| At or for the Years Ended December 31, | 1999 | 1998 | 1997 | 1996 | 1995 |
|---|---|---|---|---|---|
| *(In thousands, except per share data)* | | | | | |
| **STATEMENT OF EARNINGS DATA:** | | | | | |
| Net sales | $3,083,264 | 2,744,620 | 2,429,085 | 2,239,471 | 2,041,865 |
| Cost of sales | 2,306,405 | 2,063,333 | 1,869,221 | 1,726,765 | 1,594,050 |
| Gross profit | 776,859 | 681,287 | 559,864 | 512,706 | 447,815 |
| Selling, general and administrative expenses | 482,062 | 432,191 | 383,523 | 367,251 | 348,278 |
| Restructuring costs[a] | — | — | — | 700 | 8,439 |
| Carrying value reduction of property, plant and equipment and other assets[b] | — | 2,900 | 5,500 | 3,060 | 23,711 |
| Compensation expense for stock option exercises[c] | — | — | 2,600 | — | 4,000 |
| Operating income | 294,797 | 246,196 | 168,241 | 141,695 | 63,387 |
| Interest expense | 32,632 | 31,023 | 36,474 | 39,772 | 42,398 |
| Acquisition costs—World Merger[d] | — | 17,700 | — | — | — |
| Other expense, net | 2,266 | 2,667 | 338 | 4,586 | 1,170 |
| | 34,898 | 51,390 | 36,812 | 44,358 | 43,568 |
| Earnings before income taxes | 259,899 | 194,806 | 131,429 | 97,337 | 19,819 |
| Income taxes | 102,660 | 79,552 | 51,866 | 40,395 | 8,022 |
| Net earnings | $ 157,239 | 115,254 | 79,563 | 56,942 | 11,797 |
| Basic earnings per share[e] | $ 2.63 | 1.91 | 1.33 | 0.96 | 0.21 |
| Weighted-average common shares outstanding[e] | 59,730 | 60,393 | 59,962 | 59,310 | 57,235 |
| Diluted earnings per share[e] | $ 2.61 | 1.89 | 1.32 | 0.95 | 0.20 |
| Weighted-average common and dilutive potential common shares outstanding[e] | 60,349 | 61,134 | 60,453 | 59,899 | 58,485 |
| **BALANCE SHEET DATA:** | | | | | |
| Working capital | $ 560,057 | 438,474 | 389,378 | 390,889 | 305,370 |
| Total assets | 1,682,873 | 1,405,486 | 1,233,361 | 1,226,959 | 1,110,438 |
| Short-term note payable | — | — | — | 21,200 | 50,000 |
| Long-term debt (including current portion) | 596,065 | 377,089 | 402,854 | 486,952 | 435,940 |
| Stockholders' equity | 692,546 | 611,059 | 493,841 | 409,616 | 343,452 |

*(a) During 1995 and 1996, the Company recorded pre-tax restructuring costs of $8.4 million and $0.7 million, respectively, related to certain mill closings whose operations have been consolidated into other Mohawk facilities.*

*(b) During 1995, the Company adopted FAS No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of, as of January 1, 1995. A charge of $23.7 million was recorded for the reduction of the carrying value of property, plant and equipment at certain mills. 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) Charges of $4.0 million and $2.6 million were recorded in 1995 and 1997, respectively, 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.*

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

*(e) 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.*

## GENERAL

During the three-year period ended December 31, 1999, the Company continued to experience significant growth both internally and through acquisitions.

On July 23, 1997, the Company acquired certain assets of Diamond Rug & Carpet Mills, Inc. ("Diamond") and other assets owned by Diamond's principal stockholders for approximately $36.0 million, which consisted of $19.6 million in cash at closing, $7.0 million in cash over the six-month period following closing and a $9.4 million note payable in seven annual installments of principal plus interest at 6%. The acquisition was accounted for using the purchase method of accounting.

The Company completed its acquisitions of Newmark & James, Inc. ("Newmark") and American Weavers LLC ("American Weavers") on June 30, 1998 and August 10, 1998, respectively. Both of these acquisitions were accounted for using the purchase method of accounting. On November 12, 1998, the Company acquired all of the outstanding capital stock of World Carpets, Inc. ("World") in exchange for approximately 4.9 million shares of the Company's common stock valued at $149.5 million, based on the closing stock price on the day the agreement was executed. The acquisition of World was accounted for using the pooling-of-interests method of accounting.

On January 29, 1999, the Company acquired certain assets of Image Industries, Inc. ("Image") for approximately $192 million, including acquisition costs and the assumption of $30 million of tax-exempt debt, and on March 9, 1999, the Company acquired all of the outstanding capital stock of Durkan Patterned Carpets, Inc. ("Durkan") for approximately 3.1 million shares of the Company's common stock valued at $116.5 million based on the closing stock price the day the letter of intent was executed. The Image acquisition was accounted for using the purchase method of accounting, and the Durkan acquisition was accounted for using the pooling-of-interests method of accounting.

These acquisitions have created opportunities to enhance Mohawk's operations by (i) broadening price points, (ii) increasing vertical integration efforts, (iii) expanding distribution capabilities and (iv) facilitating entry into niche businesses, such as rugs, decorative throws and table runners.

Prior to December 31, 1999, the impact of the changeover to 2000 on computer software programs and internal operating systems was uncertain and recent publications have suggested that February 29, 2000 may cause interruptions or system failures in computer software programs or internal operating systems. In 1999, the Company spent approximately $.5 million to review and upgrade its computer and business systems in its effort to make these systems Year 2000 compliant and thereby avoid any interruptions resulting from the changeover to 2000 or the occurrence of February 29, 2000. To date, the Company has not incurred any significant interruptions as a result of the changeover to 2000 and the Company is not expecting significant interruptions as a result of the occurrence of February 29, 2000.

Effective January 1, 2000, the Company changed the estimated useful lives of certain property, plant and equipment. Management believes this change more accurately reflects the actual lives of these assets and is more consistent with industry practice. The prospective change is estimated to reduce annual depreciation expense by approximately $20.0 million in 2000. See accompanying Notes to Consolidated Financial Statements for further discussion.

## RESULTS OF OPERATIONS

### *Year Ended December 31, 1999 as Compared with Year Ended December 31, 1998*

Net sales for the year ended December 31, 1999 were $3,083.3 million, reflecting an increase of $338.6 million, or approximately 12.3%, over the $2,744.6 million reported in the year ended December 31, 1998. All major product categories achieved sales increases in 1999 as compared to 1998. The Company believes that the 1999 net sales increase was attributable to internal growth and the acquisition of Image.

Quarterly net sales and the percentage changes in net sales by quarter for 1999 versus 1998 were as follows (dollars in thousands):

| | 1999 | 1998 | *Change* |
|---|---|---|---|
| First quarter | $ 707,167 | 589,473 | 20.0% |
| Second quarter | 790,617 | 689,488 | 14.7 |
| Third quarter | 809,933 | 718,772 | 12.7 |
| Fourth quarter | 775,547 | 746,887 | 3.8 |
| Total year | $3,083,264 | 2,744,620 | 12.3% |

The Company's fiscal calendar reflected differences for the 1999 first quarter, with four more shipping days, when compared to 1998 and four fewer shipping days when the fourth quarter of 1999 is compared to 1998.

Gross profit for 1999 was $776.9 million (25.2% of net sales) and represented an increase over the gross profit of $681.3 million (24.8% of net sales) for 1998. Gross profit dollars for the current year were impacted favorably by better absorption of fixed costs through higher production volume.

Selling, general and administrative expenses for 1999 were $482.1 million (15.6% of net sales) compared to $432.2 million (15.7% of net sales) for 1998.

Interest expense for the current year was $32.6 million compared to $31.0 million in 1998. The primary factor contributing to the increase was an increase in debt levels, which was attributable to acquisitions, the stock repurchase program and capital expenditures, compared to the prior year which was offset by a decrease in the Company's weighted-average interest rate in 1999.

In the current year, income tax expense was $102.7 million, or 39.5% of earnings before income taxes. In 1998, income tax expense was $79.6 million, representing 40.8% of earnings before income taxes. The primary reason for the decrease in the 1999 effective income tax rate was that certain costs included in the nonrecurring pre-tax charge of $17.7 million related to the World acquisition recorded in 1998 were not deductible for income tax purposes.

### *Year Ended December 31, 1998 as Compared with Year Ended December 31, 1997*

Net sales for the year ended December 31, 1998 were $2,744.6 million, reflecting an increase of $315.5 million, or approximately 13%, over the $2,429.1 million reported in the year ended December 31, 1997. All major product categories achieved sales increases in 1998 as compared to 1997. These sales increases were impacted by continued favorable industry conditions and a gain in the Company's market share, which, the Company believes, primarily resulted from continued emphasis on supporting its dealers and strong customer acceptance of new product introductions.

Quarterly net sales and the percentage changes in net sales by quarter for 1998 versus 1997 were as follows (dollars in thousands):

| | 1998 | 1997 | *Change* |
|---|---|---|---|
| First quarter | $ 589,473 | 537,145 | 9.7% |
| Second quarter | 689,488 | 607,059 | 13.6 |
| Third quarter | 718,772 | 626,751 | 14.7 |
| Fourth quarter | 746,887 | 658,130 | 13.5 |
| Total year | $2,744,620 | 2,429,085 | 13.0% |

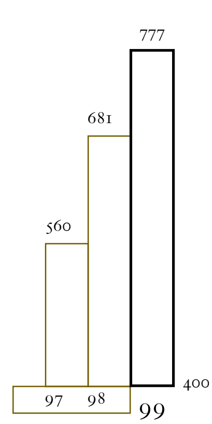
Gross profit for 1998 was $681.3 million (24.8% of net sales) and represented an increase over the gross profit of $559.9 million (23.0% of net sales) for 1997. Gross profit dollars for 1998 were impacted favorably by better absorption of fixed costs through higher production volume and continued improvements in manufacturing efficiencies from restructuring efforts.

Selling, general and administrative expenses for 1998 were $432.2 million (15.7% of net sales) compared to $383.5 million (15.8% of net sales) for 1997. Selling, general and administrative expenses as a percentage of net sales decreased primarily due to lower administrative, bad debt and sample expenses.

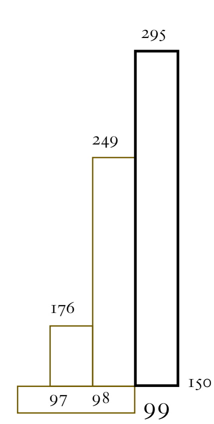
During the fourth quarter of 1998, the Company recorded a charge of $2.9 million for the write-down of fixed assets to be disposed of in connection with the World acquisition. Also, a $17.7 million charge was recorded for nonrecurring costs associated with the World acquisition.

During the fourth quarter of 1997, the Company revised its estimate of the fair value of certain property, plant and equipment held for sale. The revision resulted in a $5.5 million write-down to the carrying value of those assets. The revision was based upon current appraisals and other market information. In addition, a $2.6 million charge was recorded for additional income tax reimbursements to be made to certain executives for the exercise of stock options. The income tax reimbursements were recorded in connection with stock options granted in 1988 and 1989 related to the Company's 1988 leveraged buyout.

Gross Profit
*(In millions of dollars)*




Operating Income Before Nonrecurring Items
*(In millions of dollars)*



Interest expense for 1998 was $31.0 million compared to $36.5 million in 1997. The primary factor contributing to the decrease was a significant reduction in debt levels.

In 1998, income tax expense was $79.6 million, or 40.8% of earnings before income taxes. In 1997, income tax expense was $51.9 million, representing 39.5% of earnings before income taxes. The primary reason for the increase in the 1998 effective income tax rate was that certain costs included in the nonrecurring pre-tax charge of $17.7 million related to the World acquisition were not deductible for income tax purposes.

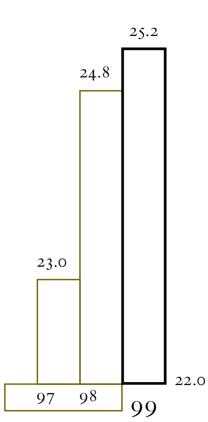
### LIQUIDITY AND CAPITAL RESOURCES

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

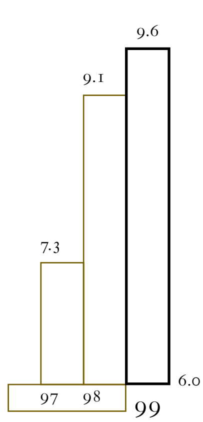
The level of accounts receivable increased from $331.9 million at the beginning of 1999 to $337.8 million at December 31, 1999. The $5.9 million increase was attributable to strong sales growth. Inventories increased from $423.8 million at the beginning of 1999 to $494.8 million at December 31, 1999, due primarily to acquisitions and the need for a higher level of inventory to meet the increased sales volume.

Capital expenditures totaled $146 million during 1999, and the Company spent an additional $162 million related to the Image acquisition.

Gross Profit
*(As a percentage of net sales)*




Operating Income Before Nonrecurring Items
*(As a percentage of net sales)*




The capital expenditures made during 1999 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 for Mohawk, including $233 million for acquisitions, have totaled $510 million over the past three years. Capital spending during 2000 is expected to range from $105 million to $120 million, the majority of which will be used to purchase equipment to increase production capacity and productivity.

On November 23, 1999, the Company amended and restated its credit agreement to provide 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%. Additionally, the termination date of the credit agreement was extended to January 28, 2004. At December 31, 1999, the Company had credit availability of $450 million under its revolving credit line and $45 million under various short-term uncommitted credit lines. At December 31, 1999, a total of approximately $110.5 million was unused under these lines. 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.

The Company's Board of Directors approved a stock repurchase plan in September 1999, whereby the Company's management was authorized to purchase up to five million common shares. In December 1999 it amended the plan to increase the shares authorized for purchase by an additional five million shares, bringing the total authorized repurchase up to 10 million shares of its outstanding common shares. For the year ended December 31, 1999 a total of approximately four million shares of the Company's common stock had been purchased at an aggregate cost of approximately $84 million. All this repurchase has been financed through the Company's operations and revolving line of credit.

### IMPACT OF INFLATION

Inflation affects the Company's manufacturing costs and operating expenses. The carpet industry has experienced moderate inflation in the prices of raw materials and outside processing for the last three years. The Company has generally passed along nylon fiber price increases to its customers.

## SEASONALITY

The carpet business is seasonal, with the Company's second, third and fourth quarters typically producing higher net sales and operating income. By comparison, results for the first quarter tend to be the weakest. This seasonality is primarily attributable to consumer residential spending patterns and higher installation levels during the spring and summer months.

## 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.

*A failure by Mohawk to complete acquisitions and successfully integrate acquired operations could materially and adversely affect its business.*
Management intends to pursue acquisitions of complementary businesses as part of its business and growth strategies. Although management regularly evaluates acquisition opportunities, it cannot offer assurance that it will be able to:

- successfully identify suitable acquisition candidates;
- obtain sufficient financing on acceptable terms to fund acquisitions;
- complete acquisitions;
- integrate acquired operations into Mohawk's existing operations; or
- profitably manage acquired businesses.

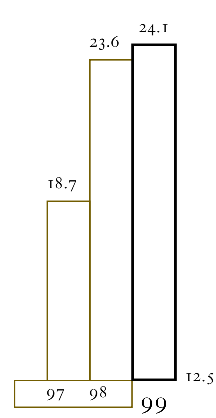
Acquired operations may not achieve levels of sales, operating income or productivity comparable to those of Mohawk's existing operations, or otherwise perform as expected. Acquisitions may also involve a number of special risks, some or all of which could have a material adverse effect on Mohawk's business,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

- possible adverse effects on Mohawk's operating results;
- diversion of Mohawk management's attention and its resources; and
- dependence on retaining and training acquired key personnel.

*The carpet industry is cyclical and a downturn in the overall economy could lessen the demand for Mohawk's products and impair growth and profitability.*
The carpet industry is cyclical and is influenced by a number of general economic factors. Prevailing interest rates, consumer confidence, spending for durable goods, disposable income, turnover in housing and the condition of the residential and commercial construction industries (including the number of new housing starts and the level of new commercial construction) all have an impact on Mohawk's growth and profitability. In addition, sales of Mohawk's principal products are related to construction and renovation of commercial and residential buildings. Any adverse cycle could lessen the overall demand for Mohawk's products and could, in turn, impair Mohawk's growth and profitability.

*The carpet business is seasonal and this seasonality causes Mohawk's results of operations to fluctuate on a quarterly basis.*
Mohawk is a calendar year end company and its results of operations for the first quarter tend to be the weakest. Mohawk's second, third and fourth quarters typically produce higher net sales and operating income. These results are primarily due to consumer residential spending patterns and more carpet being installed in the spring and summer months.

Return On Equity Before Nonrecurring Items
*(As a percentage)*



*Mohawk's business is competitive and a failure by Mohawk to compete effectively could have a material and adverse impact on Mohawk's results of operations.*
Mohawk operates in a highly competitive industry. Mohawk and other manufacturers in the carpet industry compete on the basis of price, style, quality and service. Some of Mohawk's competitors may have greater financial resources at their disposal. Mohawk has one competitor whose size could allow it certain manufacturing cost advantages compared to other industry participants. If competitors substantially increase production and marketing of competing products, then Mohawk might be required to lower its prices or spend more on product development, marketing and sales, which could adversely affect Mohawk's profitability.

*An increase in the cost of raw materials could negatively impact Mohawk's profitability.*
The cost of raw materials has a significant impact on the profitability of Mohawk. In particular, Mohawk's business requires it to purchase large volumes of nylon fiber and polypropylene resin, which is used to manufacture fiber. Mohawk does not have any long-term supply contracts for any of these products. While Mohawk generally attempts to match cost increases with price increases, large increases in the cost of such raw materials could adversely affect its business, results of operations and financial condition if it is unable to pass these costs through to its customers.

*Mohawk may be responsible for environmental cleanup, which could negatively impact profitability.*
Various federal, state and local environmental laws govern the use of Mohawk's facilities. Such laws govern:

- discharges to air and water;
- handling and disposal of solid and hazardous substances and waste; and
- remediation of contamination from releases of hazardous substances in Mohawk's facilities and off-site disposal locations.

Mohawk's operations are also governed by the laws relating to workplace safety and worker health, which, among other things, establish asbestos and noise standards and regulate the use of hazardous chemicals in the workplace. Mohawk has taken and will continue to take steps to comply with these laws. Based upon current available information, Mohawk believes that complying with environmental and safety and health requirements will not require material capital expenditures in the foreseeable future. However, Mohawk cannot provide assurance that complying with these environmental or health and safety laws and requirements will not adversely affect its business, results of operations and financial condition. Future laws, ordinances or regulations could give rise to additional compliance or remediation costs, which could have a material adverse effect on its business, results of operations and financial condition.

### FORWARD-LOOKING INFORMATION

Certain of the matters discussed in the preceding pages, particularly regarding anticipating 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. 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. 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 and floor covering markets served by Mohawk; competition from other carpet, rug and floor covering manufacturers; raw material prices; the 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.

### QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's market risk-sensitive instruments do not subject the Company to material market risk exposures.

| *(In thousands, except per share data)* *Years Ended December 31,* | 1999 | 1998 | 1997 |
|---|---|---|---|
| Net sales | $3,083,264 | 2,744,620 | 2,429,085 |
| Cost of sales | 2,306,405 | 2,063,333 | 1,869,221 |
| Gross profit | 776,859 | 681,287 | 559,864 |
| Selling, general and administrative expenses | 482,062 | 432,191 | 383,523 |
| Carrying value reduction of property, plant and equipment and other assets | — | 2,900 | 5,500 |
| Compensation expense for stock option exercises | — | — | 2,600 |
| Operating income | 294,797 | 246,196 | 168,241 |
| Other expense: | | | |
| Interest expense | 32,632 | 31,023 | 36,474 |
| Acquisition costs—World Merger | — | 17,700 | — |
| Other expense, net | 2,266 | 2,667 | 338 |
| | 34,898 | 51,390 | 36,812 |
| Earnings before income taxes | 259,899 | 194,806 | 131,429 |
| Income taxes | 102,660 | 79,552 | 51,866 |
| Net earnings | $ 157,239 | 115,254 | 79,563 |
| Basic earnings per share | $ 2.63 | 1.91 | 1.33 |
| Weighted-average common shares outstanding | 59,730 | 60,393 | 59,962 |
| Diluted earnings per share | $ 2.61 | 1.89 | 1.32 |
| Weighted-average common and dilutive potential common shares outstanding | 60,349 | 61,134 | 60,453 |

*See accompanying notes to consolidated financial statements.*

# Consolidated Balance Sheets

| (In thousands, except per share data) December 31, | 1999 | 1998 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash | $ — | 2,384 |
| Receivables | 337,824 | 331,928 |
| Inventories | 494,774 | 423,837 |
| Prepaid expenses | 25,184 | 19,322 |
| Deferred income taxes | 76,628 | 69,464 |
| Total current assets | 934,410 | 846,935 |
| Property, plant and equipment, net | 624,814 | 454,867 |
| Other assets | 123,649 | 103,684 |
| | $1,682,873 | 1,405,486 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| Current liabilities: | | |
| Current portion of long-term debt | $ 33,961 | 44,424 |
| Accounts payable and accrued expenses | 340,392 | 364,037 |
| Total current liabilities | 374,353 | 408,461 |
| Deferred income taxes | 53,783 | 47,921 |
| Long-term debt, less current portion | 562,104 | 332,665 |
| Other long-term liabilities | 87 | 5,380 |
| Total liabilities | 990,327 | 794,427 |
| Stockholders' equity: | | |
| Preferred stock, $.01 par value; 60 shares authorized; no shares issued | — | — |
| Common stock, $.01 par value; 150,000 shares authorized; 60,657 and 60,533 shares issued in 1999 and 1998, respectively | 607 | 606 |
| Additional paid-in capital | 179,993 | 172,045 |
| Retained earnings | 595,932 | 438,408 |
| | 776,532 | 611,059 |
| Less treasury stock at cost; 3,952 shares in 1999 | 83,986 | — |
| Total stockholders' equity | 692,546 | 611,059 |
| Commitments and contingencies (Notes 10 and 12) | | |
| | $1,682,873 | 1,405,486 |

*See accompanying notes to consolidated financial statements.*

| *(In thousands)* | *Common stock* Shares | Amount | *Additional paid-in capital* | *Retained earnings* | *Treasury stock* | *Total stockholders' equity* |
|---|---|---|---|---|---|---|
| Balances at December 31, 1996 | 59,757 | $598 | 162,707 | 246,311 | — | 409,616 |
| Stock options exercised | 460 | 5 | 3,631 | — | — | 3,636 |
| Dividends paid | — | — | — | (24) | — | (24) |
| Tax benefit from exercise of stock options | — | — | 1,050 | — | — | 1,050 |
| Net earnings | — | — | — | 79,563 | — | 79,563 |
| Balances at December 31, 1997 | 60,217 | 603 | 167,388 | 325,850 | — | 493,841 |
| Stock options exercised | 316 | 3 | 4,414 | — | — | 4,417 |
| Dividends paid | — | — | — | (24) | — | (24) |
| Tax benefit from exercise of stock options | — | — | 243 | — | — | 243 |
| Adjustments to conform fiscal year end of World | — | — | — | (2,672) | — | (2,672) |
| Net earnings | — | — | — | 115,254 | — | 115,254 |
| Balances at December 31, 1998 | 60,533 | 606 | 172,045 | 438,408 | — | 611,059 |
| Stock options exercised | 124 | 1 | 1,390 | — | — | 1,391 |
| Purchase of treasury stock | — | — | — | — | (83,986) | (83,986) |
| Tax benefit from exercise of stock options | — | — | 836 | — | — | 836 |
| Durkan pooling adjustment | — | — | 5,722 | — | — | 5,722 |
| Adjustments to conform fiscal year end of Durkan | — | — | — | 285 | — | 285 |
| Net earnings | — | — | — | 157,239 | — | 157,239 |
| Balances at December 31, 1999 | 60,657 | $607 | 179,993 | 595,932 | (83,986) | 692,546 |

*See accompanying notes to consolidated financial statements.*

# Consolidated Statements of Cash Flows

| *(In thousands)* Years Ended December 31, | 1999 | 1998 | 1997 |
|---|---|---|---|
| Cash flows from operating activities: | | | |
| Net earnings | $ 157,239 | 115,254 | 79,563 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | | |
| Depreciation and amortization | 105,297 | 72,591 | 72,893 |
| Deferred income taxes | (1,302) | (14,194) | (3,132) |
| Provision for doubtful accounts | 15,804 | 13,173 | 8,458 |
| Loss (gain) on sale of property, plant and equipment | 2,516 | 2,121 | (440) |
| Carrying value reduction of property, plant and equipment and other assets | — | 2,900 | 5,500 |
| Compensation expense for stock option exercises | — | — | 2,600 |
| Changes in assets and liabilities, net of effects of acquisitions: | | | |
| Receivables | 2,904 | (36,523) | (33,720) |
| Inventories | (32,437) | (31,083) | 23,610 |
| Accounts payable and accrued expenses | (57,274) | 57,295 | 29,953 |
| Other assets and prepaid expenses | (16,086) | (7,653) | 1,502 |
| Other liabilities | (5,293) | (1,673) | (2,571) |
| Net cash provided by operating activities | 171,368 | 172,208 | 184,216 |
| Cash flows from investing activities: | | | |
| Proceeds from sale of property, plant and equipment and other assets | — | — | 2,168 |
| Additions to property, plant and equipment | (145,621) | (83,180) | (47,625) |
| Acquisitions | (162,463) | (36,574) | (34,141) |
| Other | — | — | 895 |
| Net cash used in investing activities | (308,084) | (119,754) | (78,703) |
| Cash flows from financing activities: | | | |
| Net change in revolving line of credit | 255,530 | 83,658 | (83,376) |
| Payment of note payable | — | — | (21,200) |
| Payments on term loans | (32,229) | (38,554) | (22,896) |
| Redemption of acquisition indebtedness | (20,917) | (102,201) | — |
| Proceeds from new loan | — | — | 10,661 |
| (Redemption) proceeds from Industrial Revenue Bonds and other, net of payments | (7,779) | 11,329 | 11,593 |
| Change in outstanding checks in excess of cash | 15,479 | (6,486) | (5,841) |
| Dividends paid | — | (24) | (24) |
| Acquisition of treasury stock | (83,986) | — | — |
| Common stock transactions | 8,234 | 1,988 | 4,686 |
| Net cash provided by (used in) financing activities | 134,332 | (50,290) | (106,397) |
| Net change in cash | (2,384) | 2,164 | (884) |
| Cash, beginning of year | 2,384 | 220 | 1,104 |
| Cash, end of year | $ — | 2,384 | 220 |

*See accompanying notes to consolidated financial statements.*

## 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. On November 12, 1998, the Company acquired all of the outstanding capital stock of World Carpets, Inc. ("World") in exchange for 4,900 shares of the Company's common stock ("World Merger"). On November 12, 1998, the Securities and Exchange Commission declared effective a shelf registration statement to register for resale 4,900 shares of Company common stock issued in connection with the World Merger. The historical consolidated financial statements have been restated to give retroactive effect to the World Merger. The World Merger is being accounted for as a pooling-of-interests in the accompanying consolidated financial statements.

On March 9, 1999, the Company acquired all of the capital stock of Durkan Patterned Carpets, Inc. ("Durkan") for 3,150 shares of the Company's common stock ("Durkan Merger"). On April 28, 1999, a shelf registration statement was filed with the Securities and Exchange Commission to register for resale 3,150 shares of the Company's common stock in connection with the Durkan Merger. The historical consolidated financial statements have been restated to give retroactive effect to the Durkan Merger. The Durkan Merger is being accounted for as a pooling-of-interests in the accompanying consolidated financial statements.

The preparation of financial statements in conformity with generally accepted accounting principles 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 and rug manufacturer and sells carpet and rugs throughout the United States principally for residential use. The Company grants credit to customers, most of whom are retail carpet dealers, under credit terms that are customary in the industry.

Revenues are recognized when goods are shipped. 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 and the first-in, first-out (FIFO) method for the remaining 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 25 years for buildings and improvements and 5–7 years for furniture and equipment.

Effective January 1, 2000, the Company changed the estimated useful lives of buildings (25 years to 35 years), tufting equipment (7 years to 10 years), extrusion equipment (7 years to 15 years) and furniture and fixtures (5 years to 7 years). Management believes this change more accurately reflects the actual lives of these assets and is more consistent with industry practice. The prospective change is estimated to reduce annual depreciation expense by approximately $20,000 in 2000.

### (e) *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.

*(f) Earnings per Share ("EPS")*

The Company applies the provisions of Financial Accounting Standards Board ("FASB") FAS 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.

The Company's weighted-average common and dilutive potential common shares outstanding have been adjusted for the 3-for-2 stock split approved by the Board of Directors on October 23, 1997 and paid on December 4, 1997 to holders of record on November 4, 1997, and for the World and Durkan mergers. 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.

*(g) Financial Instruments*

The Company's financial instruments consist primarily of cash, accounts receivable, accounts payable, notes payable and long-term debt. The carrying amount of cash, accounts receivable, accounts payable and notes payable 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, 1999 and 1998 was $605,332 and $384,242, compared to a carrying amount of $596,065 and $377,089, respectively.

*(h) 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.

*(i) Goodwill*

Goodwill arises in connection with business combinations accounted for as purchases. Goodwill is amortized primarily on a straight-line basis over 40 years. Amortization charged to earnings was $2,808 in 1999, $2,437 in 1998 and $2,518 in 1997.

*(j) Impairment of Long-Lived Assets*

The Company accounts for long-lived assets in accordance with the provisions of FAS No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of. Under FAS No. 121, the Company evaluates impairment of long-lived assets on a business unit basis, rather than on an aggregate entity basis, whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. If the sum of the expected future undiscounted cash flows is less than the carrying amount of the asset, an impairment loss is recognized. Measurement of an impairment loss for long-lived assets is based on the fair value of the asset.

*(k) Effect of New Accounting Pronouncement*

In 1997, the FASB issued FAS No. 131, Disclosures about Segments of an Enterprise and Related Information, which supersedes FAS No. 14, Financial Reporting for Segments of a Business Enterprise. This statement, which the Company was required to adopt in fiscal year 1998, requires public companies to report certain financial and descriptive information about their reportable operating segments, including related disclosures about products and services, geographic areas and major customers. The implementation of FAS No. 131 did not have a material effect on the Company's consolidated financial statements.

*(l) Reclassifications*

Certain prior period financial statement balances have been reclassified to conform with the current period's presentation.

*December 31, 1999, 1998 and 1997 (In thousands, except per share data)*

## *Note* 2 ACQUISITIONS

The Company completed its acquisitions of Newmark & James, Inc. and American Weavers LLC on June 30, 1998 and August 10, 1998, respectively. Both of these acquisitions have been accounted for under the purchase method of accounting and their results are included in the Company's 1998 consolidated statement of earnings from the respective dates of acquisition.

On November 12, 1998, the Company acquired all of the outstanding capital stock of World in exchange for 4,900 shares of the Company's common stock. The acquisition of World has been accounted for under the pooling-of-interests basis of accounting and, accordingly, the Company's historical consolidated financial statements have been restated to include the accounts and results of operations of World. The Company incurred before-tax, nonrecurring charges aggregating $20,600 in 1998 related to the World Merger, of which $17,700 of the charge was recorded as non-operating expense and $2,900 of the charge was recorded as a write-down of World computer equipment that was disposed of.

On January 29, 1999, the Company acquired certain assets of Image Industries, Inc. ("Image") for approximately $192,000, including acquisition costs and the assumption of $30,000 of tax-exempt debt. The acquisition was accounted for using the purchase method of accounting and, accordingly, the purchase price was allocated to the assets acquired and liabilities assumed based on the estimated fair values at the date of acquisition. The estimated fair values were $205,366 for assets acquired and $42,903 for liabilities assumed.

The operating results of Image are included in the Company's 1999 consolidated statement of earnings from the date of acquisition. The following unaudited pro forma information presents a summary of consolidated results of operations of the Company and Image for the fiscal years ended December 31, 1999 and 1998, respectively, as if the acquisition had occurred at the beginning of 1998.

| | 1999 | 1998 |
|---|---|---|
| Net sales | $3,099,113 | 2,946,736 |
| Net earnings | $ 156,877 | 119,360 |
| Basic earnings per share | $ 2.63 | 1.98 |
| Diluted earnings per share | $ 2.60 | 1.95 |

On March 9, 1999, the Company acquired all of the outstanding capital stock of Durkan for approximately 3,100 shares of the Company's common stock valued at $116,500 based on the closing price the day the letter of intent was executed. The Durkan acquisition has been accounted for under the pooling-of-interests method of accounting and, accordingly, the Company's historical consolidated financial statements have been restated to include the accounts and results of operations of Durkan.

The results of operations previously reported by the separate enterprises and the combined amounts presented in the accompanying consolidated financial statements are presented below:

| | *Three Months Ended April 3,* 1999 | *Year Ended December 31,* 1998 | *Year Ended December 31,* 1997 |
|---|---|---|---|
| | *(unaudited)* | | |
| Net sales | | | |
| Mohawk | $683,494 | 2,638,820 | 2,327,341 |
| Durkan | 23,673 | 105,800 | 101,744 |
| Combined | $707,167 | 2,744,620 | 2,429,085 |
| Net earnings | | | |
| Mohawk | $ 27,128 | 107,613 | 73,424 |
| Durkan | 764 | 7,641 | 6,139 |
| Combined | $ 27,892 | 115,254 | 79,563 |

Prior to the combination, Durkan's fiscal year ended on February 28. In recording the pooling-of-interests combination, Durkan's financial statements for the year ended December 31, 1999 were combined with Mohawk's consolidated financial statements for the same period. Durkan's financial statements for the years ended February 27, 1999, and February 28, 1998 were combined with Mohawk's financial statements for the years ended December 31, 1998 and 1997, respectively.

*December 31, 1999, 1998 and 1997 (In thousands, except per share data)*

An adjustment has been made to stockholders' equity in the year ended December 31, 1999 to eliminate the effect of including Durkan's results of operations for the two months ended February 28, 1999 in the Company's consolidated financial statements for the years ended December 31, 1999 and 1998. There were no significant intercompany transactions between Mohawk and Durkan prior to the combination.

## *Note* 3 RECEIVABLES

Receivables are as follows:

| | 1999 | 1998 |
|---|---|---|
| Customers, trade | $405,477 | 385,783 |
| Other | 2,826 | 4,378 |
| | 408,303 | 390,161 |
| Less allowance for discounts, returns, claims and doubtful accounts | 70,479 | 58,233 |
| Net receivables | $337,824 | 331,928 |

## *Note* 4 INVENTORIES

The components of inventories are as follows:

| | 1999 | 1998 |
|---|---|---|
| Finished goods | $254,179 | 219,776 |
| Work in process | 65,456 | 60,266 |
| Raw materials | 175,139 | 143,795 |
| Total inventories | $494,774 | 423,837 |

## *Note* 5 PROPERTY, PLANT AND EQUIPMENT

Following is a summary of property, plant and equipment:

| | 1999 | 1998 |
|---|---|---|
| Land | $ 21,767 | 14,320 |
| Buildings and improvements | 236,119 | 177,264 |
| Machinery and equipment | 791,839 | 613,997 |
| Furniture and fixtures | 33,436 | 31,666 |
| Leasehold improvements | 4,854 | 5,085 |
| Construction in progress | 51,645 | 41,576 |
| | 1,139,660 | 883,908 |
| Less accumulated depreciation and amortization | 514,846 | 429,041 |
| Net property, plant and equipment | $ 624,814 | 454,867 |

Property, plant and equipment includes capitalized interest of $3,213, $1,661 and $799 in 1999, 1998 and 1997, respectively.

During 1998, the Company recorded a charge of $2,900 related to a write-down of computer equipment acquired in the World acquisition and disposed of in 1999.

During 1997, the Company recorded a charge of $5,500 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.

## *Note* 6 OTHER ASSETS

The components of other assets are summarized below:

| | 1999 | 1998 |
|---|---|---|
| Goodwill, net of accumulated amortization of $13,171 and $10,363, respectively | $113,560 | 85,972 |
| Other assets | 10,089 | 17,712 |
| Total other assets | $123,649 | 103,684 |

## *Note* 7 LONG-TERM DEBT

On November 23, 1999, the Company amended and restated its credit agreement to provide 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%. Additionally, the termination date of the credit agreement was extended to January 28, 2004. At December 31, 1999, the Company had credit availability of $450,000 under its revolving credit line and $45,000 under various short-term uncommitted credit lines. At December 31, 1999, a total of $110,548 was unused under these lines. 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.

*December 31, 1999, 1998 and 1997 (In thousands, except per share data)*

Long-term debt consists of the following:

| | 1999 | 1998 |
|---|---|---|
| Revolving line of credit, due January 28, 2004 | $384,452 | 128,922 |
| Durkan term loans, interest payable at prime or LIBOR plus 1.5% to 3%, payable in monthly installments of $207 | — | 11,696 |
| Durkan revolving line of credit, interest payable at LIBOR plus 1.25% to 2.75%, due November 1999 | — | 3,277 |
| Note payable to Durkan officer, interest payable at 8.5%, due February 2000 | — | 5,400 |
| 8.46% senior notes, payable in annual principal installments beginning in 1998, due September 16, 2004, interest payable quarterly | 71,429 | 85,714 |
| 7.14%–7.23% senior notes, payable in annual principal installments beginning in 1997, due September 1, 2005, interest payable semiannually | 56,666 | 66,111 |
| 8.48% term loans, payable in annual principal installments, due October 26, 2002, interest payable quarterly | 17,143 | 22,857 |
| 7.58% senior notes, payable in annual principal installments beginning in 1997, due July 30, 2003, interest payable semiannually | 5,714 | 7,143 |
| 6% term note, payable in annual principal and interest installments beginning in 1998, due July 23, 2004 | 6,679 | 8,014 |
| Industrial Revenue Bonds and other | 53,982 | 37,955 |
| Total long-term debt | 596,065 | 377,089 |
| Less current portion | 33,961 | 44,424 |
| Long-term debt, excluding current portion | $562,104 | 332,665 |

The aggregate maturities of long-term debt as of December 31, 1999 are as follows:

| | |
|---|---|
| 2000 | $ 33,961 |
| 2001 | 33,593 |
| 2002 | 33,396 |
| 2003 | 27,179 |
| 2004 | 409,546 |
| Thereafter | 58,390 |
| | $596,065 |

## *Note* 8 ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses are as follows:

| | 1999 | 1998 |
|---|---|---|
| Outstanding checks in excess of cash | $ 42,373 | 26,897 |
| Accounts payable, trade | 159,812 | 159,966 |
| Accrued expenses | 83,253 | 126,023 |
| Accrued compensation | 54,954 | 51,151 |
| Total accounts payable and accrued expenses | $340,392 | 364,037 |

## *Note* 9 STOCK OPTIONS, STOCK COMPENSATION AND TREASURY STOCK

Under the Company's 1992 and 1993 stock option plans, options may be granted to directors and key employees through 2002 and 2003 to purchase a maximum of 2,250 and 675 shares of common stock, respectively. During 1999, options to purchase 20 and 356 shares, respectively, were granted under these 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.

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 nonemployee directors to receive in lieu of cash for their annual retainers. During 1999, a total of 3 shares were awarded to the non-employee directors under the plan.

During 1997, the Board of Directors adopted the 1997 Long-Term Incentive Plan whereby the Company reserved 2,550 shares of common stock for issuance in connection with options and awards. During 1999, a total of 433 shares were awarded to employees under this plan.

*December 31, 1999, 1998 and 1997 (In thousands, except per share data)*

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

| | 1999 | 1998 | 1997 |
|---|---|---|---|
| Options outstanding at beginning of year | 1,387 | 1,568 | 2,142 |
| Options granted | 809 | 174 | 65 |
| Options exercised | (124) | (316) | (460) |
| Options canceled | (29) | (39) | (179) |
| Options outstanding at end of year | 2,043 | 1,387 | 1,568 |
| Options exercisable at end of year | 873 | 686 | 742 |
| Option prices per share: | | | |
| Options granted during the year | $19.69–35.13 | 17.23–32.31 | 5.67–19.38 |
| Options exercised during the year | $ 5.67–19.17 | 5.67–19.38 | 0.02–19.17 |
| Options canceled during the year | $ 9.33–35.13 | 5.67–31.94 | 5.67–19.17 |
| Options outstanding at end of year | $ 5.61–35.13 | 5.61–32.31 | 5.61–19.38 |

A charge of $2,600 was recorded in the fourth quarter of 1997 for income tax reimbursements to be made to certain executives for the exercise of stock options. The income tax reimbursements were recorded in connection with stock options granted in 1988 and 1989 related to the Company's 1988 leveraged buyout. The agreements allowed the Company to receive an income tax benefit on its tax return for the tax effect of the taxable compensation provided to the individuals upon the exercise of these options. Such income tax benefit resulted in a direct increase in stockholders' equity of $7,606 in 1996 primarily from the exercise of these options.

As allowed under FAS No. 123, the Company accounts for stock options granted as prescribed under Accounting Principles Board Opinion No. 25, which recognizes compensation cost based upon the intrinsic value of the award. Accordingly, no compensation expense has been recognized in the consolidated statement of earnings for any stock options granted in 1999, 1998 and 1997. The following table represents pro forma net income and pro forma earnings per share had the Company elected to account for stock option grants using the fair value based method.

| | 1999 | 1998 | 1997 |
|---|---|---|---|
| Net income | | | |
| As reported | $157,239 | 115,254 | 79,563 |
| Pro forma | 155,282 | 114,411 | 78,898 |
| Net income per common share (basic) | | | |
| As reported | $ 2.63 | 1.91 | 1.33 |
| Pro forma | 2.60 | 1.89 | 1.32 |
| Net income per common share (diluted) | | | |
| As reported | $ 2.61 | 1.89 | 1.32 |
| Pro forma | 2.57 | 1.87 | 1.31 |

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 1999, 1998 and 1997 was $15.28, $17.24 and $9.41, respectively. This fair value was estimated using the Black-Scholes option pricing model based on a weighted-average market price at grant date of $26.48 in 1999, $30.44 in 1998 and $17.03 in 1997 and the following weighed-average assumptions:

| | 1999 | 1998 | 1997 |
|---|---|---|---|
| Dividend yield | — | — | — |
| Risk-free interest rate | 6.4% | 4.7% | 6.2% |
| Volatility | 46.7% | 48.9% | 45.0% |
| Expected life (years) | 7 | 7 | 7 |

Summarized information about stock options outstanding and exercisable at December 31, 1999 is as follows:

| | *Outstanding* | | | *Exercisable* | |
|---|---|---|---|---|---|
| *Exercise Price Range* | *Number of Shares* | *Average Life*(1) | *Average Price*(2) | *Number of Shares* | *Average Price*(2) |
| Under $11.00 | 741 | 5.56 | $10.54 | 538 | 10.29 |
| $12.00 to 17.00 | 204 | 4.63 | 14.40 | 189 | 14.49 |
| $17.00 to 19.69 | 531 | 8.38 | 19.49 | 118 | 19.03 |
| $19.94 to 31.94 | 276 | 8.97 | 29.06 | 25 | 31.11 |
| $32.00 to 36.00 | 291 | 9.11 | 34.93 | 3 | 32.31 |
| Total | 2,043 | | | 873 | |

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

*(2) Weighted-average exercise price.*

*December 31, 1999, 1998 and 1997 (In thousands, except per share data)*

The Company's Board of Directors approved a stock repurchase plan in September 1999, whereby the Company's management was authorized to purchase up to 5,000 common shares. In December 1999 it amended the plan to increase the shares authorized for purchase by an additional 5,000 shares, bringing the total authorized repurchase up to 10,000 shares of its outstanding common shares. For the year ended December 31, 1999, a total of 3,952 shares of the Company's common stock had been purchased at an aggregate cost of $83,986. All of this repurchase has been financed through the Company's operations and revolving line of credit.

## *Note* 10 EMPLOYEE BENEFIT PLANS

The Company has a 401(k) retirement savings plan (the "Plan") open to substantially all of its employees who have completed one year 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. The Company amended the Plan during 1999 to match an additional $0.25 for every $1.00 of employee contributions in excess of 4% of the employee's salary up to a maximum of 6%. This change is effective January 1, 2000. Employee and employer contributions to the Plan were $14,873 and $5,080 in 1999, $12,345 and $4,213 in 1998, and $9,334 and $3,075 in 1997, respectively. The Company also made a discretionary contribution to the Plan of $2,100 during the year.

A portion of the employees who were not eligible to participate in the Plan participated in a defined contribution profit-sharing plan through June 1997. After June 1997, the employee balances in the profit-sharing plan were rolled over into the 401(k) retirement savings plan. Contributions were discretionary and the Company expensed $991 for the year ended December 31, 1997.

The World Carpet Savings Retirement Plan (the "World Plan"), a defined contribution 401(k) plan covering substantially all World employees, was merged into the Plan on March 1, 1999. Employees were eligible to participate upon completion of one year of service. Under the terms of the World Plan, World would match employee contributions up to a maximum of 2% of the employee's salary, and employees vested in the contributions based on years of credited service. For the years ended December 31, 1999, 1998 and 1997, the Company contributed approximately $142, $703 and $698, respectively, to the World Plan.

Durkan maintains a 401(k) retirement savings plan (the "Durkan Plan") open to substantially all Durkan employees. Durkan contributes $0.50 for every $1.00 of employee contributions up to a maximum of 6% of eligible wages. For the years ended December 31, 1999, 1998 and 1997, Durkan contributed approximately $343, $328 and $265, respectively, to the Durkan Plan.

## *Note* 11 INCOME TAXES

Income tax expense attributable to earnings before income taxes for the years ended December 31, 1999, 1998 and 1997 consists of the following:

| | *Current* | *Deferred* | *Total* |
|---|---|---|---|
| 1999: | | | |
| U.S. federal | $ 92,736 | (1,928) | 90,808 |
| State and local | 12,104 | (252) | 11,852 |
| | $104,840 | (2,180) | 102,660 |
| 1998: | | | |
| U.S. federal | $ 75,985 | (11,485) | 64,500 |
| State and local | 17,761 | (2,709) | 15,052 |
| | $ 93,746 | (14,194) | 79,552 |
| 1997: | | | |
| U.S. federal | $ 45,921 | (2,540) | 43,381 |
| State and local | 9,077 | (592) | 8,485 |
| | $ 54,998 | (3,132) | 51,866 |

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:

| | 1999 | 1998 | 1997 |
|---|---|---|---|
| Computed "expected" tax expense | $ 90,965 | 68,182 | 46,000 |
| State and local income taxes, net of federal income tax benefit | 7,704 | 9,784 | 4,810 |
| Amortization of goodwill | 684 | 746 | 472 |
| Other, net | 3,307 | 840 | 584 |
| | $102,660 | 79,552 | 51,866 |

*December 31, 1999, 1998 and 1997 (In thousands, except per share data)*

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 1999 and 1998 are presented below:

| | 1999 | 1998 |
|---|---|---|
| Deferred tax assets: | | |
| Accounts receivable | $ 21,621 | 17,860 |
| Inventories | 15,533 | 12,381 |
| Accrued expenses | 41,366 | 39,442 |
| Gross deferred tax assets | 78,520 | 69,683 |
| Deferred tax liabilities: | | |
| Plant and equipment | (47,138) | (43,428) |
| Prepaid expenses | (1,892) | (219) |
| Other | (6,645) | (4,493) |
| Gross deferred tax liabilities | (55,675) | (48,140) |
| Net deferred tax assets | $ 22,845 | 21,543 |

Based upon the level of historical and projected taxable income over periods in which the deferred tax assets are deductible, the Company's management believes it is more likely than not the Company will realize the benefits of these deductible differences at December 31, 1999.

## *Note* 12 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 noncancelable capital and operating leases (with initial or remaining lease terms in excess of one year) at December 31, 1999 are:

| | *Capital Leases* | *Operating Leases* | *Total Future Payments* |
|---|---|---|---|
| 2000 | $2,009 | 30,168 | 32,177 |
| 2001 | 1,432 | 24,979 | 26,411 |
| 2002 | 1,223 | 19,926 | 21,149 |
| 2003 | 647 | 15,188 | 15,835 |
| 2004 | — | 10,797 | 10,797 |
| Thereafter | — | 20,118 | 20,118 |
| Total payments | $5,311 | 121,176 | 126,487 |
| Less amount representing interest | 608 | | |
| Present value of capitalized lease payments with a weighted interest rate of 7.85% | $4,703 | | |

The Company assumed several capitalized leases from recent acquisitions for machinery and equipment, at a cost of $8,899 for both periods ended December 31, 1999 and 1998. The amortization of these capital leases is included in depreciation expense. Accumulated amortization was $3,619 at December 31, 1999 and $2,547 at December 31, 1998.

Rental expense under operating leases was $28,407, $27,347 and $20,970 in 1999, 1998 and 1997, respectively.

In December 1995, the Company and four other carpet manufacturers were added as defendants in a purported class action lawsuit, In re Carpet Antitrust Litigation, pending in the United States District Court for the Northern District of Georgia, Rome Division. The amended complaint alleges price-fixing regarding polypropylene products in violation of Section One of the Sherman Act. In September 1997, the Court determined that the plaintiffs met their burden of establishing the requirements for class certification and granted the plaintiffs' motion to certify the class. The Company is a party to two consolidated lawsuits captioned Gaehwiler v. Sunrise Carpet Industries, Inc. et al. and Patco Enterprises, Inc. v. Sunrise Carpet Industries, Inc. et al., both of which were filed in the Superior Court of the State of California, City and County of San Francisco, in 1996. Both complaints were brought on behalf of a purported class of indirect purchasers of carpet in the State of California and seek damages for alleged violations of California antitrust and unfair competition laws. The complaints filed do not specify any amount of damages but do request for any unlawful conduct to be enjoined and treble damages plus reimbursement for fees and costs. In October 1998, two plaintiffs, on behalf of an alleged class of purchasers of nylon carpet products, filed a complaint in the United States District Court for the Northern District of Georgia against the Company and two of its subsidiaries, as well as a competitor and one of its subsidiaries. The complaint alleges that the Company acted in concert with other carpet manufacturers to restrain competition in the sale of certain nylon carpet products. The Company has filed an answer, denied the allegations in the complaint and set forth its defenses. In February 1999, a similar complaint was filed in the Superior Court of the State of California, City and County of

*December 31, 1999, 1998 and 1997 (In thousands, except per share data)*

San Francisco, on behalf of a purported class based on indirect purchases of nylon carpet in the State of California and alleges violations of California antitrust and unfair competition laws. The complaints described above do not specify any specific amount of damages but do request injunctive relief and treble damages plus reimbursement for fees and costs. The Company believes it has meritorious defenses and intends to vigorously defend against these actions.

## *Note* 13 CONSOLIDATED STATEMENTS OF CASH FLOWS INFORMATION

Supplemental disclosures of cash flow information are as follows:

| | 1999 | 1998 | 1997 |
|---|---|---|---|
| Net cash paid during the year for: | | | |
| Interest | $ 37,740 | 30,852 | 37,849 |
| Income taxes | $120,371 | 75,640 | 55,882 |

## *Note* 14 QUARTERLY FINANCIAL DATA (UNAUDITED)

The supplemental quarterly financial data are as follows:

| *Quarters Ended* | *April 3,* 1999 | *July 3,* 1999 | *October 2,* 1999 | *December 31,* 1999 |
|---|---|---|---|---|
| Net sales | $707,167 | 790,617 | 809,933 | 775,547 |
| Gross profit | 178,329 | 200,911 | 203,246 | 194,373 |
| Net earnings | 27,892 | 44,093 | 45,079 | 40,175 |
| Basic earnings per share | 0.46 | 0.73 | 0.74 | 0.70 |
| Diluted earnings per share | 0.46 | 0.72 | 0.74 | 0.70 |

| *Quarters Ended* | *March 28,* 1998 | *June 27,* 1998 | *September 26,* 1998 | *December 31,* 1998 |
|---|---|---|---|---|
| Net sales | $589,473 | 689,488 | 718,772 | 746,887 |
| Gross profit | 136,389 | 177,606 | 177,762 | 189,530 |
| Net earnings | 17,135 | 35,947 | 37,060 | 25,112 |
| Basic earnings per share | 0.28 | 0.60 | 0.61 | 0.42 |
| Diluted earnings per share | 0.28 | 0.59 | 0.61 | 0.41 |

# Independent Auditors' 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, 1999 and 1998, and the related consolidated statements of earnings, stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 1999. 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 did not audit the consolidated statements of operations and cash flows of World Carpets, Inc. and Subsidiary, a wholly owned subsidiary, for the year ended June 28, 1998, which statements of operations and cash flows have been combined with those of Mohawk Industries, Inc. and subsidiaries for the year ended December 31, 1997. The consolidated statement of operations of World Carpets, Inc. and Subsidiary reflects total net sales constituting 18 percent for the year ended December 31, 1997, of the related consolidated total. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for World Carpets, Inc. and Subsidiary, is based solely on the report of the other auditors.

We conducted our audits in accordance with generally accepted auditing standards. 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 and the report of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of other auditors, 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, 1999 and 1998, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 1999, in conformity with generally accepted accounting principles.

KPMG LLP

Atlanta, Georgia
February 11, 2000

# 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 generally accepted accounting principles. 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 control structure to assure itself of the reliability of the financial statements. The internal control structure is 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 generally accepted accounting principles. 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.

David L. Kolb
Chairman and
Chief Executive Officer

John D. Swift
Chief Financial Officer

### CORPORATE HEADQUARTERS

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

### INDEPENDENT AUDITORS

KPMG LLP
Atlanta, Georgia

### CORPORATE COUNSEL

Alston & Bird LLP
Atlanta, Georgia

### TRANSFER AGENT AND REGISTRAR

First Union National Bank
Corporate Trust Client Services
1525 West W.T. Harris Blvd.
Charlotte, North Carolina 28288-1153
(704) 590-7382

### PUBLICATIONS

The Company's Annual Report, Proxy Statement, Form 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. 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.

### 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 18, 2000 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

| 1999 | *High* | *Low* |
|---|---|---|
| First quarter | $42.00 | 25.94 |
| Second quarter | 38.56 | 28.19 |
| Third quarter | 30.44 | 18.38 |
| Fourth quarter | 26.81 | 19.69 |

| 1998 | | |
|---|---|---|
| First quarter | $33.50 | 20.50 |
| Second quarter | 35.50 | 28.44 |
| Third quarter | 34.94 | 22.63 |
| Fourth quarter | 42.44 | 22.69 |

### COMMON STOCKHOLDERS OF RECORD

As of February 28, 2000, there were 467 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 Industries, Inc. is an equal opportunity employer.

♻ Printed on recycled paper.

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Mohawk Industries, Inc.

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