

MOHAWK INDUSTRIES INC
Form 10-K
February 29, 2008
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

[Mark One]

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

For the fiscal year ended December 31, 2007

OR

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

For the transition period from to

Commission File Number

01-13697

MOHAWK INDUSTRIES, INC.

(Exact name of registrant as specified in its charter)

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Delaware **52-1604305**
(State or other jurisdiction) (I.R.S. Employer

of incorporation or organization) **Identification No.)**
P. O. Box 12069, 160 S. Industrial Blvd., Calhoun, Georgia **30701**
(Address of principal executive offices) (Zip Code)
Registrant's telephone number, including area code: (706) 629-7721

Securities Registered Pursuant to Section 12(b) of the Act:

| Title of Each Class | Name of Each Exchange on Which Registered |
|--------------------------------------|--|
| Common Stock, \$.01 par value | New York Stock Exchange |

Securities Registered Pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act Yes No

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
Indicate by check whether the Registrant is a shell company (as defined by Rule 12b-2 of the Act). Yes No

The aggregate market value of the Common Stock of the Registrant held by non-affiliates (excludes beneficial owners of more than 10% of the Common Stock) of the Registrant (43,300,714 shares) on June 30, 2007 (the last business day of the Registrant's most recently completed fiscal second quarter) was \$4,364,278,964 The aggregate market value was computed by reference to the closing price of the Common Stock on such date.

Number of shares of Common Stock outstanding as of February 25, 2008: 68,392,771 shares of Common Stock, \$.01 par value.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement for the 2008 Annual Meeting of Stockholders-Part III.

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General**

Mohawk Industries, Inc., (Mohawk or the Company), a term which includes the Company and its subsidiaries, including its primary operating subsidiaries, Mohawk Carpet Corporation, Aladdin Manufacturing Corporation, Dal-Tile International Inc. and Unilin Flooring BVBA, Unilin Holding Inc., and their subsidiaries (the Unilin Group), is a leading producer of floor covering products for residential and commercial applications in the United States (U.S.) and residential applications in Europe. The Company is the second largest carpet and rug manufacturer and one of the largest manufacturers, marketers and distributors of ceramic tile, natural stone and hardwood flooring in the U.S. as well as a leading producer of laminate flooring in the U.S. and Europe. The Company had annual net sales in 2007 of \$7.6 billion. Approximately 85% of this amount was generated by sales in North America and approximately 15% was generated by sales outside North America. The Company has three reporting segments, the Mohawk segment, Dal-Tile segment and the Unilin segment. Selected financial information for the Mohawk, Dal-Tile and Unilin segments, geographic net sales and the location of long-lived assets is set forth in Note 16 to the Consolidated Financial Statements.

The Mohawk segment designs, manufactures, sources, distributes and markets its floor covering product lines, which include carpets, ceramic tile, laminate, rugs, carpet pad, hardwood and resilient, in a broad range of colors, textures and patterns for residential and commercial applications in both new construction and remodeling. The Mohawk segment markets and distributes its carpets and rugs under its soft surface floor covering brands and ceramic tile, laminate, hardwood and resilient under its hard surface floor covering brands. The Mohawk segment positions its products in all price ranges and emphasizes quality, style, performance and service. The Mohawk segment is widely recognized through its premier brand names, which include Mohawk®, Aladdin Mohawk Home Bigelow Durkan Helios Horizon Karastan Lees Merit and Ralph Lauren. The Mohawk segment markets and distributes soft and hard surface products through over 38,000 customers, which include independent floor covering retailers, home centers, mass merchandisers, department stores, commercial dealers and commercial end users. Some products are also marketed through private labeling programs. The Mohawk segment's soft surface operations are vertically integrated from the extrusion of resin to the manufacture and shipment of finished carpets and rugs.

The Dal-Tile segment designs, manufactures, sources, distributes and markets a broad line of ceramic tile, porcelain tile, natural stone and other products used in the residential and commercial markets for both new construction and remodeling. Most of the Dal-Tile segment's ceramic tile products are marketed under the Dal-Tile® and American Olean brand names and sold through independent distributors, home center retailers, tile and flooring retailers and contractors. The Dal-Tile segment operations are vertically integrated from the production of raw material for body and glaze preparation to the manufacturing and distribution of ceramic and porcelain tile.

The Unilin segment, which is headquartered in Belgium, is a leading manufacturer, licensor, distributor and marketer of laminate flooring in Europe and the U.S. Unilin is one of the leaders in laminate flooring technology, having commercialized direct pressure laminate, or DPL, a technology used in a majority of laminates today, and has developed the patented UNICLIC® glueless installation system and a variety of other new technologies, such as beveled edges, multiple length planks and new surface technologies. Unilin is the largest vertically-integrated laminate flooring manufacturer in the U.S. producing both laminate flooring and related high density fiberboard. Unilin sells its flooring products under the Quick-Step®, Columbia Flooring®, Century Flooring®, and Universal Flooring® brands through retailers, independent distributors private label and home centers. Unilin also produces insulated roofing and other wood-based panels. On August 13, 2007, the Company acquired certain wood flooring assets and liabilities of Columbia Forest Products, Inc. (Columbia) for approximately \$147 million. The acquisition enabled the Company to expand its position in the wood flooring market. Columbia's results are included in the Unilin segment and the Company's consolidated financial statements since the date of acquisition.

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Industry

The U.S. floor covering industry has grown from \$12.4 billion in sales in 1992 to \$24.2 billion in 2006. In 2006, the primary categories of the U.S. floor covering industry were carpet and rug (62%), ceramic tile (13%), hardwood (11%), resilient and rubber (8%), and laminate (6%). Each of these categories has been impacted by the average selling price per square foot, the residential builder and homeowner remodeling markets, housing starts and housing resales, average house size and home ownership. In addition, the level of sales in the floor covering industry, both in the U.S. and Europe, is influenced by consumer confidence, spending for durable goods, interest rates and availability of credit, turnover in housing, the condition of the residential and commercial construction industries and the overall strength of the economy. The U.S. floor covering industry has experienced softened demand beginning in the fourth quarter of 2006 and continuing throughout 2007, due to the downturn in the U.S. residential housing market.

Compound average growth rates for all flooring categories for the period from 2002 through 2006 have met or exceeded the growth rates (measured in sales dollars) for the real gross domestic product of the U.S. over the same period. During this period, the compound average growth rate was 4.3% for carpets and rugs, 7.6% for ceramic tile, 5.3% for resilient and rubber, 13.5% for laminate and 7.1% for hardwood.

The worldwide carpet and rug sales volume of U.S. manufacturers was approximately 2.1 billion square yards in 2006. This volume represents a market in excess of \$15 billion in sales. The carpet and rugs category has two primary markets, residential and commercial. In 2006, the residential market made up approximately 74% of industry amounts shipped and the commercial market comprised approximately 26%. An estimated 48% of industry shipments are made in response to residential replacement demand.

The U.S. ceramic tile industry shipped 3.3 billion square feet, or \$3.2 billion, in 2006. The ceramic tile industry's two primary markets, residential applications and commercial applications, represent 68% and 31% of the 2006 industry total, respectively. Of the total residential market, 62% of the dollar values of shipments are for new construction.

In 2006, the U.S. resilient and rubber industry shipped 3.3 billion square feet, representing a market of approximately \$1.9 billion. Sales of U.S. resilient are primarily distributed to the residential market for both new construction and residential replacement.

In 2006, the U.S. laminate industry shipped 1.3 billion square feet, or \$1.5 billion, of which approximately 60% was imported. In 2006, the European laminate industry produced 5.8 billion square feet which accounted for approximately 11% of the European floor covering market. Sales of U.S. laminate flooring are primarily distributed through the residential replacement market. Sales to other end user markets are not significant.

In 2006, the U.S. hardwood industry shipped 1.0 billion square feet, representing a market of approximately \$2.6 billion. Sales of U.S. hardwood are primarily distributed to the residential market for both new construction and residential replacement.

Sales and Distribution

Mohawk Segment

Through its Mohawk segment, the Company designs, manufactures, distributes and markets hundreds of styles of carpet and rugs in a broad range of colors, textures and patterns. In addition, the Mohawk segment markets and distributes ceramic tile, laminate, hardwood, resilient floor covering, carpet pad and flooring accessories. The Mohawk segment positions product lines in all price ranges and emphasizes quality, style, performance and service. The Mohawk segment markets and distributes its soft and hard surface product lines to over 38,000 customers, which include independent floor covering retailers, home centers, mass merchandisers, department stores, commercial dealers and commercial end users. Some products are also marketed through private labeling programs. Sales to residential customers represent a significant portion of the total industry and the majority of the Company's carpet and rug sales.

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The Company has positioned its premier residential carpet and rug brand names across all price ranges. Mohawk, Horizon, Helios, WundaWev[®], Ralph Lauren and Karastan are positioned to sell primarily in the medium-to-high retail price channels in the residential broadloom market. These lines have substantial brand name recognition among carpet dealers and retailers, with the Karastan and Mohawk brands having the highest consumer recognition in the industry. Karastan is the leader in the exclusive high-end market. The Aladdin and Mohawk Home brand names compete primarily in the value retail price channel. The Company markets its hard surface product lines, which include Mohawk Ceramic, Mohawk Hardwood, Congoleum and Mohawk Laminate across all price ranges.

The Company offers marketing and advertising support through dealer programs like Mohawk Floorscapes[®], Mohawk ColorCenter[®], Mohawk Floorz[®] and Karastan Gallery. These programs offer varying degrees of support to dealers in the form of sales and management training, merchandising systems, exclusive promotions and assistance in certain administrative functions such as consumer credit, advertising and insurance.

The commercial customer base is divided into several channels: corporate office space, educational institutions, hospitality facilities, retail space, public finance and health care facilities. Different purchase decision makers and decision-making processes exist for each channel. In addition, the Company produces and sells broadloom carpet and carpet tile under the brand names Bigelow Commercial[®], Lees, Durkan, Karastan Contract[®] and Merit.

The Company's sales forces are generally organized based on product type and sales channels in order to best serve each type of customer. A hub-and-spoke distribution network accomplishes the product distribution on a regional level. In this system, trucks generally deliver product from manufacturing and central distribution centers to regional and satellite warehouses. From there, it is shipped to retailers or to local distribution warehouses, then to retailers.

Dal-Tile Segment

The Dal-Tile segment designs, manufactures and markets a broad line of ceramic tile, porcelain tile and natural stone products. Products are distributed through separate distribution channels consisting of retailers, contractors, commercial users, independent distributors and home centers. The business is organized to address the specific customer needs of each distribution channel, and dedicated sales forces support the various channels.

The Company serves as a one-stop source that provides customers with one of the ceramic tile industry's broadest product lines—a complete selection of glazed floor tile, glazed wall tile, glazed and unglazed ceramic mosaic tile, porcelain tile, quarry tile and stone products, as well as allied products. In addition to products manufactured by the Company's ceramic tile business, the Company also purchases products from other manufacturers to enhance its product offering.

The Company has two of the leading brand names in the U.S. ceramic tile industry—Dal-Tile and American Olean. The Dal-Tile and American Olean brand names date back over fifty years and are well recognized in the industry. Both of these brands are supported by a fully integrated marketing program, displays, merchandising (sample boards and chip chests), literature/catalogs and an Internet website.

A network of approximately 262 sales service centers distributes primarily the Dal-Tile brand product with a fully integrated marketing program, emphasizing a focus on quality and fashion serving customers in the U.S., Canada and Puerto Rico. The service centers provide distribution points for customer pick-up, local delivery and showrooms to assist customers. The broad product offering satisfies the needs of its residential and commercial customers.

The independent distributor channel offers a distinct product line under the American Olean brand. Currently, the American Olean brand is distributed through approximately 186 independent distributors that service a variety of residential and commercial customers. The Company is focused on increasing its presence in the independent distributor channel, particularly in tile products that are most commonly used in flooring applications.

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The Company has six regional distribution centers in the Dal-Tile operations. These centers help deliver high-quality customer service by focusing on shorter lead times, increased order fill rates and improved on-time deliveries to customers.

Unilin Segment

The Unilin segment manufactures, licenses, distributes and markets laminate flooring in Europe and the U.S. It also produces hardwood flooring, insulated roofing and other wood based panels. Products are distributed through separate distribution channels consisting of retailers, independent distributors and home centers. Unilin U.S. operations also manufacture Mohawk branded laminate and hardwood flooring which sells through the Mohawk channel. The majority of Unilin's laminate sales, both in the U.S. and Europe, are for residential replacement. The business is organized to address the specific customer needs of each distribution channel.

In the U.S., the Unilin operations have three regional distribution centers for laminate and wood products. These distribution centers help deliver high-quality customer service and also enhance the Company's ability to plan and schedule production and manage inventory requirements.

In Europe, the Unilin operations distribute products directly from manufacturing facilities. This integration with manufacturing sites allows for quick responses to customer needs and high inventory turns.

The Unilin segment markets and sells laminate and hardwood flooring products under the Quick-Step, Columbia Flooring, Century Flooring, and Universal Flooring brands. In addition, Unilin also sells laminate and hardwood flooring products under private label. The Company believes Quick-Step is one of the leading brand names in the U.S. and European flooring industry.

Advertising and Promotion

The Company promotes its brands through advertising in both television and print media as well as in the form of cooperative advertising, point-of-sale displays, advertising and sponsorship of a cycling team, and marketing literature provided to assist in marketing various flooring styles. The Company also continues to rely on the substantial brand name recognition of its product lines. The cost of producing display samples, a significant promotional expense, is partially offset by sales of samples.

Manufacturing and Operations

Mohawk Segment

The Company's manufacturing operations are vertically integrated and include the extrusion of resin and post-consumer plastics into polypropylene, polyester and nylon fiber, yarn processing, backing manufacturing, tufting, weaving, dyeing, coating and finishing. Capital expenditures are primarily focused on increasing capacity, improving productivity and reducing costs. Over the past three years, the Company has incurred capital expenditures that have helped increase manufacturing efficiency and improve overall cost competitiveness.

Dal-Tile Segment

The Company believes that its manufacturing organization offers competitive advantages due to its ability to manufacture a differentiated product line consisting of one of the industry's broadest product offerings of colors, textures and finishes, as well as the industry's largest offering of trim and angle pieces and its ability to utilize the industry's newest technology. In addition, Dal-Tile also imports or sources a portion of its product to supplement its product offerings. Over the past three years, the Dal-Tile segment has invested in capital expenditures, principally in new plant and state-of-the-art equipment to increase manufacturing capacity, improve efficiency and develop new capabilities.

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Unilin Segment

The Company's laminate flooring manufacturing operations are vertically integrated, both in the U.S. and in Europe, and include high-density fiberboard (HDF) production, paper impregnation, short-cycle pressing, cutting and milling. The European operations also include resin production. Unilin has state-of-the-art equipment that results in competitive manufacturing in terms of cost and flexibility. Most of the equipment for the production of laminate flooring in Belgium and North Carolina is relatively new. The Company's laminate flooring plant in North Carolina is one of the largest in the U.S. In addition, Unilin is one of the few fully integrated laminate manufacturers in the U.S. with its own HDF production facility. The acquisition of Columbia added manufacturing capability for both engineered and prefinished solid wood flooring for the U.S. and European markets. Over the past three years, the Unilin segment has invested in capital expenditures, principally in new plants and state-of-the-art equipment to increase manufacturing capacity, improve efficiency and develop new capabilities.

The manufacturing facilities for other activities in the Unilin business (insulated roofing and other wood-based panels) are all configured for cost-efficient manufacturing and production flexibility and are competitive in the European market.

Raw Materials and Suppliers

Mohawk Segment

The principal raw materials the carpet and rug business uses are nylon, polypropylene, polyester and wool resins and fibers, synthetic backing materials, latex and various dyes and chemicals. Major raw materials used in the Company's manufacturing process are available from independent sources and the Company obtains most of its externally purchased nylon fibers principally from two major suppliers: Invista Inc., and Solutia, Inc. Although temporary disruptions of supply of carpet raw materials were experienced in 2005, the carpet and rug business has not experienced significant shortages of raw materials in recent years. The Company believes that there is an adequate supply of all grades of resin and fiber, which are readily available.

Dal-Tile Segment

In the ceramic tile business, the Company manufactures tile primarily from clay, talc, nepheline syenite and glazes. The Company has entered into a long-term supply agreement for most of its talc requirements.

The Company has long-term clay mining rights in Kentucky and Mississippi that satisfy nearly all of its clay requirements for producing unglazed quarry tile. The Company purchases a number of different grades of clay for the manufacture of its non-quarry tile. The Company believes that there is an adequate supply of all grades of clay and that all are readily available from a number of independent sources.

The Company has two suppliers for its nepheline syenite requirements. If these suppliers were unable to satisfy the requirements, the Company believes that alternative supply arrangements would be available.

Glazes are used on a significant percentage of manufactured tile. Glazes consist of frit (ground glass), zircon, stains and other materials, with frit being the largest ingredient. The Company manufactures approximately 48% of its frit requirements.

Unilin Segment

The principal raw materials used in producing boards, laminate and hardwood flooring are wood, paper, resins, coatings and stains.

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Wood supply is a very fragmented market in Europe. The Company has long-standing relationships with approximately 50 suppliers. These suppliers provide a wide variety of wood species, varying from fresh round wood to several kinds of by-products of sawmills and used wood recycled specifically for chipboard production, giving the Company a cost-effective and secure supply of raw material. In the U.S., the Company has a long-term contract with a contiguously located lumber company that supplies most of its total needs for HDF board production. Supply for hardwood flooring is both localized and global depending on the various species of hardwoods and hardwood veneers used in the production of engineered hardwood flooring being available.

Major manufacturers supply the papers required in the laminate flooring business in both Europe and the U.S. The Company manufactures most of the paper impregnation internally in its laminate flooring facilities in Europe and the U.S. In Europe, the resins for paper impregnation are manufactured by the Company, which permits greater control over the laminate flooring manufacturing process, enabling the Company to produce higher-quality products.

The Company buys the balance of its resin requirements from a number of companies. The Company believes there are ample sources of supply located within a reasonable distance of Unilin's facilities.

Competition

The principal methods of competition within the floor covering industry generally are service, style, quality, price and, to a certain extent, product innovation and technology. In each of the markets price competition and market coverage are particularly important because there is limited differentiation among competing product lines. In the laminate flooring market, the Company believes it has a competitive advantage as a result of Unilin's industry leading design and patented technologies, which allows the Company to distinguish its laminate and hardwood flooring products in the areas of finish, quality, installation and assembly. In the Mohawk and Dal-Tile segments, the investments in advanced manufacturing, computer systems, the extensive diversity of equipment, as well as the Company's marketing strategy and distribution system contribute to its ability to compete primarily on the basis of performance, quality, style and service, rather than just price. The carpet and rug industry has experienced substantial consolidation in recent years, and the Company is one of the largest carpet and rug manufacturers in the world. While the ceramic tile industry is more fragmented, the Company believes it is substantially larger than the next largest competitor and that it is the only significant manufacturer with its own North American distribution system. The Company faces competition in the laminate and hardwood flooring market from a large number of domestic and foreign manufacturers.

Mohawk Segment

The carpet and rug industry is highly competitive. Based on industry publications, the top 10 North American carpet and rug manufacturers (including their American and foreign divisions) in 2006 had worldwide carpet and rug sales in excess of \$11 billion of the over \$15 billion market. The Company believes it is the second largest producer of carpets and rugs (in terms of sales dollars) in the world based on its 2006 sales.

Dal-Tile Segment

The Company estimates that over 100 tile manufacturers, more than half of which are based outside the U.S., compete for sales of ceramic tile to customers located in the U.S. Although the U.S. ceramic tile industry is highly fragmented at both the manufacturing and distribution levels, the Company believes it is one of the largest manufacturers, distributors and marketers of ceramic tile in the U.S. and the world.

Unilin Segment

Laminate and hardwood flooring are leading growth products in the U.S. floor covering industry. Laminate flooring is produced by more than 130 industrial manufacturers in 25 countries. The Company believes it is one of the largest manufacturers, distributors and marketers of laminate flooring in the world, with a focus on

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high-end products. The Company is also one of the few vertically-integrated laminate flooring manufacturers in the U.S. producing both high density fiberboard and laminate flooring. The Company estimates that there are over 100 wood manufacturers located in various countries. With the acquisition of Columbia, the Company believes it is one of the largest manufacturers and distributors of hardwood in the U.S.

Patents and Trademarks

Intellectual property is important to the Company's business, and the Company relies on a combination of patent, copyright, trademark and trade secret laws to protect its interests.

The Company uses several trademarks that it considers important in the marketing of its products, including Aladdin, American Olean, Bigelow, Dal-Tile, Durkan, Helios, Horizon, Karastan, Lees, Mohawk, Mohawk Home, Portico®, Quick-Step, Ralph Lauren, UNILIN UNICLIC, Columbia Flooring, Century Flooring, Universal Flooring, and PureBon®.

Unilin owns a number of important patent families in Europe and the U.S. The most important of these patent families is the UNICLIC family, as well as the snap, pretension, clearance and beveled edge patent families, which protects Unilin's interlocking laminate flooring panel technology. The patents in the UNICLIC family are not expected to expire until 2017.

Sales Terms and Major Customers

The Company's sales terms are the same as those generally available throughout the industry. The Company generally permits its customers to return carpet, rug, ceramic tile, wood, vinyl and laminate flooring purchased from it within specified time periods from the date of sale, if the customer is not satisfied with the quality of the product.

During 2007, no single customer accounted for more than 5% of total net sales, and the top ten customers accounted for less than 15% of the Company's sales. The Company believes the loss of one or a few major customers would not have a material adverse effect on its business.

Employees

As of February 1, 2008, the Company employed approximately 36,200 persons consisting of approximately 29,500 in the U.S., approximately 3,500 in Mexico, approximately 2,300 in Europe, approximately 800 in Malaysia and approximately 100 in Canada. The majority of the Company's European and Mexican manufacturing employees are members of unions. Most of the Company's U.S. employees are not a party to any collective bargaining agreement. Additionally, the Company has not experienced any strikes or work stoppages in the U.S., Mexico or Malaysia for over 20 years. The Company believes that its relations with its employees are good.

Available Information

The Company's Internet address is <http://mohawkind.com>. The Company makes the following reports filed by it available, free of charge, on its website under the heading "Investor Information":

annual reports on Form 10-K;

quarterly reports on Form 10-Q;

current reports on Form 8-K; and

amendments to the foregoing reports.

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The foregoing reports are made available on the Company's website as soon as practicable after they are filed with, or furnished to, the Securities and Exchange Commission (SEC).

Item 1A. Risk Factors

Certain Factors affecting the Company's Performance

In addition to the other information provided in this Annual Report on Form 10-K, the following risk factors should be considered when evaluating an investment in shares of Common Stock.

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

The floor covering industry is sensitive to changes in general economic conditions, such as consumer confidence and income, corporate and government spending, interest rate levels, availability of credit and demand for housing. The current downturn in the U.S. housing market has negatively impacted the floor covering industry and the Company's business and further significant or prolonged declines in spending for replacement floor covering products or new construction activity could have a material adverse effect on the Company's business.

The floor covering industry in which the Company participates is highly dependent on general economic conditions, such as consumer confidence and income, corporate and government spending, interest rate levels, availability of credit and demand for housing. The Company derives a majority of the Company's sales from the replacement segment of the market. Therefore, economic changes that result in a significant or prolonged decline in spending for remodeling and replacement activities could have a material adverse effect on the Company's business and results of operations.

The floor covering industry is highly dependent on construction activity, including new construction, which is cyclical in nature and currently in a downturn. The current downturn in the U.S. housing market has negatively impacted the floor covering industry and the Company's business. Although the impact of a decline in new construction activity is typically accompanied by an increase in remodeling and replacement activity, these activities have also lagged during the current downturn. A significant or prolonged decline in residential or commercial construction activity could have a material adverse effect on the Company's business and results of operations.

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

The prices of raw materials and fuel-related costs vary with market conditions. The Company's costs for carpet raw materials and fuel-related materials are currently higher than historical averages and may remain so indefinitely. Although the Company generally attempts to pass on increases in raw material and fuel-related costs to its customers, the Company's ability to do so is dependent upon the rate and magnitude of any increase, competitive pressures and market conditions for the Company's 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, the Company's profitability may be materially adversely affected.

The Company faces intense competition in the flooring industry, which could decrease demand for the Company's products or force it to lower prices, which could have a material adverse effect on the Company's profitability.

The floor covering industry is highly competitive. The Company faces competition from a number of manufacturers and independent distributors. Some of the Company's competitors are larger and have greater resources and access to capital than the Company does. Maintaining the Company's competitive position may

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require substantial investments in the Company's product development efforts, manufacturing facilities, distribution network and sales and marketing activities. Competitive pressures may also result in decreased demand for the Company's products or force the Company to lower prices. Any of these factors could have a material adverse effect on the Company's business.

The Company may experience certain risks associated with acquisitions.

The Company has typically grown its business through acquisitions. Growth through acquisitions involves risks, many of which may continue to affect the Company after the acquisition. The Company can not give assurance that an acquired company will achieve the levels of revenue, profitability and production that the Company expects. The combination of an acquired company's business with the Company's existing businesses involves risks. The Company can not be assured that reported earnings will meet expectations because of goodwill and intangible asset impairment, increased interest costs and issuance of additional securities or incurrence of debt. The Company may also face challenges in consolidating functions, integrating the Company's organizations, procedures, operations and product lines in a timely and efficient manner and retaining key personnel. These challenges may result in:

maintaining executive offices in different locations;

manufacturing and selling different types of products through different distribution channels;

conducting business from various locations;

maintaining different operating systems and software on different computer hardware; and

providing different employment and compensation arrangements for employees.

The diversion of management attention and any difficulties encountered in the transition and integration process could have a material adverse effect on the Company's revenues, level of expenses and operating results.

Failure to successfully manage and integrate an acquisition with the Company's existing operations could lead to the potential loss of customers of the acquired business, the potential loss of employees who may be vital to the new operations, the potential loss of business opportunities or other adverse consequences that could affect the Company's financial condition and results of operations. Even if integration occurs successfully, failure of the acquisition to achieve levels of anticipated sales growth, profitability or productivity or otherwise not perform as expected, may adversely impact the Company's financial condition and results of operations.

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

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

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

The principal raw materials used in the Company's manufacturing operations include nylon and polyester and polypropylene resins and fibers, which are used primarily in the Company's carpet and rugs business; talc, clay, nepheline syenite and various glazes, including frit (ground glass), zircon and stains, which are used exclusively in the Company's ceramic tile business; wood, paper, and resins which are used primarily in the Company's laminate flooring business; and other materials. 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 the Company's business.

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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 it 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 and Europe could have a material adverse effect on the Company's business.

The Company's manufacturing facilities in Mexico and Europe represent a significant portion of the Company's capacity for ceramic tile and laminate flooring, respectively. Accordingly, an event that has a material adverse impact on either of these operations could have a material adverse effect on the Company. The business, regulatory and political environments in Mexico and Europe differ from those in the U.S., and the Company's Mexican and European operations are exposed to legal, currency, tax, political, and economic risks specific to the countries in which they occur, particularly with respect to labor regulations, which tend to be more stringent in Europe and, to a lesser extent, Mexico. The Company cannot assure investors that the Company will succeed in developing and implementing policies and strategies to counter the foregoing factors effectively in each location where the Company does business and therefore that the foregoing factors will not have a material adverse effect on the Company's operations or upon the Company's financial condition and results of operations.

The Company could face increased competition as a result of the agreements under World Trade Organization (WTO) and the North American Free Trade Agreement (NAFTA).

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

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

Fluctuations in currency exchange rates may impact the Company's financial condition and results of operations and may affect the comparability of results between the Company's financial periods.

The results of the Company's foreign subsidiaries reported in the local currency are translated into U.S. dollars for balance sheet accounts using exchange rates in effect at the balance sheet date and for the statement of earnings accounts using the Company's weighted average rates during the period. The exchange rates between some of these currencies and the U.S. dollar in recent years have fluctuated significantly and may continue to do so in the future. Although the Company has not yet experienced material losses due to foreign currency fluctuation, the Company may not be able to manage effectively the Company's currency translation risks, and volatility in currency exchange rates may have a material adverse effect on the carrying value of the Company's debt and results of operations and affect comparability of the Company's results between financial periods.

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If the Company is unable to protect the Company's intellectual property rights, particularly with respect to the Company's patented laminate flooring technology and the Company's registered trademarks, the Company's business and prospects could be harmed.

The future success and competitive position of certain of the Company's businesses, particularly the Company's laminate flooring business, depend in part upon the Company's ability to obtain and maintain proprietary technology used in the Company's principal product families. The Company relies, in part, on the patent, trade secret and trademark laws of the U.S. and countries in Europe, as well as confidentiality agreements with some of the Company's employees, to protect that technology.

The Company has obtained a number of patents relating to the Company's products and associated methods and has filed applications for additional patents, including the UNICLIC® family of patents, which protects Unilin's interlocking laminate flooring panel technology. The Company cannot assure investors that any patents owned by or issued to it will provide the Company with competitive advantages, that third parties will not challenge these patents, or that the Company's pending patent applications will be approved. In addition, patent filings by third parties, whether made before or after the date of the Company's filings, could render the Company's intellectual property less valuable.

Furthermore, despite the Company's efforts, the Company may be unable to prevent competitors and/or third parties from using the Company's technology without the Company's authorization, independently developing technology that is similar to that of the Company or designing around the Company's patents. The use of the Company's technology or similar technology by others could reduce or eliminate any competitive advantage the Company has developed, cause the Company to lose sales or otherwise harm the Company's business. In addition, if the Company does not obtain sufficient protection for the Company's intellectual property, the Company's competitiveness in the markets it serves could be significantly impaired, which would limit the Company's growth and future revenue.

The Company has obtained and applied for numerous U.S. and Foreign Service marks and trademark registrations and will continue to evaluate the registration of additional service marks and trademarks, as appropriate. The Company cannot guarantee that any of the Company's pending or future applications will be approved by the applicable governmental authorities. Moreover, even if such applications are approved, third parties may seek to oppose or otherwise challenge the registrations. A failure to obtain trademark registrations in the U.S. and in other countries could limit the Company's ability to protect the Company's trademarks and impede the Company's marketing efforts in those jurisdictions.

The Company requires third parties with access to the Company's trade secrets to agree to keep such information confidential. While such measures are intended to protect the Company's trade secrets, there can be no assurance that these agreements will not be breached, that the Company will have adequate remedies for any breach or that the Company's confidential and proprietary information and technology will not be independently developed by or become otherwise known to third parties. In any of these circumstances, the Company's competitiveness could be significantly impaired, which would limit the Company's growth and future revenue.

Companies may claim that the Company infringed their intellectual property or proprietary rights, which could cause it to incur significant expenses or prevent it from selling the Company's products.

In the past the Company has had companies claim that certain technologies incorporated in the Company's products infringe their patent rights. There can be no assurance that the Company will not receive notices in the future from parties asserting that the Company's products infringe, or may infringe, those parties' intellectual property rights. The Company cannot be certain that the Company's products do not and will not infringe issued patents or other intellectual property rights of others. Historically, patent applications in the U.S. and some foreign countries have not been publicly disclosed until the patent is issued (or, in some recent cases, until 18 months following submission), and the Company may not be aware of currently filed patent applications that relate to the Company's products or processes. If patents are later issued on these applications, the Company may be liable for infringement.

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Furthermore, the Company may initiate claims or litigation against parties for infringement of the Company's proprietary rights or to establish the invalidity, noninfringement, or unenforceability of the proprietary rights of others. Likewise, the Company may have similar claims brought against it by competitors. Litigation, either as plaintiff or defendant, could result in significant expense to the Company and divert the efforts of the Company's technical and management personnel from operations, whether or not such litigation is resolved in the Company's favor. In the event of an adverse ruling in any such litigation, the Company might be required to pay substantial damages (including punitive damages and attorneys fees), discontinue the use and sale of infringing products, expend significant resources to develop non-infringing technology or obtain licenses to infringing technology. There can be no assurance that licenses to disputed technology or intellectual property rights would be available on reasonable commercial terms, if at all. In the event of a successful claim against the Company along with failure to develop or license a substitute technology, the Company's business, financial condition and results of operations would be materially and adversely affected.

The Company is subject to changing regulation of corporate governance and public disclosure that have increased both costs and the risk of noncompliance.

The Company's stock is publicly traded. As a result, the Company is subject to the rules and regulations of federal and state agencies and financial market exchange entities charged with the protection of investors and the oversight of companies whose securities are publicly traded. These entities, including the Public Company Accounting Oversight Board, the SEC and NYSE, have in recent years issued new requirements and regulations, most notably the Sarbanes-Oxley Act of 2002. From time to time since the adoption of the Sarbanes-Oxley Act of 2002, these authorities have continued to develop additional regulations or interpretations of existing regulations. The Company's efforts to comply with the regulations and interpretations have resulted in, and are likely to continue to result in, increased general and administrative costs and diversion of management's time and attention from revenue generating activities to compliance activities.

Forward-Looking Information

Certain of the statements in this Annual Report on Form 10-K, particularly those anticipating future performance, business prospects, growth and operating strategies, proposed acquisitions, and similar matters, and those that include the words believes, anticipates, forecast, estimates or similar expressions constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended. For those statements, Mohawk claims the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. There can be no assurance that the forward-looking statements will be accurate because they are based on many assumptions, which involve risks and uncertainties. The following important factors could cause future results to differ: changes in industry conditions; competition; raw material prices; energy costs; timing and level of capital expenditures; integration of acquisitions; introduction of new products; rationalization of operations; litigation; and other risks identified in Mohawk's SEC reports and public announcements.

Item 1B. Unresolved Staff Comments

None

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The Company owns a 47,500 square foot headquarters office in Calhoun, Georgia on an eight-acre site. The Company also owns a 2,089,000 square foot manufacturing facility located in Dalton, Georgia, used by the Mohawk segment, a 1,744,072 and 974,900 square foot manufacturing facility located in Monterey, Mexico and Muskogee, Oklahoma used by the Dal-Tile segment and a 1,128,535 square foot manufacturing facility located in Wielsbeke, Belgium used by the Unilin segment. The following table summarizes the Company's facilities both owned and leased for each segment in square feet:

| Primary Purpose | Mohawk Segment | | Dal-Tile Segment | | Unilin Segment | |
|--------------------------|----------------|-----------|------------------|-----------|----------------|---------|
| | Owned | Leased | Owned | Leased | Owned | Leased |
| Manufacturing | 19,803,505 | 110,454 | 4,420,098 | | 7,509,582 | 876,529 |
| Selling and Distribution | 4,294,843 | 5,169,960 | 152,811 | 7,942,001 | 120,000 | 89,150 |
| Other | 982,825 | | 321,312 | 36,000 | 142,632 | |
| Total | 25,081,173 | 5,280,414 | 4,894,221 | 7,978,001 | 7,772,214 | 965,679 |

The Company's properties are in good condition and adequate for its requirements. The Company believes its principal plants are generally adequate to meet its production plans pursuant to the Company's long-term sales goals. In the ordinary course of business, the Company monitors the condition of its facilities to ensure that they remain adequate to meet long-term sales goals and production plans.

Item 3. Legal Proceedings

The Company is involved in 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 by the Company to be contemplated to which the Company is a party or to which any of its property is subject.

In *Shirley Williams et al. v. Mohawk Industries, Inc.*, four plaintiffs filed a putative class action lawsuit in January 2004 in the United States District Court for the Northern District of Georgia, alleging that they are former and current employees of the Company and that the actions and conduct of the Company, including the employment of persons who are not authorized to work in the United States, have damaged them and the other members of the putative class by suppressing the wages of the Company's hourly employees in Georgia. The plaintiffs seek a variety of relief, including (a) treble damages; (b) return of any allegedly unlawful profits; and (c) attorney's fees and costs of litigation. In February 2004, the Company filed a Motion to Dismiss the Complaint, which was denied by the District Court in April 2004. Following appellate review of this decision, the case has been returned to the District Court and discovery is proceeding. On December 18, 2007, the plaintiffs filed a motion for class certification and on January 30, 2008, the Company filed its opposition to such motion. The court has not yet made a ruling on the motion. The Company will continue to vigorously defend itself against this action.

In an internal review, the Company discovered that it had exchanged employee compensation information with its competitors while gathering market data. The Company discontinued this activity and voluntarily disclosed the practice to the Department of Justice. No claim has been asserted.

The Company believes that adequate provisions for resolution of all contingencies, claims and pending litigation have been made for probable losses and that the ultimate outcome of these actions will not have a material adverse effect on its financial condition but could have a material adverse effect on its results of operations in a given quarter or annual period.

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Environmental Matters

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

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of security holders of the Company during the fourth quarter ended December 31, 2007.

Table of Contents**PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**
Market for the Common Stock

The Company's common stock, \$0.01 par value per share (the "Common Stock") is quoted on the New York Stock Exchange ("NYSE") under the symbol "MHK". The table below shows the high and low sales prices per share of the Common Stock as reported on the NYSE Composite Tape, for each fiscal period indicated.

| | Mohawk Common Stock | |
|---|--------------------------------|------------|
| | High | Low |
| 2006 | | |
| First quarter | \$ 90.88 | 80.05 |
| Second quarter | 81.50 | 69.47 |
| Third quarter | 77.18 | 62.80 |
| Fourth quarter | 79.64 | 70.00 |
| 2007 | | |
| First quarter | \$ 94.35 | 75.15 |
| Second quarter | 108.00 | 81.28 |
| Third quarter | 103.73 | 80.32 |
| Fourth quarter | 87.44 | 73.40 |
| 2008 | | |
| First quarter (through February 25, 2008) | \$ 83.09 | 63.00 |

As of February 25, 2008, there were approximately 340 holders of record of Common Stock. The Company has not paid or declared any cash dividends on shares of its Common Stock since completing its initial public offering. The Company's policy is to retain all net earnings for the development of its business, and presently, it does not anticipate paying cash dividends on the Common Stock in the foreseeable future. The payment of future cash dividends will be at the sole discretion of the Board of Directors and will depend upon the Company's profitability, financial condition, cash requirements, future prospects and other factors deemed relevant by the Board of Directors.

The Company did not repurchase any of its common stock during the fourth quarter of 2007.

Table of Contents**Item 6. Selected Financial Data**

The following table sets forth the selected financial data of the Company for the periods indicated, which information is derived from the consolidated financial statements of the Company. On November 10, 2003, the Company acquired certain assets and assumed certain liabilities of the Lees Carpet division of Burlington Industries, Inc. (Lees Carpet) for approximately \$350 million in cash. On October 31, 2005, the Company acquired all the outstanding shares of Unilin Holding NV (Unilin Acquisition). The total purchase price of the Unilin Acquisition, net of cash, was approximately Euro 2.1 billion (approximately \$2.5 billion). On August 13, 2007, the Company acquired certain wood flooring assets and liabilities of Columbia Forest Products, Inc. (Columbia) for approximately \$147 million in cash. The consolidated financial statements include the results of all acquisitions from the date of acquisition. The selected financial data should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the Company's consolidated financial statements and notes thereto included elsewhere herein.

| | 2007 | At or for the Years Ended December 31, | | | 2003 |
|--|--------------|--|-----------|-----------|-----------|
| | | 2006 | 2005 | 2004 | |
| | | (In thousands, except per share data) | | | |
| Statement of earnings data: | | | | | |
| Net sales | \$ 7,586,018 | 7,905,842 | 6,620,099 | 5,880,372 | 4,999,381 |
| Cost of sales(a) | 5,471,234 | 5,674,531 | 4,851,853 | 4,256,129 | 3,605,579 |
| Gross profit | 2,114,784 | 2,231,311 | 1,768,246 | 1,624,243 | 1,393,802 |
| Selling, general and administrative expenses | 1,364,678 | 1,392,251 | 1,095,862 | 985,251 | 851,773 |
| Operating income | 750,106 | 839,060 | 672,384 | 638,992 | 542,029 |
| Interest expense | 154,469 | 173,697 | 66,791 | 53,392 | 55,575 |
| Other expense (income), net | 674 | 8,488 | 3,460 | 4,809 | (1,980) |
| U.S. customs refund(b) | (9,154) | (19,436) | | | |
| | 145,989 | 162,749 | 70,251 | 58,201 | 53,595 |
| Earnings before income taxes | 604,117 | 676,311 | 602,133 | 580,791 | 488,434 |
| Income taxes(c) | (102,697) | 220,478 | 214,995 | 209,994 | 178,285 |
| Net earnings | \$ 706,814 | 455,833 | 387,138 | 370,797 | 310,149 |
| Basic earnings per share(c) | \$ 10.37 | 6.74 | 5.78 | 5.56 | 4.68 |
| Weighted-average common shares outstanding | 68,172 | 67,674 | 66,932 | 66,682 | 66,251 |
| Diluted earnings per share(c) | \$ 10.32 | 6.70 | 5.72 | 5.49 | 4.62 |
| Weighted-average common and dilutive potential common shares outstanding | 68,492 | 68,056 | 67,644 | 67,557 | 67,121 |
| Balance sheet data: | | | | | |
| Working capital | \$ 1,238,220 | 783,148 | 1,277,087 | 972,325 | 592,310 |
| Total assets(c) | 8,680,050 | 8,212,209 | 8,066,025 | 4,429,993 | 4,187,638 |
| Long-term debt (including current portion) | 2,281,834 | 2,783,681 | 3,308,370 | 891,341 | 1,012,413 |
| Stockholders' equity | 4,707,357 | 3,715,263 | 3,058,238 | 2,668,512 | 2,297,801 |

(a) In 2005, gross margin was impacted by a non-recurring \$34,300 (\$22,300 net of tax) fair value adjustment to Unilin's acquired inventory.

(b) In 2007 and 2006, the Company received partial refunds from the U.S. government in reference to settlement of custom disputes dating back to 1982.

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- (c) During the fourth quarter of 2007, the Company implemented a change in residency of one of its foreign subsidiaries. This tax restructuring resulted in a step up in the subsidiary's taxable basis, which resulted in the recognition of a deferred tax asset of approximately \$245,000 and a related income tax benefit of approximately \$272,000.

Table of Contents**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**
Overview

The Company is a leading producer of floor covering products for residential and commercial applications in the U.S. and Europe with net sales in 2007 of \$7.6 billion. The Company is the second largest carpet and rug manufacturer, a leading manufacturer, marketer and distributor of ceramic tile, natural stone and hardwood flooring in the U.S. and a leading producer of laminate flooring in the U.S. and Europe.

The Company has three reporting segments, the Mohawk segment, the Dal-Tile segment and the Unilin segment. The Mohawk segment manufactures, markets and distributes its product lines, which include carpet, rugs, pad, ceramic tile, hardwood, resilient and laminate, through its network of regional distribution centers and satellite warehouses using Company-operated trucks, common carrier or rail transportation. The segment product lines are sold through various selling channels, which include floor covering retailers, home centers, mass merchandisers, department stores, independent distributors, commercial dealers and commercial end users. The Dal-Tile segment manufactures, markets and distributes its product lines, which include ceramic tile, porcelain tile and stone products, through its network of regional distribution centers and approximately 262 company-operated sales service centers using Company-operated trucks, common carriers or rail transportation. The segment product lines are purchased by floor covering retailers, home centers, independent distributors, tile specialty dealers, tile contractors, and commercial end users. The Unilin segment manufactures, markets and distributes its product lines, which include laminate flooring, wood flooring, insulated roofing and other wood-based panels through various selling channels, which include independent retailers, home centers, independent distributors, contractors, and commercial users.

In 2006, the primary categories of the U.S. floor covering industry were carpet and rug (62%), ceramic tile (13%), hardwood (11%), resilient and rubber (8%), and laminate (6%). While the U.S. floor covering industry has experienced softened demand in 2007, due to the downturn in the U.S. residential housing market, compound average growth rates for all flooring categories for the period from 2002 through 2006 have met or exceeded the growth rates (measured in sales dollars) for the real gross domestic product of the U.S. over the same period. During this period, the compound average growth rate was 4.3% for carpets and rugs, 7.6% for ceramic tile, 5.3% for resilient and rubber, 13.5% for laminate and 7.1% for hardwood.

The Company reported net earnings of \$706.8 million or diluted earnings per share (EPS) of \$10.32, compared to net earnings of \$455.8 million and \$6.70 EPS for 2006. The increase in EPS resulted primarily from a tax restructuring in one of the Company's foreign subsidiaries, which resulted in the recognition of a deferred tax asset of approximately \$245 million and a related income tax benefit of approximately \$272 million. In addition, EPS was favorably impacted by continued growth in the European and commercial channels and favorable Euro exchange rates. The increase was partially offset by lower sales demand in the Company's U.S. residential new construction and replacement channels, which the Company believes is primarily attributable to the slowing U.S. housing industry.

The Company believes that industry demand for the products manufactured by the Company will continue to be impacted by the softened demand beginning in the fourth quarter of 2006 and continuing throughout 2007, and because of this the Company anticipates continued slow U.S. industry sales in the first quarter of 2008 that will impact margins and earnings. Both of our Mohawk and Dal-Tile segments reflect these industry trends, although the Company believes both are well-positioned for industry improvement in the long-term. The Company also continues to be impacted by higher raw material costs. The Company continues to look at ways to reduce manufacturing, administration, and marketing expenses based on current industry conditions and will continue to adjust as required.

Table of Contents**Results of Operations**

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

| | 2007 | For the Years Ended December 31, | | | | 2005 |
|--|--------------|----------------------------------|-----------|--------|-----------|--------|
| | | 2006 | | | | |
| (In thousands) | | | | | | |
| Statement of earnings data: | | | | | | |
| Net sales | \$ 7,586,018 | 100.0% | 7,905,842 | 100.0% | 6,620,099 | 100.0% |
| Cost of sales | 5,471,234 | 72.1% | 5,674,531 | 71.8% | 4,851,853 | 73.3% |
| Gross profit | 2,114,784 | 27.9% | 2,231,311 | 28.2% | 1,768,246 | 26.7% |
| Selling, general and administrative expenses | 1,364,678 | 18.0% | 1,392,251 | 17.6% | 1,095,862 | 16.6% |
| Operating income | 750,106 | 9.9% | 839,060 | 10.6% | 672,384 | 10.2% |
| Interest expense | 154,469 | 2.0% | 173,697 | 2.2% | 66,791 | 1.0% |
| Other (income) expense, net | 674 | 0.0% | 8,488 | 0.1% | 3,460 | 0.1% |
| U.S. customs refund | (9,154) | -0.1% | (19,436) | -0.2% | | 0.0% |
| | 145,989 | 1.9% | 162,749 | 2.1% | 70,251 | 1.1% |
| Earnings before income taxes | 604,117 | 8.0% | 676,311 | 8.6% | 602,133 | 9.1% |
| Income taxes | (102,697) | -1.4% | 220,478 | 2.8% | 214,995 | 3.2% |
| Net earnings | \$ 706,814 | 9.3% | 455,833 | 5.8% | 387,138 | 5.8% |

Year Ended December 31, 2007, as Compared with Year Ended December 31, 2006

Net sales for the year ended December 31, 2007, were \$7,586.0 million, reflecting a decrease of \$319.8 million, or approximately 4.0%, from the \$7,905.8 million reported for the year ended December 31, 2006. The decrease primarily occurred in the Company's U.S. residential new construction and replacement channels, which the Company believes was caused by the slowing U.S. housing industry offset by stronger sales within the European product categories and the impact of the acquisition of the Columbia wood flooring business. The Mohawk segment recorded net sales of \$4,205.7 million in 2007 compared to \$4,742.1 million in 2006, representing a decrease of \$536.4 million, or approximately 11.3%. The decrease was due to lower demand in its residential new construction and replacement channels, which the Company believes resulted primarily from the slowing U.S. housing industry. The Dal-Tile segment recorded net sales of \$1,937.7 million in 2007, representing a decrease of \$4.1 million, or approximately 0.2%, compared to \$1,941.8 million reported in 2006. The decrease was primarily attributable to lower sales within its residential channel, which the Company believes was due to the slowing U.S. housing industry. The Unilin segment recorded net sales of \$1,487.6 million in 2007 compared to \$1,236.9 million in 2006, representing an increase of \$250.7 million, or approximately 20.3%. The increase in sales was driven by an increase in selling prices, higher demand in Europe, favorable Euro exchange rates, the acquisition of the Columbia wood flooring business and an increase in patent revenues.

Quarterly net sales and the percentage changes in net sales by quarter for 2007 versus 2006 were as follows (dollars in thousands)

| | 2007 | 2006 | Change |
|----------------|--------------|-----------|--------|
| First quarter | \$ 1,863,863 | 1,925,106 | -3.2% |
| Second quarter | 1,977,210 | 2,058,123 | -3.9 |
| Third quarter | 1,937,677 | 2,024,019 | -4.3 |
| Fourth quarter | 1,807,268 | 1,898,594 | -4.8 |
| Total year | \$ 7,586,018 | 7,905,842 | -4.0% |

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Gross profit was \$2,114.8 million (27.9% of net sales) for 2007 and \$2,231.3 million (28.2% of net sales) for 2006. Gross profit as a percentage of net sales for 2007 was unfavorably impacted by lower sales volume in the U.S., higher raw material costs and plant shutdowns in the U.S. offset by price increases and higher demand in Europe.

Selling, general and administrative expenses for 2007 were \$1,364.7 million (18.0% of net sales) compared to \$1,392.3 million (17.6% of net sales) for 2006. The increase in the selling, general and administrative expenses as a percentage of net sales was primarily attributable to lower sales in proportion to selling, general and administrative expenses.

Operating income for 2007 was \$750.1 million (9.9% of net sales) compared to \$839.1 million (10.6% of net sales) in 2006. Operating income as a percentage of net sales in 2007 was unfavorably impacted by lower sales volume, which the Company believes was primarily attributable to the slowing U.S. housing industry, and plant shutdowns partially offset by higher sales in Europe. Operating income attributable to the Mohawk segment was \$254.9 million (6.1% of segment net sales) in 2007 compared to \$387.4 million (8.2% of segment net sales) in 2006. Operating income as a percentage of the Mohawk segment net sales was unfavorably impacted by its residential new construction and replacement channels, which the Company believes resulted from the slowing U.S. housing industry, increased manufacturing costs resulting from lower production volume, higher raw material costs and plant shutdowns. Operating income attributable to the Dal-Tile segment was \$258.7 million (13.4% of segment net sales) in 2007, compared to \$270.9 million (14.0% of segment net sales) in 2006. Operating income as a percentage of the Dal-Tile segment net sales was unfavorably impacted by its residential channel, which the Company believes resulted from the slowing U.S. housing industry and a plant shutdown. Operating income attributable to the Unilin segment was \$272.3 million (18.3% of segment net sales) for 2007 compared to \$214.1 million (17.3% of segment net sales) for 2006. Operating income as a percentage of the Unilin segment was favorably impacted by an increase in selling prices and higher demand.

Interest expense for 2007 was \$154.5 million compared to \$173.7 million in 2006. The decrease in interest expense for 2007 as compared to 2006 was attributable to lower average debt, partially offset by higher interest rates in 2007 when compared to 2006.

The Company has received partial refunds from the U.S. government in reference to settling custom disputes dating back to 1982. Accordingly, the Company recorded a gain of \$9.2 million (\$5.8 million net of taxes) and \$19.4 million (\$12.3 million net of taxes) in other income (expense) in 2007 and 2006, respectively. Additional future recoveries will be recorded as realized.

The Company had an income tax benefit of \$102.7 million, or (17.0)% of earnings before income taxes for 2007, compared to an income tax expense of \$220.5 million, or 32.6% of earnings before income taxes for 2006. During the fourth quarter of 2007, the Company implemented a change in residency of one of its foreign subsidiaries. This tax restructuring resulted in a step up in the subsidiary's taxable basis, which resulted in the recognition of a deferred tax asset of \$245.1 million and a related income tax benefit of \$271.6 million. The recognition of the deferred tax asset resulted in a reduction in the Company's effective tax rate for the year. In addition the tax rate also decreased due to a greater percentage of income in lower taxed jurisdictions and changes implemented in the third quarter of 2007, which resulted in higher interest deductions outside the U.S.

Year Ended December 31, 2006, as Compared with Year Ended December 31, 2005

Net sales for the year ended December 31, 2006, were \$7,905.8 million, reflecting an increase of \$1,285.7 million, or approximately 19.4%, over the \$6,620.1 million reported for the year ended December 31, 2005. The increased net sales are primarily attributable to the acquisition of Unilin in October 2005 (which represented approximately 81% of the net sales growth), internal sales growth within hard surfaces and selling price increases. The Mohawk segment recorded net sales of \$4,742.1 million in 2006 compared to \$4,716.7 million in 2005, representing an increase of \$25.4 million or approximately 0.5%. The increase was attributable to selling

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price increases and internal growth within the commercial soft surface category and hard surface product categories offset by declines in the new construction and residential replacement soft surface categories. The Dal-Tile segment recorded net sales of \$1,941.8 million in 2006, reflecting an increase of \$207.0 million or 11.9%, over the \$1,734.8 million reported in 2005. The increase was attributable to internal growth in all product categories, acquisitions and selling price increases. The Unilin segment recorded net sales of \$1,236.9 million for twelve months of 2006 compared to \$168.8 million for two months of 2005.

Quarterly net sales and the percentage changes in net sales by quarter for 2006 versus 2005 were as follows (dollars in thousands)

| | 2006 | 2005 | Change |
|-------------------|---------------------|------------------|--------------|
| First quarter | \$ 1,925,106 | 1,493,222 | 28.9% |
| Second quarter | 2,058,123 | 1,624,692 | 26.7 |
| Third quarter | 2,024,019 | 1,697,634 | 19.2 |
| Fourth quarter(1) | 1,898,594 | 1,804,551 | 5.2 |
| Total year | \$ 7,905,842 | 6,620,099 | 19.4% |

(1) The fourth quarter of 2005 includes two months of Unilin sales.

Gross profit was \$2,231.3 million (28.2% of net sales) for 2006 and \$1,768.2 million (26.7% of net sales) for 2005. Gross profit as a percentage of net sales was favorably impacted by the Unilin Acquisition, selling price increases, internal growth and acquisitions within the Dal-Tile segment. The increase was offset by increased raw material, distribution and start up costs when compared to 2005. In addition, the 2005 gross margin was impacted by a non-recurring \$34.3 million (\$22.3 million net of taxes) fair value adjustment applied to Unilin's acquired inventory.

Selling, general and administrative expenses for 2006 were \$1,392.3 million (17.6% of net sales) compared to \$1,095.9 million (16.6% of net sales) for 2005. The increase in selling, general and administrative expenses as a percentage of net sales was primarily attributable to amortization of intangibles and the expensing of stock options, which was not required in 2005, during the current year when compared to 2005.

Operating income for 2006 was \$839.1 million (10.6% of net sales) compared to \$672.4 million (10.2% of net sales) in 2005. The increase in operating income for 2006 was favorably impacted by the Unilin Acquisition when compared to 2005. Operating income attributable to the Mohawk segment was \$387.4 million (8.2% of segment net sales) in 2006 compared to \$426.8 million (9.0% of segment net sales) in 2005. The percentage decrease in operating income resulted primarily from slower new construction and residential replacement demand within its soft surface product categories, an increase in raw material and energy costs, and increased selling and distribution costs, offset by selling price increases and internal growth within its commercial and hard surface product categories. Operating income attributable to the Dal-Tile segment was \$270.9 million (14.0% of segment net sales) in 2006, compared to \$260.2 million (15.0% of segment net sales) in 2005. The decrease in operating income as a percentage of net sales resulted primarily from higher distribution costs and start up costs at its Muskogee location offset by acquisitions and plant closing costs in the fourth quarter of 2006. Operating income attributable to the Unilin segment was \$214.1 million (17.3% of segment net sales) for 2006 compared to a loss of \$5.2 million for 2005.

The Company has received partial refunds from the U.S. government in reference to settling custom disputes dating back to 1982. Accordingly, the Company recorded a gain of \$19.4 million (\$12.3 million net of taxes) in other income (expense) for the twelve months ended December 31, 2006. Additional future recoveries will be recorded as realized.

Interest expense for 2006 was \$173.7 million compared to \$66.8 million in 2005. The increase in interest expense for 2006 as compared to 2005 was attributable to higher average debt levels as a result of the Unilin Acquisition. In addition, interest rates in 2006 were higher when compared to 2005.

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Income tax expense was \$220.5 million, or 32.6% of earnings before income taxes for 2006 compared to \$215.0 million, or 35.7% of earnings before income taxes for 2005. The decrease in the tax rate is due to the combination of domestic and international tax rates resulting from the Unilin Acquisition when compared to 2005.

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 trade receivables and credit terms from suppliers.

Cash flows generated by operations for 2007 were \$875.1 million compared to \$782.0 million for 2006. Contributing to the improved cash flow was reduced working capital and increased depreciation and amortization compared to the prior year.

Net cash used in investing activities in 2007 was \$310.2 million compared to \$236.7 million for 2006. The increase is due to higher acquisition investments during 2007 as compared to 2006 partially offset by lower capital spending. Capital expenditures, including \$2.8 billion for acquisitions, have totaled \$3.4 billion over the past three years. Capital spending during 2008 for the Mohawk, Dal-Tile and Unilin segments combined, excluding acquisitions, is estimated to range from \$300 million to \$350 million, which includes approximately \$100 million for strategic capacity expansions, and the remaining capital expenditures will be used primarily to purchase equipment and to add manufacturing and distribution capacity. The Company will assess the need to make the capacity expansion additions during the year based on economic and industry conditions.

Net cash used in financing activities for 2007 was \$540.0 million compared to \$620.8 million in 2006. The primary reason for the change was the repayment of certain indebtedness offset by increased borrowings relating to the Columbia acquisition.

On October 28, 2005, the Company entered into a \$1.5 billion five-year, senior, unsecured, revolving credit and term loan facility (the "senior unsecured credit facilities"). The senior unsecured credit facilities replaced a then-existing credit facility and various uncommitted credit lines. The Company entered into the senior unsecured credit facility to finance the Unilin Acquisition and to provide for working capital requirements. The senior unsecured credit facilities consist of (i) a multi-currency \$750.0 million revolving credit facility, (ii) a \$389.2 million term loan facility and (iii) a Euro 300.0 million term loan facility, all of which mature on October 28, 2010. At December 31, 2007, \$215.5 million of borrowings was outstanding under these facilities. The borrowings outstanding are comprised of \$141.9 million under the revolving credit facility and Euro 50.0 million, or approximately \$73.6 million, borrowings outstanding under the Euro term facility. The balance of the \$389.2 million term loan facility was repaid in 2006.

At December 31, 2007, a total of approximately \$504.4 million was available under the revolving credit facility. The amount used under the revolving credit facility at December 31, 2007, was \$245.6 million. The amount used under the revolving credit facility is composed of \$141.9 million borrowings, \$55.6 million standby letters of credit guaranteeing the Company's industrial revenue bonds and \$48.1 million standby letters of credit related to various insurance contracts and foreign vendor commitments.

The senior unsecured credit facilities bear interest at (i) the greater of (x) prime rate or (y) the overnight federal funds rate plus 0.50%, or (ii) LIBOR plus an indexed amount based on the Company's senior, unsecured, long-term debt rating.

The Company has an on-balance sheet trade accounts receivable securitization agreement (the "Securitization Facility"). The Securitization Facility allows the Company to borrow up to \$350.0 million based on available accounts receivable. At December 31, 2007 and 2006, the Company had \$190.0 million outstanding. The Securitization Facility is secured by trade receivables. During the third quarter of 2007, the Company extended the term of its Securitization Facility until July 2008.

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On November 8, 2005, one of the Company's subsidiaries entered into a Euro 130.0 million, five-year unsecured, revolving credit facility, maturing on November 8, 2010 (the Euro revolving credit facility). This agreement bears interest at EURIBOR plus an indexed amount based on the Company's senior, unsecured, long-term debt rating. The Company guaranteed the obligations of that subsidiary under the Euro revolving credit facility and any of the Company's other subsidiaries that become borrowers under the Euro revolving credit facility. As of December 31, 2007, the Company had no borrowings outstanding under this facility. As of December 31, 2006, the Company had borrowings outstanding of Euro 18.8 million, or approximately \$24.8 million, under this facility.

The Company's senior unsecured credit facilities and the Euro revolving credit facility both contain debt to capital ratio requirements and other customary covenants. The Company was in compliance with these covenants at December 31, 2007. Under both of these credit facilities, the Company must pay an annual facility fee ranging from 0.06% to 0.25% depending upon the Company's senior, unsecured long-term debt rating.

On January 17, 2006, the Company issued \$500.0 million aggregate principal amount of 5.750% notes due 2011 and \$900.0 million aggregate principal amount of 6.125% notes due 2016. The net proceeds from the issuance of these notes were used to pay off a \$1.4 billion bridge credit facility entered into in connection with the Unilin Acquisition. Interest payable on each series of the notes is subject to adjustment if either Moody's Investor Service, Inc. or Standard & Poor's Ratings Services, or both, downgrades the rating they have assigned to the notes. Each rating agency downgrade results in a 0.25% increase in the interest rate, subject to a maximum increase of 1% per rating agency. If later the rating of these notes improves, then the interest rates would be reduced accordingly. The provision for increasing the interest rate will no longer apply if the rating of these notes from both rating agencies improves above the rating of these notes in effect at the time of the issuance of the notes. There have been no adjustments to the interest rate of these notes.

In 2002, the Company issued \$300.0 million aggregate principal amount of its senior 6.5% notes due 2007 and \$400.0 million aggregate principal amount of its senior 7.2% notes due 2012. In April 2007, the Company repaid its \$300.0 million aggregate principal amount of its senior 6.5% notes. The Company used \$220.0 and \$80.0 million of its availability under its Securitization Facility and its revolving credit facility, respectively, to repay the 6.5% notes.

The Company believes that cash generated from operations in 2008 and availability under its existing revolving credit facility will be sufficient to meet its capital expenditures and working capital requirements in 2008.

The Company's Board of Directors has authorized the repurchase of up to 15 million shares of the Company's outstanding common stock. Since the inception of the program in 1999, a total of approximately 11.5 million shares have been repurchased at an aggregate cost of approximately \$334.7 million. All of these repurchases have been financed through the Company's operations and banking arrangements.

On October 31, 2005, the Company entered into a Discounted Stock Purchase Agreement (the DSPA) with certain members of the Unilin management team (the Unilin Management). Under the terms of the DSPA, the Company will be obligated to make cash payments to the Unilin Management in the event that certain performance goals are satisfied. In each of the years in the five-year period ended December 31, 2010, the remaining members of Unilin Management can earn amounts, in the aggregate, equal to the average value of 30,671 shares of the Company's common stock over the 20 trading day period ending on December 31 of the prior year. Any failure in a given year to reach the performance goals may be rectified, and consequently the amounts payable with respect to achieving such criteria may be made, in any of the other years. The amount of the liability is measured each period and recognized as compensation expense in the statement of operations. During the fiscal year ended December 31, 2007, the Company expensed approximately \$2.3 million under the DSPA.

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

The following is a summary of the Company's future minimum payments under contractual obligations as of December 31, 2007 (in thousands):

| | Total | 2008 | 2009 | 2010 | 2011 | 2012 | Thereafter |
|---|---------------------|----------------|----------------|----------------|----------------|----------------|------------------|
| Recorded Contractual Obligations: | | | | | | | |
| Long-term debt, including current maturities and capital leases | \$ 2,281,834 | 260,439 | 4,141 | 215,685 | 500,197 | 400,201 | 901,171 |
| Unrecorded Contractual Obligations: | | | | | | | |
| Interest payments on long-term debt and capital leases(1) | 641,389 | 136,604 | 124,042 | 121,908 | 85,115 | 63,419 | 110,301 |
| Operating leases | 458,656 | 106,376 | 93,337 | 72,930 | 56,530 | 42,824 | 86,659 |
| Purchase commitments (2) | 372,568 | 279,236 | 85,399 | 7,582 | 351 | | |
| Expected pension contributions(3) | 1,958 | 1,958 | | | | | |
| Guarantees | 89,546 | 89,546 | | | | | |
| | 1,564,117 | 613,720 | 302,778 | 202,420 | 141,996 | 106,243 | 196,960 |
| Total | \$ 3,845,951 | 874,159 | 306,919 | 418,105 | 642,193 | 506,444 | 1,098,131 |

- (1) For fixed rate debt, the Company calculated interest based on the applicable rates and payment dates. For variable rate debt, the Company estimated average outstanding balances for the respective periods and applied interest rates in effect at December 31, 2007 to these balances.
- (2) Includes commitments for natural gas, electricity and raw material purchases.
- (3) Includes the estimated pension contributions for 2008 only, as the Company is unable to estimate the pension contributions beyond 2008. As of December 31, 2007, the Company has accrued income tax liabilities for uncertain tax positions of \$116.9 million, of which \$48.8 million is current. These liabilities have not been presented in the table above due to uncertainty as to amounts and timing regarding future payments.

Critical Accounting Policies

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

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

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

Accounts receivable and revenue recognition. Revenues are recognized when there is persuasive evidence of an arrangement, delivery has occurred, the price has been fixed or is determinable, and collectibility can be reasonably assured. 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 has been determined using the first-in first-out method (FIFO). Costs included in inventory include raw materials, direct and indirect labor and employee benefits, depreciation, general manufacturing overhead and various other costs of manufacturing. Market, with respect to all inventories, is replacement cost or net realizable value. Inventories on hand are compared against anticipated future usage, which is a function of historical usage, anticipated future selling price, expected sales below cost, excessive quantities and an evaluation for obsolescence. Actual results could differ from assumptions used to value obsolete inventory, excessive inventory or inventory expected to be sold below cost and additional reserves may be required.