertising is classified as a selling, general and administrative expense. Co-op advertising expenses, a component of advertising and promotion expenses, were $10,389 in 2004, $9,355 in 2003 and $14,090 in 2002.

(J) Impairment of Long-Lived Assets

Long-lived assets and intangibles subject to amortization are reviewed for impairment when changes in circumstances indicate that the carrying amount of the asset may not be recoverable. If the carrying amount of the asset exceeds the expected undiscounted cash flows of the asset, an impairment charge is recognized equal to the amount by which the carrying amount exceeds the expected undiscounted cash flows. Assets to be disposed of are reported at the lower of the carrying amount or fair value less estimated costs of disposal and are no longer depreciated.

December 31, 2004, 2003 and 2002 (In thousands, except per share data)

(k) Foreign Currency Translation

The Company's subsidiaries that operate outside the United States use their local currency as the functional currency, with the exception of operations carried out in Canada and Mexico, in which case the functional currency is the U.S. dollar. Other than Canada and Mexico, the functional currency is translated into U.S. dollars for balance sheet accounts using the month end rates in effect as of the balance sheet date and average exchange rate for revenue and expense accounts for each respective period. The translation adjustments are deferred as a separate component of stockholders' equity, within other comprehensive income. Gains or losses resulting from transactions denominated in foreign currencies are included in other income or expense, within the consolidated statements of earnings. The assets and liabilities of the Company's Canada and Mexico operations are re-measured using a month end rate, except for non-monetary assets and liabilities, which are re-measured using the historical exchange rate. Income and expense accounts are re-measured using an average monthly rate for the period, except for expenses related to those balance sheet accounts that are re-measured using historical exchange rates. The resulting re-measurement adjustment is reported in the consolidated statements of operations when incurred.

(l) Earnings per Share ("EPS")

Basic net earnings per share ("EPS") is calculated using net earnings available to common stockholders divided by the weighted-average number of shares of common stock outstanding during the year. Diluted EPS is similar to basic EPS except that the weighted-average number of shares is increased to include the number of additional common shares that would have been outstanding if the potentially dilutive common shares had been issued.

Dilutive common stock options are included in the diluted EPS calculation using the treasury stock method. Common stock options that were not included in the diluted EPS computation because the options' exercise price was greater than the average market price of the common shares for the periods presented were 21, 605 and 571 for 2004, 2003 and 2002, respectively.

Computations of basic and diluted earnings per share are presented in the following table:

	Years Ended December 31,		
	2004	2003	2002
Net earnings	$368,622	310,149	284,489
Weighted-average common and dilutive potential common shares outstanding:			
Weighted-average common shares outstanding	66,682	66,251	63,723
Add weighted-average dilutive potential common shares – options to purchase common shares, net	875	870	1,138
Weighted-average common and dilutive potential common shares outstanding	67,557	67,121	64,861
Basic earnings per share	$ 5.53	4.68	4.46
Diluted earnings per share	$ 5.46	4.62	4.39

(m) Stock-Based Compensation

Effective January 1, 2003, the Company adopted the disclosure provisions of SFAS No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure." This statement amends SFAS No. 123, "Accounting for Stock-Based Compensation," to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based compensation and requires prominent disclosure in both the annual and interim financial statements of the method of accounting used and the financial impact of stock-based compensation. As permitted by SFAS No. 123, the Company accounts for stock options granted as prescribed under Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," which recognizes compensation cost based upon the intrinsic value of the award.

December 31, 2004, 2003 and 2002 (In thousands, except per share data)

If the Company had elected to recognize compensation expense based upon the fair value at the grant dates for awards under its plans, the Company's net earnings per share would have been reduced as follows:

	2004	2003	2002
Net earnings as reported	$368,622	310,149	284,489
Deduct: Stock-based employee compensation expense determined under fair value based method for all options, net of related tax effects	(7,519)	(6,284)	(4,972)
Pro forma net earnings	$361,103	303,865	279,517
Net earnings per common share (basic)			
As reported	$ 5.53	4.68	4.46
Pro forma	$ 5.42	4.59	4.39
Net earnings per common share (diluted)			
As reported	$ 5.46	4.62	4.39
Pro forma	$ 5.36	4.54	4.31

The average fair value of options granted during 2004, 2003 and 2002 was $34.39, $24.73 and $26.72, respectively. This fair value was estimated using the Black-Scholes option pricing model based on a weighted-average market price at grant date of $74.62 in 2004, $53.93 in 2003 and $62.11 in 2002 and the following weighted-average assumptions:

	2004	2003	2002
Dividend yield	–	–	–
Risk-free interest rate	2.9%	2.3%	3.0%
Volatility	43.1%	44.9%	39.7%
Expected life (years)	6	6	6

(N) Effect of New Accounting Pronouncements

In December 2004, the FASB issued FASB Staff Position 109-1, "Application of FASB Statement No. 109, "Accounting for Income Taxes" ("SFAS No. 109") to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004" ("FSP 109-1"). The American Jobs Creation Act of 2004 (the "Jobs Act") provides a tax deduction for income from qualified domestic production activities. FSP 109-1 provides the treatment for the deduction as a special deduction as described in SFAS No. 109. The Company is currently evaluating the effect that the manufacturer's deduction will have on future results. FSP 109-1 is effective prospectively as of January 1, 2005.

In December 2004, the FASB issued FASB Staff Position 109-2, "Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004" ("FSP 109-2"), which provides guidance under SFAS No. 109 with respect to recording the potential impact of the repatriation provisions of the Jobs Act on enterprises' income tax expense and deferred tax liability. The Jobs Act was enacted on October 22, 2004. FSP 109-2 states that an enterprise is allowed time beyond the financial reporting period of enactment to evaluate the effect of the Jobs Act on its plan for reinvestment or repatriation of foreign earnings for purposes of applying FASB Statement No. 109. The Company has not yet completed evaluating the impact of the repatriation provisions and has not adjusted its tax expense or deferred tax liability to reflect the repatriation provisions of the Jobs Act.

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs – An Amendment of ARB No. 43, Chapter 4" ("SFAS 151"). SFAS 151 amends the guidance in ARB No. 43, Chapter 4, "Inventory Pricing," to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material (spoilage). Among other provisions, the new rule requires that items such as idle facility expense, excessive spoilage, double freight, and re-handling costs be recognized as current-period charges regardless of whether they meet the criterion of "so abnormal" as stated in ARB No. 43. Additionally, SFAS 151 requires that the allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS 151 is effective for fiscal years beginning after June 15, 2005. The Company is currently evaluating SFAS 151 and does not expect it to have a material impact on the Company's consolidated financial statements.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123R"), which replaces SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123") and supercedes APB Opinion No. 25, "Accounting for Stock Issued to Employees." SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values beginning with the first interim or annual period after June 15, 2005. Transition may be accomplished using either the prospective or retrospective methods. The Company currently measures compensation costs related to share-based payments under APB Opinion No. 25. The Company is currently evaluating the transition methods under SFAS 123R and will begin expensing stock options in the third quarter of 2005.

(o) Fiscal Year

The Company ends its fiscal year on December 31. Each of the first three quarters in the fiscal year ends on the Saturday nearest the calendar quarter end.

(p) Reclassifications

In 2004, the Company reclassified certain prior period financial statement balances to conform to current presentations.

Note 2
ACQUISITIONS

On March 20, 2002, the Company acquired all of the outstanding capital stock of Dal-Tile International Inc. ("Dal-Tile"), a leading manufacturer and distributor of ceramic tile in the United States, for approximately $1,468,325, consisting of approximately 12,900 shares of the Company's common stock, options to purchase approximately 2,100 shares of the Company's common stock and approximately $717,638 in cash, including direct acquisition costs. The Company's common stock and options were valued at approximately $750,687 based on the measurement date stock price of $55.04 per share ($710,420) and the estimated fair value of the options using the Black-Scholes option-pricing model ($40,267). The acquisition was accounted for by the purchase method and, accordingly, the results of operations of Dal-Tile have been included in the Company's consolidated financial statements from March 20, 2002. The purchase price was allocated to the assets acquired and liabilities assumed based upon the estimated fair values at the date of acquisition. The trademark value was established based upon an independent appraisal. The excess of the purchase price over the fair value of the net identifiable assets acquired of approximately $1,168,286 was recorded as goodwill. None of the goodwill is expected to be deductible for income tax purposes. The primary reason for the acquisition was to expand the Company's presence in the ceramic tile and stone markets.

Mohawk considered whether identifiable intangible assets, such as customer relationships, patents, covenants not to compete, software, production backlog, marketing agreements, unpatented technology and trade secrets, might exist and none were identified other than trademarks, during the purchase price negotiations and during the subsequent purchase price allocation evaluation. Accordingly, the valuation resulted in the recognition of goodwill and trademarks.

In accordance with SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142"), goodwill recorded in the Dal-Tile acquisition will not be amortized. Additionally, the Company determined that the trademark intangible assets have indefinite useful lives because they are expected to generate cash flows indefinitely. Goodwill and the trademark intangible assets are subject to annual impairment testing.

December 31, 2004, 2003 and 2002 (In thousands, except per share data)

The following table summarizes the fair values of the assets acquired and liabilities assumed at the date of acquisition.

Current assets	$ 322,042
Property, plant and equipment	223,267
Goodwill	1,168,286
Intangible assets-trademarks	146,700
Other assets	4,930
Total assets acquired	1,865,225
Current liabilities	132,124
Long-term debt	181,300
Other liabilities	83,476
Total liabilities assumed	396,900
Net assets acquired	$1,468,325

The following unaudited pro forma financial information presents the combined results of operations of Mohawk and Dal-Tile as if the acquisition had occurred at the beginning of 2002, after giving effect to certain adjustments, including increased interest expense on debt related to the acquisition, the elimination of goodwill amortization and related income tax effects. The pro forma information does not necessarily reflect the results of operations that would have occurred had Mohawk and Dal-Tile constituted a single entity during such periods. The following table discloses the results for the fiscal year ended December 31:

	2002
Net sales	$4,753,002
Net earnings	294,846
Basic earnings per share	4.39
Diluted earnings per share	4.32

On May 5, 2003, the Company acquired certain assets of International Marble and Granite of Colorado, Inc., a distributor of natural stone slabs and tile. The primary reason for the acquisition was to expand the Company's presence in the stone flooring and countertop slab market. The acquisition was accounted for by the purchase method and, accordingly, the results of operations are included within the Dal-Tile segment from May 5, 2003. The purchase price was not significant.

On June 30, 2003, the Company acquired certain assets of a manufacturer and distributor of washable bath rugs. The primary reason for the acquisition was to expand the Company's presence in the bath mat market. The acquisition was accounted for by the purchase method and, accordingly, the results of operations are included within the Mohawk segment from June 30, 2003. The purchase price was not significant.

On November 10, 2003, the Company acquired the assets and assumed certain liabilities of the carpet division of Burlington Industries, Inc. ("Lees Carpet") from W.L. Ross & Company for approximately $352,009 in cash. The results of Lees Carpet have been included with the Mohawk segment results in the Company's consolidated financial statements since that date. The primary reason for the acquisition was to expand the Company's presence in the commercial carpet market.

The following table summarizes the fair values of the assets acquired and the liabilities assumed at the date of acquisition for Lees Carpet.

Current assets	$ 62,939
Property, plant and equipment	53,424
Goodwill	78,083
Intangible assets	178,340
Other assets	52
Total assets acquired	372,838
Current liabilities	12,829
Other liabilities	8,000
Total liabilities assumed	20,829
Net assets acquired	$352,009

Of the approximately $178,340 of acquired intangible assets, approximately $125,580 was assigned to trade names and not subject to amortization. The remaining $52,760 was assigned to customer relationships with a weighted-average useful life of approximately 15 years. Goodwill of approximately $78,083 was assigned to the Mohawk segment. The goodwill is deductible for income tax purposes.

December 31, 2004, 2003 and 2002 (In thousands, except per share data)

The following unaudited pro forma financial information presents the combined results of operations of Mohawk and Lees Carpet as if the acquisition had occurred at the beginning of 2002, after giving effect to certain adjustments, including increased interest expense on debt related to the acquisition, the amortization of customer relationships, depreciation and related income tax effects. The pro forma information does not necessarily reflect the results of operations that would have occurred had Mohawk and Lees Carpet constituted a single entity during such periods. The following table discloses the results for the fiscal years ended December 31:

	2003	2002
Net sales	$5,216,312	4,777,526
Net earnings	316,386	290,996
Basic earnings per share	4.78	4.57
Diluted earnings per share	4.71	4.49

Note 3
RECEIVABLES

Receivables are as follows:

	2004	2003
Customers, trade	$746,233	663,269
Other	9,720	4,648
	755,953	667,917
Less allowance for discounts, returns, claims and doubtful accounts	95,303	94,417
Net receivables	$660,650	573,500

Note 4
INVENTORIES

The components of inventories are as follows:

	2004	2003
Finished goods	$ 665,565	535,645
Work in process	86,883	72,981
Raw materials	265,535	223,789
Total inventories	$1,017,983	832,415

The carrying value of LIFO inventory approximates replacement value at December 31, 2004 and 2003, respectively. There were no LIFO liquidations in either 2004 or 2003.

Note 5
GOODWILL AND OTHER INTANGIBLE ASSETS

The Company evaluates its goodwill and indefinite life intangibles on an annual basis for impairment. The Company has two reporting segments, the Mohawk segment and the Dal-Tile segment and, accordingly, has assigned the acquired goodwill and indefinite life intangibles to the respective reporting segments. During the fourth quarter of 2004, the Company evaluated the goodwill and indefinite life intangibles using the discounted cash flow approach and determined that there was no impairment.

The following table summarizes the components of intangible assets:

	2004	2003
Carrying amount of amortized intangible assets:		
Customer relationships	$ 54,160	53,010
Patents	600	600
	$ 54,760	53,610
Accumulated amortization of amortized intangible assets:		
Customer relationships	$ 4,324	541
Patents	70	10
	$ 4,394	551
Indefinite life intangible assets:		
Trade names	$272,280	272,280
Total other intangible assets	$322,646	325,339
Aggregate amortization expense for the year ended December 31	$ 3,843	551

Estimated amortization expense for years ended December 31, are as follows:

2005	$4,002
2006	4,002
2007	3,779
2008	3,619
2009	3,591

December 31, 2004, 2003 and 2002 (In thousands, except per share data)

The changes in the carrying amount of goodwill for the years ended December 31, 2004 and 2003 are as follows:

	Mohawk	Dal-Tile	Total
Balance as of January 1, 2003	$109,167	1,168,286	1,277,453
Goodwill acquired during the year	85,916	5,331	91,247
Balances as of December 31, 2003	195,083	1,173,617	1,368,700
Goodwill acquired during the year	1,549	7,100	8,649
Balances as of December 31, 2004	$196,632	1,180,717	1,377,349

The increase in goodwill during 2004 was attributable to an acquisition made within the Dal-Tile reporting segment and an earn-out payment related to an acquisition made within the Mohawk reporting segment during 2003.

Note 6
PROPERTY, PLANT AND EQUIPMENT

Following is a summary of property, plant and equipment:

	2004	2003
Land	$ 59,638	59,621
Buildings and improvements	378,389	367,007
Machinery and equipment	1,233,140	1,154,387
Furniture and fixtures	44,371	45,680
Leasehold improvements	24,120	19,912
Construction in progress	78,165	88,883
	1,817,823	1,735,490
Less accumulated depreciation and amortization	912,491	816,405
Net property, plant and equipment	$ 905,332	919,085

Property, plant and equipment includes capitalized interest of $3,197, $5,634 and $2,126 in 2004, 2003 and 2002, respectively. Depreciation expense was $117,768, $104,450 and $96,819 for 2004, 2003 and 2002, respectively.

Note 7
LONG-TERM DEBT

On September 29, 2004, the Company amended its five-year revolving credit facility with interest rates of either (i) LIBOR plus 0.4% to 1.4%, depending upon the Company's performance measured against certain financial ratios, or (ii) the base rate plus 0-0.5%, depending upon the Company's performance measured against certain financial ratios. The facility was increased from $200,000 to $300,000. The increase in the facility replaces the $100,000 364-day facility, which expired during the third quarter of 2004. The credit agreement contains customary financial and other covenants. The Company must pay an annual facility fee ranging from .15% to .50% of the total credit commitment, depending upon the Company's performance measured against specific coverage ratios. At December 31, 2004, a total of approximately $234,130 was available under both the credit facility and uncommitted credit lines compared to $237,344 available under both the credit facility and uncommitted credit lines at December 31, 2003. The amount used under both the credit facility and uncommitted credit lines at December 31, 2004, consisted of $37,721 under the Company's revolving credit facility and unsecured credit lines, $55,599 standby letters of credit guaranteeing the Company's industrial revenue bonds and $22,550 standby letters of credit related to various insurance contracts and foreign vendor commitments. The revolving credit facility and uncommitted credit lines are unsecured.

The Company has an on-balance sheet trade accounts receivable securitization agreement (the "Securitization Facility"). The Securitization Facility allows the Company to borrow up to $350,000 based on available accounts receivable. At December 31, 2004, the Company had $90,000 outstanding secured by approximately $825,799 million of trade receivables compared to $182,000 secured by approximately $649,018 of trade receivables at December 31, 2003. During the third quarter of 2004, the Company extended the term of its Securitization Facility until August 2005 and amended certain representations and warranties.

December 31, 2004, 2003 and 2002 (In thousands, except per share data)

Long-term debt consists of the following:

	2004	2003
Short term uncommitted credit lines	$ 37,721	–
364-Day Credit Agreement, due September 29, 2004	–	41,701
Securitization Facility, due August 1, 2005	90,000	182,000
6.50% senior notes, payable April 15, 2007, interest payable semiannually	300,000	300,000
7.20% senior notes, payable April 15, 2012, interest payable semiannually	400,000	400,000
8.46% senior notes, payable in annual principal installments beginning in 1998, due September 16, 2004, interest payable quarterly	–	14,286
7.14%-7.23% senior notes, payable in annual principal installments beginning in 1997, due September 1, 2005, interest payable semiannually	9,447	18,889
6% term note, payable in annual principal and interest installments beginning in 1998, due July 23, 2004	–	1,336
Industrial revenue bonds and other	54,173	54,201
Total long-term debt	891,341	1,012,413
Less current portion	191,341	302,968
Long-term debt, excluding current portion	$700,000	709,445

The aggregate maturities of long-term debt as of December 31, 2004 are as follows:

2005	$191,341
2006	–
2007	300,000
2008	–
2009	–
Thereafter	400,000
	$891,341

December 31, 2004, 2003 and 2002 (In thousands, except per share data)

Note 8
ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses are as follows:

	2004	2003
Outstanding checks in excess of cash	$ 33,719	30,429
Accounts payable, trade	277,851	245,746
Accrued expenses	180,978	185,099
Income taxes payable	16,143	76,913
Accrued compensation	114,370	99,753
Total accounts payable and accrued expenses	$623,061	637,940

Note 9
DERIVATIVE FINANCIAL INSTRUMENTS

Natural Gas Risk Management

The Company uses a combination of natural gas futures contracts and long-term supply agreements to manage unanticipated changes in natural gas prices. The contracts are based on forecasted usage of natural gas measured in Million British Thermal Units ("MMBTU").

The Company has designated the natural gas futures contracts as cash flow hedges. The outstanding contracts are valued at market with the offset applied to other comprehensive income, net of applicable income taxes and any hedge ineffectiveness.

Any gain or loss is reclassified from other comprehensive income and recognized in cost of goods sold in the same period or periods during which the hedged transaction affects earnings. At December 31, 2004, the Company had natural gas contracts that mature from January 2005 to March 2005 with an aggregate notional amount of approximately 1,010 MMBTU's. The fair value of these contracts was a liability of $1,280. At December 31, 2003, the Company had natural gas contracts outstanding with an aggregate notional amount of approximately 3,950 MMBTU's. The fair value of these contracts was an asset of $3,565. The offset to these assets is recorded in other comprehensive income, net of applicable income taxes. The ineffective portion of the derivative is recognized in the cost of goods sold within the consolidated statements of earnings and was not significant for the periods reported. The amount that the Company anticipates that will be reclassified out of accumulated other comprehensive income in the next twelve months is a loss of approximately $1,280.

The Company's natural gas long-term supply agreements are accounted for under the normal purchases provision within SFAS No. 133 and its amendments. At December 31, 2004, the Company had normal purchase commitments of approximately 1,892 MMBTU's for periods maturing from January 2005 through March 2006. The contracted value of these commitments was approximately $9,879 and the fair value of these commitments was approximately $11,941, at December 31, 2004. At December 31, 2003, the Company had normal purchase commitments of approximately 3,095 MMBTU's. The contracted value of these commitments was approximately $13,774 and the fair value of these commitments was approximately $17,018.

Foreign Currency Rate Management

The Company enters into foreign exchange forward contracts to hedge foreign denominated costs associated with its operations in Mexico. The objective of these transactions is to reduce volatility of exchange rates where these operations are located by fixing a portion of their costs in U.S. currency. Accordingly, these contracts have been designated as cash flow hedges. Gains and losses are reclassified from other comprehensive income and recognized in cost of goods sold in the same period or periods during which the hedged transaction affects earnings. The Company had forward contracts to purchase approximately 145,284 Mexican pesos at December 31, 2003. The aggregate U.S. dollar value of these contracts at December 31, 2003 was approximately $12,665. The contracts are marked to market in other current liabilities with the offset to other comprehensive income, net of applicable income taxes. Unrealized losses at December 31, 2003 were not significant. The Company had no forward contracts outstanding at December 31, 2004.

December 31, 2004, 2003 and 2002 (In thousands, except per share data)

NOTE 10
PRODUCT WARRANTIES

The Company warrants certain qualitative attributes of its products for up to 20 years. The Company records a provision for estimated warranty and related costs, based on historical experience and periodically adjusts these provisions to reflect actual experience.

Product warranties are as follows:

	2004	2003	2002
Balance at beginning of year	$24,063	28,919	32,406
Warranty claims	(45,553)	(50,040)	(55,999)
Warranty expense	44,963	45,184	52,512
Balance at end of year	$23,473	24,063	28,919

NOTE 11
STOCK OPTIONS, STOCK COMPENSATION AND TREASURY STOCK

Under the 2002 Long-Term Incentive Plan, options may be granted to directors and key employees through 2012 to purchase a maximum of 3,200 shares of common stock. Under the 2002 plan, options that were not issued from the 1992, 1993 and 1997 plans were cancelled. During 2004, 2003 and 2002, options to purchase 411, 565 and 731 shares, respectively, were granted under the 1992, 1993, 1997 and 2002 plans. Options granted under each of these plans expire 10 years from the date of grant and become exercisable at such dates and at prices as determined by the Compensation Committee of the Company's Board of Directors. In connection with the acquisition of Dal-Tile in 2002, the Company issued 2,096 options to employees of Dal-Tile in exchange for their respective options.

During 1996, the Company adopted the 1997 Non-Employee Director Stock Compensation Plan. The plan provides for awards of common stock of the Company for non-employee directors to receive in lieu of cash for their annual retainers. During 2004, 2003 and 2002, a total of 1, 1 and 2 shares, respectively, were awarded to the non-employee directors under the plan.

Additional information relating to the Company's stock option plans follows:

	2004	2003	2002
Options outstanding at beginning of year	2,413	2,624	1,916
Options granted for Dal-Tile acquisition	–	–	2,096
Options granted	411	565	731
Options exercised	(464)	(679)	(2,056)
Options canceled	(79)	(97)	(63)
Options outstanding at end of year	2,281	2,413	2,624
Options exercisable at end of year	791	765	1,017
Option prices per share:			
Options granted during the year	$61.33-90.97	48.50-74.93	38.73-65.02
Options exercised during the year	$ 9.33-65.02	6.67-63.14	5.67-49.09
Options canceled during the year	$11.17-82.50	9.33-63.90	9.58-63.14
Options outstanding at end of year	$ 9.33-90.97	9.33-74.93	6.67-65.02
Options exercisable at end of year	$ 9.33-74.93	9.33-65.02	6.67-53.01

December 31, 2004, 2003 and 2002 (In thousands, except per share data)

Summarized information about stock options outstanding and exercisable at December 31, 2004, is as follows:

	Outstanding			Exercisable	
Exercise price range	Number of Shares	Average Life[1]	Average Price[2]	Number of Shares	Average Price[2]
Under $30.53	650	4.56	$23.09	446	$20.08
$30.69-48.50	509	7.24	44.40	159	37.39
$49.09-63.14	493	7.39	60.93	119	60.87
$63.90-73.45	555	8.60	70.27	66	65.54
$73.54-84.85	67	9.48	81.42	1	74.93
$90.97-90.97	7	9.96	90.97	–	–
Total	2,281	6.91	49.41	791	33.55

(1) Weighted-average contractual life remaining in years.

(2) Weighted-average exercise price.

The Company's Board of Directors has authorized the repurchase of up to 15,000 shares of its outstanding common stock. For the year ended December 31, 2004, a total of approximately 250 shares of the Company's common stock was purchased at an aggregate cost of approximately $18,413. Since the inception of the program, a total of approximately 11,207 shares has been repurchased at an aggregate cost of approximately $311,543. All of these repurchases have been financed through the Company's operations and banking arrangements.

Note 12
EMPLOYEE BENEFIT PLANS

The Company has a 401(k) retirement savings plan (the "Mohawk Plan") open to substantially all of its employees who have completed 90 days of eligible service. For the Mohawk segment, the Company contributes $0.50 for every $1.00 of employee contributions up to a maximum of 4% of the employee's salary and an additional $0.25 for every $1.00 of employee contributions in excess of 4% of the employee's salary up to a maximum of 6%. For the Dal-Tile segment, the Company contributes $.50 for every $1.00 of employee contributions up to a maximum of 6% of the employee's salary. Employee and employer contributions to the Mohawk Plan were $35,440 and $13,896 in 2004, $28,807 and $10,995 in 2003, and $20,237 and $7,359 in 2002, respectively. The Company also made a discretionary contribution to the Mohawk Plan of approximately $5,214, $4,595 and $3,797 in 2004, 2003 and 2002, respectively.

Note 13
INCOME TAXES

Income tax expense for the years ended December 31, 2004, 2003 and 2002, consists of the following:

	Current	Deferred	Total
2004:			
U.S. federal	$158,704	32,541	191,245
State, local and other	11,363	6,159	17,522
	$170,067	38,700	208,767
2003:			
U.S. federal	$132,849	38,696	171,545
State, local and other	10,661	(3,921)	6,740
	$143,510	34,775	178,285
2002:			
U.S. federal	$133,914	9,859	143,773
State, local and other	3,089	12,278	15,367
	$137,003	22,137	159,140

December 31, 2004, 2003 and 2002 (In thousands, except per share data)

Income tax expense attributable to earnings before income taxes differs from the amounts computed by applying the U.S. statutory federal income tax rate to earnings before income taxes as follows:

	2004	2003	2002
Computed "expected" tax expense	$202,087	170,952	155,270
State and local income taxes, net of federal income tax benefit	11,675	5,071	8,741
Foreign income taxes	(892)	2,495	1,248
Tax credits	(1,821)	(2,312)	(5,000)
Other, net	(2,282)	2,079	(1,119)
	$208,767	178,285	159,140

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2004 and 2003, are presented below:

	2004	2003
Deferred tax assets:		
Accounts receivable	$ 32,008	41,582
Inventories	9,641	25,312
State net operating loss	7,020	7,142
Accrued expenses	62,767	61,003
Gross deferred tax assets	111,436	135,039
Deferred tax liabilities:		
Plant and equipment	(129,287)	(117,857)
Intangibles	(83,545)	(72,954)
Other liabilities	(35,054)	(43,637)
Gross deferred tax liabilities	(247,886)	(234,448)
Net deferred tax liability	$(136,450)	(99,409)

Based upon the expected reversal of deferred tax liabilities and the level of historical and projected taxable income over periods in which the deferred tax assets are deductible, the Company's management believes it is more likely than not the Company will realize the benefits of these deductible differences.

Income tax expense of $1,659 was recorded in other comprehensive income related to the Company's hedge instruments as of December 31, 2004.

The Company does not provide for U.S. federal and state income taxes on the cumulative undistributed earnings of its foreign subsidiaries because such earnings are reinvested and will continue to be reinvested indefinitely. At December 31, 2004, the Company had not provided federal income taxes on earnings of approximately $48,172 from its foreign subsidiaries. Should these earnings be distributed in the form of dividends or otherwise, the Company would be subject to both U.S. income taxes and withholding taxes in various international jurisdictions. These taxes will be partially offset by U.S. foreign tax credits.

The American Jobs Creation Act of 2004 was enacted on October 22, 2004. This new law made numerous and substantive changes in the taxation of foreign-sourced and domestic income. As of this date, the U.S. Treasury Department has not issued regulations providing implementation guidance for this new law. Due to the lack of guidance and the complex calculations involved, the Company has not completed its analysis of the effect this legislation may have on it.

In the normal course of business, the Company's tax returns are subject to examination by various taxing authorities. Such examinations may result in future tax and interest assessments by these taxing authorities, and the Company has accrued a liability when it believes that it is probable that it will be assessed. Differences between the estimated and actual amounts determined upon ultimate resolution, individually or in the aggregate, are not expected to have a material adverse effect on the Company's consolidated financial position but could possibly be material to the Company's consolidated results of operations or cash flow of any one period.

December 31, 2004, 2003 and 2002 (In thousands, except per share data)

NOTE 14
COMMITMENTS AND CONTINGENCIES

The Company is obligated under various operating leases for office and manufacturing space, machinery, and equipment.

Future minimum lease payments under non-cancelable operating leases (with initial or remaining lease terms in excess of one year) as of December 31:

2005	$ 81,803
2006	67,656
2007	50,934
2008	39,980
2009	31,133
Thereafter	61,786
Total payments	$333,292

Rental expense under operating leases was $87,659, $78,007 and $62,066 in 2004, 2003 and 2002, respectively.

The Company has approximately $36,693 and $23,433 as of December 31, 2004 and 2003 in standby letters of credit for various insurance contracts and commitments to foreign vendors that expire within two years.

The Company is involved in routine litigation from time to time in the regular course of its business. Except as noted below, there are no material legal proceedings pending or known to be contemplated to which the Company is a party or to which any of its property is subject.

The Company is subject to various federal, state, local and foreign environmental health and safety laws and regulations, including those governing air emissions, wastewater discharges, the use, storage, treatment and disposal of solid and hazardous materials, and the cleanup of contamination associated therewith. Because of the nature of the Company's business, the Company has incurred, and will continue to incur, costs relating to compliance with such laws and regulations. The Company is involved in various proceedings relating to environmental matters and is currently engaged in environmental investigation, remediation and post-closure care programs at certain sites. The Company has provided accruals for such activities that it has determined to be both probable and reasonably estimable. The Company does not expect that the ultimate liability with respect to such activities will have a material adverse effect on it.

NOTE 15
CONSOLIDATED STATEMENTS OF CASH FLOWS INFORMATION

Supplemental disclosures of cash flows information are as follows:

	2004	2003	2002
Net cash paid during the year for:			
Interest	$ 60,744	61,424	43,866
Income taxes	$226,227	139,914	59,931
Supplemental schedule of non-cash investing and financing activities:			
Fair value of assets acquired in acquisition	$ –	407,320	1,865,225
Liabilities assumed in acquisition	–	(23,199)	(396,900)
Issuance of common stock and options in acquisition	–	–	(750,687)
	$ –	384,121	717,638

December 31, 2004, 2003 and 2002 (In thousands, except per share data)

Note 16
SEGMENT REPORTING

The Company has two reporting segments, the Mohawk segment and the Dal-Tile segment. The Mohawk segment (an aggregation of the Mohawk Flooring reporting unit and the Mohawk Home reporting unit) manufactures, sources, markets and distributes its product lines, which include carpet, rugs, pad, ceramic tile, hardwood, resilient and laminate through independent floor covering retailers, home centers, mass merchandisers, department stores, commercial dealers and commercial end users. The Dal-Tile segment product lines include ceramic tile, porcelain tile and stone products sold through tile and flooring retailers, contractors, independent distributors and home centers.

Amounts disclosed for each segment are prior to any elimination or consolidation entries. Corporate general and administrative expenses amounts attributable to each segment are estimated and allocated accordingly. Segment performance is evaluated based on operating income. Export sales are not significant and long-lived assets located outside the United States of America, principally Mexico, were $97,425 and $85,339 at December 31, 2004 and 2003, respectively.

Segment information is as follows:

	2004	2003	2002
Net sales:			
Mohawk	$4,368,831	3,730,845	3,618,777
Dal-Tile	1,511,541	1,268,536	898,180
	$5,880,372	4,999,381	4,516,957
Operating income:			
Mohawk	$ 424,256	364,040	390,936
Dal-Tile	219,831	187,245	139,888
Corporate and eliminations	(8,497)	(9,256)	(8,759)
	$ 635,590	542,029	522,065
Depreciation and amortization:			
Mohawk	$ 89,479	78,450	77,416
Dal-Tile	29,210	24,638	18,266
Corporate	4,399	3,527	6,260
	$ 123,088	106,615	101,942
Capital expenditures (excluding acquisitions):			
Mohawk	$ 66,563	55,587	79,235
Dal-Tile	38,720	57,856	31,311
Corporate	1,318	1,188	1,388
	$ 106,601	114,631	111,934
Assets:			
Mohawk	$2,257,153	2,086,716	
Dal-Tile	2,063,195	1,967,206	
Corporate and eliminations	82,770	109,653	
	$4,403,118	4,163,575	

December 31, 2004, 2003 and 2002 (In thousands, except per share data)

Note 17
QUARTERLY FINANCIAL DATA (UNAUDITED)

The supplemental quarterly financial data are as follows:

	Quarters Ended			
	April 3, 2004	July 3, 2004	October 2, 2004	December 31, 2004
Net sales	$1,389,725	1,485,897	1,529,651	1,475,099
Gross profit	365,546	403,319	436,053	415,923
Net earnings	66,307	87,158	112,687	102,470
Basic earnings per share	1.00	1.31	1.69	1.54
Diluted earnings per share	0.98	1.29	1.67	1.52

	Quarters Ended			
	March 29, 2003	June 28, 2003	September 27, 2003	December 31, 2003
Net sales	$1,083,422	1,245,870	1,301,547	1,368,542
Gross profit	282,726	348,407	373,734	388,935
Net earnings	41,640	74,985	91,382	102,142
Basic earnings per share	0.63	1.14	1.38	1.54
Diluted earnings per share	0.62	1.12	1.36	1.51

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON CONSOLIDATED FINANCIAL STATEMENTS

Mohawk Industries, Inc. and Subsidiaries

The Board of Directors and Stockholders
Mohawk Industries, Inc.:

We have audited the accompanying consolidated balance sheets of Mohawk Industries, Inc. and subsidiaries as of December 31, 2004 and 2003, and the related consolidated statements of earnings, stockholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2004. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Mohawk Industries, Inc. and subsidiaries as of December 31, 2004 and 2003, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2004, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Mohawk Industries, Inc.'s internal control over financial reporting as of December 31, 2004, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 11, 2005 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

KPMG LLP

Atlanta, Georgia
March 11, 2005

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Mohawk Industries, Inc. and Subsidiaries

The Board of Directors and Stockholders
Mohawk Industries, Inc.:

We have audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting, that Mohawk Industries, Inc. maintained effective internal control over financial reporting as of December 31, 2004, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Mohawk Industries, Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment, and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Mohawk Industries, Inc. maintained effective internal control over financial reporting as of December 31, 2004, is fairly stated, in all material respects, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also, in our opinion, Mohawk Industries, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2004 based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Mohawk Industries, Inc. and subsidiaries as of December 31, 2004 and 2003, and the related consolidated statements of earnings, stockholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2004, and our report dated March 11, 2005 expressed an unqualified opinion on those consolidated financial statements.

KPMG LLP

Atlanta, Georgia
March 11, 2005

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Mohawk Industries, Inc. and Subsidiaries

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934, as amended). The Company's management assessed the effectiveness of its internal control over financial reporting as of December 31, 2004. In making this assessment, the Company's management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in Internal Control – Integrated Framework. The Company's management has concluded that, as of December 31, 2004, its internal control over financial reporting is effective based on these criteria. The Company's independent registered public accounting firm, KPMG LLP, has issued an attestation report on management's assessment of the Company's internal control over financial reporting, which is included herein.

Jeffrey S. Lorberbaum
Chairman, President and Chief Executive Officer

Frank H. Boykin
Chief Financial Officer and Vice President – Finance

STOCKHOLDER INFORMATION

Mohawk Industries, Inc. and Subsidiaries

CORPORATE HEADQUARTERS

P.O. Box 12069
160 South Industrial Boulevard
Calhoun, Georgia 30703
(706) 629-7721

INDEPENDENT AUDITORS

KPMG LLP
Atlanta, Georgia

CORPORATE COUNSEL

Alston & Bird LLP
Atlanta, Georgia

TRANSFER AGENT AND REGISTRAR

Wachovia Equity Services Group
1525 West W.T. Harris Blvd., 3C3
Charlotte, North Carolina 28262-8522
(704) 590-7390

PUBLICATIONS

The Company's Annual Report, Proxy Statement, Form 8-K, 10-K and 10-Q reports are available without charge and can be ordered via our stockholder communications service at 1 (800) 625-7721 or via the Internet at www.mohawkind.com under investor relations. Written requests should be sent to Christi Scarbro at the Company's headquarters address above.

PRODUCT INQUIRES

For more information about Mohawk's products, call toll-free: 1 (800) 622-6227 or visit our Web site at www.mohawk-flooring.com.

INVESTOR/ANALYST CONTACT

For additional information about Mohawk, please contact Frank H. Boykin at (706) 624-2695 or at the Company's headquarters address above.

ANNUAL MEETING OF STOCKHOLDERS

The Annual Meeting of Stockholders of Mohawk Industries, Inc. will be held at the Company's headquarters on South Industrial Boulevard in Calhoun, Georgia, on Wednesday, May 18, 2005, at 10:00 a.m. For directions and a map, call Christi Scarbro at (706) 624-2246.

COMMON STOCK PRICE RANGE

Mohawk's common stock is traded on the New York Stock Exchange under the symbol MHK. The table below sets forth the high and low sales prices per share of the common stock as reported by the exchange, for each fiscal period indicated.

MOHAWK COMMON STOCK

2004	HIGH	LOW
First Quarter	$85.79	$68.77
Second Quarter	82.98	68.89
Third Quarter	81.60	69.07
Fourth Quarter	92.44	74.05

2003	HIGH	LOW
First Quarter	$59.38	$41.00
Second Quarter	63.04	47.65
Third Quarter	75.75	55.25
Fourth Quarter	75.48	67.07

COMMON STOCKHOLDERS OF RECORD

As of March 5, 2005, there were 388 common stockholders of record.

ENVIRONMENTAL AWARENESS

Mohawk supports environmental awareness by encouraging recycling, waste management and energy conservation in its business practices and operating procedures.

DIVERSITY

Mohawk is an Equal Opportunity/Affirmative Action Employer committed to attracting a diverse pool of applicants.

NYSE AFFIRMATION CERTIFICATIONS

As Chief Executive Officer of Mohawk Industries, Inc., and as required by Section 303A.12(a) of the New York Stock Exchange Listed Company Manual, I hereby certify that as of the date hereof I am not aware of any violation by the Company of NYSE's Corporate Governance listing standards.

Jeffrey S. Lorberbaum
Chairman, President and
Chief Executive Officer

The Company has filed the certifications of its Chief Executive Officer and Chief Financial Officer required by Section 302 of Sarbanes-Oxley Act of 2002 as an exhibit to the Company's Form 10-K for the fiscal year ended December 31, 2004.

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