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AT OR FOR THE YEARS ENDED DECEMBER 31,  
IN THOUSANDS, EXCEPT PER SHARE DATA

**2003**2002<sup>(h)</sup>**Statement of Earnings Data:**

Net sales	\$5,005,053	4,522,336
Cost of sales	3,645,677	3,282,269
Gross profit	1,359,376	1,240,067
Selling, general and administrative expenses	817,347	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	542,029	522,065
Interest expense <sup>(e)</sup>	55,575	68,972
Acquisition costs—World Merger <sup>(f)</sup>	–	–
Other (income) expense, net	(1,980)	9,464
	53,595	78,436
Earnings before income taxes	488,434	443,629
Income taxes	178,285	159,140
Net earnings	\$ 310,149	284,489
Basic earnings per share <sup>(g)</sup>	\$ 4.68	4.46
Weighted-average common shares outstanding <sup>(g)</sup>	66,251	63,723
Diluted earnings per share <sup>(g)</sup>	\$ 4.62	4.39
Weighted-average common and dilutive potential common shares outstanding <sup>(g)</sup>	67,121	64,861

**Balance Sheet Data:**

Working capital	\$ 646,483	640,846
Total assets	4,163,575	3,596,743
Short-term note payable	–	–
Long-term debt (including current portion)	1,012,413	820,427
Stockholders' equity	2,297,801	1,982,879

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

(b) During 1996, the Company recorded a charge of \$3.1 million arising from the write-down of property, plant and equipment to be disposed of related to the closing of a manufacturing facility in 1996 and a revision in the estimate of fair value of certain property, plant and equipment based on current market conditions related to mill closings in 1995. During

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

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

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 intangibles for impairment.

**OVERVIEW**

The Company is the leading producer of floorcovering products for residential and commercial applications in the United States. The Company is the second largest carpet and rug manufacturer, and a leading manufacturer, marketer and distributor of ceramic tile and natural stone, in the United States. Annual floorcovering sales within the United States in 2002 were approximately \$20.3 billion. The Company had annual net sales in 2003 in excess of \$5.0 billion.

The primary categories of the floorcovering industry include carpet and rugs (65%), ceramic tile (12%), vinyl and rubber (10%), 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 2002 have met or 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 3.6% for carpet and rugs, 10.3% for ceramic tile, 1.3% for vinyl and rubber and 8.0% for hardwood. Laminate, which is a relatively new product, experienced a compound average growth rate of 41.5% from 1996 through 2002. 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 provided a unique opportunity to help the Company achieve its strategic goal of becoming one of the world's leading floorcovering manufacturers and distributors.

The Company continues to experience growth both internally and through acquisitions.

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

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

The Company has two operating segments, the Mohawk segment and the Dal-Tile segment. The Mohawk segment sells and distributes its product lines, which include broadloom carpet, rugs, pad, ceramic tile, hardwood, vinyl and laminate through independent floor covering retailers, home centers, mass merchandisers, department stores, commercial dealers and commercial end users. The Dal-Tile segment product lines include ceramic tile, porcelain tile and stone products sold through company-operated sales service centers, independent distributors and home centers.

**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 revenues and 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.

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 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 and legal title passes to the customer. The Company provides allowances for expected cash discounts, returns, claims and doubtful accounts based upon historical bad debt and claims experience and periodic evaluation of specific customer accounts and the aging of accounts receivable. If the financial condition of the Company’s customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.
- Inventories are stated at the lower of cost or market (net realizable value). Cost is determined using the last-in, first-out method (LIFO) 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 and anticipated future selling price, in order to evaluate obsolescence and excessive quantities, and expected sales below cost. Actual results could differ from assumptions used to value obsolete, excessive inventory or inventory expected to be sold below cost and additional reserves may be required.

- Goodwill and indefinite life intangible assets are subject to annual impairment testing. The impairment tests are based on determining the fair value of the specified reporting units and indefinite life intangible assets based on management judgments and assumptions using estimated future cash flows. These judgments and assumptions could materially change the value of the specified reporting units and indefinite life intangible assets and, therefore, could materially impact the Company’s consolidated financial statements.
- 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**

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

AT OR FOR THE YEARS ENDED DECEMBER 31,	<b>2003</b>				2002				2001	
IN THOUSANDS										
<b>Statement of Earnings Data:</b>										
Net sales	\$5,005,053	100.0%	4,522,336	100.0%	3,445,945	100.0%				
Cost of sales	3,645,677	72.8%	3,282,269	72.6%	2,613,043	75.8%				
Gross profit	1,359,376	27.2%	1,240,067	27.4%	832,902	24.2%				
Selling, general and administrative expenses	817,347	16.3%	718,002	15.9%	505,745	14.7%				
Operating income	542,029	10.9%	522,065	11.5%	327,157	9.5%				
Interest expense	55,575	1.1%	68,972	1.5%	29,787	0.9%				
Other (income) expense, net	(1,980)	0.0%	9,464	0.2%	5,954	0.2%				
	53,595	1.1%	78,436	1.7%	35,741	1.1%				
Earnings before income taxes	488,434	9.8%	443,629	9.8%	291,416	8.4%				
Income taxes	178,285	3.6%	159,140	3.5%	102,824	3.0%				
Net earnings	\$ 310,149	6.2%	284,489	6.3%	188,592	5.4%				

During 2003, specifically the first half of 2003, the Company and industry performance as a whole was impacted negatively by the overall weak conditions in the U.S. economy and cautious consumer and commercial spending. The Company believes that the residential replacement business is recovering in response to improved economic conditions. The Company believes that the commercial business is also beginning to show signs of improvement at certain price points and anticipates the higher end business will improve later in 2004. The Company is implementing a price increase in both the Mohawk and Dal-Tile segment during the first quarter of 2004 to compensate for increased raw material prices, resulting from higher oil and natural gas prices and higher import prices.

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

Net sales for the year ended December 31, 2003, were \$5,005.1 million, reflecting an increase of \$482.7 million, or approximately 10.7%, over the \$4,522.3 million reported in the year ended December 31, 2002. The increased net sales were attributable to the acquisition of Dal-Tile and Lees Carpet and internal growth. The Mohawk segment

recorded net sales of \$3,736.5 million in 2003 compared to \$3,624.2 million in 2002, representing an increase of \$112.4 million or approximately 3.1%. The growth was attributable to the Lees Carpet acquisition and internal growth of product lines. The Dal-Tile segment recorded net sales of \$1,268.5 million in 2003, reflecting an increase of \$370.4 million or 41.2%, over the \$898.2 million reported in the year ended December 31, 2002. The Dal-Tile results are not included in the Company's consolidated financial statements prior to the March 20, 2002 acquisition. However, when the Dal-Tile net sales for the year ended December 31, 2003, are compared to the Dal-Tile pro forma net sales of \$1,134.2 million for the year ended December 31, 2002 (derived by combining Dal-Tile net sales of \$236.0 million prior to the March 20, 2002 acquisition date, after reclassifications to conform to Mohawk's presentation, with reported Dal-Tile net sales of \$898.2 million for the period ending December 31, 2002), an increase of approximately 11.8% for the period was realized. The growth was primarily attributable to growth within residential products. The Company believes this pro forma net sales information will be useful to investors because it allows investors to compare the results of the two periods.

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

	2003	2002	CHANGE
First quarter	\$1,084,715	866,710	25.2%
Second quarter	1,247,181	1,227,747	1.6
Third quarter	1,303,166	1,224,403	6.4
Fourth quarter	1,369,991	1,203,476	13.8
Total year	\$5,005,053	4,522,336	10.7%

Gross profit was \$1,359.4 million (27.2% of net sales) for 2003 and \$1,240.1 million (27.4% of net sales) for 2002. The reduction in percentage was primarily attributable to a change in the selling mix, increased raw material prices resulting from higher oil and natural gas prices, higher import prices and start up costs related to the new Dal-Tile manufacturing facility.

Selling, general and administrative expenses for 2003 were \$817.3 million (16.3% of net sales) compared to \$718.0 million (15.9% of net sales) for 2002. The increased percentage was primarily attributable to the acquisition of Dal-Tile, which has higher selling, general and administrative expenses.

Operating income for 2003 was \$542.0 million (10.9% of net sales) compared to \$522.1 million (11.5% of net sales) in 2002. Operating income attributable to the Mohawk segment was \$364.0 million (9.7% of segment net sales) in 2003 compared to \$390.9 million (10.8% of segment net sales) in 2002. The percentage decrease in operating income was attributable to the higher costs associated with oil and natural gas prices and a change in the selling mix. Operating income attributable to the Dal-Tile segment was \$187.2 million (14.8% of segment net sales) in 2003, compared to \$139.9 million (15.6% of segment net sales) in 2002. The decrease in operating income as a percentage of net sales is primarily attributable to a change in the product mix, higher import prices and start-up costs of a new manufacturing facility. On a pro forma combined basis, the Dal-Tile segment operating income was \$171.7 million (15.1% of pro forma segment net sales) for 2002 (derived by combining Dal-Tile operating income of \$31.8 million prior to the March 20, 2002 acquisition, after reclassifications to conform to Mohawk's presentation, with reported Dal-Tile operating income of \$139.9 million for the period ended December 31, 2002). The Company believes that presentation of this pro forma combined operating income information will be useful to investors because it allows investors to compare the results between the two periods.

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

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

#### 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. On a pro forma combined basis, the Dal-Tile segment net sales were \$1,134.2 million (derived by combining Dal-Tile net sales of \$236.0 million prior to the March 20, 2002 acquisition date, after reclassifications to conform to Mohawk's presentation, with reported Dal-Tile net sales of \$898.2 million for the period ending December 31, 2002) for 2002. This compares to Dal-Tile net sales of \$1,036.8 million (derived from net sales prior to the March 20, 2002, acquisition) for 2001, resulting in an increase of approximately 9.4% for the period. The growth was primarily attributable to growth within residential products. The Company believes this pro forma net sales information will be useful to investors because it allows investors to compare the results of the two periods.

Quarterly net sales and the percentage changes in net sales by quarter for 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	\$4,522,336	3,445,945	31.2%

Gross profit was \$1,240.1 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 \$522.1 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 \$390.9 million (10.8% 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. On a pro forma combined basis, the Dal-Tile segment operating income was \$171.7 million (15.1% of pro forma segment net sales) for 2002 (derived by combining Dal-Tile operating income of \$31.8 million prior to the March 20, 2002 acquisition, after reclassifications to conform to Mohawk's presentation, with reported Dal-Tile operating income of \$139.9 million for the period ended December 31, 2002). This compares to Dal-Tile operating income of \$154.6 million (14.9% of Dal-Tile net sales) for 2001. The Company believes that presentation of this pro forma combined operating income information will be useful to investors because it allows investors to compare the results between the two periods.

Interest expense for 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.

#### 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 \$501.1 million at the beginning of 2003 to \$573.5 million at December 31, 2003. The \$72.4 million increase was primarily attributable to the acquisition of Lees Carpet and internal sales growth. Inventories increased from \$678.0 million at the beginning of 2003 to \$832.4 million at December 31, 2003, due primarily to building inventory for hard surface product categories within the Mohawk and Dal-Tile segments and the acquisition of Lees Carpet.

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 acquisitions, capital expenditures totaled \$114.6 million during 2003. The capital expenditures made during 2003 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 \$1,101.8 million for acquisitions, have totaled \$1,381.2 million over the past three years. The Company's capital spending during 2004, excluding acquisitions, is expected to range from \$140 million to \$160 million, and will be used primarily to purchase equipment to increase production capacity and productivity.

On September 30, 2003, the Company entered into a new revolving line of credit agreement providing up to \$300 million with interest rates of either (i) LIBOR plus 0.4% to 1.5%, depending upon the Company's performance measured against certain financial ratios, or (ii) the base



rate plus 0-0.6% depending upon the Company's performance measured against certain financial ratios. The new facility replaces a \$450 million facility that was due to expire in January 2004. The facility is comprised of two tranches, a \$200 million tranche expiring in September 2008 and a \$100 million tranche expiring in September 2004. The \$100 million tranche of the facility is renewable annually. The credit agreement contains customary financial and other covenants. The Company must pay an annual facility fee ranging from .15% to .50% of the total credit commitment, depending upon the Company's performance measured against specific coverage ratios, under the revolving credit line. Additionally, at December 31, 2003, the Company had credit facilities of \$300 million under its revolving credit facility and \$50 million under various short-term uncommitted credit lines. At December 31, 2003, a total of \$237.3 million was unused under the combined revolving credit facility and uncommitted credit lines. The revolving credit facility and uncommitted lines of credit are unsecured.

In connection with the Dal-Tile acquisition during 2002, the Company entered into a 364-day term loan facility (the "Bridge Facility") 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 \$90 million under the Company's revolving credit facility. On June 13, 2002, the Company exchanged \$295 million of its registered 6.50% senior notes due 2007, Series C for an equal amount of its Series A senior notes and \$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.

On August 4, 2003, the Company entered into an on-balance sheet trade accounts receivable securitization agreement ("Securitization Facility") replacing two previous facilities that were due to expire in October 2003. The Securitization Facility allows the Company to borrow up to \$350 million based on available accounts receivable. The Company sells, on a non-recourse revolving basis, its accounts receivable to a special purpose entity, which in turn obtains loan advances that are secured by the receivable pool from a third-party commercial paper conduit sponsored by financial institutions. The Securitization Facility is subject to annual renewal. At December 31, 2003, the Company had approximately \$182 million outstanding secured by approximately \$649.0 million of trade receivables.

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, 2003, a total of approximately 593,000 shares of the Company's common stock were purchased at an aggregate cost of approximately \$27.8 million. Since the inception of the program, a total of approximately 11 million shares have been repurchased at an aggregate cost of approximately \$293.1 million. All of these repurchases have been financed through the Company's operations and banking arrangements.

The Company believes that the combined total of the revolving credit facility, short-term uncommitted credit lines and the Securitization Facility of \$700 million is adequate to support its capital and working capital requirements.

The following is a summary of the Company's future minimum payments under contractual obligations as of December 31, 2003 (in thousands):

	PAYMENTS DUE BY PERIOD						TOTAL
	2004	2005	2006	2007	2008	THEREAFTER	
Long-term debt	\$248,795	9,445	6,500	300,000	—	447,673	1,012,413
Operating leases	72,857	57,202	44,517	31,183	22,602	45,363	273,724
Purchase commitments <sup>(1)</sup>	66,481	48,968	48,000	48,000	48,000	—	259,449
	<u>\$388,133</u>	<u>115,615</u>	<u>99,017</u>	<u>379,183</u>	<u>70,602</u>	<u>493,036</u>	<u>1,545,586</u>

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

**RECENT ACCOUNTING PRONOUNCEMENTS**

In January 2003, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 46 ("FIN 46"), "*Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51,*" which addresses consolidation by business enterprises of variable interest entities ("VIEs") either: (1) that do not have sufficient equity investment at risk to permit the entity to finance its activities without additional subordinated financial support, or (2) in which the equity investors lack an essential characteristic of a controlling financial interest. In December 2003, the FASB issued modifications to FIN 46 ("Revised Interpretations") resulting in multiple effective dates based on the nature as well as the creation date of the VIE. VIEs created after January 31, 2003, but prior to January 1, 2004, may be accounted for either based on the original interpretation or the Revised Interpretations. However, the Revised Interpretations must be applied no later than the first quarter of 2004. VIEs created after January 1, 2004, must be accounted for under the Revised Interpretations. Non-Special Purpose Entities created prior to February 1, 2003, should be accounted for under the revised interpretation's provisions no later than the first quarter of fiscal 2004. The Company has adopted FIN 46, which did not have, and does not expect the Revised Interpretations to have, a material impact on 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 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 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 which are cyclical in nature. A prolonged decline in residential or commercial construction activity could have a material adverse effect on the Company's business.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

#### **FORWARD-LOOKING INFORMATION**

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

**QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Financial exposures are managed as an integral part of the Company's risk management program, which seeks to reduce the potentially adverse effect that the volatility of the 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.

**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, 2003, the Company had natural gas contracts that mature from January 2004 to December 2004 with an aggregate notional amount of approximately 3.9 million MMBTU's. The fair value of these contracts was an asset of \$3.6 million. At December 31, 2002, the Company had natural gas contracts outstanding with a notional amount of approximately 1.4 million MMBTU's. The fair value of these contracts was an asset of \$1.9 million. The offset to these assets is recorded in other comprehensive income, net of applicable income taxes.

The Company's natural gas long-term supply agreements are accounted for under the normal purchases provision within SFAS No. 133 and its amendments. At December 31, 2003, the Company has normal purchase commitments of approximately 3.1 million MMBTU's for periods maturing from January 2004 through September 2005. The contracted value of these commitments was approximately \$13.8 million and the fair value of these commitments was approximately \$17.0 million, at December 31, 2003. At December 31, 2002, the Company had normal purchase commitments of approximately 4.6 million MMBTU's. The contracted value of these commitments was approximately \$17.4 million and the fair value of these commitments was approximately \$19.7 million.

**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 U.S. currency. Gains and losses are recognized in cost of goods sold in the same period or periods during which the hedged transaction affects earnings. Accordingly, these contracts have been designated as cash flow hedges. The Company had forward contracts to purchase approximately 145.3 million and 357.5 million Mexican pesos at December 31, 2003 and 2002, respectively. The aggregate U.S. Dollar value of these contracts at December 31, 2003 and 2002 was approximately \$12.7 million and \$34.6 million, respectively. The contracts are marked to market in other current liabilities with the offset to other comprehensive income, net of applicable income taxes. Unrealized losses at December 31, 2003 and 2002 respectively, were not significant.

**INTEREST RATE MANAGEMENT**

In 2002, the Company determined that its \$100 million interest rate swap was ineffective. Consequently, the \$10.7 million unrealized loss associated with the swap was recorded as a realized loss in interest expense during the fourth quarter of 2002. The Company continues to carry the liability on its consolidated balance sheets, and the interest rate swap is marked to market at the end of each reporting period. The change in fair value for the year ended December 31, 2003, was not significant.



**Gross Profit**  
(In millions)

**Operating Income**  
(In millions)

YEARS ENDED DECEMBER 31, IN THOUSANDS, EXCEPT PER SHARE DATA	2003	2002	2001
Net sales	\$5,005,053	4,522,336	3,445,945
Cost of sales	3,645,677	3,282,269	2,613,043
Gross profit	1,359,376	1,240,067	832,902
Selling, general and administrative expenses	817,347	718,002	505,745
Operating income	542,029	522,065	327,157
Other expense (income):			
Interest expense	55,575	68,972	29,787
Other expense	6,252	13,455	7,780
Other income	(8,232)	(3,991)	(1,826)
	53,595	78,436	35,741
Earnings before income taxes	488,434	443,629	291,416
Income taxes	178,285	159,140	102,824
Net earnings	\$ 310,149	284,489	188,592
Basic earnings per share	\$ 4.68	4.46	3.60
Weighted-average common shares outstanding	66,251	63,723	52,418
Diluted earnings per share	\$ 4.62	4.39	3.55
Weighted-average common and dilutive potential common shares outstanding	67,121	64,861	53,141

See accompanying notes to consolidated financial statements.

DECEMBER 31,	<b>2003</b>	2002
IN THOUSANDS, EXCEPT PER SHARE DATA		
<b>Assets</b>		
Current assets:		
Receivables	\$ 573,500	501,129
Inventories	832,415	678,008
Prepaid expenses	43,043	37,368
Deferred income taxes	84,260	82,074
Total current assets	<u>1,533,218</u>	<u>1,298,579</u>
Property, plant and equipment, net	919,085	855,324
Goodwill	1,368,700	1,277,453
Other intangible assets	325,339	146,700
Other assets	17,233	18,687
	<u>\$4,163,575</u>	<u>3,596,743</u>
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Current portion of long-term debt	\$ 248,795	27,427
Accounts payable and accrued expenses	637,940	630,306
Total current liabilities	<u>886,735</u>	<u>657,733</u>
Deferred income taxes	183,669	145,973
Long-term debt, less current portion	763,618	793,000
Other long-term liabilities	31,752	17,158
Total liabilities	<u>1,865,774</u>	<u>1,613,864</u>
Stockholders' equity:		
Preferred stock, \$.01 par value; 60 shares authorized; no shares issued	-	-
Common stock, \$.01 par value; 150,000 shares authorized; 77,050 and 76,371 shares issued in 2003 and 2002, respectively	770	763
Additional paid-in capital	1,035,733	1,006,550
Retained earnings	1,541,761	1,231,612
Accumulated other comprehensive income	2,313	1,126
	<u>2,580,577</u>	<u>2,240,051</u>
Less treasury stock at cost; 10,515 and 10,006 shares in 2003 and 2002, respectively	<u>282,776</u>	<u>257,172</u>
Total stockholders' equity	<u>2,297,801</u>	<u>1,982,879</u>
Commitments and contingencies (Note 14)		
	<u>\$4,163,575</u>	<u>3,596,743</u>

See accompanying notes to consolidated financial statements.

**Consolidated Statements of Stockholders' Equity and Comprehensive Income**

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Mohawk Industries, Inc. + Subsidiaries

	COMMON STOCK		ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS	ACCUMULATED OTHER		TOTAL STOCKHOLDERS' EQUITY
	SHARES	AMOUNT			COMPREHENSIVE INCOME (LOSS)	TREASURY STOCK	
IN THOUSANDS							
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 to executive incentive plan	—	—	—	—	—	145	145
Tax benefit from exercise of stock options	—	—	4,847	—	—	—	4,847
Comprehensive Income:							
Unrealized loss on hedge instruments							
net of taxes	—	—	—	—	(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 to executive incentive plan	—	—	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							
net of taxes	—	—	—	—	(2,805)	—	(2,805)
Net earnings	—	—	—	284,489	—	—	284,489
Total Comprehensive Income							288,452
Balances at December 31, 2002	76,371	763	1,006,550	1,231,612	1,126	(257,172)	1,982,879
Stock options exercised	679	7	18,283	—	—	—	18,290
Purchase of treasury stock	—	—	—	—	—	(27,839)	(27,839)
Grant to employee profit sharing plan	—	—	2,080	—	—	1,929	4,009
Grant to executive incentive plan	—	—	63	—	—	306	369
Tax benefit from exercise of stock options	—	—	8,757	—	—	—	8,757
Comprehensive Income:							
Currency translation adjustment	—	—	—	—	47	—	47
Unrealized gain on hedge instruments							
net of taxes	—	—	—	—	1,140	—	1,140
Net earnings	—	—	—	310,149	—	—	310,149
Total Comprehensive Income							311,336
Balances at December 31, 2003	77,050	\$770	1,035,733	1,541,761	2,313	(282,776)	2,297,801

See accompanying notes to consolidated financial statements.

36 **Consolidated Statements of Cash Flows**

Mohawk Industries, Inc. + Subsidiaries

YEARS ENDED DECEMBER 31, IN THOUSANDS	2003	2002	2001
Cash flows from operating activities:			
Net earnings	\$ 310,149	284,489	188,592
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation and amortization	106,615	101,942	84,167
Deferred income taxes	34,775	33,712	5,563
Tax benefit on stock options exercised	8,757	5,463	4,847
Loss on sale of property, plant and equipment	3,267	2,762	2,910
Changes in assets and liabilities, net of effects of acquisitions:			
Receivables	(47,443)	34,657	(46,066)
Inventories	(104,964)	(15,215)	43,190
Accounts payable and accrued expenses	(2,769)	105,464	48,754
Other assets and prepaid expenses	(5,592)	(13,111)	(811)
Other liabilities	6,595	9,347	101
Net cash provided by operating activities	<u>309,390</u>	<u>549,510</u>	<u>331,247</u>
Cash flows from investing activities:			
Additions to property, plant and equipment	(114,631)	(111,934)	(52,913)
Acquisitions	(384,121)	(717,638)	-
Net cash used in investing activities	<u>(498,752)</u>	<u>(829,572)</u>	<u>(52,913)</u>
Cash flows from financing activities:			
Net change in revolving line of credit	37,299	(29,491)	(181,964)
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	182,000	(125,000)	(66,104)
Payments on term loans	(26,492)	(32,208)	(32,212)
Redemption of acquisition indebtedness	-	(202,564)	-
Industrial revenue bonds and other, net of payments	(821)	(1,307)	(1,115)
Change in outstanding checks in excess of cash	6,925	(15,519)	2,117
Acquisition of treasury stock	(27,839)	(64,034)	(8,159)
Common stock transactions	18,290	50,185	9,103
Net cash provided by (used in) financing activities	<u>189,362</u>	<u>280,062</u>	<u>(278,334)</u>
Net change in cash	-	-	-
Cash, beginning of year	-	-	-
Cash, end of year	<u>\$ -</u>	<u>-</u>	<u>-</u>

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.

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 specific customer accounts and 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 are stated at cost, including capitalized interest. 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 shorter of the estimated useful life or 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 Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets" the Company tests goodwill and other intangible assets with indefinite lives for impairment on an annual basis (or on an interim basis if an event occurs that might reduce the fair value of the reporting unit below its carrying value). The Company conducts testing for impairment during the fourth quarter of its fiscal year. Intangible assets that do not have indefinite lives are amortized based on weighted average lives.

**(f) Income Taxes**

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

**(g) Financial Instruments**

The Company's financial instruments consist primarily of receivables, accounts payable, accrued expenses and long-term debt. The carrying amount of receivables, accounts payable and accrued expenses approximates their fair value because of the short-term maturity of such instruments. 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, 2003, and 2002 was \$1,095,590 and \$894,462, compared to a carrying amount of \$1,012,413 and \$820,427, respectively.

**(h) Derivative Instruments**

Effective January 1, 2001, the Company adopted SFAS 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

December 31, 2003, 2002, and 2001 (in thousands, except per share data)

Mohawk Industries, Inc. + Subsidiaries

comprehensive income until the hedged item is recognized in earnings. The Company engages in activities that expose it to market risks, including the effects of changes in interest rates, exchange rates and 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) Shipping and Handling**

Costs related to shipping and handling are included in cost of sales for all periods presented.

#### **(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 \$26,990 in 2003, \$31,829 in 2002 and \$28,845 in 2001.

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, a component of advertising and promotion expenses, were \$9,355 in 2003, \$14,090 in 2002 and \$11,803 in 2001.

#### **(k) Impairment of Long-Lived Assets**

In 2002, the Company adopted SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets."

The adoption of SFAS No. 144 did not affect the Company's financial statements. 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. In accordance with SFAS No. 144 long-lived assets and intangibles subject to amortization, are reviewed for impairment when changes in circumstances indicate that the carrying amount of the asset may not be recoverable. If the carrying amount of the asset exceeds the expected undiscounted cash flows of the asset, an impairment charge is recognized equal to the amount by which the carrying amount exceeds the expected undiscounted cash flows. Assets to be disposed of are reported at the lower of the carrying amount or fair value less estimated costs of disposal and are no longer depreciated.

#### **(l) Foreign Currency Translation**

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

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Mohawk Industries, Inc. + Subsidiaries

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

The Company applies the provisions of Financial Accounting Standards Board "FASB" 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 not significant.

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

	2003	2002	2001
Net earnings	\$310,149	284,489	188,592
Weighted-average common and dilutive potential common shares outstanding:			
Weighted-average common shares outstanding	66,251	63,723	52,418
Add weighted-average dilutive potential common shares—options to purchase common shares, net	870	1,138	723
Weighted-average common and dilutive potential common shares outstanding	67,121	64,861	53,141
Basic earnings per share	\$ 4.68	4.46	3.60
Diluted earnings per share	\$ 4.62	4.39	3.55

**(n) Stock Based Compensation**

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

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

	2003	2002	2001
Net earnings as reported	\$310,149	284,489	188,592
Deduct: Stock-based employee compensation expense determined under fair value-based method for all options, net of related tax effects	(6,284)	(4,972)	(3,198)
Pro forma net earnings	\$303,865	279,517	185,394
Net earnings per common share (basic)			
As reported	\$ 4.68	4.46	3.60
Pro forma	\$ 4.59	4.39	3.54
Net earnings per common share (diluted)			
As reported	\$ 4.62	4.39	3.55
Pro forma	\$ 4.54	4.31	3.49

December 31, 2003, 2002, and 2001 (in thousands, except per share data)

Mohawk Industries, Inc. + Subsidiaries

The average fair value of options granted during 2003, 2002 and 2001 was \$24.73, \$26.72 and \$15.27, respectively. This fair value was estimated using the Black-Scholes option pricing model based on a weighted-average market price at grant date of \$53.93 in 2003, \$62.11 in 2002 and \$31.91 in 2001 and the following weighted-average assumptions:

	2003	2002	2001
Dividend yield	—	—	—
Risk-free interest rate	2.3%	3.0%	4.1%
Volatility	31.3%	39.7%	43.3%
Expected life (years)	6	6	6

#### (o) Effect of New Accounting Pronouncements

In January 2003, the FASB issued FASB Interpretation No. 46 ("FIN 46"), "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51," which addresses consolidation by business enterprises of variable interest entities ("VIEs") either: (1) that do not have sufficient equity investment at risk to permit the entity to finance its activities without additional subordinated financial support, or (2) in which the equity investors lack an essential characteristic of a controlling financial interest. In December 2003, the FASB issued modifications to FIN 46, ("Revised Interpretations") resulting in multiple effective dates based on the nature as well as the creation date of the VIE. VIEs created after January 31, 2003, but prior to January 1, 2004, may be accounted for either based on the original interpretation or the Revised Interpretations. However, the Revised Interpretations must be applied no later than the first quarter of 2004. VIEs created after January 1, 2004, must be accounted for under the Revised Interpretations. Non-Special Purpose Entities created prior to February 1, 2003, should be accounted for under the revised interpretation's provisions no later than the first quarter of fiscal 2004. The Company has adopted FIN 46, which did not have a material impact and does not expect the Revised Interpretations to have a material impact on the Company's consolidated financial statements.

In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." This standard amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities under SFAS No. 133.

The standard is effective for contracts entered into or modified after June 30, 2003. The Company has adopted SFAS No. 133 and it did not have a material impact on the Company's consolidated financial statements.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." SFAS 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity, and imposes certain additional disclosure requirements. The provisions of SFAS No. 150 are generally effective for all financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The Company has adopted SFAS No. 150 and it did not have a material impact on the Company's consolidated financial statements.

#### (p) 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.

#### (q) Reclassifications

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

#### NOTE 2. ACQUISITIONS

On March 20, 2002, the Company acquired all of the outstanding capital stock of Dal-Tile International Inc. ("Dal-Tile"), a leading manufacturer and distributor of ceramic tile in the United States, for approximately \$1,468,325, consisting of approximately 12,900 shares of the Company's common stock, options to purchase approximately 2,100 shares of the Company's common stock and approximately \$717,638 in cash, including direct acquisition costs. The Company's common stock and options were valued at approximately \$750,687 based on the measurement date stock price of \$55.04 per share (\$710,420) and the estimated fair value of the options using the Black-Scholes option-pricing model (\$40,267). The acquisition was accounted for by the purchase method and, accordingly, the results of operations of Dal-Tile have been included in the Company's consolidated financial statements from March 20, 2002. The purchase price was allocated to the assets acquired and liabilities assumed based upon the estimated fair values at the date of acquisition.

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The trademark value was established based upon an independent appraisal. The excess of the purchase price over the fair value of the net identifiable assets acquired of approximately \$1,168,286 was recorded as goodwill. None of the goodwill is expected to be deductible for income tax purposes. The primary reason for the acquisition was to expand the Company's presence in the ceramic tile and stone markets.

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

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

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. 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

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

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

On November 10, 2003, the Company acquired the assets and assumed certain liabilities of the carpet division of Burlington Industries, Inc. ("Lees Carpet") from W.L. Ross & Company for approximately \$349,839 in cash. The results of Lees Carpet have been included with the Mohawk segment results in the Company's consolidated financial statements since that date. The primary reason for the acquisition was to expand the Company's presence in the commercial carpet market.

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

Current assets	\$ 62,942
Property, plant and equipment	53,469
Goodwill	78,035
Intangible assets	178,340
Other assets	52
Total assets acquired	<u>372,838</u>
Current liabilities	14,999
Other liabilities	8,000
Total liabilities assumed	<u>22,999</u>
Net assets acquired	<u>\$349,839</u>

Of the approximately \$178,340 of acquired intangible assets, approximately \$125,580 was assigned to trade names and not subject to amortization. The remaining \$52,760 was assigned to customer relationships with a weighted-average useful life of approximately 15 years. Goodwill of approximately \$78,035 was assigned to the Mohawk segment. The goodwill is expected to be deductible for tax purposes.

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

	2003	2002
Net sales	\$5,222,159	4,782,905
Net earnings	316,386	290,996
Basic earnings per share	4.78	4.57
Diluted earnings per share	4.71	4.49

#### NOTE 3. RECEIVABLES

Receivables are as follows:

	2003	2002
Customers, trade	\$663,269	578,429
Other	4,648	7,373
	<u>667,917</u>	<u>585,802</u>
Less allowance for discounts, returns, claims and doubtful accounts	94,417	84,673
Net receivables	<u>\$573,500</u>	<u>501,129</u>

#### NOTE 4. INVENTORIES

The components of inventories are as follows:

	2003	2002
Finished goods	\$535,645	436,080
Work in process	72,981	67,907
Raw materials	223,789	174,021
Total inventories	<u>\$832,415</u>	<u>678,008</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 and indefinite life intangibles on an annual basis for impairment. Furthermore, any goodwill and indefinite life intangibles that was acquired in a purchase business combination completed after June 30, 2001, will not be amortized. Goodwill and indefinite life intangibles that was acquired in business combinations completed before July 1, 2001, is no longer being amortized. The Company has two operating segments the Mohawk unit and the Dal-Tile unit and, accordingly, has assigned the acquired goodwill and indefinite life intangibles to the respective operating segments. During the fourth quarter of 2003, the Company evaluated both the goodwill and indefinite life intangibles using the discounted cash flow approach and determined that there was no impairment.

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The following table summarizes the components of intangible assets:

	2003	2002
Carrying amount of		
amortized intangible assets:		
Customer relationships	\$ 53,010	–
Patents	600	–
	<u>\$ 53,610</u>	<u>–</u>
Accumulated amortization of		
amortized intangible assets:		
Customer relationships	\$ 541	–
Patents	10	–
	<u>\$ 551</u>	<u>–</u>
Unamortized intangible assets:		
Trade names	<u>\$272,280</u>	<u>146,700</u>
Aggregate amortization expense		
For the year ended December 31	<u>\$ 551</u>	<u>–</u>

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

2004	\$3,619
2005	3,619
2006	3,619
2007	3,619
2008	3,619

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

	MOHAWK SEGMENT	DAL-TILE SEGMENT	TOTAL
Balance as of			
January 1, 2002	\$109,167	–	109,167
Goodwill acquired			
during the year	–	1,168,286	1,168,286
Balances as of			
December 31, 2002	109,167	1,168,286	1,277,453
Goodwill acquired			
during the year	85,916	5,331	91,247
Balances as of			
December 31, 2003	<u>\$195,083</u>	<u>1,173,617</u>	<u>1,368,700</u>

The following table discloses the Company's earnings, assuming the exclusion of goodwill amortization for the fiscal year ended December 31:

	2001
Net earnings	\$188,592
Add back: Goodwill amortization, net of income taxes	<u>2,022</u>
Adjusted net earnings	<u>\$190,614</u>
Basic earnings per share	\$ 3.60
Add back: Goodwill amortization, net of income taxes	<u>0.04</u>
Adjusted net earnings	<u>\$ 3.64</u>
Diluted earnings per share	\$ 3.55
Add back: Goodwill amortization, net of income taxes	<u>0.04</u>
Adjusted net earnings	<u>\$ 3.59</u>

#### NOTE 6. PROPERTY, PLANT AND EQUIPMENT

Following is a summary of property, plant and equipment:

	2003	2002
Land	\$ 59,621	56,671
Buildings and improvements	367,007	339,630
Machinery and equipment	1,154,387	1,052,567
Furniture and fixtures	45,680	42,421
Leasehold improvements	19,912	16,354
Construction in progress	<u>88,883</u>	<u>77,468</u>
	1,735,490	1,585,111
Less accumulated depreciation and amortization	<u>816,405</u>	<u>729,787</u>
Net property, plant and equipment	<u>\$ 919,085</u>	<u>855,324</u>

Property, plant and equipment includes capitalized interest of \$5,634, \$2,126 and \$1,855 in 2003, 2002 and 2001, respectively.



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#### NOTE 7. LONG-TERM DEBT

On September 30, 2003, the Company entered into a new revolving line of credit agreement providing up to \$300,000 with interest rates of either (i) LIBOR plus 0.4% to 1.5%, depending upon the Company's performance measured against certain financial ratios, or (ii) the base rate plus 0-0.6% depending upon the Company's performance measured against certain financial ratios. The new facility replaces a \$450,000 facility that was due to expire in January 2004. The facility is comprised of two tranches, a \$200,000 tranche expiring in September 2008 and a \$100,000 tranche expiring in September 2004. The \$100,000 tranche of the facility is renewable annually. The credit agreement contains customary financial and other covenants. The Company must pay an annual facility fee ranging from .15% to .50% of the total credit commitment, depending upon the Company's performance measured against specific coverage ratios, under the revolving credit line. Additionally, at December 31, 2003, the Company had credit facilities of \$300,000 under its revolving credit facility and \$50,000 under various short-term uncommitted credit lines. At December 31, 2003, a total of \$237,344 was unused under the combined revolving credit facility and uncommitted credit lines. The revolving credit facility and uncommitted lines of credit are unsecured.

In connection with the Dal-Tile acquisition during 2002, the Company entered into a 364-day term loan facility (the "Bridge Facility") 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% senior 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.

On August 4, 2003, the Company entered into an on-balance sheet trade accounts receivable securitization agreement ("Securitization Facility") replacing two previous facilities that were due to expire in October 2003. The Securitization Facility allows the Company to borrow up to \$350,000 based on available accounts receivable. The Company sells, on a non-recourse revolving basis, its accounts receivable to a special purpose entity, which in turn obtains loan advances that are secured by the receivable pool from a third-party commercial paper conduit sponsored by financial institutions. The Securitization Facility is subject to annual renewal. At December 31, 2003, the Company had approximately \$182,000 outstanding secured by approximately \$649,018 of trade receivables.

The Company guarantees its industrial revenue bonds with various standby letters of credit, which were in aggregate \$55,599 at December 31, 2003 and 2002.

Long-term debt consists of the following:

	<b>2003</b>	2002
364-Day Credit Agreement,		
due September 29, 2004	\$ 41,701	-
Revolving line of credit,		
due January 28, 2004	-	4,402
Securitization Facility,		
due August 4, 2004	182,000	-
6.50% senior notes, payable		
April 15, 2007 interest		
payable semiannually	300,000	300,000
7.20% senior notes, payable		
April 15, 2012 interest		
payable semiannually	400,000	400,000
8.46% senior notes, payable in		
annual principal installments		
beginning in 1998, due		
September 16, 2004,		
interest payable quarterly	14,286	28,571
7.14%-7.23% senior notes,		
payable in annual principal		
installments beginning in		
1997, due September 1, 2005,		
interest payable semiannually	18,889	28,333
7.58% senior notes, payable in		
annual principal installments		
beginning in 1997, due		
July 30, 2003, interest		
payable semiannually	-	1,428
6% term note, payable in		
annual principal and interest		
installments beginning in		
1998, due July 23, 2004	1,336	2,671
Industrial revenue bonds and other	54,201	55,022
Total long-term debt	<u>1,012,413</u>	<u>820,427</u>
Less current portion	<u>248,795</u>	<u>27,427</u>
Long-term debt, excluding		
current portion	<u>\$ 763,618</u>	<u>793,000</u>



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The aggregate maturities of long-term debt as of December 31, 2003 are as follows:

2004	\$ 248,795
2005	9,445
2006	6,500
2007	300,000
2008	—
Thereafter	447,673
	<u>\$1,012,413</u>

**NOTE 8. ACCOUNTS PAYABLE AND ACCRUED EXPENSES**

Accounts payable and accrued expenses are as follows:

	2003	2002
Outstanding checks		
in excess of cash	\$ 30,429	23,504
Accounts payable, trade	245,746	236,272
Accrued expenses	262,012	263,891
Accrued compensation	99,753	106,639
Total accounts payable		
and accrued expenses	<u>\$637,940</u>	<u>630,306</u>

**NOTE 9. DERIVATIVE FINANCIAL INSTRUMENTS****Natural Gas Risk Management**

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

The Company has designated the natural gas futures contracts as cash flow hedges. The outstanding contracts are valued at market with the offset 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, 2003, the Company had natural gas contracts that mature from January 2004 to December 2004 with an aggregate notional amount of approximately 3,950 MMBTU's. The fair value of these contracts was an asset of \$3,565. 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 was an asset of \$1,911. The offset to these assets is recorded in other comprehensive income, net of applicable income taxes, respectively.

The Company's long-term natural gas supply agreements are accounted for under the normal purchases provision within SFAS No. 133 and its amendments. At December 31, 2003, the Company has normal purchase commitments of approximately 3,095 MMBTU's for periods maturing from January 2004 through September 2005. The contracted value of these commitments was approximately \$13,774 and the fair value of these commitments was approximately \$17,018, at December 31, 2003. At December 31, 2002, the Company had normal purchase commitments of approximately 4,650 MMBTU's. The contracted value of these commitments was approximately \$17,441 and the fair value of these commitments was approximately \$19,694.

**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 U.S. currency. Gains and losses are recognized in cost of goods sold in the same period or periods during which the hedged transaction affects earnings. Accordingly, these contracts have been designated as cash flow hedges. The Company had forward contracts to purchase approximately 145,284 and 357,522 Mexican pesos at December 31, 2003 and 2002, respectively. The aggregate U.S. dollar value of these contracts at December 31, 2003, and 2002, was approximately \$12,665 and \$34,581, respectively. The contracts are marked to market in other current liabilities with the offset to other comprehensive income, net of applicable income taxes. Unrealized losses at December 31, 2003 and 2002, respectively, were not significant.

**Interest Rate Management**

In 2002, the Company determined that its \$100,000 interest rate swap was ineffective. Consequently, the \$10,700 unrealized loss associated with the swap was recorded as a realized loss in interest expense during the fourth quarter of 2002. The Company continues to carry the liability on its consolidated balance sheets and the interest rate swap is marked to market at the end of each reporting period. The change in fair value for the year ended December 31, 2003, was not significant.

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**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:

	2003	2002	2001
Balance at beginning of year	\$ 7,184	7,021	6,506
Warranty claims	(52,237)	(61,718)	(52,125)
Warranty expense	50,243	61,881	52,640
Balance at end of year	<u>\$ 5,190</u>	<u>7,184</u>	<u>7,021</u>

**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 2003, 2002, and 2001, options to purchase 565, 731, and 704 shares, respectively, were granted under the 1992, 1993, 1997 and 2002 plans. Options granted under each of these plans expire 10 years from the date of grant and become exercisable at such dates and at prices as determined by the Compensation Committee of the Company's Board of Directors. In connection with the acquisition of Dal-Tile in 2002, the Company issued 2,096 options to employees of Dal-Tile in exchange for their respective options.

During 1996, the Company adopted the 1997 Non-Employee Director Stock Compensation Plan. The plan provides for awards of common stock of the Company for non-employee directors to receive in lieu of cash for their annual retainers. During 2003, 2002, and 2001 a total of one, two, and two shares, respectively, were awarded to the non-employee directors under the plan.

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

	2003	2002	2001
Options outstanding at beginning of year	2,624	1,916	1,868
Options granted for Dal-Tile acquisition	—	2,096	—
Options granted	565	731	704
Options exercised	(679)	(2,056)	(570)
Options canceled	(97)	(63)	(86)
Options outstanding at end of year	<u>2,413</u>	<u>2,624</u>	<u>1,916</u>
Options exercisable at end of year	<u>765</u>	<u>1,017</u>	<u>599</u>

Option prices per share:

Options granted during the year	<u>\$ 48.50-74.93</u>	<u>38.73-65.02</u>	<u>23.33-53.01</u>
Options exercised during the year	<u>\$ 6.67-63.14</u>	<u>5.67-49.09</u>	<u>5.67-35.13</u>
Options canceled during the year	<u>\$ 9.33-63.90</u>	<u>9.58-63.14</u>	<u>5.67-42.86</u>
Options outstanding at end of year	<u>\$ 9.33-74.93</u>	<u>6.67-65.02</u>	<u>5.61-53.01</u>
Options exercisable at end of year	<u>\$ 9.33-65.02</u>	<u>6.67-53.01</u>	<u>5.61-35.13</u>

Summarized information about stock options outstanding and exercisable at December 31, 2003, 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 \$20.16	411	3.80	\$15.49	348	\$14.72
\$20.20-30.50	111	5.87	22.95	69	22.59
\$30.53-30.53	407	7.16	30.53	91	30.53
\$30.69-48.50	651	7.89	42.95	142	34.05
\$49.09-58.00	151	8.83	55.24	18	53.55
\$63.14-74.93	682	8.49	64.56	97	63.41
Total	<u>2,413</u>			<u>765</u>	

1) Weighted-average contractual life remaining in years.

2) Weighted-average exercise price.

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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, 2003, a total of approximately 593 shares of the Company's common stock were purchased at an aggregate cost of approximately \$27,839. Since the inception of the program, a total of approximately 10,957 shares have been repurchased at an aggregate cost of approximately \$293,129. All of these repurchases have been financed through the Company's operations and banking arrangements.

**NOTE 12. EMPLOYEE BENEFIT PLANS**

The Company has a 401(k) retirement savings plan (the "Mohawk Plan") open to substantially all of its employees who have completed 90 days of eligible service. Effective January 1, 2003, the Dal-Tile International Inc. Employees' Retirement Savings Plan was merged into the Mohawk Plan. For the Mohawk segment, the Company contributes \$0.50 for every \$1.00 of employee contributions up to a maximum of 4% of the employee's salary and an additional \$0.25 for every \$1.00 of employee contribution in excess of 4% of the employee's salary up to a maximum of 6%. For the Dal-Tile segment, the Company contributes \$.50 for every \$1.00 of employee contributions up to a maximum of 6% of the employee's salary. Employee and employer contributions to the Mohawk Plan were \$28,807 and \$10,995 in 2003, \$20,237 and \$7,359 in 2002, and \$18,322 and \$6,521 in 2001, respectively. The Company also made a discretionary contribution to the Mohawk Plan of approximately \$4,595, \$3,797 and \$2,500 in 2003, 2002 and 2001, respectively.

**NOTE 13. INCOME TAXES**

Income tax expense attributable to earnings before income taxes for the years ended December 31, 2003, 2002 and 2001, consists of the following:

	CURRENT	DEFERRED	TOTAL
2003:			
U.S. federal	\$132,849	38,696	171,545
State, local and other	10,661	(3,921)	6,740
	<u>\$143,510</u>	<u>34,775</u>	<u>178,285</u>
2002:			
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>
2001:			
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>

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:

	2003	2002	2001
Computed "expected"			
tax expense	\$170,952	155,270	101,996
State and local income taxes, net of federal income tax benefit	5,071	8,741	9,652
Foreign income taxes	2,495	1,248	-
Amortization of goodwill	-	-	709
Tax credits	(2,312)	(5,000)	(5,000)
Other, net	2,079	(1,119)	(4,533)
	<u>\$178,285</u>	<u>159,140</u>	<u>102,824</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, 2003 and 2002, are presented below:

	2003	2002
Deferred tax assets:		
Accounts receivable	\$ 3,940	3,627
Inventories	25,312	18,138
Prepaid expenses	-	655
Accrued expenses	61,003	67,706
Other	1,147	7,735
Gross deferred tax assets	<u>91,402</u>	<u>97,861</u>
Deferred tax liabilities:		
Plant and equipment	(117,857)	(103,831)
Intangibles	(72,954)	(57,929)
Gross deferred tax liabilities	<u>(190,811)</u>	<u>(161,760)</u>
Net deferred tax liability	<u>\$ (99,409)</u>	<u>(63,899)</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, 2003.

December 31, 2003, 2002, and 2001 (in thousands, except per share data)

Mohawk Industries, Inc. + Subsidiaries

**NOTE 14. COMMITMENTS AND CONTINGENCIES**

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

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

2004	\$ 72,857
2005	57,202
2006	44,517
2007	31,183
2008	22,602
Thereafter	45,363
Total payments	<u>\$273,724</u>

Rental expense under operating leases was \$78,007, \$62,066 and \$39,072 in 2003, 2002 and 2001, respectively.

The Company has approximately \$23,433 and \$19,600 as of December 31, 2003, and 2002, 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.

**NOTE 15. CONSOLIDATED STATEMENTS OF CASH FLOWS INFORMATION**

Supplemental disclosures of cash flow information are as follows:

	2003	2002	2001
Net cash paid			
during the year for:			
Interest	\$ 61,424	43,866	31,789
Income taxes	<u>\$139,914</u>	<u>59,931</u>	<u>73,498</u>
Supplemental schedule			
of non-cash investing			
and financing activities:			
Fair value of assets			
acquired in acquisition	\$407,320	1,865,225	-
Liabilities assumed			
in acquisition	(23,199)	(396,900)	-
Issuance of common			
stock and options			
in acquisition	-	(750,687)	-
	<u>\$384,121</u>	<u>717,638</u>	<u>-</u>

December 31, 2003, 2002, and 2001 (in thousands, except per share data)

Mohawk Industries, Inc. + Subsidiaries

**NOTE 16. OTHER INCOME AND EXPENSE**

Other income and expense are as follows:

	2003	2002	2001
Miscellaneous income	\$8,232	3,991	1,826
Miscellaneous expense	6,252	13,455	3,966
Amortization expense	-	-	3,814
	<u>\$6,252</u>	<u>13,455</u>	<u>7,780</u>

**NOTE 17. SEGMENT REPORTING**

The Company has two operating segments, the Mohawk segment and the Dal-Tile segment. The Mohawk segment sells and distributes its product lines, which include broadloom carpet, rugs, pad, ceramic tile, hardwood, vinyl and laminate through independent floor covering retailers, home centers, mass merchandisers, department stores, commercial dealers and commercial end users. The Dal-Tile segment product lines include ceramic tile, porcelain tile and stone products sold through company-operated sales service centers, independent distributors and home centers. Amounts disclosed for each segment are prior to any elimination or consolidation entries. Corporate general and administrative expenses amounts attributable to each segment are estimated and allocated accordingly. Export sales are not significant and long-lived assets located outside the United States of America, principally Mexico, were \$85,001 and \$83,842 at December 31, 2003 and 2002, respectively.

Segment information is as follows:

	2003	2002	2001
Net sales:			
Mohawk	\$3,736,517	3,624,156	3,445,945
Dal-Tile	1,268,536	898,180	-
	<u>\$5,005,053</u>	<u>4,522,336</u>	<u>3,445,945</u>
Operating income:			
Mohawk	\$ 364,040	390,936	336,672
Dal-Tile	187,245	139,888	-
Corporate and eliminations	(9,256)	(8,759)	(9,515)
	<u>\$ 542,029</u>	<u>522,065</u>	<u>327,157</u>
Depreciation and amortization:			
Mohawk	\$ 81,977	83,676	84,167
Dal-Tile	24,638	18,266	-
	<u>\$ 106,615</u>	<u>101,942</u>	<u>84,167</u>
Capital expenditures (excluding acquisitions):			
Mohawk	\$ 56,775	80,623	52,913
Dal-Tile	57,856	31,311	-
	<u>\$ 114,631</u>	<u>111,934</u>	<u>52,913</u>
Assets:			
Mohawk	\$2,086,716	1,638,336	1,656,813
Dal-Tile	1,967,206	1,832,701	-
Corporate and eliminations	109,653	125,706	111,672
	<u>\$4,163,575</u>	<u>3,596,743</u>	<u>1,768,485</u>

50 **Notes to Consolidated Financial Statements**

*December 31, 2003, 2002, and 2001 (in thousands, except per share data)*

Mohawk Industries, Inc. + Subsidiaries

**NOTE 18. QUARTERLY FINANCIAL DATA (UNAUDITED)**

The supplemental quarterly financial data are as follows:

QUARTERS ENDED	<b>MARCH 29,</b>	<b>JUNE 28,</b>	<b>SEPTEMBER 27,</b>	<b>DECEMBER 31,</b>
	<b>2003</b>	<b>2003</b>	<b>2003</b>	<b>2003</b>
Net sales	\$1,084,715	1,247,181	1,303,166	1,369,991
Gross profit	274,796	340,103	364,886	379,591
Net earnings	41,640	74,985	91,382	102,142
Basic earnings per share	0.63	1.14	1.38	1.54
Diluted earnings per share	0.62	1.12	1.36	1.51

QUARTERS ENDED	<b>MARCH 30,</b>	<b>JUNE 29,</b>	<b>SEPTEMBER 28,</b>	<b>DECEMBER 31,</b>
	<b>2002</b>	<b>2002</b>	<b>2002</b>	<b>2002</b>
Net sales	\$ 866,710	1,227,747	1,224,403	1,203,476
Gross profit	215,377	339,906	341,403	343,381
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

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, 2003 and 2002, 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, 2003. 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, 2003 and 2002, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2003, 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 5, 2004

**Management's Report**

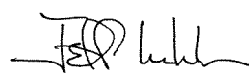
The management of Mohawk Industries, Inc. is responsible for the integrity and objectivity of the consolidated financial statements. The financial statements were prepared in conformity with accounting principles generally accepted in the United States of America. Some of the amounts included in these 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

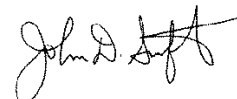
and the internal audit function, and corrective action is taken if needed.

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

**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**

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 8-K, 10-K and 10-Q reports are available with out 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 Web site 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 Wednesday, May 19, 2004, 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**

<b>2003</b>	HIGH	LOW
First Quarter	\$ 59.38	41.00
Second Quarter	63.04	47.65
Third Quarter	75.75	55.25
Fourth Quarter	75.48	67.07
<hr/>		
<b>2002</b>	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

**COMMON STOCKHOLDERS OF RECORD**

As of March 2, 2004, there were 411 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.