

MOHAWK INDUSTRIES INC

Form 10-Q

November 12, 2008

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

[Mark One]

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

For the quarterly period ended September 27, 2008

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**  
(State or other jurisdiction of  
incorporation or organization)

**52-1604305**  
(I.R.S. Employer  
Identification No.)

**P. O. Box 12069, 160 S. Industrial Blvd., Calhoun, Georgia**  
(Address of principal executive offices)

**30701**  
(Zip Code)

**Registrant's telephone number, including area code: (706) 629-7721**

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 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 "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) 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

The number of shares outstanding of the issuer's classes of common stock as of November 10, 2008, the latest practicable date, is as follows:  
68,414,100 shares of Common Stock, \$.01 par value.

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**MOHAWK INDUSTRIES, INC.**

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PART I. FINANCIAL INFORMATION

ITEM I. FINANCIAL STATEMENTS

MOHAWK INDUSTRIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS

(In thousands)

(Unaudited)

	September 27, 2008	December 31, 2007
Current assets:		
Cash and cash equivalents	\$ 62,025	89,604
Receivables, net	933,741	821,113
Inventories	1,234,696	1,276,568
Prepaid expenses and other assets	122,464	123,395
Deferred income taxes	151,160	139,040
<b>Total current assets</b>	<b>2,504,086</b>	<b>2,449,720</b>
Property, plant and equipment, at cost	3,424,937	3,313,635
Less accumulated depreciation and amortization	1,460,998	1,337,914
<b>Net property, plant and equipment</b>	<b>1,963,939</b>	<b>1,975,721</b>
Goodwill	1,529,321	2,797,339
Tradenames	547,782	707,086
Other intangible assets, net	407,044	464,783
Deferred income taxes and other assets	20,260	285,401
	<b>\$ 6,972,432</b>	<b>8,680,050</b>

See accompanying notes to condensed consolidated financial statements.

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## MOHAWK INDUSTRIES, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

## LIABILITIES AND STOCKHOLDERS' EQUITY

(In thousands, except per share data)

(Unaudited)

	September 27, 2008	December 31, 2007
<b>Current liabilities:</b>		
Current portion of long-term debt	\$ 131,663	260,439
Accounts payable and accrued expenses	980,918	951,061
<b>Total current liabilities</b>	<b>1,112,581</b>	<b>1,211,500</b>
Deferred income taxes	469,533	614,619
Long-term debt, less current portion	1,924,698	2,021,395
Other long-term liabilities	119,475	125,179
<b>Total liabilities</b>	<b>3,626,287</b>	<b>3,972,693</b>
<b>Stockholders' equity:</b>		
Preferred stock, \$.01 par value; 60 shares authorized; no shares issued		
Common stock, \$.01 par value; 150,000 shares authorized; 79,453 and 79,404 shares issued in 2008 and 2007, respectively	795	794
Additional paid-in capital	1,214,714	1,203,957
Retained earnings	2,131,731	3,462,343
Accumulated other comprehensive income, net	322,450	363,981
	<b>3,669,690</b>	<b>5,031,075</b>
Less treasury stock at cost; 11,040 and 11,046 shares in 2008 and 2007, respectively	323,545	323,718
<b>Total stockholders' equity</b>	<b>3,346,145</b>	<b>4,707,357</b>
	<b>\$ 6,972,432</b>	<b>8,680,050</b>

See accompanying notes to condensed consolidated financial statements.

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## MOHAWK INDUSTRIES, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

(In thousands, except per share data)

(Unaudited)

	Three Months Ended	
	September 27, 2008	September 29, 2007
Net sales	\$ 1,763,034	1,937,677
Cost of sales	1,323,963	1,392,294
Gross profit	439,071	545,383
Selling, general and administrative expenses	321,259	344,569
Impairment of goodwill and other intangibles	1,418,912	
Operating (loss) income	(1,301,100)	200,814
Other expense (income):		
Interest expense	30,540	37,518
Other expense	4,942	8,541
Other income	(741)	(9,340)
	34,741	36,719
Earnings (loss) before income taxes	(1,335,841)	164,095
Income taxes	148,940	42,041
Net (loss) earnings	\$ (1,484,781)	122,054
Basic (loss) earnings per share	\$ (21.70)	1.79
Weighted-average common shares outstanding	68,411	68,281
Diluted (loss) earnings per share	\$ (21.70)	1.78
Weighted-average common and dilutive potential common shares outstanding	68,411	68,597

See accompanying notes to condensed consolidated financial statements.

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## MOHAWK INDUSTRIES, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

(In thousands, except per share data)

(Unaudited)

	Nine Months Ended	
	September 27, 2008	September 29, 2007
Net sales	\$ 5,341,176	5,778,750
Cost of sales	3,959,374	4,153,229
Gross profit	1,381,802	1,625,521
Selling, general and administrative expenses	993,609	1,055,882
Impairment of goodwill and other intangibles	1,418,912	
Operating (loss) income	(1,030,719)	569,639
Other expense (income):		
Interest expense	97,049	118,235
Other expense	16,184	17,394
Other income	(7,554)	(16,717)
U.S. Customs refund, net		(9,154)
	105,679	109,758
Earnings (loss) before income taxes	(1,136,398)	459,881
Income taxes	194,215	132,181
Net (loss) earnings	\$ (1,330,613)	327,700
Basic (loss) earnings per share	\$ (19.45)	4.81
Weighted-average common shares outstanding	68,396	68,118
Diluted (loss) earnings per share	\$ (19.45)	4.79
Weighted-average common and dilutive potential common shares outstanding	68,396	68,461

See accompanying notes to condensed consolidated financial statements.

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## MOHAWK INDUSTRIES, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine Months Ended	
	September 27, 2008	September 29, 2007
Cash flows from operating activities:		
Net (loss) earnings	\$ (1,330,613)	327,700
Adjustments to reconcile net earnings to net cash provided by (used in) operating activities:		
Impairment of goodwill and other intangibles	1,418,912	
Depreciation and amortization	226,020	224,864
Deferred income taxes	124,785	19,470
Loss on disposal and impairment of property, plant and equipment	2,903	8,739
Excess tax benefit from stock-based compensation	(317)	(6,336)
Stock-based compensation expense	9,076	10,635
Changes in operating assets and liabilities, net of effects of acquisition:		
Receivables	(111,565)	(48,840)
Inventories	44,147	(3,626)
Accounts payable and accrued expenses	46,650	53,532
Other assets and prepaid expenses	(59,560)	20,729
Other liabilities	1,091	(5,030)
Net cash provided by operating activities	371,529	601,837
Cash flows from investing activities:		
Additions to property, plant and equipment, net	(155,322)	(97,832)
Acquisitions, net of cash acquired	(8,346)	(142,772)
Net cash used in investing activities	(163,668)	(240,604)
Cash flows from financing activities:		
Payments on revolving line of credit	(1,055,425)	(1,338,613)
Proceeds from revolving line of credit	962,380	1,214,799
Net change in asset securitization borrowings	(140,000)	80,000
Payments on senior notes and term loan		(300,000)
Payments of other debt	(301)	(248)
Excess tax benefit from stock-based compensation	317	6,336
Change in outstanding checks in excess of cash	(4,036)	(34,964)
Proceeds from stock option exercises	1,657	28,544
Net cash used in financing activities	(235,408)	(344,146)
Effect of exchange rate changes on cash and cash equivalents	(32)	1,085
Net change in cash	(27,579)	18,172
Cash, beginning of period	89,604	63,492
Cash, end of period	\$ 62,025	81,664



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See accompanying notes to condensed consolidated financial statements.

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MOHAWK INDUSTRIES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

1. Interim reporting

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with instructions to Form 10-Q and do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. These statements should be read in conjunction with the consolidated financial statements and notes thereto, and the Company's description of critical accounting policies, included in the Company's 2007 Annual Report on Form 10-K, as filed with the Securities and Exchange Commission.

2. New pronouncements

In September 2006, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards ( SFAS ) No. 157, *Fair Value Measurements* ( SFAS No. 157 ). SFAS No. 157 defines fair value, establishes a framework for measuring fair value and requires enhanced disclosures about fair value measurements. SFAS No. 157 requires companies to disclose the fair value of financial instruments according to a fair value hierarchy. Additionally, companies are required to provide certain disclosures regarding instruments within the hierarchy, including a reconciliation of the beginning and ending balances for each major category of assets and liabilities. SFAS No. 157 is effective for the Company's fiscal year beginning January 1, 2008 for financial assets and liabilities and January 1, 2009 for non-financial assets and liabilities. The adoption of SFAS No. 157 for financial assets and liabilities on January 1, 2008 did not have a material impact on the Company's consolidated financial statements. The Company is currently evaluating the impact, if any, of SFAS No. 157 for non-financial assets and liabilities on its consolidated financial statements.

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Post Retirement Plans-an amendment of FASB Statements No. 87, 88, 106 and 132(R)* ( SFAS No. 158 ). The Company adopted all provisions of SFAS No. 158 as of December 31, 2006, except for the measurement date provisions, which are effective for fiscal years ending after December 15, 2008. The adoption of the measurement provisions of SFAS No. 158 on January 1, 2008 did not have any impact on the Company's consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities-including an amendment of FASB Statement No. 115* ( SFAS No. 159 ). SFAS No. 159 expands the use of fair value accounting but does not affect existing standards which require assets or liabilities to be carried at fair value. The objective of SFAS No. 159 is to improve financial reporting by providing companies with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. Under SFAS No. 159, a company may elect to use fair value to measure eligible items at a specified election date and report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. Eligible items include, but are not limited to, accounts and loans receivable, available-for-sale and held-to-maturity securities, equity method investments, accounts payable, guarantees, issued debt and firm commitments. The Company adopted SFAS No. 159 effective January 1, 2008, but did not elect to fair value any of the eligible assets or liabilities. Therefore, the adoption did not have any impact on the Company's consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* ( SFAS 141R ). SFAS 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. SFAS 141R also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS 141R is to be applied prospectively to business combinations for which the acquisition date is on or after January 1, 2009. Once



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## MOHAWK INDUSTRIES, INC. AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

adopted, SFAS 141R will impact the recognition and measurement of future business combinations and certain income tax benefits recognized from prior business combinations.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements - an amendment of Accounting Research Bulletin No. 51* ( SFAS No. 160 ). SFAS No. 160 establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest, and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. SFAS No. 160 also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS No. 160 is effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating the potential impact, if any, of the adoption of SFAS No. 160 on its consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities* ( SFAS No. 161 ). SFAS No. 161 is intended to improve financial reporting about derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity's financial position, financial performance, and cash flows. The provisions of SFAS No. 161 are effective for the first quarter of 2009. The Company is currently evaluating the impact of the provisions of SFAS No. 161 on its consolidated financial statements.

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles* ( SFAS No. 162 ). SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements. SFAS No. 162 is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles*. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial statements.

In October 2008, the FASB issued FSP 157-3 *Determining Fair Value of a Financial Asset in a Market That Is Not Active* ( FSP 157-3 ). FSP 157-3 clarifies the application of SFAS No. 157 as it relates to the valuation of financial assets in a market that is not active for those financial assets. This FSP is effective immediately and includes those periods for which financial statements have not been issued. The Company currently does not have any financial assets that are valued using inactive markets, and as such is not impacted by the issuance of this FSP.

## 3. Receivables

Receivables are as follows:

	September 27, 2008	December 31, 2007
Customers, trade	\$ 967,963	845,446
Other	29,493	31,977
	997,456	877,423
Less allowance for discounts, returns, claims and doubtful accounts	63,715	56,310
Net receivables	\$ 933,741	821,113



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## MOHAWK INDUSTRIES, INC. AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

## 4. Inventories

The components of inventories are as follows:

	September 27, 2008	December 31, 2007
Finished goods	\$ 753,372	804,408
Work in process	114,718	100,582
Raw materials	366,606	371,578
Total inventories	\$ 1,234,696	1,276,568

## 5. Intangible assets and goodwill

Goodwill is tested annually for impairment during the fourth quarter or earlier upon the occurrence of certain events or substantive changes in circumstances. The Company considers the relationship between its market capitalization and its book value, among other factors, when reviewing for indicators of impairment. The goodwill impairment tests are based on determining the fair value of the specified reporting units based on management judgments and assumptions using the discounted cash flows and comparable company market valuation approaches. The Company has identified Mohawk, Dal-Tile, Unilin Flooring, Unilin Chipboard and Melamine, and Unilin Roofing as its reporting units for the purposes of allocating goodwill and intangibles as well as assessing impairments. The valuation approaches are subject to key judgments and assumptions that are sensitive to change such as judgments and assumptions about appropriate sales growth rates, operating margins, weighted average cost of capital ( WACC ), and comparable company market multiples. When developing these key judgments and assumptions, the Company considers economic, operational and market conditions that could impact the fair value of the reporting unit. However, estimates are inherently uncertain and represent only management's reasonable expectations regarding future developments. These estimates and the judgments and assumptions upon which the estimates are based will, in all likelihood, differ in some respects from actual future results. Should a significant or prolonged deterioration in economic conditions occur, such as continued declines in spending for new construction, remodeling and replacement activities; the inability to pass increases in the costs of raw materials and fuel on to its customers; or a decline in comparable company market multiples, then key judgments and assumptions could be impacted. Generally, a moderate decline in estimated operating income or a small increase in WACC or a decline in market capitalization could result in an additional indication of impairment.

As noted above, the Company considers the relationship between its market capitalization and its book value, among other factors, when reviewing for indicators of impairment. The Company believes that the weakness in the U.S. residential housing market and the slowing European economy are principal factors in the prolonged decline in its market capitalization as compared to its book value. During the third quarter of 2008, the Company concluded that the weakness in the U.S. residential housing market is likely to persist based on its review of, among other things, sequential quarterly housing starts, recent turmoil surrounding the nation's largest mortgage lenders, the potential negative impact on the availability of mortgage financing and housing start forecasts published by national home builder associations pushing recovery in the U.S. residential housing market further out in 2009.

As a result of these impairment indicators, in the third quarter the Company performed an interim first step of its goodwill impairment test and determined that the carrying values of certain reporting units exceeded their fair values, indicating that goodwill was impaired. Having determined that goodwill was impaired, the Company began performing the second step of the goodwill impairment test which involves calculating the implied fair value of goodwill by allocating the fair value of the reporting unit to all of its assets and liabilities other than goodwill (including both recognized and unrecognized intangible assets) and comparing the residual amount to the carrying value of goodwill. As of the date of the filing of the Company's Quarterly Report on



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## MOHAWK INDUSTRIES, INC. AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

Form 10-Q for the quarter ended September 27, 2008, the Company estimates that the implied fair value of its goodwill is less than its carrying value by approximately \$1,262,255, which the Company has recognized as an impairment of goodwill in the accompanying condensed consolidated results of operations for the quarter and nine months ended September 27, 2008. The \$1,262,255 impairment of goodwill is an estimate based on the results of the determination and preliminary allocation of fair value, which the Company expects to complete in the fourth quarter of 2008.

The impairment evaluation for indefinite lived intangible assets, which for the Company are its trademarks, is conducted during the fourth quarter of each year, or more frequently if events or changes in circumstances indicate that an asset might be impaired. The determination of fair value used in the impairment evaluation is based on discounted estimates of future sales projections attributable to ownership of the trademarks. Significant judgments inherent in this analysis include assumptions about appropriate sales growth rates, royalty rates, WACC and the amount of expected future cash flows. The judgments and assumptions used in the estimate of fair value are generally consistent with past performance and are also consistent with the projections and assumptions that are used in current operating plans. Such assumptions are subject to change as a result of changing economic and competitive conditions. The determination of fair value is highly sensitive to differences between estimated and actual cash flows and changes in the related discount rate used to evaluate the fair value of the trademarks. Estimated cash flows are sensitive to changes in the economy among other things. As a result of the impairment indicators described above, during the third quarter of 2008, the Company evaluated its intangible assets with indefinite lives for impairment. The Company compared the estimated fair value of its trademarks to its carrying value and determined that there was a preliminary trademark impairment of approximately \$54,455 in the Mohawk segment and a preliminary trademark impairment of approximately \$102,202 in the Unilin segment, which the Company has recognized as an impairment of intangibles in the accompanying condensed consolidated results of operations for the quarter and nine months ended September 27, 2008.

The Company reviews long-lived assets, including its intangible assets subject to amortization which, for the Company are its patents and customer relationships, for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of long-lived assets to future undiscounted net cash flows expected to be generated by these assets. If such assets are considered to be impaired, the impairment recognized is the amount by which the carrying amount of the assets exceeds the fair value of the assets. As a result of the impairment indicators described above, during the third quarter of 2008, the Company tested its long-lived assets for impairment by comparing the estimated future undiscounted net cash flows expected to be generated by these assets to their carrying value and determined that there was no impairment.

The components of goodwill and other intangible assets are as follows:

Goodwill:

	Mohawk	Dal-Tile	Unilin	Total
Balance as of January 1, 2008	\$ 199,132	1,186,013	1,412,194	2,797,339
Goodwill recognized during the period (1)		1,767	(1,317)	450
Impairment charge	(199,132)	(531,930)	(531,193)	(1,262,255)
Currency translation during the period			(6,213)	(6,213)
Balance as of September 27, 2008	\$	655,850	873,471	1,529,321

(1)



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The Company acquired certain stone center assets in the Dal-Tile segment and adjusted certain pre-acquisition tax liabilities in the Unilin segment.

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## MOHAWK INDUSTRIES, INC. AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

Intangible assets:

	<b>Tradenames</b>
Indefinite life assets not subject to amortization:	
Balance as of January 1, 2008	\$ 707,086
Currency translation during the period	(2,647)
Impairment charge	(156,657)
Balance as of September 27, 2008	\$ 547,782

	<b>Customer relationships</b>	<b>Patents</b>	<b>Total</b>
Intangible assets subject to amortization:			
Balance as of January 1, 2008	\$ 256,092	208,691	464,783
Intangible assets recognized during the period	2,980		2,980
Amortization during period	(37,465)	(22,599)	(60,064)
Currency translation during the period	(103)	(552)	(655)
Balance as of September 27, 2008	\$ 221,504	185,540	407,044

Amortization expense:

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 27, 2008</b>	<b>September 29, 2007</b>	<b>September 27, 2008</b>	<b>September 29, 2007</b>
Amortization expense	\$ 20,043	23,700	60,064	69,769

## 6. Accounts payable and accrued expenses

	<b>September 27, 2008</b>	<b>December 31, 2007</b>
Outstanding checks in excess of cash	\$ 20,583	24,619
Accounts payable, trade	440,931	399,141
Accrued expenses	299,662	321,547
Income taxes payable	50,837	42,090
Deferred tax liability	10,399	11,890

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Accrued compensation	158,506	151,774
Total accounts payable and accrued expenses	\$ 980,918	951,061

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## MOHAWK INDUSTRIES, INC. AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

## 7. Product Warranties

The Company warrants certain qualitative attributes of its products for up to 33 years. The Company records a provision for estimated warranty and related costs, based on historical experience and periodically adjusts these provisions to reflect actual experience. The warranty obligation is as follows:

	Three Months Ended		Nine Months Ended	
	September 27, 2008	September 29, 2007	September 27, 2008	September 29, 2007
Balance at beginning of period	\$ 42,227	29,920	46,187	30,712
Warranty claims paid	(20,965)	(13,297)	(61,081)	(41,680)
Warranty expense	26,949	16,661	63,105	44,252
Balance at end of period	\$ 48,211	33,284	48,211	33,284

## 8. Comprehensive income

Comprehensive income is as follows:

	Three Months Ended		Nine Months Ended	
	September 27, 2008	September 29, 2007	September 27, 2008	September 29, 2007
Net (loss) earnings	\$ (1,484,781)	122,054	(1,330,613)	327,700
Other comprehensive (loss) income:				
Foreign currency translation	(210,548)	109,702	(38,360)	157,765
Unrealized gain (loss) on derivative instruments, net of income taxes	(4,115)	462	(3,171)	1,113
Comprehensive (loss) income	\$ (1,699,444)	232,218	(1,372,144)	486,578

## 9. Stock compensation

The Company accounts for its stock-based compensation plans in accordance with SFAS No. 123R, *Share-Based Payment* (SFAS No. 123R). Under SFAS No. 123R, all stock-based compensation cost is measured at the grant date, based on the estimated fair value of the award, and is recognized as an expense in the statement of earnings over the requisite service period.

Under the Company's 2007 Incentive Plan (2007 Plan), the Company reserved up to 3,200 shares of common stock for issuance upon the grant or exercise of stock options, restricted stock, restricted stock units (RSUs) and other types of awards, as defined under the 2007 Plan. Option awards are generally granted with an exercise price equal to the market price of the Company's common stock on the date of the grant and generally vest between three and five years with a 10-year contractual term. Restricted stock and RSUs are generally granted with a price equal

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to the market price of the Company's common stock on the date of the grant and generally vest between three and five years.

The Company granted 146 and 64 options to employees at a weighted-average grant-date fair value of \$20.26 and \$33.68 per share for the nine months ended September 27, 2008 and September 29, 2007, respectively. The Company recognized stock-based compensation costs related to stock options of \$1,637 (\$1,037 net of taxes) and \$2,158 (\$1,367 net of taxes) for the three months ended September 27, 2008 and

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MOHAWK INDUSTRIES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

September 29, 2007, respectively, and \$4,889 (\$3,097 net of taxes) and \$6,802 (\$4,309 net of taxes) for the nine months ended September 27, 2008 and September 29, 2007, respectively, which has been allocated to selling, general and administrative expenses. Pre-tax unrecognized compensation expense for stock options granted to employees and outside directors, net of estimated forfeitures, was \$9,150 as of September 27, 2008, and will be recognized as expense over a weighted-average period of approximately 2.3 years.

The fair value of the option award is estimated on the date of grant using the Black-Scholes-Merton valuation model. Expected volatility is based on the historical volatility of the Company's common stock. The Company uses historical data to estimate option exercise and forfeiture rates within the valuation model.

The Company granted 72 and 144 RSU's at a weighted-average grant-date fair value of \$75.05 and \$93.61 per unit for the nine months ended September 27, 2008 and September 29, 2007, respectively. The Company recognized stock-based compensation costs related to the issuance of RSU's of \$804 (\$509 net of taxes) and \$820 (\$519 net of taxes) for the three months ended September 27, 2008 and September 29, 2007, respectively, and \$3,919 (\$2,483 net of taxes) and \$3,608 (\$2,286 net of taxes) for the nine months ended September 27, 2008 and September 29, 2007, respectively, which has been allocated to selling, general and administrative expenses. Pre-tax unrecognized compensation expense for unvested RSU's granted to employees, net of estimated forfeitures, was \$8,384 as of September 27, 2008, and will be recognized as expense over a weighted-average period of approximately 2.6 years. No restricted stock awards were granted and compensation expense related to prior grants was not significant for the three or nine months ended September 27, 2008. Restricted stock awards granted and the related compensation expense was not significant for the three or nine months ended September 29, 2007.

10. Earnings per share

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

Dilutive common stock options and RSU's are included in the diluted EPS calculation using the treasury stock method. Excluded from the computation of diluted EPS are stock options and RSU's of 1,460 and 673 shares because their effect would have been anti-dilutive for the three month period ended September 27, 2008 and September 29, 2007, respectively and 1,314 and 726 shares because their effect would have been anti-dilutive for the nine month period ended September 27, 2008 and September 29, 2007, respectively.

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## MOHAWK INDUSTRIES, INC. AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 27, 2008	September 29, 2007	September 27, 2008	September 29, 2007
Net (loss) earnings	\$ (1,484,781)	122,054	(1,330,613)	327,700
Weighted-average common and dilutive potential common shares outstanding:				
Weighted-average common shares outstanding	68,411	68,281	68,396	68,118
Add weighted-average dilutive potential common shares - options and RSU s to purchase common shares, net		316		343
Weighted-average common and dilutive potential common shares outstanding	68,411	68,597	68,396	68,461
Basic (loss) earnings per share	\$ (21.70)	1.79	(19.45)	4.81
Diluted (loss) earnings per share	\$ (21.70)	1.78	(19.45)	4.79

## 11. Supplemental Condensed Consolidated Statements of Cash Flows Information

	Nine Months Ended	
	September 27, 2008	September 29, 2007
Net cash paid during the period for:		
Interest	\$ 112,068	134,873
Income taxes	\$ 88,323	155,036

## 12. Segment reporting

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 primarily in North America, 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 primarily in North America, which include ceramic tile, porcelain tile and stone products, through its network of regional distribution centers and approximately 250 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 primarily in North America and Europe, which include laminate flooring, wood flooring, medium-density fiberboard, roofing systems and other wood products through various selling channels, which include retailers, home centers, independent distributors, contractors, and commercial users.





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## MOHAWK INDUSTRIES, INC. AND SUBSIDIARIES

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The accounting policies for each operating segment are consistent with the Company's policies for the consolidated financial statements. Amounts disclosed for each segment are prior to any elimination or consolidation entries. Corporate general and administrative expenses attributable to each segment are estimated and allocated accordingly. Segment performance is evaluated based on operating income.

Segment information is as follows:

	Three Months Ended		Nine Months Ended	
	September 27, 2008	September 29, 2007	September 27, 2008	September 29, 2007
Net sales:				
Mohawk	\$ 953,827	1,076,745	2,827,297	3,237,818
Dal-Tile	472,031	497,420	1,402,593	1,469,568
Unilin	357,785	378,446	1,173,065	1,094,073
Intersegment Sales	(20,609)	(14,934)	(61,779)	(22,709)
	\$ 1,763,034	1,937,677	5,341,176	5,778,750
Operating income: (1)				
Mohawk	\$ (224,376)	77,002	(167,542)	185,177
Dal-Tile	(479,918)	63,109	(364,808)	196,857
Unilin	(592,549)	71,034	(482,472)	213,270
Corporate and Eliminations	(4,257)	(10,331)	(15,897)	(25,665)
	\$ (1,301,100)	200,814	(1,030,719)	569,639

	As of	
	September 27, 2008	December 31, 2007
Assets:		
Mohawk	\$ 2,122,463	2,302,527
Dal-Tile	1,736,212	2,259,811
Unilin	2,912,280	3,916,739
Corporate and Eliminations	201,477	200,973
	\$ 6,972,432	8,680,050

- (1) Operating income includes the impact of the preliminary impairment of goodwill and other intangibles recognized in the third quarter of 2008 of \$253,587 for the Mohawk segment, \$531,930 for the Dal-Tile segment and \$633,395 for the Unilin segment.

13. Employee Benefit Plans

The Company has various pension plans covering employees in Belgium, France and the Netherlands (the Non-U.S. Plans ) that it acquired with the acquisition of Unilin Holding NV in October 2005. Benefits under the Non-U.S. Plans depend on compensation and years of service. The Non-U.S. Plans are funded in accordance with local regulations.

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## MOHAWK INDUSTRIES, INC. AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

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Pension expense for the Non-U.S. Plans includes the following components:

	Non-U.S. Plans			
	Three Months Ended		Nine Months Ended	
	September 27, 2008	September 29, 2007	September 27, 2008	September 29, 2007
Service cost of benefits earned	\$ 415	470	1,424	1,380
Interest cost on projected benefit obligation	279	251	903	697
Estimated return on plan assets	(205)	(188)	(678)	(538)
Amortization of actuarial net gain	(6)		(19)	
<b>Net pension expense</b>	<b>\$ 483</b>	<b>533</b>	<b>1,630</b>	<b>1,539</b>

The Company contributed \$1,506 to its Non-U.S. Plans in the nine months ended September 27, 2008 and expects to make cash contributions of approximately \$502 during the remainder of 2008.

#### 14. Commitments, Contingencies and Other

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 was returned to the District Court for further proceedings. On December 18, 2007, the plaintiffs filed a motion for class certification.

On March 3, 2008, the District Court denied the plaintiffs motion for class certification. The plaintiffs then appealed the decision to the United States Court of Appeals for the 11th Circuit on March 17, 2008. Discovery has been stayed at the District Court while the appeal is pending. 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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The Company has received partial refunds from the United States government in reference to settling custom disputes dating back to 1982. To date, the Company has received partial refunds totaling \$28,590 (\$18,087 net of taxes). No refunds were recorded during the three or nine month periods ended September 27, 2008 or during the three months ended September 29, 2007. For the nine months ended September 29, 2007, the Company recognized refunds of \$9,154 (\$5,812 net of taxes) in other income in the accompanying condensed consolidated results of operations. Additional future recoveries, if any, will be recorded when realized.

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## MOHAWK INDUSTRIES, INC. AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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## 15. Fair Value of Financial Instruments

As noted above in Note 2, the Company has only adopted the provisions of SFAS No. 157 with respect to its financial assets and liabilities that are measured at fair value within the condensed consolidated financial statements. For assets and liabilities measured at fair value on a recurring basis during the period under the provisions of SFAS No. 157, the Company uses an income approach to value the assets and liabilities for outstanding derivative contracts, which include natural gas futures contracts and foreign exchange forward contracts. The income approach consists of a discounted cash flow model that takes into account the present value of future cash flows under the terms of the contracts using current market information as of the reporting date such as natural gas and foreign exchange spot and forward rates.

The following table provides a summary of the fair values of assets and liabilities under SFAS No. 157:

	September 27, 2008	Fair Value Measurements at September 27, 2008 Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Derivatives	\$ (4,640)		(4,640)	

## 16. Income Taxes

Income tax expense attributable to earnings differs from the amount computed by applying the U.S. statutory federal income tax rate to earnings principally due to (1) a preliminary impairment of non-deductible goodwill, (2) foreign interest deductions, and (3) the recognition of a valuation allowance against a deferred tax asset. The deferred tax balances at September 27, 2008 reflect the impact of the preliminary impairment of goodwill and other intangibles as well as the valuation allowance on the deferred tax assets as described below.

In the fourth quarter of 2007, the Company moved the intellectual property and treasury operations of an indirectly owned European entity to a new office in another jurisdiction in Europe. The Company also indirectly owned a holding company in the new jurisdiction that provided certain treasury functions to Unilin and the move allowed for the consolidation of the historical intellectual property and treasury operations to be combined with those of the holding company's treasury operations in a single jurisdiction in order to integrate and streamline the operations, to facilitate international acquisitions and to improve tax and cost efficiencies. This restructuring resulted in a step up in the subsidiary's taxable basis of its intellectual property. The step up relates primarily to intangible assets which will be amortized over 10 years for tax purposes. During the fourth quarter of 2007, the Company evaluated the evidence for recognition of the deferred tax asset created through the restructuring and determined that, based on the available evidence, the deferred tax asset would more likely than not be realized. The deferred tax asset recognized at December 31, 2007 was approximately \$245,000 and the related income tax benefit recognized in the financial statements was approximately \$272,000.

During the third quarter of 2008, the Company reassessed the need for a valuation allowance against its deferred tax assets. Cash flows have decreased from that projected as of December 31, 2007, primarily due to the slowing worldwide economy and declining sales volume. The Company determined that, given the current and expected economic conditions and the corresponding reductions in cash flows, its ability to realize the benefit of the deferred tax asset related to the European step up transaction described above as well as tax losses generated in the same jurisdiction was not more likely than not. Accordingly, the Company recorded a valuation allowance against the deferred tax asset in the amount of \$253,000 during the quarter ended September 27, 2008.



**Table of Contents****Item 2. 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 primarily in North America, 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 primarily in North America, which include ceramic tile, porcelain tile and stone products, through its network of regional distribution centers and approximately 250 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 primarily in North America and Europe, which include laminate flooring, wood flooring, medium-density fiberboard, roofing systems and other wood products through various selling channels, which include retailers, home centers, independent distributors, contractors, and commercial users.

The Company reported net loss of \$1,484.8 million or diluted (loss) earnings per share (EPS) of (\$21.70) for the third quarter of 2008, compared to net earnings of \$122.1 million or \$1.78 EPS for the third quarter of 2007. The change in EPS resulted primarily from a preliminary \$1,418.9 million pre-tax impairment charge to reduce the carrying amount of goodwill and other intangibles, a charge of \$253 million to record a tax valuation allowance against the carrying amount of a deferred tax asset recognized in the fourth quarter of 2007, lower sales volumes, which the Company believes is attributable to slowing U.S. residential housing, commercial and European demand, and rising raw material and energy costs.

The Company reported net loss of \$1,330.6 million or diluted (loss) EPS of (\$19.45) for the nine months ended September 27, 2008, compared to net earnings of \$327.7 million or \$4.79 EPS for the same period of 2007. The change in EPS resulted primarily from a preliminary \$1,418.9 million pre-tax impairment charge to reduce the carrying amount of goodwill and other intangibles, a charge of \$253 million to record a tax valuation allowance against the carrying amount of a deferred tax asset recognized in the fourth quarter of 2007, lower sales volumes, which the Company believes is attributable to slowing U.S. residential housing, commercial and European demand, and rising raw material and energy costs.

**Results of Operations****Quarter Ended September 27, 2008, as Compared with Quarter Ended September 29, 2007****Net Sales**

Net sales for the quarter ended September 27, 2008 were \$1,763.0 million, reflecting a decrease of \$174.7 million, or 9.0%, from the \$1,937.7 million reported for the quarter ended September 29, 2007. The decrease was primarily driven by a decline in sales volumes of approximately \$228 million due to the continued decline in the U.S. residential market, softening commercial demand and slowing European demand, partially offset by a benefit of approximately \$43 million due to the net effect of price increases and product mix and a benefit of approximately \$23 million due to favorable foreign exchange rates.

*Mohawk Segment* - Net sales decreased \$122.9 million, or 11.4%, to \$953.8 million in the current quarter compared to \$1,076.7 million in the third quarter of 2007. The decrease was primarily driven by a decline in sales volumes of approximately \$153 million due to the continued decline in the U.S. residential market and

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softening commercial demand, partially offset by a benefit of approximately \$42 million due to the net effect of price increases and product mix.

*Dal-Tile Segment* - Net sales decreased \$25.4 million, or 5.1%, to \$472.0 million in the current quarter compared to \$497.4 million in the third quarter of 2007. The decrease was primarily driven by a decline in sales volumes of approximately \$21 million due to the continued decline in the U.S. residential market and negative price and product mix of \$4 million, net, as customers trade down.

*Unilin Segment* - Net sales decreased \$20.6 million, or 5.4%, to \$357.8 million in the current quarter compared to \$378.4 million in the third quarter of 2007. The decrease was driven by a decline in sales volumes of approximately \$54 million due to the continued decline in the U.S. residential market and slowing European demand, partially offset by a benefit of approximately \$23 million due to favorable foreign exchange rates and increased sales of approximately \$12 million from the wood flooring acquisition completed in the third quarter of 2007 ( Wood Acquisition ).

**Gross profit**

Gross profit for the third quarter of 2008 was \$439.1 million (24.9% of net sales) and represented a decrease of \$106.3 million, or 19.5%, compared to gross profit of \$545.4 million (28.1% of net sales) for the prior year's third quarter. Gross profit in the current quarter was unfavorably impacted by approximately \$76 million in increased costs for raw materials and energy, net of cost savings initiatives and approximately \$66 million resulting from a decline in sales volume.

**Selling, general and administrative expenses**

Selling, general and administrative expenses for the third quarter of 2008 were \$321.3 million (18.2% of net sales), reflecting a decrease of \$23.3 million, or 6.8%, compared to \$344.6 million (17.8% of net sales) for the prior year's third quarter. The decrease in SG&A is attributable to various cost savings initiatives implemented by the Company, offset by \$4 million due to unfavorable foreign exchange rates.

**Impairment of goodwill and intangibles**

During the third quarter of 2008, the Company recorded a preliminary \$1,418.9 million (\$1,307.4 million net of tax) impairment charge to reduce the carrying amount of the Company's goodwill and intangible assets to their estimated fair value based upon the results of an interim impairment test. The Company performed an interim impairment test because of a prolonged decline in the Company's market capitalization which the Company believes is primarily a result of the weakness in the U.S. residential housing market and the slowing European economy. During the third quarter of 2008, the Company concluded that the weakness in the U.S. residential housing market is likely to persist based on its review of, among other things, sequential quarterly housing starts, recent turmoil surrounding the nation's largest mortgage lenders, the potential negative impact on the availability of mortgage financing and housing start forecasts published by national home builder associations pushing recovery in the U.S. residential housing market further out in 2009. The total impairment included \$253.6 million in the Mohawk segment, \$531.9 million in the Dal-Tile segment and \$633.4 million in the Unilin segment. If, in the future, the Company's market capitalization and/or the estimated fair value of the Company's reporting units were to decline further, it may be necessary to record an additional impairment charge.

**Operating (loss) income**

Operating loss for the third quarter of 2008 was \$1,301.1 million reflecting a decrease of \$1,501.9 million compared to operating income of \$200.8 million (10.4% of net sales) in the third quarter of 2007. The decrease was primarily driven by the recognition of a preliminary impairment of goodwill and other intangibles of \$1,418.9 million, a decline in sales volumes of approximately \$66 million and rising costs for raw materials and energy of approximately \$51 million, net of cost savings initiatives, partially offset by a benefit of approximately \$51 million due to the net effect of price increases and product mix.



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*Mohawk Segment* - Operating loss was \$224.4 million in the third quarter of 2008 reflecting a decrease of \$301.4 million compared to operating income of \$77.0 million (7.2% of segment net sales) in the third quarter of 2007. The decrease was primarily due to the preliminary impairment of goodwill and other intangibles of \$253.6 million, a decline in sales volumes of approximately \$36 million and rising costs for raw materials and energy of approximately \$39 million, net of cost savings initiatives, partially offset by a benefit of approximately \$41 million due to the net effect of price increases and product mix.

*Dal-Tile Segment* - Operating loss was \$479.9 million in the third quarter of 2008 reflecting a decrease of \$543.0 million compared to operating income of \$63.1 million (12.7% of segment net sales) for the third quarter of 2007. The decrease was primarily due to the preliminary impairment of goodwill of approximately \$531.9 million, rising costs for raw materials and energy of approximately \$9 million, net of cost savings initiatives, and a decline in sales volumes of approximately \$7 million, partially offset by a benefit of approximately \$8 million due to the net effect of price increases and product mix.

*Unilin Segment* - Operating loss was \$592.5 million in the third quarter of 2008 reflecting a decrease of \$663.5 million compared to operating income of \$71.0 million (18.8% of segment net sales) for the third quarter of 2007. The decrease was primarily due to the preliminary impairment of goodwill and other intangibles of approximately \$633.4 million, a decline in sales volumes of approximately \$24 million and rising costs for raw materials and energy of approximately \$10 million, net of cost savings initiatives.

**Interest expense**

Interest expense for the third quarter of 2008 was \$30.5 million compared to \$37.5 million in the third quarter of 2007. The decrease in interest expense was directly related to lower average debt levels in the current quarter when compared to the third quarter of 2007.

**Income tax expense**

Income tax expense was \$148.9 million for the third quarter of 2008 compared to \$42.0 million, or 25.6% of earnings before income taxes, for the prior year's third quarter. The change in the tax rate is principally due to the impact on pre-tax earnings of a preliminary impairment of non-deductible goodwill and the recognition of a valuation allowance of \$253 million against the deferred tax benefit described below.

In the fourth quarter of 2007, the Company moved the intellectual property and treasury operations of an indirectly owned European entity to a new office in another jurisdiction in Europe. The Company also indirectly owned a holding company in the new jurisdiction that provided certain treasury functions to Unilin and the move allowed for the consolidation of the historical intellectual property and treasury operations to be combined with those of the holding company's treasury operations in a single jurisdiction in order to integrate and streamline the operations, to facilitate international acquisitions and to improve tax and cost efficiencies. This restructuring resulted in a step up in the subsidiary's taxable basis of its intellectual property. The step up relates primarily to intangible assets which will be amortized over 10 years for tax purposes. During the fourth quarter of 2007, the Company evaluated the evidence for recognition of the deferred tax asset created through the restructuring and determined that, based on the available evidence, the deferred tax asset would more likely than not be realized. The deferred tax asset recognized at December 31, 2007 was approximately \$245 million and the related income tax benefit recognized in the financial statements was approximately \$272 million.

During the third quarter of 2008, the Company reassessed the need for a valuation allowance against its deferred tax assets. Cash flows have decreased from that projected as of December 31, 2007, primarily due to the slowing worldwide economy and declining sales volume. The Company determined that, given the current and expected economic conditions and the corresponding reductions in cash flows, its ability to realize the benefit of the deferred tax asset related to the European step up transaction described above as well as tax losses generated in the same jurisdiction was not more likely than not. Accordingly the Company recorded a valuation allowance against the deferred tax asset in the amount of \$253 million during the quarter ended September 27, 2008.

**Table of Contents****Nine Months Ended September 27, 2008, as Compared with Nine Months Ended September 29, 2007****Net Sales**

Net sales for the nine months ended September 27, 2008 were \$5,341.2 million, reflecting a decrease of \$437.6 million, or 7.6%, from the \$5,778.8 million reported for the nine months ended September 29, 2007. The decrease was primarily driven by a decline in sales volumes of approximately \$660 million due to the continued decline in the U.S. residential markets, softening commercial demand and slowing European demand, partially offset by a benefit of approximately \$135 million due to the net effect of price increases and product mix, and a benefit of approximately \$80 million due to favorable foreign exchange rates.

*Mohawk Segment* - Net sales decreased \$410.5 million, or 12.7%, to \$2,827.3 million in the current nine months compared to \$3,237.8 million in the first nine months of 2007. The decrease was primarily driven by a decline in sales volumes of approximately \$486 million due to the continued decline in the U.S. residential market and softening commercial demand, partially offset by a benefit of approximately \$94 million due to the net effect of price increases and product mix.

*Dal-Tile Segment* - Net sales decreased \$67.0 million, or 4.6%, to \$1,402.6 million in the current nine months compared to \$1,469.6 million in the first nine months of 2007. This decrease was primarily driven by a decline in sales volumes of approximately \$88 million due to the continued decline in the U.S. residential market, partially offset by a benefit of approximately \$21 million due to the net effect of price increases and product mix.

*Unilin Segment* - Net sales increased \$79.0 million, or 7.2%, to \$1,173.1 million in the current nine months compared to \$1,094.1 million in the first nine months of 2007. The increase in net sales was driven by a benefit of approximately \$84 million due to the Wood Acquisition, a benefit of approximately \$80 million due to favorable foreign exchange rates and a benefit of approximately \$21 million due to the net effect of price increases and product mix, partially offset by a decline in sales volumes of approximately \$86 million due to the continued decline in the U.S. residential market and slowing European demand.

**Gross profit**

Gross profit for the first nine months of 2008 was \$1,381.8 million (25.9% of net sales) and represented a decrease of \$243.7 million, or 15.0%, compared to gross profit of \$1,625.5 million (28.1% of net sales) for the prior year's first nine months. Gross profit was unfavorably impacted by increasing costs for raw materials and energy of approximately \$213 million, net of cost savings initiatives, and a decline in volumes of approximately \$181 million, partially offset by the net effect of price increases and product mix of approximately \$153 million.

**Selling, general and administrative expenses**

Selling, general and administrative expenses for the first nine months of 2008 were \$993.6 million (18.6% of net sales), reflecting a decrease of \$62.3 million, or 5.9%, compared to \$1,055.9 million (18.3% of net sales) for the prior year's first nine months. The decrease in SG&A is attributable to various cost savings initiatives implemented by the Company, offset by \$21 million of unfavorable foreign exchange. The increase in selling, general and administrative expenses as a percentage of net sales was primarily attributable to leveraging over lower net sales.

**Impairment of goodwill and intangibles**

During the third quarter of 2008, the Company recorded a preliminary \$1,418.9 million (\$1,307.4 million net of tax) impairment charge to reduce the carrying amount of the Company's goodwill and intangible assets to their estimated fair value based upon the results of an interim impairment test. The Company performed an interim impairment test because of a prolonged decline in the Company's market capitalization which the Company believes is primarily a result of the weakness in the U.S. residential housing market and the slowing European economy. During the third quarter of 2008, the Company concluded that the weakness in the U.S. residential housing market is likely to persist based on its review of, among other things, sequential quarterly

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housing starts, recent turmoil surrounding the nation's largest mortgage lenders, the potential negative impact on the availability of mortgage financing and housing start forecasts published by national home builder associations pushing recovery in the U.S. residential housing market further out in 2009. The total impairment included \$253.6 million in the Mohawk segment, \$531.9 million in the Dal-Tile segment and \$633.4 million in the Unilin segment. If, in the future, the Company's market capitalization and/or the estimated fair value of the Company's reporting units were to decline further, it may be necessary to record an additional impairment charge.

**Operating (loss) income**

Operating loss for the first nine months of 2008 was \$1,030.7 million reflecting a decrease of \$1,600.3 million compared to operating income of \$569.6 million (9.9% of net sales) in the first nine months of 2007. The decrease was primarily driven by the recognition of a preliminary impairment of goodwill and other intangibles of \$1,418.9 million, a decline in sales volumes of approximately \$177 million and rising costs for raw materials and energy of approximately \$108 million, net of cost savings initiatives, partially offset by a benefit of approximately \$128 million due to the net effect of price increases and product mix.

*Mohawk Segment* - Operating loss was \$167.5 million in the first nine months of 2008 reflecting a decrease of \$352.7 million compared to operating income of \$185.2 million (5.7% of segment net sales) in the first nine months of 2007. The decrease was primarily due to the preliminary impairment of goodwill and other intangibles of \$253.6 million, a decline in sales volumes of approximately \$94 million and rising costs for raw materials and energy of approximately \$51 million, net of cost savings initiatives, partially offset by a benefit of approximately \$70 million due to the net effect of price increases and product mix.

*Dal-Tile Segment* - Operating loss was \$364.8 million in the first nine months of 2008 reflecting a decrease of \$561.7 million compared to operating income of \$196.9 million (13.4% of segment net sales) for the first nine months of 2007. The decrease was primarily due to the preliminary impairment of goodwill of \$531.9 million, rising costs for raw materials and energy of approximately \$34 million, net of cost savings initiatives, and a decline in sales volumes of approximately \$30 million, partially offset by a benefit of approximately \$39 million due to the net effect of price increases and product mix.

*Unilin Segment* - Operating loss was \$482.5 million in the first nine months of 2008 reflecting a decrease of \$695.8 million compared to operating income of \$213.3 million (19.5% of segment net sales) for the first nine months of 2007. The decrease was primarily due to the preliminary impairment of goodwill and other intangibles of \$633.4 million, a decline in sales volumes of approximately \$54 million and rising costs for raw materials and energy of approximately \$33 million, net of cost savings initiatives, partially offset by a benefit of approximately \$20 million due to the net effect of price increases and product mix.

**Interest expense**

Interest expense for the first nine months of 2008 was \$97.0 million compared to \$118.2 million for the first nine months of 2007. The decrease in interest expense was directly related to lower average debt levels in the first nine months of 2008 when compared to the first nine months of 2007.

**Income tax expense**

Income tax expense was \$194.2 million for the first nine months of 2008 compared to \$132.2 million, or 28.7% of earnings before income taxes, for the prior year's first nine months. The change in the tax rate is principally due to the impact on pre-tax earnings of a preliminary impairment of non-deductible goodwill and the recognition of a valuation allowance of \$253 million against the deferred tax benefit described above.

**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.

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Cash flows provided by operations for the first nine months of 2008 were \$371.5 million compared to cash flows provided by operations of \$601.8 million for the first nine months of 2007. The decrease in operating cash flows for the first nine months of 2008 as compared to the first nine months of 2007 is primarily attributable to lower earnings from declining business conditions, the timing of receipts due to a calendar shift in the fourth quarter of 2007 as compared to 2006, a change in customer mix and lower accounts payable and accruals due to lower volumes, partially offset by lower inventory levels.

Net cash used in investing activities for the first nine months of 2008 was \$163.7 million compared to \$240.6 million for the first nine months of 2007. The increase is due to an increase in and the timing of additional plant capital spending during 2008 as compared to 2007. Capital spending during the remainder of 2008 for the Mohawk, Dal-Tile and Unilin segments combined, excluding acquisitions, is expected to range from \$45 million to \$55 million, and will be used primarily to purchase equipment and to streamline manufacturing capacity.

Net cash used in financing activities for the first nine months of 2008 was \$235.4 million compared to net cash used in financing activities of \$344.1 million for the same period in 2007. The Company has paid down approximately \$233 million of debt during the first nine months of 2008.

During the third quarter of 2008 the Company's \$750 million revolving credit facility was impacted by the bankruptcy of Lehman Brothers Holdings Inc (Lehman). As a result of the bankruptcy, the Company can no longer utilize its Lehman credit commitment of \$100 million, thus reducing the Company's borrowing availability by \$100 million. The Company believes the remaining banks in its revolving credit facility are stable and that the remaining availability is adequate to meet its liquidity requirements.

At September 27, 2008, a total of \$427.7 million was available under the Company's revolving credit facility, which excludes the Lehman credit commitment of \$100 million. The amount used under the revolving credit facility at September 27, 2008 was \$222.3 million. The amount used under the revolving credit facility is composed of \$119.5 million of borrowings, \$55.6 million of standby letters of credit guaranteeing the Company's industrial revenue bonds and \$47.2 million of standby letters of credit related to various insurance contracts and foreign vendor commitments. The Company's \$750 million revolving credit facility matures on October 28, 2010 and bears interest, at the Company's option, 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.

At September 27, 2008, a total of \$190 million (USD equivalent) was available under the Company's 130 million Euro revolving credit facility. This facility is available to the Company's European subsidiaries and guaranteed by the Company. The facility matures on November 8, 2010 and bears interest at Euribor 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 (Securitization Facility). At September 27, 2008, the Company had \$50.0 million outstanding secured by trade receivables. On July 28, 2008, the Company amended and restated the Securitization Facility, reduced total availability from \$350.0 million to \$250.0 million due to its adequate liquidity position, and extended the term until July 2009.

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. Interest payable on each series of the notes is subject to adjustment if either Moody's Investors 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. Each 0.25% increase in the interest rate of these notes would increase the Company's interest expense by approximately \$3.5 million per year. To date, there have been no adjustments to the interest rate of these notes. However, on November 7, 2008, Moody's Investors Service, Inc. announced that it placed the Company's Baa3 long term rating on review for possible downgrade.

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### **Contractual Obligations**

There have been no significant changes to the Company's contractual obligations as disclosed in the Company's 2007 Annual Report filed on Form 10-K.

### **Critical Accounting Policies and Estimates**

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 in its 2007 Form 10-K. 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.

Other than the Critical Accounting Policy described below, there have been no significant changes to the Company's critical accounting policies and estimates during the period. The Company's critical accounting policies and estimates are described in its 2007 Annual Report filed on Form 10-K.

*Goodwill and other intangibles* - Goodwill is tested annually for impairment during the fourth quarter or earlier upon the occurrence of certain events or substantive changes in circumstances. The Company considers the relationship between its market capitalization and its book value, among other factors, when reviewing for indicators of impairment. The goodwill impairment tests are based on determining the fair value of the specified reporting units based on management judgments and assumptions using the discounted cash flows and comparable company market valuation approaches. The Company has identified Mohawk, Dal-Tile, Unilin Flooring, Unilin Chipboard and Melamine, and Unilin Roofing as its reporting units for the purposes of allocating goodwill and intangibles as well as assessing impairments. The valuation approaches are subject to key judgments and assumptions that are sensitive to change such as judgments and assumptions about appropriate sales growth rates, operating margins, weighted average cost of capital ( WACC ), and comparable company market multiples. When developing these key judgments and assumptions, the Company considers economic, operational and market conditions that could impact the fair value of the reporting unit. However, estimates are inherently uncertain and represent only management's reasonable expectations regarding future developments. These estimates and the judgments and assumptions upon which the estimates are based will, in all likelihood, differ in some respects from actual future results. Should a significant or prolonged deterioration in economic conditions occur, such as continued declines in spending for new construction, remodeling and replacement activities; the inability to pass increases in the costs of raw materials and fuel on to its customers; or a decline in comparable company market multiples, then key judgments and assumptions could be impacted. Generally, a moderate decline in estimated operating income or a small increase in WACC or a decline in market capitalization could result in an additional indication of impairment

As noted above, the Company considers the relationship between its market capitalization and its book value, among other factors, when reviewing for indicators of impairment. The Company believes that the weakness in the U.S. residential housing market and the slowing European economy are principal factors in the prolonged decline in its market capitalization as compared to its book value. During the third quarter of 2008, the Company concluded that the weakness in the U.S. residential housing market is likely to persist based on its review of, among other things, sequential quarterly housing starts, recent turmoil surrounding the nation's largest mortgage lenders, the potential negative impact on the availability of mortgage financing and housing start forecasts published by national home builder associations pushing recovery in the U.S. residential housing market further out in 2009.

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The impairment test for intangible assets not subject to amortization involves a comparison of the estimated fair value of the intangible asset with its carrying value. If the carrying value of the intangible asset exceeds its fair value, an impairment loss is recognized in an amount equal to that excess. The estimates of fair value of intangible assets not subject to amortization are determined using a discounted cash flows valuation. Significant judgments inherent in this analysis include assumptions about appropriate sales growth rates, royalty rates, WACC and the amount of expected future cash flows. These judgments and assumptions are subject to the variability discussed above.

As a result of these impairment indicators, in the third quarter the Company performed an interim first step of its goodwill impairment test and determined that the carrying values of certain reporting units exceeded their fair values, indicating that goodwill was impaired. Having determined that goodwill was impaired, the Company began performing the second step of the goodwill impairment test which involves calculating the implied fair value of goodwill by allocating the fair value of the reporting unit to all of its assets and liabilities other than goodwill (including both recognized and unrecognized intangible assets) and comparing the residual amount to the carrying value of goodwill. As of the date of the filing of the Company's Quarterly Report on Form 10-Q for the quarter ended September 27, 2008, the Company estimates that the implied fair value of its goodwill is less than its carrying value by approximately \$1,262.2 million, which the Company has recognized as an impairment of goodwill in the accompanying condensed consolidated results of operations for the quarter and nine months ended September 27, 2008. The \$1,262.2 million impairment of goodwill is an estimate based on the results of the determination of and, preliminary allocation of fair value, which the Company expects to complete in the fourth quarter of 2008.

The impairment evaluation for indefinite lived intangible assets, which for the Company are its trademarks, is conducted during the fourth quarter of each year, or more frequently if events or changes in circumstances indicate that an asset might be impaired. The determination of fair value used in the impairment evaluation is based on discounted estimates of future sales projections attributable to ownership of the trademarks. Significant judgments inherent in this analysis include assumptions about appropriate sales growth rates, royalty rates, WACC and the amount of expected future cash flows. The judgments and assumptions used in the estimate of fair value are generally consistent with past performance and are also consistent with the projections and assumptions that are used in current operating plans. Such assumptions are subject to change as a result of changing economic and competitive conditions. The determination of fair value is highly sensitive to differences between estimated and actual cash flows and changes in the related discount rate used to evaluate the fair value of the trademarks. Estimated cash flows are sensitive to changes in the economy among other things. As a result of the impairment indicators described above, during the third quarter of 2008, the Company evaluated its intangible assets with indefinite lives for impairment. The Company compared the estimated fair value of its trademarks to its carrying value and determined that there was a preliminary trademark impairment of approximately \$54.5 million in the Mohawk segment and a preliminary trademark impairment of approximately \$102.2 million in the Unilin segment, which the Company has recognized as an impairment of intangibles in the accompanying condensed consolidated results of operations for the quarter and nine months ended September 27, 2008.

The Company reviews long-lived assets, including its intangible assets subject to amortization which, for the Company are its patents and customer relationships, for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of long-lived assets to future undiscounted net cash flows expected to be generated by these assets. If such assets are considered to be impaired, the impairment recognized is the amount by which the carrying amount of the assets exceeds the fair value of the assets. As a result of the impairment indicators described above, during the third quarter of 2008, the Company tested its long-lived assets for impairment by comparing the estimated future undiscounted net cash flows expected to be generated by these assets to their carrying value and determined that there was no impairment.

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In September 2006, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards ( SFAS ) No. 157, *Fair Value Measurements* ( SFAS No. 157 ). SFAS No. 157 defines fair value, establishes a framework for measuring fair value and requires enhanced disclosures about fair value measurements. SFAS No. 157 requires companies to disclose the fair value of financial instruments according to a fair value hierarchy. Additionally, companies are required to provide certain disclosures regarding instruments within the hierarchy, including a reconciliation of the beginning and ending balances for each major category of assets and liabilities. SFAS No. 157 is effective for the Company's fiscal year beginning January 1, 2008 for financial assets and liabilities and January 1, 2009 for non-financial assets and liabilities. The adoption of SFAS No. 157 for financial assets and liabilities on January 1, 2008 did not have a material impact on the Company's consolidated financial statements. The Company is currently evaluating the impact, if any, of SFAS No. 157 for non-financial assets and liabilities on its consolidated financial statements.

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Post Retirement Plans - an amendment of FASB Statements No. 87, 88, 106 and 132(R)* ( SFAS No. 158 ). The Company adopted all provisions of SFAS No. 158 as of December 31, 2006, except for the measurement date provisions, which are effective for fiscal years ending after December 15, 2008. The adoption of the measurement provisions of SFAS No. 158 on January 1, 2008 did not have any impact on the Company's consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities-including an amendment of FASB Statement No. 115* ( SFAS No. 159 ). SFAS No. 159 expands the use of fair value accounting but does not affect existing standards which require assets or liabilities to be carried at fair value. The objective of SFAS No. 159 is to improve financial reporting by providing companies with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. Under SFAS No. 159, a company may elect to use fair value to measure eligible items at a specified election date and report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. Eligible items include, but are not limited to, accounts and loans receivable, available-for-sale and held-to-maturity securities, equity method investments, accounts payable, guarantees, issued debt and firm commitments. The Company adopted SFAS No. 159 effective January 1, 2008, but did not elect to fair value any of the eligible assets or liabilities. Therefore, the adoption did not have any impact on its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* ( SFAS 141R ). SFAS 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. SFAS 141R also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS 141R is to be applied prospectively to business combinations for which the acquisition date is on or after January 1, 2009. Once adopted, SFAS 141R will impact the recognition and measurement of future business combinations and certain income tax benefits recognized from prior business combinations.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements - an amendment of Accounting Research Bulletin No. 51* ( SFAS No. 160 ). SFAS No. 160 establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest, and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. SFAS No. 160 also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS No. 160 is effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating the potential impact, if any, of the adoption of SFAS No. 160 on its consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities* ( SFAS No. 161 ). SFAS No. 161 is intended to improve financial reporting about derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand

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their effects on an entity's financial position, financial performance, and cash flows. The provisions of SFAS No. 161 are effective for the first quarter of 2009. The Company is currently evaluating the impact of the provisions of SFAS No. 161 on its consolidated financial statements.

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles* (SFAS No. 162). SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements. SFAS No. 162 is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles*. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial statements.

In October 2008, the FASB issued FSP 157-3 *Determining Fair Value of a Financial Asset in a Market That Is Not Active* (FSP 157-3). FSP 157-3 clarifies the application of SFAS No. 157 as it relates to the valuation of financial assets in a market that is not active for those financial assets. This FSP is effective immediately and includes those periods for which financial statements have not been issued. The Company currently does not have any financial assets that are valued using inactive markets, and as such is not impacted by the issuance of this FSP.

## **Impact of Inflation**

Inflation affects the Company's manufacturing costs, distribution costs and operating expenses. The carpet and tile industry have experienced significant inflation in the prices of raw materials and fuel-related costs beginning in the first quarter of 2004, predominately related to the oil-based materials it purchases. The laminate industry has experienced moderate inflation in the prices of raw material since the beginning of 2006. For the period from 1999 through the beginning of 2004, the carpet and tile industry experienced moderate inflation in the prices of raw materials and fuel-related costs. In the past, the Company has generally been able to pass along these price increases to its customers and has been able to enhance productivity to help offset increases in costs resulting from inflation in its operations.

## **Seasonality**

The Company is a calendar year-end company. With respect to its Mohawk and Dal-Tile segments, its results of operations for the first quarter tend to be the weakest. The second, third and fourth quarters typically produce higher net sales and operating income in these segments. These results are primarily due to consumer residential spending patterns for floor covering, which historically have decreased during the first two months of each year following the holiday season. The Unilin segment's second and fourth quarters typically produce higher net sales and earnings followed by a moderate first quarter and a weaker third quarter. The third quarter is traditionally the weakest due to the European holiday in late summer.

## **Forward-Looking Information**

Certain of the statements in this Form 10-Q, 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.



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**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

There have been no significant changes to the Company's exposure to market risk as disclosed in the Company's 2007 Annual Report filed on Form 10-K.

**Item 4. Controls and Procedures**

Based on an evaluation of the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this report, the Company's Chief Executive Officer and Chief Financial Officer have concluded that such controls and procedures were effective for the period covered by this report. No change in the Company's internal control over financial reporting occurred during the period covered by this report that materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

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**PART II. OTHER INFORMATION**

**Item 1. 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 was returned to the District Court for further proceedings. On December 18, 2007, the plaintiffs filed a motion for class certification.

On March 3, 2008, the District Court denied the plaintiffs motion for class certification. The plaintiffs then appealed the decision to the United States Court of Appeals for the 11<sup>th</sup> Circuit on March 17, 2008. Discovery has been stayed at the District Court while the appeal is pending. 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.

**Item 1A. Risk Factors**

In addition to the other information provided in this Form 10-Q, 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 current uncertainty in the credit markets, downturns in the global economy and the Company's business could affect the overall availability and cost of credit.***

The current uncertainty in the credit markets could also limit demand for our products, and affect the overall availability and cost of credit. At this time, it is unclear whether and to what extent the actions taken by the U.S. government, and other measures currently being implemented or contemplated, will mitigate the effects of the situation. While we have no immediate need to access the credit markets at this time, the impact of the current situation on our ability to obtain financing in the future, and the cost and terms of it, is uncertain. These and other economic factors could have a material adverse effect on demand for our products and on our financial condition and operating results. Further, these generally negative economic and business conditions may factor into our periodic credit ratings assessment by either or both Moody's Investors Service, Inc. and Standard & Poor's Ratings Services. The rating agency's evaluation is based on a number of factors, which include scale and diversification, brand strength, profitability, leverage, liquidity and interest coverage. On November 7, 2008, Moody's Investors Service, Inc. announced that it placed the Company's Baa3 long term rating on review for possible downgrade. A downgrade in our credit rating could increase our cost of credit, and we can provide no assurances that such an event will not occur.

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*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. and global economies, along with the housing markets in such economies, has negatively impacted the floor covering industry and the Company's business. These difficult economic conditions may continue or deteriorate in the foreseeable future. Further, significant or prolonged declines in such economies or 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. and global economies, along with the housing markets in such economies, 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. The difficult economic conditions may continue or deteriorate in the foreseeable future. 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.

*In periods of rising costs, the Company may be unable to pass cost increases 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. 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 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:

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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. For certain of such raw materials, the Company is dependent on one or a small number of suppliers. An adverse change in the Company's relationship with such a supplier, the financial condition of such a supplier or such supplier's ability to manufacture or deliver such raw materials to the Company could lead to an interruption of supply. 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.

***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.

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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.

***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

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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.

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.

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*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.

*Declines in the Company's business conditions may result in an impairment of the Company's goodwill and/or intangible assets which could result in a material non-cash charge.*

A decrease in the Company's market capitalization, including a short-term decline in stock price, or a negative long-term performance outlook, could result in an impairment of its goodwill and/or indefinite lived intangible assets which results when the carrying value of the Company's reporting units exceed their fair value.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

None.

**Item 3. Defaults Upon Senior Securities**

None.

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

None.

**Item 5. Other Information**

None.

**Item 6. Exhibits****No. Description**

- 10.1 Second Amended and Restated Credit and Security Agreement, dated as of July 28, 2008, among Mohawk Factoring, Inc., Mohawk Servicing, Inc., Victory Receivables Corporation, Three Pillars Funding LLC, SunTrust Bank, The Bank of Tokyo-Mitsubishi UFJ, Ltd., New York Branch, individually and as a co-agent, and SunTrust Robinson Humphrey, Inc., as a co-agent and administrative (Incorporated by reference to the Company's Current Report on Form 8-K filed with the SEC on August 1, 2008).
- 10.2 Second Amended and Restated Receivables Purchase and Sale Agreement, dated as of July 28, 2008, among Mohawk Carpet Distribution, L.P. and Dal-Tile Corporation, Dal-Tile SSC West, Inc. and Dal-Tile SSC East, Inc., as originators, and Mohawk Factoring, Inc., as the Buyer (Incorporated by reference to the Company's Current Report on Form 8-K filed with the SEC on August 1, 2008).

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- 31.1 Certification Pursuant to Rule 13a-14(a).
- 31.2 Certification Pursuant to Rule 13a-14(a).
- 32.1 Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.



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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

MOHAWK INDUSTRIES, INC.  
(Registrant)

Dated: November 11, 2008

By: /s/ Jeffrey S. Lorberbaum  
JEFFREY S. LORBERBAUM  
Chairman, President and  
Chief Executive Officer  
(principal executive officer)

Dated: November 11, 2008

By: /s/ Frank H. Boykin  
FRANK H. BOYKIN  
Chief Financial Officer  
(principal financial officer)