

INTERFACE INC  
Form 10-K  
March 02, 2017  
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**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

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**Form 10-K**

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

**For the Fiscal Year Ended January 1, 2017**

**Commission File No.: 001-33994**

**Interface, Inc.**

*(Exact name of registrant as specified in its charter)*

**Georgia**  
*(State of incorporation)*

**58-1451243**  
*(I.R.S. Employer Identification No.)*

**2859 Paces Ferry Road, Suite 2000**  
**Atlanta, Georgia**  
*(Address of principal executive offices)*

**30339**  
*(zip code)*

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Registrant's telephone number, including area code: (770) 437-6800

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

<u>Title of Each Class</u>	<u>Name of Each Exchange on Which Registered:</u>
Common Stock, \$0.10 Par Value Per Share	Nasdaq Global Select Market
Series B Participating Cumulative Preferred Stock Purchase Rights	Nasdaq Global Select Market

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 Section 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 whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). 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 the definitions of "large accelerated filer," "accelerated filer" and a "smaller reporting company" in Rule 12b-2 of the Securities Exchange Act of 1934. (Check one):

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Large Accelerated Filer Accelerated Filer Non-Accelerated Filer Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  
YES NO

Aggregate market value of the voting and non-voting stock held by non-affiliates of the registrant as of July 1, 2016:  
\$1,199,061,440 (63,275,010 shares valued at the closing sale price of \$15.42 on July 1, 2016). See Item 12.

Number of shares outstanding of each of the registrant's classes of Common Stock, as of February 17, 2017:

<u>Class</u>	<u>Number of Shares</u>
Common Stock, \$0.10 par value per share	64,230,649

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Proxy Statement for the 2017 Annual Meeting of Shareholders are incorporated by reference into Part III.

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**PART I**

**ITEM 1. BUSINESS**

**Introduction and General**

*References in this Annual Report on Form 10-K to “Interface,” “the Company,” “we,” “our,” “ours” and “us” refer to Interface Inc. and its subsidiaries or any of them, unless the context requires otherwise.*

We are a worldwide leader in design, production and sales of modular carpet, also known as carpet tile. For the past several years, modular carpet sales growth in the floorcovering industry has significantly outpaced the growth of the overall industry, as architects, designers and end users increasingly recognized the unique and superior attributes of modular carpet, including its dynamic design capabilities, greater economic value (which includes lower costs as a result of reduced waste in both installation and replacement), and installation ease and speed.

As a global company with a reputation for high quality, reliability and premium positioning, we market modular carpet in over 110 countries under the established brand names *Interface*® and *FLOR*®. Our principal geographic markets are the Americas, Europe and Asia-Pacific, where the percentages of our total net sales were approximately 59%, 25% and 16%, respectively, for fiscal year 2016.

Capitalizing on our leadership in modular carpet for the corporate office market segment, we are executing a market diversification strategy to increase our presence and market share for modular carpet in non-corporate office market segments, such as government, education, healthcare, hospitality and retail space. Our diversification strategy also targets the U.S. residential market segment for carpet. As a result of our efforts, our mix of corporate office versus non-corporate office modular carpet sales in the Americas was 44% and 56%, respectively, for 2016. Company-wide, our mix of corporate office versus non-corporate office sales was 59% and 41%, respectively, in 2016. We believe the appeal and utilization of modular carpet is growing in non-corporate office market segments, and we are using our considerable skills and experience with designing, producing and marketing modular products that make us the market leader in the corporate office segment to support and facilitate our penetration into these segments around the world.

**Our Strengths**

Our principal competitive strengths include:

*Market Leader in Attractive Modular Carpet Segment.* We are the world’s leading manufacturer of carpet tile. Modular carpet has become more prevalent across all commercial interiors markets as designers, architects and end users have become more familiar with its unique attributes. We continue to drive this trend with our product innovations and designs discussed below. According to the annual *Floor Focus* interiors industry survey of the top 250 designers in the United States, carpet tile was ranked as the number one “hot product” for each of the years 2002 through 2012, and was ranked number two for each of the years 2013 through 2016. We believe that we are well positioned to lead and capitalize upon the continued shift to modular carpet, both domestically and around the world.

*Established Brands and Reputation for Quality, Reliability and Leadership.* Our products are known in the industry for their high quality, reliability and premium positioning in the marketplace, and our established brand names are leaders in the industry. The 2016 *Floor Focus* survey ranked Interface first in “Best Overall Business Experience” among carpet companies, and it ranked our *Interface* brand second in the survey categories of service, quality, design and performance. In the North American residential market segment, our *FLOR* brand is known for its high style carpet design squares that consumers assemble to create custom rugs, runners or wall-to-wall designs in the home. On the international front, *Interface* is a well-recognized brand name in carpet tiles for commercial and institutional use. More generally, we believe that as the appeal and utilization of modular carpet continues to expand into market segments such as government, healthcare, education, hospitality, and retail and residential space, our reputation as the pioneer of modular carpet — as well as our established brands and leading market position for modular carpet in the corporate office segment — will enhance our competitive advantage in marketing to the customers in these new markets.

*Innovative Product Design and Development Capabilities.* Our product design and development capabilities have long given us a significant competitive advantage, and we believe they continue to do so as modular carpet’s appeal and utilization expand across virtually every market segment and around the globe. One of our recent design innovations is the introduction of long and narrow rectangular carpet tiles in the shape of planks, and even more narrow versions known as *Skinny Planks*<sup>™</sup>. The use of planks and *Skinny Planks* increases the design versatility of our carpet tile, as these products can create aesthetics (such as a herringbone pattern) that are different from, or enhance, that of our traditional square carpet tiles.

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The award-winning design firm David Oakey Designs has had a pivotal role in developing our plank and *Skinny Plank* products, as well as many of our other innovative product designs, and our long-standing exclusive relationship with David Oakey Designs remains vibrant and augments our internal research, development and design staff. As another example, David Oakey Designs has developed products that are manufactured using state-of-the-art tufting technology which allows us to pinpoint tufts of different colored yarns in virtually any arrangement within a carpet tile. These unique designs are best exemplified by our *Urban Retreat*®, *Net Effect*® and *Human Nature*® collections, which are sold throughout our international operations.

Historically, one of our best design innovations is our *i2*™ modular product line, which includes our popular *Entropy*® product for which we received a patent in 2005 on the key elements of its design. The *i2* line introduced and features mergeable dye lots, and includes a number of carpet tile products that are designed to be installed randomly without reference to the orientation of neighboring tiles. The *i2* line offers cost-efficient installation and maintenance, interactive flexibility, and recycled and recyclable materials. Another more recent innovation is our *TacTiles*® carpet tile installation system, which uses small squares of adhesive plastic film to connect intersecting carpet tiles, thus eliminating the need for traditional carpet adhesive and resulting in a reduction in installation time and waste materials.

*Made-to-Order and Global Manufacturing Capabilities.* We have a distinct competitive advantage in meeting two principal requirements of the specified products markets we primarily target — that is, providing custom samples quickly and on-time delivery of customized final products. We also can generate realistic digital samples that allow us to create a virtually unlimited number of new design concepts and distribute them instantly for customer review, while at the same time reducing sampling waste. About half of our modular carpet products worldwide are made-to-order. Our made-to-order capabilities not only enhance our marketing and sales, they significantly improve our inventory turns. Our global manufacturing capabilities in modular carpet production are an important component of this strength, and give us an advantage in serving the needs of multinational corporate customers that require products and services at various locations around the world. Our manufacturing locations across four continents enable us to compete effectively with local producers in our international markets, while giving international customers more favorable delivery times and freight costs.

*Recognized Global Leadership in Ecological Sustainability.* Our long-standing goal and commitment to be ecologically “sustainable” — that is, the point at which we are no longer a net “taker” from the earth and do no harm to the biosphere — have emerged as a competitive strength for our business and remain a strategic initiative. It includes *Mission Zero*®, our global branding initiative, which represents our mission to eliminate any negative impact our companies may have on the environment by the year 2020. It also includes a bold new mission called *Climate Take Back*™, in which we seek to lead the industry in designing and making products in ways that will maintain a climate fit for life. Our acknowledged leadership position and expertise in this area resonate deeply with many of our customers and prospects around the globe, and provide us with a differentiating advantage in competing for business among architects, designers and end users of our products, who often make purchase decisions based on “green” factors. The 2016 *Floor Focus* survey named our Interface business the top among “Green Leaders,” and gave us the top “Green Kudos” honors for our *Net-Works*® recycled fishing net partnership as well as our new *Climate Take Back* mission.



*Experienced and Motivated Management and Sales Force.* An important component of our competitive position is the quality of our management team and its commitment to developing and maintaining an engaged and accountable workforce. Our team is highly skilled and dedicated to guiding our overall growth and expansion into our targeted market segments, while maintaining our leadership in traditional markets and our high contribution margins. We utilize an internal marketing and predominantly commissioned sales force of more than 650 experienced personnel, stationed at over 70 locations in over 30 countries, to market our products and services in person to our customers. Our incentive compensation and our sales and marketing training programs are tailored to promote performance and facilitate leadership by our executives both in strategic areas as well as the Company as a whole.

### **Our Business Strategy and Principal Initiatives**

Our business strategy is to continue to use our leading position in modular carpet and our product design and global made-to-order capabilities as a platform from which to drive acceptance of modular carpet products across several industry segments, while maintaining our leadership position in the corporate office market segment. We will seek to increase revenues and profitability by capitalizing on the above strengths and pursuing the following key strategic initiatives:

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*Continue to Penetrate Non-Corporate Office Market Segments.* We will continue our strategic focus on product design and marketing and sales efforts for non-corporate office market segments such as government, education, healthcare, hospitality, retail and residential space. We began this initiative as part of a market diversification strategy to reduce our exposure to the more severe economic cyclicality of the corporate office segment, and it has become a principal strategy generally for growing our business and enhancing profitability. To implement this strategy, we:

introduced specialized product offerings tailored to the unique demands of these segments, including specific designs, functionalities and prices;

created special sales teams dedicated to penetrating these segments at a high level, with a focus on specific customer accounts rather than geographic territories; and

realigned incentives for our corporate office segment sales force generally in order to encourage their efforts, and where appropriate, to assist our penetration of these other segments.

As part of this strategy, our *FLOR* line of products focuses on the U.S. residential carpet and rugs market segment. These products were specifically created to bring high style modular carpet and rugs to the North American residential market. Historically, we offered *FLOR* in three primary sales channels – catalogs, the Internet, and in our *FLOR* retail stores. In the fourth quarter of 2016, we adopted a restructuring plan that includes the closure of *FLOR*'s headquarters office and most retail *FLOR* stores. When the restructuring plan is completed, *FLOR* will focus on internet sales as well as crossover sales by our commercial sales force.

*Penetrate Expanding Geographic Markets for Modular Products.* The popularity of modular carpet continues to increase compared with other floorcovering products across most markets, internationally as well as in the United States. While maintaining our leadership in the corporate office segment, we will continue to build upon our position as the worldwide leader for modular carpet in order to promote sales in all market segments globally. A principal part of our international focus – which utilizes our global marketing capabilities and sales infrastructure – is the significant opportunities in several emerging geographic markets for modular carpet. These emerging markets, such as China, India and Eastern Europe, represent large and growing economies that are essentially new markets for modular carpet products. Other expanding geographic markets, such as Germany and Italy, are established markets that are transitioning to the use of modular carpet from historically low levels of penetration. Each of these geographic markets represents a significant growth opportunity for our modular carpet business.

*Continue to Minimize Expenses and Invest Strategically.* We have steadily trimmed costs from our operations for several years through multiple initiatives, which have made us leaner today and for the future. Our supply chain and other cost containment initiatives have improved our cost structure and yielded operating efficiencies. While we still seek to minimize our expenses in order to increase profitability, we will also take advantage of strategic opportunities to invest in systems, processes and personnel that can help us grow our business and increase profitability and value.

*Sustain Leadership in Product Design and Development.* As discussed above, our leadership position for product design and development is a competitive advantage and key strength. Our plank, *Skinny Plank*, and *i2* products and *TacTiles* installation system have confirmed our position as an innovation leader in modular carpet. We will continue initiatives to sustain, augment and capitalize upon that strength to continue to increase our market share in targeted market segments. Our *Mission Zero* and *Climate Take Back* initiatives, which draw upon and promote our ecological sustainability commitment, are part of those initiatives and include placing our *Mission Zero* and *Climate Take Back* logos on many of our marketing and merchandising materials distributed throughout the world.

*Use Strong Free Cash Flow Generation to Strengthen Our Balance Sheet.* Our principal business has been structured – including through our rationalization and repositioning initiatives – to yield high contribution margins and generate strong free cash flow (by which we mean cash available to apply towards debt service and potential stock repurchases, strategic acquisitions and the like). Our historical investments in global manufacturing capabilities and mass customization techniques and facilities, which we have maintained, also contribute to our ability to generate substantial levels of free cash flow. We expect to use our strong free cash flow generation capability to potentially repurchase shares and strengthen our financial position, or re-invest in our operations. We will also continue to execute programs to reduce costs further and enhance free cash flow. In addition, our existing capacity to increase production levels without significant capital expenditures will further enhance our generation of free cash flow as demand for our products rises.

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### **Challenges**

In order to capitalize on our strengths and to implement successfully our business strategy and the principal initiatives discussed above, we will have to handle successfully several challenges that confront us or that affect our industry in general. As discussed in the Risk Factors in Item 1A of this Report, several factors could make it difficult for us, including:

- sales of our principal products have been and may continue to be affected by adverse economic cycles in the renovation and construction of commercial and institutional buildings;
- we compete with a large number of manufacturers in the highly competitive commercial floorcovering products market, and some of these competitors have greater financial resources than we do;
- our success depends significantly upon the efforts, abilities and continued service of our senior management executives and our principal design consultant, and our loss of any of them could affect us adversely;
- our substantial international operations are subject to various political, economic and other uncertainties that could adversely affect our business results;
- large increases in the cost of petroleum-based raw materials could adversely affect us if we are unable to pass these cost increases through to our customers;
- unanticipated termination or interruption of any of our arrangements with our primary third party suppliers of synthetic fiber could have a material adverse effect on us; and
- we have a significant amount of indebtedness, which could have important negative consequences to us.

We believe our business model is strong enough, and our strategic initiatives are properly calibrated, for us to handle these and other challenges we will encounter in our business.

### **Seasonality**

Historically, our first quarter has typically been our slowest quarter while our fourth quarter has typically been our best quarter, with sales generally increasing throughout the course of the fiscal year. However, in recent years, as our sales efforts and results in the education market segment (which has a heavy buying season in the summer months) have increased and currency fluctuations have impacted us, our third quarter sales have been the highest.

## Our Products and Services

### *Modular Carpet*

Interface is the world's largest manufacturer and marketer of modular carpet. Our modular carpet system, which is marketed under the established global brands *Interface* and *FLOR*, utilizes carpet tiles cut in precise, dimensionally stable squares (usually 50 cm x 50 cm) or rectangles (such as planks and *Skinny Planks*) to produce a floorcovering that combines the appearance and texture of traditional soft floorcovering with the advantages of a modular carpet system. Our *GlasBac*® technology employs a fiberglass-reinforced polymeric composite backing that provides dimensional stability and reduces the need for adhesives or fasteners. We also make carpet tiles with a backing containing post-industrial and/or post-consumer recycled materials, which we market under the *GlasBacRE* brand. In addition, we make carpet tile with yarn containing varying degrees of post-consumer nylon, depending on the style and color.

Our carpet tile has become popular for a number of reasons. Carpet tile incorporating our reinforced backing may be easily removed and replaced, permitting rearrangement of furniture without the inconvenience and expense associated with removing, replacing or repairing other soft surface flooring products, including broadloom carpeting. Because a relatively small portion of a carpet installation often receives the bulk of traffic and wear, the ability to rotate carpet tiles between high traffic and low traffic areas and to selectively replace worn tiles can significantly increase the average life and cost efficiency of the floorcovering. In addition, carpet tile facilitates access to sub-floor air delivery systems and telephone, electrical, computer and other wiring by lessening disruption of operations. It also eliminates the cumulative damage and unsightly appearance commonly associated with frequent cutting of conventional carpet as utility connections and disconnections are made. We believe that, within the overall floorcovering market, the worldwide demand for modular carpet is increasing as more customers recognize these advantages.

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We use a number of conventional and technologically advanced methods of carpet construction to produce carpet tiles in a wide variety of colors, patterns, textures, pile heights and densities. These varieties are designed to meet both the practical and aesthetic needs of a broad spectrum of commercial interiors – particularly offices, healthcare facilities, airports, educational and other institutions, hospitality spaces, and retail facilities – and residential interiors. Our carpet tile systems permit distinctive styling and patterning that can be used to complement interior designs, to set off areas for particular purposes and to convey graphic information. While we continue to manufacture and sell a substantial portion of our carpet tile in standard styles, most of our modular carpet sales in the Americas and Asia-Pacific are custom or made-to-order products designed to meet customer specifications.

In addition to general uses of our carpet tile, we produce and sell a specially adapted version of our carpet tile for the healthcare facilities market. Our carpet tile possesses characteristics — such as the use of the *Intersept*® antimicrobial, static-controlling nylon yarns, and thermally pigmented, colorfast yarns — which make it suitable for use in these facilities in place of hard surface flooring. Moreover, we launched our *FLOR* line of products to specifically target modular carpet sales to the residential market segment. We also have created modular carpet products (some of which are part of our *i2* product line) specifically designed for each of the education, hospitality and retail market segments.

We also manufacture and sell two-meter roll goods that are structure-backed and offer many of the advantages of both carpet tile and broadloom carpet. These roll goods are often used in conjunction with carpet tiles to create special design effects. Our current principal customers for these products are in the education, healthcare and government market segments.

### ***Modular Resilient Flooring***

In 2016, we began offering a category of products that we call “modular resilient flooring”, and our first product introductions into this category were luxury vinyl tile (“LVT”) products in a four-city test market in the U.S. We recognize that our customers are buying multiple flooring types to service individual projects, while also looking to partner with fewer suppliers that can offer more products and services. In the annual *Floor Focus* survey described above, LVT has been ranked as the number one “hot product” each of the past four years. Expanding our product portfolio to include modular resilient flooring, and specifically LVT, allows us to meet this growing demand and pursue new or incremental sales opportunities. LVT also shares many of the same attributes and benefits with carpet tile, and we were able to leverage our experience in modular carpet tile in designing a product specification to meet our aesthetic and performance standards. We also selected a reputable third party to manufacture the products to our specifications, thus allowing us to enter the product category with minimal capital commitments.

In 2017, we plan to launch our LVT products globally, beginning with the Level Set™ Collection which includes 36 styles of tiles with printed top layers in a variety of aesthetic looks, including natural woodgrains and stones, textured woodgrains, and patterns. These products are modular and come in sizes that match certain of our modular carpet

planks and squares. They also are engineered to the same height as our modular carpet, which means better coverage of irregularities in the sub-floor, lower sound transference from floor to floor, and the ability to install our LVT and modular carpet products side by side without transition strips or layering. In addition, the Level Set Collection is constructed with the same type of backing as our carpet tiles and can be installed with our TacTiles installation system.

### ***Other Products and Services***

We sell a proprietary antimicrobial chemical compound under the registered trademark *Intersept* that we incorporate in all of our modular carpet products and have licensed to another company for use in air filters. We also sell our *TacTiles* carpet tile installation system, along with a variety of traditional adhesives and products for carpet installation and maintenance that are manufactured by a third party. In addition, we continue to manufacture and sell our *Intercell*® brand raised/access flooring product in Europe. We also continue to provide “turnkey” project management services for national accounts and other large customers through our *InterfaceSERVICES*™ business.

In August 2012, we sold our Bentley Prince Street broadloom carpet business segment to a third party. This business designed, manufactured and marketed high-end, designer-oriented broadloom and modular carpet for commercial and residential markets. As a result of this sale, we no longer have a presence in the broadloom carpet market.

### ***Marketing and Sales***

We have traditionally focused our carpet marketing strategy on major accounts, seeking to build lasting relationships with national and multinational end-users, and on architects, engineers, interior designers, contracting firms, and other specifiers who often make or significantly influence purchasing decisions. While most of our sales are in the corporate office segment, both new construction and renovation, we also emphasize sales in other segments, including retail space, government institutions, schools, healthcare facilities, tenant improvement space, hospitality centers, residences and home office space. Our marketing efforts are enhanced by the established and well-known brand names of our carpet products, including *Interface* and *FLOR*.

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An important part of our marketing and sales efforts involves the preparation of custom-made samples of requested carpet designs, in conjunction with the development of innovative product designs and styles to meet the customer's particular needs. In most cases, we can produce samples to customer specifications in less than five days, which significantly enhances our marketing and sales efforts and has increased our volume of higher margin custom or made-to-order sales. In addition, through our websites, we have made it easy to view and request samples of our products. We also use technology which allows us to provide digital, simulated samples of our products, which helps reduce raw material and energy consumption associated with our samples.

We primarily use our internal marketing and sales force to market our carpet products. In order to implement our global marketing efforts, we have product showrooms or design studios in the United States, Canada, Mexico, Brazil, Denmark, England, France, Germany, Spain, the Netherlands, India, Australia, Norway, United Arab Emirates, Russia, Singapore, Hong Kong, Thailand, China and elsewhere. We expect to open offices in other locations around the world as necessary to capitalize on emerging marketing opportunities.

We distribute our products through two primary channels: (1) direct sales to end users; and (2) indirect sales through independent contractors or distributors. In each case, we may also call upon architects, engineers, interior designers, contracting firms and other specifiers who often make or substantially influence purchasing decisions.

## *Manufacturing*

We manufacture carpet at two locations in the United States and at facilities in the Netherlands, the United Kingdom, Thailand, China and Australia.

Having foreign manufacturing operations enables us to supply our customers with carpet from the location offering the most advantageous delivery times, duties and tariffs, exchange rates, and freight expense, and enhances our ability to develop a strong local presence in foreign markets. We believe that the ability to offer consistent products and services on a worldwide basis at attractive prices is an important competitive advantage in servicing multinational customers seeking global supply relationships. We will consider additional locations for manufacturing operations in other parts of the world as necessary to meet the demands of customers in international markets.

Our raw materials are generally available from multiple sources – both regionally and globally – with the exception of synthetic fiber (nylon yarn). For yarn, we principally rely upon two major global suppliers, but we also have significant relationships with at least two other suppliers. Although our number of principal yarn suppliers is limited, we do have the capability to manufacture carpet using face fiber produced from two separate polymer feedstocks – nylon 6 and nylon 6,6 – which provides additional flexibility with respect to yarn supply inputs, if needed. Our global



sourcing strategy, including with respect to our principal yarn suppliers and dual polymer manufacturing capability, allows us to help guard against any potential shortages of raw materials or raw material suppliers in a specific polymer supply chain.

We have a flexible-inputs carpet backing line, which we call “*Cool Blue*™”, at our modular carpet manufacturing facility in LaGrange, Georgia. Using next generation thermoplastic technology, the custom-designed backing line dramatically improves our ability to keep reclaimed and waste carpet in the production “technical loop,” and further permits us to explore other plastics and polymers as inputs. We also have technology that more cleanly separates the face fiber and backing of reclaimed and waste carpet, thus making it easier to recycle some of its components and providing a purer supply of inputs for the *Cool Blue* process. This technology, which is part of our *ReEntry*®2.0 carpet reclamation program, allows us to send some of the reclaimed face fiber back to our fiber supplier to be blended with virgin or other post-industrial materials and extruded into new fiber.

The environmental management systems of our floorcovering manufacturing facilities in LaGrange, Georgia, West Point, Georgia, Northern Ireland, the Netherlands, Thailand, China and Australia are certified under International Standards Organization (ISO) Standard No. 14001.

Our significant international operations are subject to various political, economic and other uncertainties, including risks of restrictive taxation policies, foreign exchange restrictions, changing political conditions and governmental regulations. We also receive a substantial portion of our revenues in currencies other than U.S. dollars, which makes us subject to the risks inherent in currency translations. Although our ability to manufacture and ship products from facilities in several foreign countries reduces the risks of foreign currency fluctuations we might otherwise experience, we also engage from time to time in hedging programs intended to further reduce those risks.

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### *Competition*

We compete, on a global basis, in the sale of our modular carpet products with other carpet manufacturers and manufacturers of vinyl and other types of floorcoverings, including broadloom carpet. Although the industry has experienced significant consolidation, a large number of manufacturers remain in the industry. We believe we are the largest manufacturer of modular carpet in the world. However, a number of domestic and foreign competitors manufacture modular carpet as one segment of their business, and some of these competitors have financial resources greater than ours. In addition, some of the competing carpet manufacturers have the ability to extrude at least some of their requirements for fiber used in carpet products, which decreases their dependence on third party suppliers of fiber.

We believe the principal competitive factors in our primary floorcovering markets are brand recognition, quality, design, service, broad product lines, product performance, marketing strategy and pricing. In the corporate office market segment, modular carpet competes with various floorcoverings, of which broadloom carpet is the most common. We believe the quality, service, design, better and longer average product performance, flexibility (design options, selective rotation or replacement, use in combination with roll goods) and convenience of our modular carpet are our principal competitive advantages.

We believe we have competitive advantages in several other areas as well. First, having both an internal design staff as well as our relationship with David Oakey Designs allows us to introduce numerous innovative and attractive carpet tile products to our customers. Additionally, we believe that our global manufacturing capabilities are an important competitive advantage in serving the needs of multinational corporate customers. We believe that the incorporation of the *Intersept* antimicrobial chemical agent into the backing of our modular carpet enhances our ability to compete successfully across all of our market segments generally, and specifically with resilient tile in the healthcare market.

In addition, we believe that our goal and commitment to be ecologically “sustainable” by 2020 is a brand-enhancing, competitive strength as well as a strategic initiative. Our customers are concerned about the environmental and broader ecological implications of their operations and the products they use in them. Our leadership, knowledge and expertise in the area, especially in the “green building” movement and related environmental certification programs, resonate deeply with many of our customers and prospects around the globe. Our modular carpet products historically have had inherent installation and maintenance advantages that translated into greater efficiency and waste reduction. We are using raw materials and production technologies, such as our *Cool Blue* backing line and our *ReEntry 2.0* reclaimed carpet separation process, that directly reduce the adverse impact of those operations on the environment and limit our dependence on petrochemicals.

### **Product Design, Research and Development**

We maintain an active research, development and design staff of approximately 80 people and also draw on the research and development efforts of our suppliers, particularly in the areas of fibers, yarns and modular carpet backing materials. Our research and development costs were \$14.3 million, \$14.5 million and \$13.9 million in 2016, 2015, and 2014, respectively.

Our research and development team provides technical support and advanced materials research and development for us. The team assisted in the development of our *NexStep*® backing, which employs moisture-impervious polycarbonate precoating technology with a chlorine-free urethane foam secondary backing, and also helped develop a post-consumer recycled content, polyvinyl chloride, or PVC, extruded sheet process that has been incorporated into our *GlasBacRE* modular carpet backing. Our post-consumer recycled content PVC extruded sheet exemplifies our commitment to “closing-the-loop” in recycling. More recently, this team developed our *TacTiles* carpet tile installation system, which uses small squares of adhesive plastic film to connect intersecting carpet tiles. The team also helped implement our *Cool Blue* flexible inputs backing line and our *ReEntry 2.0* reclaimed carpet separation technology and post-consumer recycling technology for nylon face fibers. With a goal of supporting sustainable product designs in floorcoverings applications, we continue to evaluate renewable polymers for use in our products.

Our research and development team also is the coordinator of our QUEST and EcoSense initiatives (discussed below under “Environmental Initiatives”) and supports the dissemination, consultancies and technical communication of our global sustainability endeavors. This team also provides all biochemical and technical support to *Intersept* antimicrobial chemical product initiatives.

Innovation and increased customization in product design and styling are the principal focus of our product development efforts, and this focus has led to several design breakthroughs such as our plank and *Skinny Plank* products, as well as our i2 product line. Our carpet design and development team is recognized as an industry leader in carpet design and product engineering for the commercial and institutional markets.

David Oakey Designs provides carpet design and consulting services to us pursuant to a consulting agreement, and this firm augments our internal research, development and design staff. David Oakey Designs’ services under the agreement include creating commercial carpet designs for use by our modular carpet businesses throughout the world, and overseeing product development, design and coloration functions for our modular carpet business in North America. The agreement can be terminated by either party upon six months prior written notice to the other party. David Oakey Designs also contributed to our ability to efficiently produce many products from a single yarn system. Our mass customization production approach evolved, in major part, from this concept. In addition to increasing the number and variety of product designs, which enables us to increase high margin custom sales, the mass customization approach increases inventory turns and reduces inventory levels (for both raw materials and standard products) and their related costs because of our more rapid and flexible production capabilities.



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**Environmental Initiatives**

In the latter part of 1994, we commenced a new industrial ecological sustainability initiative called EcoSense, inspired in part by the interest of customers concerned about the environmental implications of how they and their suppliers do business. EcoSense, which includes our QUEST waste reduction initiative, is directed towards the elimination of energy and raw materials waste in our businesses, and, on a broader and more long-term scale, the practical reclamation — and ultimate restoration — of shared environmental resources. The initiative involves a commitment by us:

- to learn to meet our raw material and energy needs through recycling of carpet and other petrochemical products and harnessing benign energy sources; and
- to pursue the creation of new processes to help sustain the earth's non-renewable natural resources.

We have engaged some of the world's leading authorities on global ecology as environmental advisors. The list of advisors includes: Paul Hawken, author of *The Ecology of Commerce: A Declaration of Sustainability* and *The Next Economy*, and co-author of *Natural Capitalism: Creating the Next Industrial Revolution*; Amory Lovins, energy consultant and co-founder of the Rocky Mountain Institute; John Picard, President of E2 Environmental Enterprises; Bill Browning, fellow and former director of the Rocky Mountain Institute's Green Development Services; Janine M. Benyus, author of *Biomimicry*; and Bob Fox, renowned architect.

As more customers in our target markets share our view that sustainability is good business and not just good deeds, our acknowledged leadership position should strengthen our brands and provide a differentiated advantage in competing for business. To further raise awareness of our goal of becoming sustainable, we launched our *Mission Zero* global branding initiative, which represents our mission to eliminate any negative impact our companies may have on the environment by the year 2020. In 2016, we launched the *Climate Take Back* initiative, in which we seek to lead industry in designing and making products in ways that will maintain a climate fit for life. Our *Mission Zero* and *Climate Take Back* logos appear on many of our marketing and merchandising materials distributed throughout the world.

A high point in our pursuit of sustainability is our partnership with the Zoological Society of London on a program called *Net-Works*®. Together we are working with communities in the Philippines to collect discarded fishing nets that are damaging a large coral reef, and diverting them to our yarn supplier where they are recycled into new carpet fiber. *Net-Works* provides a source of income for members of these communities in the Philippines, while also cleaning up the beaches and waters where they live and work. Our *Net Effect* Collection of carpet tile products, among others, contains yarn that is partly made from the recycled fishing nets collected through the *Net-Works* program. Through 2016, this program has collected more than 125 tons of discarded fishing nets. *Net-Works* is a big step in redesigning our supply chain from a linear take-make-waste process toward a closed loop system, and it advances our ultimate goal of becoming a restorative enterprise.

## **Backlog**

Our backlog of unshipped orders was approximately \$107.8 million at February 12, 2017, compared with approximately \$111.4 million at February 14, 2016. Historically, backlog is subject to significant fluctuations due to the timing of orders for individual large projects and currency fluctuations. All of the backlog orders at February 12, 2017 are expected to be shipped during the succeeding six to nine months.

## **Patents and Trademarks**

We own numerous patents in the United States and abroad on floorcovering products and on manufacturing processes. The duration of United States patents is between 14 and 20 years from the date of filing of a patent application or issuance of the patent; the duration of patents issued in other countries varies from country to country. We maintain an active patent and trade secret program in order to protect our proprietary technology, know-how and trade secrets. Although we consider our patents to be very valuable assets, we consider our know-how and technology even more important to our current business than patents, and, accordingly, believe that expiration of existing patents or nonissuance of patents under pending applications would not have a material adverse effect on our operations.

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We also own many trademarks in the United States and abroad. In addition to the United States, the primary jurisdictions in which we have registered our trademarks are the European Union, Canada, Australia, New Zealand, Japan, and various countries in Central America, South America and Asia. Some of our more prominent registered trademarks include: *Interface*, *FLOR*, *Intersept*, *GlasBac*, *Mission Zero*, and *Net-Works*. Trademark registrations in the United States are valid for a period of 10 years and are renewable for additional 10-year periods as long as the mark remains in actual use. The duration of trademarks registered in other jurisdictions varies.

**Financial Information by Operating Segments and Geographic Areas**

The Notes to Consolidated Financial Statements appearing in Item 8 of this Report set forth information concerning our sales and long-lived assets by geographic areas, which are also our operating segments. Following the sale of Bentley Prince Street, we have only one reporting segment. Current and prior periods have been reclassified to include the results of operations and related disposal costs, gains and losses for the Bentley Prince Street business as discontinued operations. In addition, assets and liabilities of the Bentley Prince Street business have been reported in assets and liabilities held for sale for all reported periods.

**Employees**

At January 1, 2017, we employed a total of 3,278 employees worldwide. Of such employees, 1,962 were clerical, staff, sales, supervisory and management