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## Selected Financial Data

In thousands, except per share data  
At or for the Years ended December 31, 2002<sup>(h)</sup>

### STATEMENT OF EARNINGS DATA:

Net sales	\$ 4,522,336
Cost of sales	3,285,222
Gross profit	1,237,114
Selling, general and administrative expenses	718,002
Restructuring costs <sup>(a)</sup>	-
Carrying value reduction of property, plant and equipment and other assets <sup>(b)</sup>	-
Class action legal settlement <sup>(c)</sup>	-
Compensation expense for stock option exercises <sup>(d)</sup>	-
Operating income	519,112
Interest expense <sup>(e)</sup>	68,972
Acquisition costs – World Merger <sup>(f)</sup>	-
Other expense, net	6,511
Earnings before income taxes	443,629
Income taxes	159,140
Net earnings	\$ 284,489
Basic earnings per share <sup>(g)</sup>	\$ 4.46
Weighted-average common shares outstanding <sup>(g)</sup>	63,723
Diluted earnings per share <sup>(g)</sup>	\$ 4.39
Weighted-average common and dilutive potential common shares outstanding <sup>(g)</sup>	64,861

### BALANCE SHEET DATA:

Working capital	\$ 681,869
Total assets	3,596,743
Short-term note payable	-
Long-term debt (including current portion)	820,427
Stockholders' equity	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.

## Selected Financial Data

2001	2000	1999	1998	1997	1996
3,445,945	3,404,034	3,211,575	2,848,810	2,521,297	2,324,486
2,613,043	2,581,185	2,434,716	2,167,523	1,961,433	1,811,780
832,902	822,849	776,859	681,287	559,864	512,706
505,745	505,734	482,062	432,191	383,523	367,251
-	-	-	-	-	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

- (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.
- (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 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 life intangibles for impairment.

# Management's Discussion and Analysis of Financial Condition and Results of Operations

## General

During the three-year period ended December 31, 2002, the Company continued to experience growth both internally and through acquisitions.

On November 14, 2000, the Company acquired certain assets of Crown Crafts, Inc. ("Crown Crafts"). Under the agreement, the Company paid approximately \$37 million in cash for substantially all of the fixed assets and inventory of the division. The acquisition was accounted for using the purchase method of accounting.

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, consisting of approximately 12.9 million shares of the Company's common stock, options to purchase approximately 2.1 million shares of the Company's common stock and \$718 million in cash. The Company's common stock and options were valued at \$751 million based on the measurement date stock price of \$55.04 per share (\$710.4 million) and the estimated fair value of options using the Black-Scholes option-pricing model (\$40.3 million). 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 from March 20, 2002. The purchase price was allocated to the assets acquired and liabilities assumed based upon estimated fair values at the date of acquisition. The excess of the purchase price over the fair value of the net identifiable assets acquired of approximately \$1,168.3 million was recorded as goodwill. The primary reasons for the acquisition included:

- the ability to combine Mohawk's current efforts in the hard-flooring business with Dal-Tile's larger, more established ceramic tile and natural stone business;
- the opportunity to use Mohawk and Dal-Tile's existing distribution channels to increase sales of both carpets and hard floorcoverings;
- the potential to improve service and reduce costs by adding Dal-Tile's distribution network to Mohawk's logistical and distribution system;
- the potential to reduce manufacturing costs and increase quality by identifying manufacturing best practices; and
- the potential to reduce general, administrative, overhead and other miscellaneous costs by spreading fixed costs over a larger business.

Effective November 1, 2000, the Company entered into an agreement with Congoleum Corporation, Inc., to become a national distributor of their vinyl products. This agreement was the final step which gave the Company access to a complete line of soft and hard floor covering products to supply to customers throughout the United States.

The primary categories of the floorcovering industry include carpet and rugs (65%), ceramic tile (10%), vinyl and rubber (12%), hardwood (9%) and laminate (4%). Compound average growth rates in units sold (measured in square yards) for all categories except the vinyl and rubber category, for the period from 1992 through 2001, have exceeded the growth rate 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 4.5% for carpet and rugs, 9.6% for ceramic tile, 3.1% for vinyl and rubber and 8.1% for hardwood. Laminate, which is a relatively new product, experienced a compound average growth rate of 33.6% from 1996 through 2001. Although beginning from a smaller base, the growth rates for hard floorcoverings may indicate increasing consumer preference for these products for certain applications. In response to this increasing demand, the Company has increased its distribution of hard surface products, including ceramic tile, vinyl, hardwood and laminate. The acquisition of Dal-Tile provides a unique opportunity to help the Company achieve its strategic goal of becoming one of the world's leading floorcovering manufacturers and distributors.

As a result of the Dal-Tile acquisition, the Company has determined that it has two operating segments, the Mohawk segment and the Dal-Tile segment. The Mohawk segment is comprised of all the product lines and operations that were the Company's prior to the Dal-Tile acquisition. The Dal-Tile segment is comprised of the Dal-Tile product lines and operations.

## Critical Accounting Policies

The Company's discussion and analysis of financial condition and results of operations are based on its consolidated financial statements that were prepared in accordance with accounting principles generally accepted in the United States of America.

The Company makes estimates and assumptions when preparing financial statements. These estimates and assumptions affect various matters, including:

- reported amounts of assets and liabilities in the Company's Consolidated Balance Sheets at the dates of the financial statements,
- disclosure of contingent assets and liabilities at the dates of the financial statements, and
- reported amounts of expenses in the Company's Consolidated Statements of Earnings during the reporting periods. These estimates involve judgments with respect to, among other things, future economic factors that are difficult to predict and are beyond management's control. As a result, actual amounts could differ from these estimates.

# Management's Discussion and Analysis of Financial Condition and Results of Operations

The Securities and Exchange Commission ("SEC") issued disclosure guidance for accounting policies that management believes are most "critical." The SEC defines these critical accounting policies 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 more significant judgments and estimates in preparing its consolidated financial statements and could represent critical accounting policies as defined by the SEC. The Company discusses its significant accounting policies, including those that do not require management to make difficult, subjective, or complex judgments or estimates, in Note 1 to the Consolidated Financial Statements:

- Accounts receivable and revenue recognition. Revenues are recognized when goods are shipped, which is when 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 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) predominantly 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. Inventories on hand are compared against anticipated future usage, which is a function of historical usage, in order to evaluate obsolescence and excessive quantities. Actual results could differ from assumptions used to value obsolete or excessive inventory and additional reserves may be required.
- Goodwill and intangible assets are subject to annual impairment testing. The impairment tests are based on determining the fair value of the specified reporting units based on management judgements and assumptions using estimated cash flows. These judgments and assumptions could materially change the value of the specified reporting units and, therefore, could materially impact the Company's consolidated 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.

## Results of Operations

### Year Ended December 31, 2002, as Compared with Year Ended December 31, 2001

Net sales for the year ended December 31, 2002, were \$4,522.3 million, reflecting an increase of \$1,076.4 million, or approximately 31.2%, over the \$3,445.9 million reported in the year ended December 31, 2001. The increased net sales were attributable to the Dal-Tile acquisition and internal growth of the Mohawk segment product lines. The Mohawk segment recorded net sales of \$3,624.2 million in 2002 compared to \$3,445.9 million in 2001, representing an increase of \$178.2 million or approximately 5.2%. The growth was attributable to all segment product lines. Since the completion of the Dal-Tile acquisition, the Dal-Tile segment recorded net sales of \$898.2 million in 2002. A comparison of net sales for the Dal-Tile segment for 2002 and 2001, in each case including Dal-Tile's net sales (after reclassifications to conform to Mohawk's presentation) prior to the acquisition, shows an increase of \$97.4 million, or approximately 9.4%, from \$1,036.8 million to \$1,134.2 million.

Quarterly net sales and the percentage changes in net sales by quarter for 2002 versus 2001 were as follows (dollars in thousands):

	2002	2001	Change
First quarter	\$ 866,710	777,339	11.5%
Second quarter	1,227,747	864,958	41.9
Third quarter	1,224,403	907,850	34.9
Fourth quarter	1,203,476	895,798	34.3
Total year	<u>\$ 4,522,336</u>	<u>3,445,945</u>	<u>31.2%</u>

# Management's Discussion and Analysis of Financial Condition and Results of Operations

Gross profit was \$1,237.1 million (27.4% of net sales) for 2002 and \$832.9 million (24.2% of net sales) for 2001. Gross profit as a percentage of net sales in 2002 was favorably impacted when compared to 2001 by Dal-Tile's higher gross profit percentage and improved manufacturing efficiencies within the Mohawk segment.

Selling, general and administrative expenses for 2002 were \$718.0 million (15.9% of net sales) compared to \$505.7 million (14.7% of net sales) for 2001. The increased percentage was attributable to the Dal-Tile segment which has higher selling, general and administrative expenses, but also has higher gross profit as a percentage of net sales. The Mohawk and Dal-Tile (including selling, general and administrative costs prior to the acquisition of Dal-Tile) segments selling, general and administrative expenses reflected improvements over 2001, when compared to 2002. The improvements were due to better control of operating costs as net sales increased.

Operating income for 2002 was \$519.1 million (11.5% of net sales) compared to \$327.2 million (9.5% of net sales) in 2001. Operating income attributable to the Mohawk segment was \$388.4 million (10.7% of segment net sales) in 2002 compared to \$336.7 million (9.8% of segment net sales) in 2001. Operating income attributable to the Dal-Tile segment was \$139.9 million (15.6% of segment net sales) in 2002. A comparison of operating income for the Dal-Tile segment's 2002 and 2001, in each case including Dal-Tile's operating income (after reclassifications to conform to Mohawk's presentation) prior to the acquisition, shows an increase of \$17.1 million, or approximately 11.1%, from \$154.6 million (14.9% of segment net sales) to \$171.7 million (15.1% of segment net sales).

Interest expense for 2002 was \$69.0 million compared to \$29.8 million in 2001. The increase in interest expense was attributable to additional debt incurred in March 2002 to finance the acquisition of Dal-Tile, the write-off of approximately \$10.7 million relating to an interest rate swap previously accounted for as a cash flow hedge and an increase in the average borrowing rate due to a change in the mix of fixed rate and variable rate debt, when compared to 2001.

Income tax expense was \$159.1 million, or 35.9% of earnings before income taxes for 2002 compared to \$102.8 million, or 35.3% of earnings before income taxes for 2001.

## Year Ended December 31, 2001, as Compared with Year Ended December 31, 2000

Net sales for the year ended December 31, 2001, were \$3,445.9 million, reflecting an increase of \$41.9 million, or approximately 1.2%, over the \$3,404.0 million reported in the year ended December 31, 2000. The Company believes that the 2001 net sales increase was attributable primarily to internal growth in carpet, rugs, padding and hard surface products.

Quarterly net sales and the percentage changes in net sales by quarter for 2001 versus 2000 were as follows (dollars in thousands):

	2001	2000	Change
First quarter	\$ 777,339	799,403	-2.8%
Second quarter	864,958	890,980	-2.9
Third quarter	907,850	875,765	3.7
Fourth quarter	895,798	837,886	6.9
Total year	\$ 3,445,945	3,404,034	1.2%

Gross profit was \$832.9 million (24.2% of net sales) for 2001 and \$822.8 million (24.2% of net sales) for 2000. Favorable material and fuel costs and an improved product mix impacted gross profit dollars for 2001.

Selling, general and administrative expenses for 2001 were \$505.7 million (14.7% of net sales) compared to \$505.7 million (14.9% of net sales) for 2000.

Interest expense for 2001 was \$29.8 million compared to \$38.0 million in 2000. The primary factors contributing to the decrease were lower debt levels compared to 2000.

Income tax expense for 2001 was \$102.8 million or 35.3% of earnings before income taxes. In 2000, income tax expense was \$105.0 million, representing 39.2% of earnings before income taxes. The reduction in the effective income tax rate was primarily due to tax credits and other tax strategies.

## 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.

The level of accounts receivable increased from \$404.9 million at the beginning of 2002 to \$501.1 million at December 31, 2002. The \$96.2 million increase was primarily attributable to the acquisition of Dal-Tile. Inventories increased from \$531.4 million at the beginning of 2002 to \$678.0 million at December 31, 2002, due primarily to the Dal-Tile acquisition.

# Management's Discussion and Analysis of Financial Condition and Results of Operations

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.

Excluding the acquisition of Dal-Tile, capital expenditures totaled \$111.9 million during 2002. The capital expenditures made during 2002 were incurred primarily to modernize and expand manufacturing facilities and equipment. The Company's capital projects are primarily focused on increasing capacity, improving productivity and reducing costs. Capital expenditures, including \$754.5 million for acquisitions, have totaled \$992.8 million over the past three years. The Company's capital spending during 2003, excluding acquisitions, is expected to range from \$120 million to \$140 million, and will be used primarily to purchase equipment to increase production capacity and productivity.

The Company's revolving line of credit agreement provides for an interest rate of either (i) LIBOR plus 0.2% to 0.5%, depending upon the Company's performance measured against certain financial ratios, or (ii) the prime rate less 1.0% and has a termination date of January 28, 2004. At December 31, 2002, the Company had credit facilities of \$450 million under its revolving credit line and \$55 million under various short-term uncommitted credit lines. At December 31, 2002, a total of \$462.5 million was unused under these lines. All of these lines are unsecured. The credit agreement contains customary financial and other covenants. The Company must pay an annual facility fee ranging from .0015 to .0025 of the total credit commitment, depending upon the Company's performance measured against specific coverage ratios, under the revolving credit line.

In connection with the Dal-Tile acquisition, the Company entered into a 364-day term loan facility (the "Bridge Facility") on March 20, 2002, to finance a portion of the acquisition. On April 2, 2002, the Company sold \$300 million of its 6.50% senior notes due 2007, Series A and \$400 million of its 7.20% senior notes due 2012, Series B through institutional private placements and used the proceeds to repay outstanding indebtedness of approximately \$601 million under the Bridge Facility and approximately \$0.9 million under the Company's revolving credit facility. On June 13, 2002, the Company exchanged approximately \$295 million of its registered 6.50% notes due 2007, Series C for an equal amount of its Series A senior notes and approximately \$397.8 million of its registered 7.20% senior notes due 2012, Series D for an equal amount of its Series B senior notes. Interest on each series is payable semiannually.

The Company has two trade accounts receivable securitization agreements with bank agents for

asset-backed commercial paper conduits. These facilities enable the Company to borrow up to \$205 million through the Mohawk segment and up to \$75 million through its Dal-Tile segment. Each securitization is secured by the respective segment trade receivables and is subject to annual renewal. At December 31, 2002, the Company had no amounts outstanding under either securitization facility, both of which were available up to their respective facility limits. At December 31, 2001, the Mohawk segment had \$125 million outstanding secured by approximately \$461.1 million of receivables.

The Company's debt structure also includes a combination of variable rate industrial revenue bonds and fixed rate term notes and senior notes with interest rates ranging from 1.28% up to 8.46%. The industrial revenue bonds mature beginning in 2006 through 2019 and the term and senior notes mature through 2012. The industrial revenue bonds are backed by unsecured letters of credit. The term and senior notes are also unsecured. The aggregate principal amount of industrial revenue bonds, term and senior notes was \$815.2 million at December 31, 2002.

On January 3, 2001, the Company entered into a five-year interest rate swap, which converted a notional amount of approximately \$100 million of its variable rate debt to a fixed rate. Under the agreement, payments are made based on a fixed rate of 5.82% and received on a LIBOR based variable rate. Differentials received or paid under the agreement will be recognized as interest expense. During December 2002, the Company determined, based on future cash flow projections, that the cash flow hedge would more than likely become ineffective as strong cash flow has allowed the Company to significantly reduce its outstanding LIBOR based variable rate debt below the \$100 million hedged notional amount. The unrealized loss on the interest rate swap previously included in other comprehensive income has been recorded as a realized loss in interest expense in the fourth quarter of 2002. The amount recorded in interest expense was \$10.7 million. The Company continues to carry the liability on its consolidated balance sheet at its fair value and the interest rate swap will be marked to market in future reporting periods with any changes being recorded in interest expense.

The Company's Board of Directors has authorized the repurchase of up to 15 million shares of its outstanding common stock. For the year ended December 31, 2002, a total of approximately 1.4 million shares of the Company's common stock were purchased at an aggregate cost of approximately \$64.0 million. Since the inception of the program, a total of approximately 10.4 million shares have been repurchased at an aggregate cost of approximately \$265.3 million. All of these repurchases have been financed through the Company's operations and banking arrangements.

# Management's Discussion and Analysis of Financial Condition and Results of Operations

The following is a summary of the Company's future minimum payments under contractual obligations as of December 31, 2002 (in thousands):

	Payments due by period						Total
	2003	2004	2005	2006	2007	Thereafter	
Long-term debt	\$ 26,663	29,380	9,448	6,500	300,000	447,672	819,663
Capital leases	764	-	-	-	-	-	764
Operating leases	60,936	49,346	37,248	27,754	16,944	26,235	218,463
Purchase commitments <sup>(1)</sup>	50,040	10,712	3,628	-	-	-	64,380
	<u>\$ 138,403</u>	<u>89,438</u>	<u>50,324</u>	<u>34,254</u>	<u>316,944</u>	<u>473,907</u>	<u>1,103,270</u>

(1) Includes commitments for natural gas and foreign currency purchases.

## Recent Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board issued SFAS No. 143, "Accounting for Asset Retirement Obligations" ("SFAS No. 143"). SFAS No. 143 provides new guidance on the recognition and measurement of an asset retirement obligation and its associated asset retirement cost. It also provides accounting guidance for legal obligations associated with the retirement of tangible long-lived assets. The Company adopted SFAS No. 143 on January 1, 2003 and it is not expected to materially impact the Company's consolidated financial statements.

In April 2002, the Financial Accounting Standards Board issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections." The Statement rescinds SFAS No. 4, "Reporting Gains and Losses from Extinguishment of Debt," and an amendment of that Statement, SFAS No. 64, "Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements." SFAS No. 145 recognizes that the use of debt extinguishment can be a part of the risk management strategy of a company and hence, the classification of all early extinguishment of debt as an extraordinary item may no longer be appropriate. In addition, the Statement amends SFAS No. 13, "Accounting for Leases," to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. Provisions of this Statement, as they relate to Statement No. 13, are to be effective for transactions occurring after May 15, 2002. Provisions, which relate to Statement No. 4, are effective for fiscal years beginning after May 15, 2002. The Company adopted SFAS No. 145 on January 1, 2003, and it is not expected to materially impact the Company's consolidated financial statements.

In November 2002, the Financial Accounting Standards Board issued SFAS No. 146 "Accounting for the Costs Associated with Exit or Disposal Activities," ("SFAS No. 146"). SFAS No. 146 is effective for exit or disposal activities initiated after December 31, 2002, and requires recording costs associated with exit or disposal activities at their fair values when a liability has been incurred. Effective January 1, 2003, the Company adopted SFAS No. 146 and it is not expected to materially impact the Company's consolidated financial statements.

In November 2002, the Financial Accounting Standards Board issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("Fin 45"). Fin 45 requires that the guarantor recognize, at the inception of certain guarantees, a liability for the fair value of the obligation undertaken in issuing such guarantee. Fin 45 also requires additional disclosure about the guarantor's obligations under certain guarantees that it has issued. The initial recognition and measurement provisions of this interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002, and the disclosure requirements are effective after December 15, 2002, and are included in footnote 10 to the consolidated financial statements.

In December 2002, the Financial Accounting Standards Board issued SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure an amendment of FASB Statement No. 123" ("SFAS No. 148"). This statement amends SFAS No. 123 to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation and amends the disclosure requirements of SFAS 123 to require prominent disclosures in both annual and interim financial statements about the method of



# Management's Discussion and Analysis of Financial Condition and Results of Operations

accounting for stock-based employee compensation and the effect of the method used on reported results. The transition and annual disclosure provisions of SFAS No. 148 are effective for fiscal years ending after December 15, 2002. Effective January 1, 2003, the Company adopted the disclosure requirements of SFAS No. 148 regarding disclosure requirements for condensed consolidated financial statements for interim periods. The Company has not determined whether it will voluntarily change to the fair value based method of accounting for stock-based employee compensation.

In January 2003, the Financial Accounting Standards Board issued Interpretation No. 46, "*Consolidation of Variable Interest Entities and Interpretation of ARB No. 51*" ("Fin 46"). Fin 46 establishes the criteria for consolidating variable interest entities. The Company is evaluating Fin 46, which is effective for fiscal years or interim periods beginning after June 15, 2003, to variable entities that were acquired before February 1, 2003. The Company does not expect Fin 46 to materially impact the Company's consolidated financial statements.

## Impact of Inflation

Inflation affects the Company's manufacturing costs and operating expenses. The carpet and tile industry has experienced 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 floorcovering, 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 this Annual Report, the following risk factors should be considered when evaluating an investment in shares of Mohawk 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 failure to integrate Mohawk and Dal-Tile successfully by managing the challenges of that integration may result in the Company not achieving the anticipated potential benefits of the merger.**

The Company faces challenges in consolidating functions, integrating its organizations, procedures, operations and product lines in a timely and efficient manner and retaining key personnel.

These challenges will result principally because the two companies currently:

- maintain executive offices in different locations;
- manufacture and sell different types of products through different distribution channels;
- conduct their businesses from various locations; and
- have different employment and compensation arrangements for their employees.

In addition, Dal-Tile has a significant manufacturing operation in Mexico, and the Company has not previously operated a manufacturing facility outside of the United States. As a result, the integration will be complex and will require additional attention from members of management. The diversion of management attention and any difficulties encountered in the transition and integration process could have a material adverse effect on the Company's revenues, level of expenses and operating results.

**The floorcovering industry is cyclical and prolonged declines in residential or commercial construction activity could have a material adverse effect on the Company's business.**

The U.S. floorcovering industry is highly dependent on residential and commercial construction activity, including new construction as well as remodeling. New construction activity and remodeling, to a lesser degree, are cyclical in nature and a prolonged decline in residential or commercial construction activity could have a material adverse effect on the Company's business, financial condition and results of operations. Construction activity is significantly affected by numerous factors, all of which are beyond the Company's control, including:

- national and local economic conditions;
- interest rates;
- housing demand;
- employment levels;
- changes in disposable income;
- financing availability;
- commercial rental vacancy rates;
- business expenditures;
- federal and state income tax policies; and
- consumer confidence.

The U.S. construction industry has experienced

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significant downturns in the past, which have adversely affected suppliers to the industry, including suppliers of floorcoverings. The industry could experience similar downturns in the future, which could have a negative impact on the Company’s business, financial condition and results of operations.

**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 large number of domestic and foreign manufacturers and independent distributors of floorcovering products. Some of its existing and potential competitors may be larger and have greater resources and access to capital than it does. Maintaining the Company’s competitive position may require it to make 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 and in the loss of market share. In addition, the Company faces, and will continue to face, pressure on sales prices of its products from competitors, as well as from large customers. As a result of any of these factors, there could be a material adverse effect on the Company’s sales and profitability.

**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:

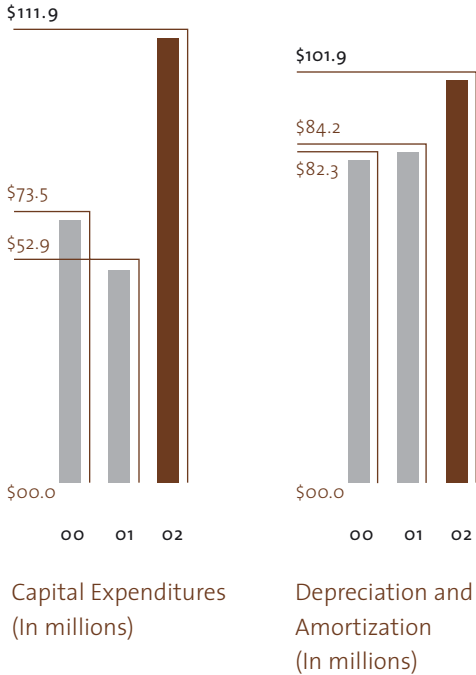
- successfully identify suitable acquisition candidates;
- obtain sufficient financing on acceptable terms to fund acquisitions;
- complete acquisitions; or
- profitably manage acquired businesses.

Acquired operations may not achieve levels of sales, operating income or productivity comparable to those of its existing operations, or otherwise perform as expected. Acquisitions may also involve a number of special risks, some or all of which could have a material and adverse effect on the Company’s business, results of operations and financial condition, including, among others:

- the Company’s inability to integrate operations, systems and procedures and to eliminate redundancies and excess costs effectively;
- diversion of management’s attention and resources; and
- difficulty retaining and training acquired key personnel.

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

The Company’s business is dependent upon a continuous supply of raw materials from third party suppliers. The principal raw materials used in its manufacturing operations include: nylon fiber and polypropylene resin, which are used exclusively in its carpet and rug business; talc, clay, impure nepheline syenite, pure 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 impure nepheline syenite and pure 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, financial condition and results of operations.



# Management's Discussion and Analysis of Financial Condition and Results of Operations

**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.**

Significant increases in the costs of raw materials and natural gas used in the manufacture of the Company's products could have a material adverse effect on its operating margins and its business, financial condition and results of operations. The Company purchases nylon fiber, polypropylene resin, talc, clay, impure nepheline syenite, pure nepheline syenite, frit, zircon, stains and other materials from third party suppliers. The cost of some of these materials, like nylon and polypropylene resin, is related to oil prices. The Company also purchases significant amounts of natural gas to supply the energy required in some of its production processes. The prices of these raw materials and of natural gas vary with market conditions. Although the Company generally attempts to pass on increases in the costs of raw materials and natural gas to its customers, the Company's ability to do so is, to a large extent, 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 federal, state, local and foreign 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. New or additional requirements could be imposed, and the Company could incur material expenditures to comply with new or existing regulations.

The nature of the Company's operations and previous operations by others at real property currently or formerly owned or operated by the Company and the disposal of waste at third party sites 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. The Company has been, and will continue to be, subject to these claims.

The discovery of presently unknown environmental conditions, changes in environmental, health, and safety laws and regulations, enforcement of existing or new requirements or other unanticipated events could give rise to expenditures and liabilities, including fines or penalties, that could have a material adverse effect on the Company's business, operating results or financial condition.

**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 a number of inherent risks, including:

- changes in international trade laws, such as the North American Free Trade Agreement, or NAFTA, affecting the Company's import and export activities in Mexico;
- changes in Mexican labor laws and regulations affecting the Company's ability to hire and retain employees in Mexico;
- currency exchange restrictions and fluctuations in the value of foreign currency;
- potentially adverse tax consequences;
- local laws concerning repatriation of profits;
- political conditions in Mexico;
- unexpected changes in the regulatory environment in Mexico; and
- changes in general economic conditions in Mexico.

**The Company could face increased competition as a result of the General Agreement on Tariffs and Trade and the North American Free Trade Agreement.**

The United States is party to the General Agreement on Tariffs and Trade ("GATT"). Under GATT, the United States currently imposes import duties on ceramic tile imported from countries outside North America at no more than 12%, to be reduced ratably to no less than 8.5% by 2004. Accordingly, as these duties decrease, GATT may stimulate competition from manufacturers in these countries, which now export, or may seek to export, ceramic tile to the United States. The Company is uncertain what effect GATT may have on its operations.

# Management’s Discussion and Analysis of Financial Condition and Results of Operations

The North American Free Trade Agreement (“NAFTA”) was entered into by Canada, Mexico and the United States and over a transition period will remove most customs duties imposed on goods traded among the three countries. In addition, NAFTA will remove or limit many investment restrictions, liberalize trade in services, provide a specialized means for settlement of, and remedies for, trade disputes arising under applicable laws and will result in new laws and regulations to further these goals. Although NAFTA lowers the tariffs imposed on the Company’s ceramic tile manufactured in Mexico and sold in the United States, it may also stimulate competition in the United States and Canada from manufacturers located in Mexico, which could negatively affect the Company’s business.

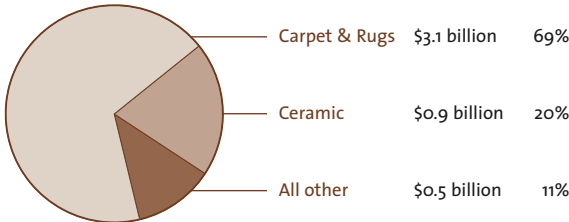
### Forward-Looking Information

Certain of the matters discussed in the preceding pages, particularly regarding anticipation of future financial performance, business prospects, growth and operating strategies, proposed acquisitions, new products and similar matters, and those preceded by, followed by or that otherwise include the words “believes,” “expects,” “anticipates,” “intends,” “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 and 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. Those statements are based on assumptions regarding the Company’s ability to maintain its sales growth and gross margins and to control costs. These or other assumptions could prove inaccurate and therefore, there can be no assurance that the “forward-looking statements” will prove to be accurate. Forward-looking statements involve a number of risks and uncertainties. The following important factors, in addition to those discussed elsewhere in this document, affect the future results of Mohawk and could cause those results to differ materially from those expressed in the forward-looking statements: materially adverse changes in economic conditions generally in the carpet, rug, ceramic tile and other floorcovering markets served by Mohawk; the successful integration of Dal-Tile into Mohawk’s business; competition from other carpet, rug, ceramic tile and floorcovering manufacturers; raw material prices; declines in residential or commercial construction activity; timing and level of capital expenditures; the successful integration of acquisitions, including the challenges inherent in

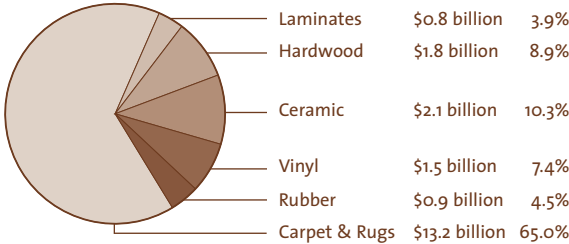
diverting Mohawk management’s attention and resources from other strategic matters and from operational matters for an extended period of time; the successful introduction of new products; the successful rationalization of existing operations; and other risks identified from time to time in the Company’s SEC reports and public announcements. Any forward-looking statements represent Mohawk’s estimates only as of the date of this report and should not be relied upon as representing Mohawk’s estimates as of any subsequent date. While Mohawk may elect to update forward-looking statements at some point in the future, Mohawk specifically disclaims any obligation to do so, even if Mohawk’s estimates change.

### 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 interest rate, 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.



2002 Mohawk Sales



2001 Floorcovering Industry Sales

# Management's Discussion and Analysis of Financial Condition and Results of Operations

## Interest Rate Risk Management

The Company used an interest rate swap contract to adjust the proportion of total debt that was subject to variable interest rates as compared to fixed interest rates. Under the interest rate swap contract, the Company agreed to pay an amount equal to a fixed-rate of interest times a notional principal amount of \$100 million, and to receive in return an amount equal to a specified variable-rate of interest times the same notional principal amount. The notional amounts of the contracts are not exchanged, and no other cash payments are made. The contract fair value is reflected on the consolidated balance sheets and related gains or losses were deferred in other comprehensive income. These deferred gains and losses are recognized in income as an adjustment to interest expense over the same period in which the related interest payments being hedged are recognized in income. However, to the extent that any of these contracts are not considered to be 100% effective in offsetting the change in the value of the interest payments being hedged, any changes in fair value relating to the ineffective portion of these contracts is immediately recognized in earnings. During December 2002, the Company determined, based on future cash flow projections, that the cash flow hedge would more than likely become ineffective as strong cash flow has allowed the Company to significantly reduce its outstanding LIBOR based variable rate debt below the \$100 million hedged notional amount. The unrealized loss on the interest rate swap previously included in other comprehensive income has been recorded as a realized loss in interest expense in the fourth quarter of 2002. The amount recorded in interest expense was \$10.7 million. The Company continues to carry the liability on its consolidated balance sheets at its fair value and the interest rate swap will be marked to market in future reporting periods with any changes being recorded in interest expense. The floating interest rate at which the hedge was deemed ineffective was 1.42%. A 50 basis point change in interest rates would reduce/increase interest expense by approximately \$1.5 million.

## 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 going to other comprehensive income, net of applicable income taxes and any hedge ineffectiveness. Any gain or loss is recognized in cost of goods sold in the same period or periods during which the hedged transaction affects earnings. At December 31, 2002, the Company had natural gas contracts outstanding with an aggregate notional amount of approximately 1.5 million MMBTU's. The fair value of these contracts, which mature from January 2003 to December 2004, was an asset of \$1.9 million, with the offset recorded in other comprehensive income, net of applicable income taxes.

The long-term supply agreements are accounted for under the normal purchases provision within SFAS No. 133 and its amendments. At December 31, 2002, the Company has normal purchase commitments of approximately 4.6 million MMBTU's for periods maturing from January 2003 through August 2005. The contracted value of these commitments was approximately \$17.4 million and the fair value of these commitments was approximately \$19.7 million, at December 31, 2002.

## Foreign Currency Rate Management

The Company enters into foreign exchange forward contracts to hedge 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 US currency. Gains and losses are recognized in cost of sales in the same period or periods during which the hedged transaction affects earnings. Accordingly, these contracts have been designated as cash flow hedges. At December 31, 2002, the Company had forward contracts maturing from January 2003 through December 2003, to purchase approximately 357.5 million Mexican pesos. The aggregate U.S. Dollar value of these contracts at December 31, 2002 was approximately \$34.6 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, 2002 were not material.



Debt-to-Total Capitalization Ratio

# Consolidated Statements of Earnings

In thousands, except per share data

	Years ended December 31,		
	2002	2001	2000
Net sales	\$ 4,522,336	3,445,945	3,404,034
Cost of sales	3,285,222	2,613,043	2,581,185
Gross profit	1,237,114	832,902	822,849
Selling, general and administrative expenses	718,002	505,745	505,734
Class action legal settlement	-	-	7,000
Operating income	519,112	327,157	310,115
Other expense (income):			
Interest expense	68,972	29,787	38,044
Other expense	12,425	7,780	5,660
Other income	(5,914)	(1,826)	(1,218)
	75,483	35,741	42,486
Earnings before income taxes	443,629	291,416	267,629
Income taxes	159,140	102,824	105,030
Net earnings	\$ 284,489	188,592	162,599
Basic earnings per share	\$ 4.46	3.60	3.02
Weighted-average common shares outstanding	63,723	52,418	53,769
Diluted earnings per share	\$ 4.39	3.55	3.00
Weighted-average common and dilutive potential common shares outstanding	64,861	53,141	54,255

See accompanying notes to consolidated financial statements.

# Consolidated Balance Sheets

In thousands, except per share data

	December 31,	2002	2001
<b>ASSETS</b>			
Current assets:			
Receivables	\$	501,129	404,875
Inventories		678,008	531,405
Prepaid expenses		37,368	24,884
Deferred income taxes		82,074	70,058
Total current assets		1,298,579	1,031,222
Property, plant and equipment, net		855,324	619,703
Goodwill		1,277,453	109,167
Other intangible assets		146,700	-
Other assets		18,687	8,393
	\$	3,596,743	1,768,485
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>			
Current liabilities:			
Current portion of long-term debt	\$	27,427	158,366
Accounts payable and accrued expenses		589,283	423,495
Total current liabilities		616,710	581,861
Deferred income taxes		186,996	84,955
Long-term debt, less current portion		793,000	150,067
Other long-term liabilities		17,158	3,051
Total liabilities		1,613,864	819,934
Stockholders' equity:			
Preferred stock, \$.01 par value; 60 shares authorized; no shares issued		-	-
Common stock, \$.01 par value; 150,000 shares authorized; 76,371 and 61,408 shares issued in 2002 and 2001, respectively		763	614
Additional paid-in capital		1,006,550	197,247
Retained earnings		1,231,612	947,123
Accumulated other comprehensive income (loss)		1,126	(2,837)
		2,240,051	1,142,147
Less treasury stock at cost; 10,006 and 8,715 shares in 2002 and 2001, respectively		257,172	193,596
Total stockholders' equity		1,982,879	948,551
Commitments and contingencies (Note 14)			
	\$	3,596,743	1,768,485

See accompanying notes to consolidated financial statements.

# Consolidated Statements of Stockholders' Equity and Comprehensive Income

	In thousands		Additional paid-in capital	Retained earnings	Accumulated other comprehensive income (loss)	Treasury stock	Total stockholders' equity
	Common stock						
	Shares	Amount					
Balances at							
December 31, 1999	60,657	\$ 607	179,993	595,932	-	(83,986)	692,546
Stock options exercised	181	1	2,396	-	-	-	2,397
Purchase of treasury stock	-	-	-	-	-	(106,689)	(106,689)
Grant to employee profit sharing plan	-	-	-	-	-	2,593	2,593
Tax benefit from exercise of stock options	-	-	914	-	-	-	914
Net earnings	-	-	-	162,599	-	-	162,599
Balances at							
December 31, 2000	60,838	608	183,303	758,531	-	(188,082)	754,360
Stock options exercised	570	6	9,097	-	-	-	9,103
Purchase of treasury stock	-	-	-	-	-	(8,159)	(8,159)
Grant to employee profit sharing plan	-	-	-	-	-	2,500	2,500
Grant for executive incentive program	-	-	-	-	-	145	145
Tax benefit from exercise of stock options	-	-	4,847	-	-	-	4,847
Comprehensive income:							
Unrealized loss on hedge instruments	-	-	-	-	(2,837)	-	(2,837)
Net earnings	-	-	-	188,592	-	-	188,592
Total Comprehensive income							185,755
Balances at							
December 31, 2001	61,408	614	197,247	947,123	(2,837)	(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	-	-	-	-	-	(64,034)	(64,034)
Grant to employee profit sharing plan	-	-	3,040	-	-	282	3,322
Grant for executive incentive program	-	-	77	-	-	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	-	-	-	-	(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	(257,172)	1,982,879

See accompanying notes to consolidated financial statements.



# Consolidated Statements of Cash Flows

	In thousands			
	Years ended December 31,	2002	2001	2000
Cash flows from operating activities:				
Net earnings	\$	284,489	188,592	162,599
Adjustments to reconcile net earnings to net cash provided by operating activities:				
Depreciation and amortization		101,942	84,167	82,346
Deferred income taxes		33,712	5,563	32,179
Tax benefit on stock options exercised		5,463	4,847	914
Loss on sale of property, plant and equipment		2,762	2,910	205
Changes in assets and liabilities, net of effects of acquisitions:				
Receivables		34,657	(46,066)	(18,248)
Inventories		(15,215)	43,190	(70,209)
Accounts payable and accrued expenses		105,464	48,754	33,770
Other assets and prepaid expenses		(13,111)	(811)	(3,257)
Other liabilities		9,347	101	27
Net cash provided by operating activities		549,510	331,247	220,326
Cash flows from investing activities:				
Additions to property, plant and equipment		(111,934)	(52,913)	(73,475)
Acquisitions		(717,638)	-	(36,844)
Net cash used in investing activities		(829,572)	(52,913)	(110,319)
Cash flows from financing activities:				
Net change in revolving line of credit		(29,491)	(181,964)	(168,595)
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 securitizations		(125,000)	(66,104)	191,104
Payments on term loans		(32,208)	(32,212)	(32,226)
Redemption of acquisition indebtedness		(202,564)	-	-
Industrial revenue bonds and other, net of payments		(1,307)	(1,115)	3,480
Change in outstanding checks in excess of cash		(15,519)	2,117	522
Acquisition of treasury stock		(64,034)	(8,159)	(106,689)
Common stock transactions		50,185	9,103	2,397
Net cash provided by (used in) financing activities		280,062	(278,334)	(110,007)
Net change in cash		-	-	-
Cash, beginning of year		-	-	-
Cash, end of year	\$	-	-	-

See accompanying notes to consolidated financial statements.

# Notes to Consolidated Financial Statements

December 31, 2002, 2001 and 2000 (in thousands, except per share data)

## 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 broadloom carpet, rug and ceramic tile manufacturer and sells carpet, rugs, ceramic tile and other floorcovering materials 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 the aging of the accounts receivable.

### (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 substantially all inventories within the Mohawk segment and the first-in, first-out (FIFO) method for the Dal-Tile segment inventories.

### (d) Property, Plant and Equipment

Property, plant and equipment is stated at cost, including interest on funds borrowed to finance the acquisition or construction of major capital additions. Depreciation is calculated on a straight-line basis over the estimated remaining useful lives, which are 35 years for buildings and improvements, 15 years for extrusion equipment, 10 years for tufting equipment, the life of the lease for leasehold improvements, five years for vehicles and seven years for other equipment, and furniture and fixtures.

### (e) Goodwill and Other Intangible Assets

In accordance with the provisions of SFAS No. 142, 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.

### (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. 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 accounts receivable, accounts payable, accrued expenses and long-term debt. The carrying amount of accounts receivable, accounts payable and accrued expenses approximates their fair value because of the short-term maturity of such instruments. 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, 2002 and 2001, was \$894,462 and \$311,617, compared to a carrying amount of \$820,427 and \$308,433, respectively.

### (h) Derivative Instruments

Effective January 1, 2001, the Company adopted Statement of Financial Accounting Standards No. 133 "Accounting for Derivative Instruments and Hedging Activities" ("SFAS No.133") and its amendments which require 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

# Notes to Consolidated Financial Statements

December 31, 2002, 2001 and 2000 (in thousands, except per share data)

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 changes in 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. There was no impact on the consolidated financial statements upon adoption of SFAS No.133.

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) 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.

## (j) 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 \$31,829 in 2002, \$28,845 in 2001 and \$25,526 in 2000.

In 2001, the EITF reached consensus on Issue No. 01-09 "Accounting for Consideration Given by a Vendor to a Customer" ("EITF 01-09"). This issuance provides guidance primarily on income statement classification of consideration from a vendor to a purchaser of the vendor's products. Generally, cash consideration is to be 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 were \$14,090 in 2002, \$11,803 in 2001 and \$11,570 in 2000.

## (k) Impairment of Long-Lived Assets

In 2002, the Company adopted Statement of Financial Accounting Standards Board No. 144 ("SFAS No. 144"), "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 replaced SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets to Be Disposed Of." SFAS No. 144 establishes a single accounting model for the impairment or disposal of long-lived assets including discontinued operations. On determining that assets have been impaired or are to be disposed of, including discontinued operations, the Company measures the lower of the carrying value or fair value less costs to sell, whether reported in continuing operations or discontinued operations. SFAS No. 144 also broadens the reporting of discontinued operations to include all components of an entity with operations that can be distinguished from the rest of the entity.

## (l) Earnings per Share ("EPS")

The Company applies the provisions of Financial Accounting Standards Board SFAS No. 128, Earnings per Share, which requires companies to present basic EPS and diluted EPS. Basic EPS excludes dilution and is computed by dividing income available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Company.

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 are immaterial.

# Notes to Consolidated Financial Statements

December 31, 2002, 2001 and 2000 (in thousands, except per share data)

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

	2002	2001	2000
Net earnings	\$ 284,489	188,592	162,599
Weighted-average common and dilutive potential common shares outstanding:			
Weighted-average common shares outstanding	63,723	52,418	53,769
Add weighted-average dilutive potential common shares – options to purchase common shares, net	1,138	723	486
Weighted-average common and dilutive potential common shares outstanding	64,861	53,141	54,255
Basic earnings per share	\$ 4.46	3.60	3.02
Diluted earnings per share	\$ 4.39	3.55	3.00

## (m) Effect of New Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board issued SFAS No. 143, "Accounting for Asset Retirement Obligations" ("SFAS No. 143"). SFAS No. 143 provides new guidance on the recognition and measurement of an asset retirement obligation and its associated asset retirement cost. It also provides accounting guidance for legal obligations associated with the retirement of tangible long-lived assets. The Company adopted SFAS No. 143 on January 1, 2003 and it is not expected to materially impact the Company's consolidated financial statements.

In April 2002, the Financial Accounting Standards Board issued SFAS No. 145, "Rescission of Financial Accounting Standards Board Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections." The Statement rescinds SFAS No. 4, "Reporting Gains and Losses from Extinguishment of Debt," and an amendment of that Statement, SFAS No. 64, "Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements." SFAS No. 145 recognizes that the use of debt extinguishment can be a part of the risk management strategy of a company and hence, the classification of all early extinguishment of debt as an extraordinary item may no longer be appropriate. In addition, the Statement amends SFAS No. 13, "Accounting for Leases," to

eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. Provisions of this Statement, as they relate to Statement No. 13, are to be effective for transactions occurring after May 15, 2002. Provisions, which relate to Statement No. 4, are effective for fiscal years beginning after May 15, 2002. The Company adopted SFAS No. 145 on January 1, 2003, and it is not expected to materially impact the Company's consolidated financial statements.

In November 2002, the Financial Accounting Standards Board issued SFAS No. 146, "Accounting for the Costs Associated with Exit or Disposal Activities," ("SFAS No. 146"). SFAS No. 146 is effective for exit or disposal activities initiated after December 31, 2002 and requires recording costs associated with exit or disposal activities at their fair values when a liability has been incurred. Effective January 1, 2003, the Company adopted SFAS No. 146 and it is not expected to materially impact the Company's consolidated financial statements.

In November 2002, the Financial Accounting Standards Board issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others," ("Fin 45"). Fin 45 requires that the guarantor recognize, at the inception of certain guarantees, a liability for the fair value of the obligation undertaken in issuing such guarantee. Fin 45 also requires additional disclosure about the guarantor's obligations under certain guarantees that it has issued. The initial recognition and measurement provisions of this interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002 and the disclosure requirements are effective after December 15, 2002 and are included in footnote 10 to the consolidated financial statements.

In December 2002, the Financial Accounting Standards Board issued SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure an amendment of FASB Statement No. 123" ("SFAS No. 148"). This statement amends SFAS No. 123 to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation and amends the disclosure requirements SFAS 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The transition and annual disclosure provisions of SFAS No. 148 are effective for fiscal years ending after December 15, 2002. Effective January 1, 2003, the Company adopted the disclosure requirements of SFAS No. 148 regarding disclosure requirements for

# Notes to Consolidated Financial Statements

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condensed consolidated financial statements for interim periods. The Company has not determined whether it will voluntarily change to the fair value based method of accounting for stock-based employee compensation.

In January 2003, the Financial Accounting Standards Board issued Interpretation No. 46, "Consolidation of Variable Interest Entities and Interpretation of ARB No. 51" ("Fin 46"). Fin 46 establishes the criteria for consolidating variable interest entities. The Company is evaluating Fin 46, which is effective for fiscal years or interim periods beginning after June 15, 2003, to variable entities that were acquired before February 1, 2003. The Company does not expect Fin 46 to materially impact the Company's consolidated financial statements.

## Note 2. Acquisitions

On November 14, 2000, the Company acquired certain fixed assets and inventory of Crown Crafts, Inc., using the purchase method of accounting and accordingly, the purchase price was allocated to the assets acquired and the liabilities assumed based on estimated fair values at the date of acquisition. The estimated fair values were \$37,284 for assets acquired and \$440 for liabilities assumed.

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 reasons for the acquisition included:

- the ability to combine Mohawk's current efforts in the hard-flooring business with Dal-Tile's larger, more established ceramic tile and natural stone business;

- the opportunity to use Mohawk and Dal-Tile's existing distribution channels to increase sales of both carpets and hard floorcoverings;
- the potential to reduce overhead and other costs by adding Dal-Tile's distribution network to Mohawk's logistical and distribution system;
- the potential to reduce manufacturing costs and increase quality by identifying manufacturing best practices; and
- the potential to reduce general, administrative, overhead and other miscellaneous costs by spreading fixed costs over a larger business.

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 Statement of Financial Accounting Standards 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.

The following table summarizes the preliminary estimated 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	<u>1,865,225</u>
Current liabilities	132,124
Long-term debt	181,300
Other liabilities	83,476
Total liabilities assumed	<u>396,900</u>
Net assets acquired	<u>\$ 1,468,325</u>

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 2001, 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.

# Notes to Consolidated Financial Statements

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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 years ended December 31:

	2002	2001
Net sales	\$ 4,758,380	4,482,741
Net earnings	294,846	242,601
Basic earnings per share	4.39	3.63
Diluted earnings per share	4.32	3.58

## Note 3. Receivables

Receivables are as follows:

	2002	2001
Customers, trade	\$ 578,429	479,219
Other	7,373	5,037
	<u>585,802</u>	<u>484,256</u>
Less allowance for discounts, returns, claims and doubtful accounts	84,673	79,381
Net receivables	\$ <u>501,129</u>	<u>404,875</u>

## Note 4. Inventories

The components of inventories are as follows:

	2002	2001
Finished goods	\$ 436,080	287,525
Work in process	67,907	68,088
Raw materials	174,021	175,792
Total inventories	\$ <u>678,008</u>	<u>531,405</u>

## Note 5. Goodwill and Other Intangible Assets

Effective January 1, 2002, the Company adopted SFAS No. 142, which requires the Company to evaluate its goodwill on an annual basis for impairment. Furthermore, any goodwill that was acquired in a purchase business combination completed after June 30, 2001, will not be amortized. Goodwill that was acquired in business combinations completed before July 1, 2001, is no longer being amortized. The Company has two reportable units: the Mohawk unit and the Dal-Tile unit, and accordingly, has assigned the acquired goodwill to the respective reporting units. The amount assigned to the Mohawk unit was \$109,167 and \$1,168,286 to the Dal-Tile unit.

During the fourth quarter of 2002, the Company evaluated both reporting units using the discounted cash flow approach and determined that there was no impairment for either reportable unit.

The following table discloses the Company's earnings, assuming it excluded goodwill amortization for the fiscal years ended December 31:

	2002	2001	2000
Net earnings	\$ 284,489	188,592	162,599
Add back: Goodwill amortization, net of income taxes	-	2,022	2,006
Adjusted net earnings	<u>\$ 284,489</u>	<u>190,614</u>	<u>164,605</u>
Basic earnings per share	\$ 4.46	3.60	3.02
Add back: Goodwill amortization, net of income taxes	-	0.04	0.04
Adjusted net earnings	<u>\$ 4.46</u>	<u>3.64</u>	<u>3.06</u>
Diluted earnings per share	\$ 4.39	3.55	3.00
Add back: Goodwill amortization, net of income taxes	-	0.04	0.03
Adjusted net earnings	<u>\$ 4.39</u>	<u>3.59</u>	<u>3.03</u>

## Note 6. Property, Plant and Equipment

Following is a summary of property, plant and equipment:

	2002	2001
Land	\$ 56,671	24,355
Buildings and improvements	339,630	275,174
Machinery and equipment	1,052,567	910,454
Furniture and fixtures	42,421	34,677
Leasehold improvements	16,354	6,405
Construction in progress	77,468	26,654
	<u>1,585,111</u>	<u>1,277,719</u>
Less accumulated depreciation and amortization	729,787	658,016
Net property, plant and equipment	\$ <u>855,324</u>	<u>619,703</u>

Property, plant and equipment includes capitalized interest of \$2,126, \$1,855 and \$3,097 in 2002, 2001 and 2000, respectively.

# Notes to Consolidated Financial Statements

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Effective January 1, 2000, the Company extended the estimated useful lives on certain property, plant and equipment. The impact of the change was to increase net earnings for 2000 by approximately \$14,600, or \$0.27 per share.

## Note 7. Long-Term Debt

The Company's revolving line of credit agreement provides for an interest rate of either (i) LIBOR plus 0.2% to 0.5%, depending upon the Company's performance measured against certain financial ratios, or (ii) the prime rate less 1.0% and has a termination date of January 28, 2004. At December 31, 2002, the Company had credit facilities of \$450,000 under its revolving credit line and \$55,000 under various short-term uncommitted credit lines. At December 31, 2002, a total of \$462,501 was unused under these lines. All of these lines are unsecured. The credit agreement contains customary financial and other covenants. The Company must pay an annual facility fee ranging from .0015 to .0025 of the total credit commitment, depending upon the Company's performance measured against specific coverage ratios, under the revolving credit line.

In connection with the Dal-Tile acquisition, the Company entered into a 364-day term loan facility (the "Bridge Facility") on March 20, 2002, to finance a portion of the acquisition. On April 2, 2002, the Company sold \$300,000 of its 6.50% senior notes due 2007, Series A and \$400,000 of its 7.20% senior notes due 2012, Series B through institutional private placements and used the proceeds to repay outstanding indebtedness of approximately \$601,000 under the Bridge Facility and approximately \$90,000 under the Company's revolving credit facility. On June 13, 2002, the Company exchanged \$294,965 of its registered 6.50% notes due 2007, Series C for an equal amount of its Series A senior notes and \$397,800 of its registered 7.20% senior notes due 2012, Series D for an equal amount of its Series B senior notes. Interest on each series is payable semiannually.

The Company has two trade accounts receivable securitization agreements with bank agents for asset-backed commercial paper conduits. These facilities enable the Company to borrow up to \$205,000 through the Mohawk segment and up to \$75,000 through its Dal-Tile segment. Each securitization is secured by the respective segment trade receivables and is subject to annual renewal. At December 31, 2002, the Company had no amounts outstanding under either securitization facility, both of which were available up to their respective facility limits. At December 31, 2001,

the Mohawk segment had \$125,000 outstanding secured by approximately \$461,072 of receivables.

The Company guarantees the Industrial Revenue Bonds with various standby letters of credit, which were in aggregate \$55,200 at December 31, 2002, and 2001.

Long-term debt consists of the following:

	2002	2001
Revolving line of credit,		
due January 28, 2004	\$ 4,402	33,893
Asset securitization,		
due October 24, 2003	-	125,000
6.50% senior notes, payable		
April 15, 2007 interest		
payable semiannually	300,000	-
7.20% senior notes, payable		
April 15, 2012 interest		
payable semiannually	400,000	-
8.46% senior notes, payable in		
annual principal installments		
beginning in 1998, due		
September 16, 2004,		
interest payable quarterly	28,571	42,857
7.14%-7.23% senior notes,		
payable in annual principal		
installments beginning in		
1997, due September 1, 2005,		
interest payable semiannually	28,333	37,778
8.48% term loans, payable in		
annual principal installments,		
due October 26, 2002,		
interest payable quarterly	-	5,714
7.58% senior notes, payable in		
annual principal installments		
beginning in 1997, due		
July 30, 2003, interest		
payable semiannually	1,428	2,857
6% term note, payable in annual		
principal and interest		
installments beginning		
in 1998, due July 23, 2004	2,671	4,007
Industrial revenue bonds and other	55,022	56,327
Total long-term debt	820,427	308,433
Less current portion	27,427	158,366
Long-term debt, excluding		
current portion	\$ 793,000	150,067

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The aggregate maturities of long-term debt as of December 31, 2002, are as follows:

2003	\$ 27,427
2004	29,380
2005	9,448
2006	6,500
2007	300,000
Thereafter	447,672
	<u>\$ 820,427</u>

## Note 8. Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses are as follows:

	2002	2001
Outstanding checks		
in excess of cash	\$ 23,504	45,012
Accounts payable, trade	236,272	171,620
Accrued expenses	222,868	132,944
Accrued compensation	106,639	73,919
Total accounts payable and accrued expenses	<u>\$ 589,283</u>	<u>423,495</u>

## Note 9. Derivative Financial Instruments

### Interest Rate Risk Management

The Company used an interest rate swap contract to adjust the proportion of total debt that was subject to variable interest rates as compared to fixed interest rates. Under the interest rate swap contract, the Company agreed to pay an amount equal to a fixed rate of interest times a notional principal amount of \$100,000, and to receive in return an amount equal to a specified variable rate of interest times the same notional principal amount. The notional amounts of the contracts are not exchanged, and no other cash payments are made. The contract fair value is reflected on the consolidated balance sheets and related gains or losses were deferred in other comprehensive income. These deferred gains and losses are recognized in income as an adjustment to interest expense over the same period in which the related interest payments being hedged are recognized in income. However, to the extent that any of these contracts are not considered to be 100% effective in offsetting the change in the value of the interest payments being hedged, any changes in fair value relating to the ineffective portion of these

contracts is immediately recognized in earnings. During December 2002, the Company determined, based on future cash flow projections, that the cash flow hedge would more than likely become ineffective as strong cash flow has allowed the Company to significantly reduce its outstanding LIBOR based variable rate debt below the \$100,000 hedged notional amount. The unrealized loss on the interest rate swap previously included in other comprehensive income has been recorded in interest expense in the fourth quarter of 2002. The amount recorded in interest expense was \$10,700. The Company continues to carry the liability on the consolidated balance sheets at its fair value and it will be marked to market in future reporting periods with any changes being recorded in interest expense.

### 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 going to other comprehensive income, net of applicable income taxes and any hedge ineffectiveness. Any gain or loss is recognized in cost of goods sold in the same period or periods during which the hedged transaction affects earnings. At December 31, 2002, the Company had natural gas contracts outstanding with an aggregate notional amount of approximately 1,450 MMBTU's. The fair value of these contracts, which mature from January 2003 to December 2004, was an asset of \$1,911, with the offset recorded in other comprehensive income, net of applicable income taxes.

The long-term supply agreements are accounted for under the normal purchases provision within SFAS No. 133 and its amendments. At December 31, 2002, the Company has normal purchase commitments of approximately 4,560 MMBTU's for periods maturing from January 2003 through August 2005. The contracted value of these commitments was approximately \$17,441 and the fair value of these commitments was approximately \$19,694, at December 31, 2002.



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## Foreign Currency Rate Management

The Company enters into foreign exchange forward contracts to hedge 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 US currency. Gains and losses are recognized in cost of sales in the same period or periods during which the hedged transaction affects earnings. Accordingly, these contracts have been designated as cash flow hedges. At December 31, 2002, the Company had forward contracts maturing from January 2003 through December 2003, to purchase approximately 357,522 Mexican pesos. The aggregate U.S. Dollar value of these contracts at December 31, 2002, was approximately \$34,581. 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, 2002, were not material.

## 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:

	2002	2001	2000
Balance at beginning of year	\$ 7,021	6,506	6,532
Warranty claims	(61,718)	(52,125)	(49,426)
Warranty expense	61,881	52,640	49,400
Balance at end of year	\$ 7,184	7,021	6,506

## 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 2002, 2001 and 2000, options to purchase 731, 704, and 181 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, 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 2002, 2001, and 2000 a total of two, two, and four shares, respectively, were awarded to the non-employee directors under the plan.

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

	2002	2001	2000
Options outstanding at beginning of year	1,916	1,868	2,043
Options granted for Dal-Tile acquisition	2,096	-	-
Options granted	731	704	184
Options exercised	(2,056)	(570)	(181)
Options canceled	(283)	(86)	(178)
Options outstanding at end of year	2,404	1,916	1,868
Options exercisable at end of year	796	599	931
Option prices per share:			
Options granted during the year	\$ 38.73-65.02	23.33-53.01	20.13-26.26
Options exercised during the year	\$ 5.67-49.09	5.67-35.13	5.67-19.70
Options canceled during the year	\$ 9.58-63.14	5.67-42.86	6.67-35.14
Options outstanding at end of year	\$ 6.67-65.02	5.61-53.01	5.61-35.13
Options exercisable at end of year	\$ 6.67-53.01	5.61-35.13	5.61-35.13

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As allowed under SFAS No. 123, "Accounting for Stock Based Compensation," 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. Accordingly, no compensation expense has been recognized in the consolidated statements of earnings for any stock options granted in 2002, 2001 and 2000. The following table represents pro forma net earnings and pro forma earnings per share had the Company elected to account for stock option grants using the fair value based method.

	2002	2001	2000
Net earnings as reported	\$ 284,489	188,592	162,599
Deduct: Stock-based employee compensation expense determined under fair value based method for all options, net of related tax effects.	(4,972)	(3,198)	(2,286)
Pro forma net earnings	\$ 279,517	185,394	160,313
Net earning per common share (basic)			
As reported	\$ 4.46	3.60	3.02
Pro forma	\$ 4.39	3.54	2.98
Net earnings per common share (diluted)			
As reported	\$ 4.39	3.55	3.00
Pro forma	\$ 4.31	3.49	2.95

This pro forma impact only takes into account options granted since January 1, 1996, and is likely to increase in future years as additional options are granted and amortized ratably over the vesting period. The average fair value of options granted during 2002, 2001 and 2000 was \$26.72, \$15.27 and \$13.00, respectively. This fair value was estimated

using the Black-Scholes option pricing model based on a weighted-average market price at grant date of \$62.11 in 2002, \$31.91 in 2001 and \$22.69 in 2000 and the following weighted-average assumptions:

	2002	2001	2000
Dividend yield	-	-	-
Risk-free interest rate	3.0%	4.1%	5.1%
Volatility	39.7%	43.3%	48.1%
Expected life (years)	6	6	7

Summarized information about stock options outstanding and exercisable at December 31, 2002, is as follows:

Exercise price range	Outstanding		Exercisable		
	Number of Shares	Average Life <sup>(1)</sup>	Average Price <sup>(2)</sup>	Number of Shares	Average Price <sup>(2)</sup>
Under \$19.69	575	4.42	\$ 15.46	467	\$ 14.49
\$19.93-30.50	249	7.08	22.77	105	23.19
\$30.53-30.53	499	8.16	30.53	68	30.53
\$30.69-53.53	425	7.34	37.45	156	34.56
\$58.00-58.00	42	9.95	58.00	-	-
\$63.14-65.20	614	9.18	63.37	-	-
Total	<u>2,404</u>			<u>796</u>	

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, 2002, a total of approximately 1,371 shares of the Company's common stock were purchased at an aggregate cost of approximately \$64,034. Since the inception of the program, a total of approximately 10,364 shares have been repurchased at an aggregate cost of approximately \$265,291. All of these repurchases have been financed through the Company's operations and banking arrangements.

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## 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. 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 contribution in excess of 4% of the employee's salary up to a maximum of 6%. Employee and employer contributions to the Mohawk Plan were \$20,237 and \$7,359 in 2002, \$18,322 and \$6,521 in 2001, and \$16,926 and \$6,055 in 2000, respectively. The Company also made a discretionary contribution to the Mohawk Plan of approximately \$3,797, \$2,500 and \$2,500 in 2002, 2001 and 2000, respectively.

The Dal-Tile International Inc. Employees' Retirement Savings Plan (the "Dal-Tile Plan") is a defined contribution 401(k) plan covering substantially all Dal-Tile employees. Employees were eligible to participate after completion of 60 days of service. Under the terms of the Dal-Tile Plan, Dal-Tile contributes \$.50 for every \$1.00 of employee contributions up to a maximum of 6% of the employee's salary and employees are vested in the contributions based on years of credited service. Employee and employer contributions to the Dal-Tile Plan were \$5,026 and \$2,103 in 2002, respectively. The Dal-Tile Plan was merged into the Mohawk Plan effective January 1, 2003. Dal-Tile also maintains a performance based profit sharing plan in which the Company contributed approximately \$1,588 in 2002.

## Note 13. Income Taxes

Income tax expense attributable to earnings before income taxes for the years ended December 31, 2002, 2001 and 2000, consists of the following:

	Current	Deferred	Total
<b>2002:</b>			
U.S. federal	\$ 133,914	9,859	143,773
State, local and other	3,089	12,278	15,367
	<u>\$ 137,003</u>	<u>22,137</u>	<u>159,140</u>
<b>2001:</b>			
U.S. federal	\$ 82,246	5,728	87,974
State, local and other	15,015	(165)	14,850
	<u>\$ 97,261</u>	<u>5,563</u>	<u>102,824</u>
<b>2000:</b>			
U.S. federal	\$ 64,444	28,466	92,910
State, local and other	8,407	3,713	12,120
	<u>\$ 72,851</u>	<u>32,179</u>	<u>105,030</u>

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:

	2002	2001	2000
Computed "expected" tax expense	\$ 155,270	101,996	93,670
State and local income taxes, net of federal income tax benefit	9,989	9,652	7,878
Amortization of goodwill	-	709	700
Tax credits	(5,000)	(5,000)	-
Other, net	(1,119)	(4,533)	2,782
	<u>\$ 159,140</u>	<u>102,824</u>	<u>105,030</u>

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2002 and 2001, are presented below:

	2002	2001
<b>Deferred tax assets:</b>		
Accounts receivable	\$ -	3,286
Inventories	16,526	19,089
Prepaid expenses	655	-
Accrued expenses	67,706	49,030
Gross deferred tax assets	<u>84,887</u>	<u>71,405</u>
<b>Deferred tax liabilities:</b>		
Plant and equipment	(105,443)	(72,934)
Trademarks	(57,929)	-
Prepaid expenses	-	(1,347)
Other	(26,437)	(12,021)
Gross deferred tax liabilities	<u>(189,809)</u>	<u>(86,302)</u>
Net deferred tax liability	<u>\$ (104,922)</u>	<u>(14,897)</u>

Based upon the expected reversal of deferred tax liabilities, 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 at December 31, 2002.

# Notes to Consolidated Financial Statements

December 31, 2002, 2001 and 2000 (in thousands, except per share data)

## Note 14. Commitments and Contingencies

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

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

	Capital Leases	Operating Leases	Total Future Payments
2003	\$ 798	60,936	61,734
2004	-	49,346	49,346
2005	-	37,248	37,248
2006	-	27,754	27,754
2007	-	16,944	16,944
Thereafter	-	26,235	26,235
Total payments	\$ 798	218,463	219,261
Less amount representing interest	34		
Present value of capitalized lease payments with a weighted interest rate of 7.60%	\$ 764		

The Company assumed several capitalized leases from recent acquisitions for machinery and equipment, at a cost of \$5,010 as of December 31, 2002 and 2001. The amortization of these capital leases is included in depreciation expense. Accumulated amortization was \$4,245 and \$2,038 as of December 31, 2002 and 2001, respectively.

Rental expense under operating leases was \$62,066, \$39,072 and \$36,392 in 2002, 2001 and 2000, respectively.

The Company has approximately \$19,600 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 reserves 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.

Three sites near Mohawk's Dallas facility in its Dal-Tile segment are involved in environmental cleanup projects relating principally to the disposal or alleged disposal by Dal-Tile of waste materials containing lead compounds. Dal-Tile's approved closure plans have been implemented and each site is now undergoing post-closure care. Dal-Tile has been named as a potentially responsible party under the federal Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA") and similar state statutes for the disposal of certain hazardous substances at various other sites in the United States. The Company does not believe that any future costs for these sites will have a material adverse effect on it.

# Notes to Consolidated Financial Statements

December 31, 2002, 2001 and 2000 (in thousands, except per share data)

## Note 15. Consolidated Statements of Cash Flows Information

Supplemental disclosures of cash flow information are as follows:

	2002	2001	2000
Net cash paid during the year for:			
Interest	\$ 43,866	31,789	39,866
Income taxes	\$ 59,931	73,498	74,592
Supplemental schedule of non-cash investing and financing activities:			
Fair value of assets acquired in acquisition	\$ 1,865,225	-	37,284
Liabilities assumed in acquisition	(396,900)	-	(440)
Issuance of common stock and options in acquisition	(750,687)	-	-
	\$ 717,638	-	36,844

## Note 16. Other Income and Expense

Other income and expense are as follows:

	2002	2001	2000
Miscellaneous income	\$ 5,914	1,826	1,218
Miscellaneous expense	\$ 12,425	3,966	2,010
Amortization expense	-	3,814	3,650
	\$ 12,425	7,780	5,660

## Note 17. Segment Reporting

The Company has two reportable segments, the Mohawk segment and the Dal-Tile segment. The Mohawk segment is comprised of all the product lines and operations that were the Company's prior to the Dal-Tile acquisition. The Dal-Tile segment is comprised of the Dal-Tile product lines and operations. 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 information is as follows:

	2002	2001	2000
Net sales:			
Mohawk	\$ 3,624,156	3,445,945	3,404,034
Dal-Tile	898,180	-	-
	\$ 4,522,336	3,445,945	3,404,034
Operating income:			
Mohawk	\$ 388,422	336,672	327,540
Dal-Tile	139,888	-	-
Corporate and eliminations <sup>(a)</sup>	(9,198)	(9,515)	(17,425)
	\$ 519,112	327,157	310,115
Depreciation and amortization:			
Mohawk	\$ 83,676	84,167	82,346
Dal-Tile	18,266	-	-
	\$ 101,942	84,167	82,346
Capital expenditures (excluding acquisitions):			
Mohawk	\$ 80,623	52,913	73,475
Dal-Tile	31,311	-	-
	\$ 111,934	52,913	73,475
Assets:			
Mohawk	\$ 1,638,336	1,656,813	1,692,020
Dal-Tile	1,832,701	-	-
Corporate and eliminations	125,706	111,672	103,358
	\$ 3,596,743	1,768,485	1,795,378

(a) Includes one-time charge in 2000 of \$7,000 for two class action legal settlements.

# Notes to Consolidated Financial Statements

December 31, 2002, 2001 and 2000 (in thousands, except per share data)

## Note 18. Quarterly Financial Data (Unaudited)

The supplemental quarterly financial data are as follows:

	Quarters ended	March 30,	June 29,	September 28,	December 31,
		2002	2002	2002	2002
Net sales		\$ 866,710	1,227,747	1,224,403	1,203,476
Gross profit		214,595	339,186	340,657	342,676
Net earnings		43,210	75,518	81,560	84,201
Basic earnings per share		0.80	1.12	1.22	1.27
Diluted earnings per share		0.77	1.10	1.21	1.25

	Quarters ended	March 31,	June 30,	September 29,	December 31,
		2001	2001	2001	2001
Net sales		\$ 777,339	864,958	907,850	895,798
Gross profit		177,322	216,154	219,424	220,002
Net earnings		27,206	46,466	55,727	59,193
Basic earnings per share		0.52	0.89	1.06	1.12
Diluted earnings per share		0.51	0.88	1.05	1.11

## Independent Auditor's Report

### 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, 2002 and 2001, 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, 2002. 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 auditing standards generally accepted in the United States of America. 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, 2002 and 2001, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America.

As discussed in notes 1 and 5 to the consolidated financial statements, the Company changed its method of accounting for goodwill and other intangible assets in 2002.

**KPMG LLP**

Atlanta, Georgia  
February 6, 2003

## Management's Report

The management of Mohawk Industries, Inc. is responsible for the integrity and objectivity of the consolidated financial statements. The financial statements were prepared in conformity with accounting principles generally accepted in the United States of America. Some of the amounts included in these consolidated financial statements are estimates based upon management's best judgment of current conditions and circumstances. Management is also responsible for preparing other financial information included in the annual report.

The Company's management depends on the Company's internal controls to assure itself of the reliability of the financial statements. The internal controls are designed to provide reasonable assurance, at appropriate cost, that assets are safeguarded and transactions are executed in accordance with management's authorizations and recorded properly to permit the preparation of financial statements in accordance with accounting principles generally accepted in the United States of America. Periodic reviews of internal controls are

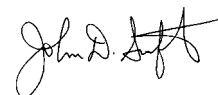
made by management and the internal audit function, and corrective action is taken if needed.

The Audit Committee of the Board of Directors, consisting of outside directors, provides oversight of financial reporting. The Company's internal audit function and independent auditors meet with the Audit Committee to discuss financial reporting and internal control issues and have full and free access to the Audit Committee.

The consolidated financial statements have been audited by the Company's independent auditors and their report is presented above. The independent auditors are approved each year by the Audit Committee and the Board of Directors.



Jeffrey S. Lorberbaum  
President and  
Chief Executive Officer



John D. Swift  
Chief Financial Officer

# Stockholder Information

## Corporate Headquarters

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

## Independent Auditors

KPMG LLP  
Atlanta, GA

## Corporate Counsel

Alston & Bird LLP  
Atlanta, GA

## Transfer Agent and Registrar

Wachovia Bank, N.A.  
Shareholder Services Department  
1525 West W.T. Harris Blvd.  
Charlotte, North Carolina 28288-1153  
1-800-829-8432

## 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](http://www.mohawkind.com) under investor relations. Written requests should be sent to:

Christi Scarbro  
Mohawk Industries, Inc.  
P.O. Box 12069  
160 South Industrial Boulevard  
Calhoun, Georgia 30703

## Product Inquiries

For more information about Mohawk's products, call toll-free: 1-800-622-6227 or visit our website at [www.mohawkind.com](http://www.mohawkind.com).

## Investor / Analyst Contact

For additional information about Mohawk, please contact:

John D. Swift  
Chief Financial Officer  
Mohawk Industries, Inc.  
P.O.Box 12069  
160 South Industrial Boulevard  
Calhoun, Georgia 30703  
(706) 624-2247

## 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 Thursday, May 15, 2003, 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

2002	High	Low
First Quarter	\$ 68.10	50.50
Second Quarter	70.60	57.25
Third Quarter	62.24	40.25
Fourth Quarter	63.40	43.75

2001	High	Low
First Quarter	\$ 32.60	25.50
Second Quarter	35.85	27.91
Third Quarter	47.13	29.85
Fourth Quarter	55.55	35.90

## Common Stockholders of Record

As of February 20, 2003, there were 421 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.

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



Partially printed on recycled paper.