

MOHAWK INDUSTRIES INC  
Form 10-Q  
November 06, 2006

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 30, 2006

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 19826

MOHAWK INDUSTRIES, INC.  
(Exact name of registrant as specified in its charter)

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, or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act):

Large accelerated filer  Accelerated filer  Non-accelerated filer

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 capital stock as of October 27, 2006, the latest practicable date, is as follows:  
67,723,180 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 SHEETSASSETS  
(In thousands)  
(Unaudited)

|   | September 30, 2006 | December 31, 2005 |
|---|--------------------|-------------------|
| Current assets:                                   |                    |                   |
| Cash and cash equivalents                         | \$ 69,730          | 134,585           |
| Receivables                                       | 958,416            | 848,666           |
| Inventories                                       | 1,275,435          | 1,215,427         |
| Prepaid expenses                                  | 126,895            | 140,789           |
| Deferred income taxes                             | 55,128             | 49,534            |
| Total current assets                              | 2,485,604          | 2,389,001         |
| Property, plant and equipment, at cost            | 3,005,177          | 2,824,837         |
| Less accumulated depreciation and<br>amortization | 1,135,904          | 1,014,109         |
| Net property, plant and equipment                 | 1,869,273          | 1,810,728         |
| Goodwill  | 2,685,092          | 2,621,963         |
| Tradenames  | 646,933            | 622,094           |
| Other intangible assets                           | 521,806            | 552,003           |
| Other assets                                      | 25,933             | 44,248            |
|   | \$ 8,234,641       | 8,040,037         |

See accompanying notes to condensed consolidated financial statements.

MOHAWK INDUSTRIES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETSLIABILITIES AND STOCKHOLDERS' EQUITY  
(In thousands, except per share data)  
(Unaudited)

|  | September 30, 2006  | December 31, 2005 |
|--|---------------------|-------------------|
| Current liabilities:   |                     | -                 |
| Current portion of long-term debt  | \$ 509,151          | 113,809           |
| Accounts payable and accrued expenses  | 1,124,974           | 998,105           |
| <b>Total current liabilities</b>   | <b>1,634,125</b>    | <b>1,111,914</b>  |
| Deferred income taxes  | 591,273             | 643,283           |
| Long-term debt, less current portion   | 2,438,732           | 3,194,561         |
| Other long-term liabilities  | 40,010              | 32,041            |
| <b>Total liabilities</b>   | <b>4,704,140</b>    | <b>4,981,799</b>  |
| Stockholders' equity:  |                     |                   |
| Preferred stock, \$.01 par value; 60 shares<br>authorized; no shares issued  | -                   | -                 |
| Common stock, \$.01 par value; 150,000 shares<br>authorized; 78,748 and 78,478 shares issued<br>in 2006 and 2005, respectively | 787                 | 785               |
| <b>Additional paid-in capital</b>  | <b>1,145,803</b>    | <b>1,123,991</b>  |
| Retained earnings  | 2,626,039           | 2,299,696         |
| <b>Accumulated other comprehensive income, net</b>   | <b>81,718</b>       | <b>(47,433)</b>   |
|  | 3,854,347           | 3,377,039         |
| Less treasury stock at cost; 11,051 and 10,981<br>shares in 2006 and 2005, respectively  | 323,846             | 318,801           |
| <b>Total stockholders' equity</b>  | <b>3,530,501</b>    | <b>3,058,238</b>  |
|  | <b>\$ 8,234,641</b> | <b>8,040,037</b>  |

See accompanying notes to condensed consolidated financial statements.

MOHAWK INDUSTRIES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

(In thousands, except per share data)  
(Unaudited)

|  | Three Months Ended |                 |
|--|--------------------|-----------------|
|  | September 30, 2006 | October 1, 2005 |
| Net sales  | \$ 2,024,019       | 1,697,634       |
| Cost of sales  | 1,455,508          | 1,234,680       |
| Gross profit   | 568,511            | 462,954         |
| Selling, general and administrative expenses                             | 345,771            | 274,052         |
| Operating income   | 222,740            | 188,902         |
| Other expense (income):  |                    |                 |
| Interest expense   | 44,655             | 10,775          |
| Other expense  | 2,668              | 1,970           |
| Other income   | (2,613)            | (2,370)         |
| U.S. Customs refund, net   | (8,834)            | -               |
| Earnings before income taxes   | 35,876             | 10,375          |
| Income taxes   | 186,864            | 178,527         |
| Net earnings   | \$ 59,156          | 62,764          |
| Basic earnings per share   | \$ 1.89            | 1.73            |
| Weighted-average common shares outstanding                               | 67,704             | 66,865          |
| Diluted earnings per share   | \$ 1.88            | 1.71            |
| Weighted-average common and dilutive potential common shares outstanding | 68,021             | 67,519          |

See accompanying notes to condensed consolidated financial statements.

MOHAWK INDUSTRIES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

(In thousands, except per share data)  
(Unaudited)

|  | Nine Months Ended  |                 |
|--|--------------------|-----------------|
|  | September 30, 2006 | October 1, 2005 |
| Net sales  | \$ 6,007,248       | 4,815,548       |
| Cost of sales  | 4,330,015          | 3,524,060       |
| Gross profit   | 1,677,233          | 1,291,488       |
| Selling, general and administrative expenses                             | 1,067,547          | 806,144         |
| Operating income   | 609,686            | 485,344         |
| Other expense (income):  |                    |                 |
| Interest expense   | 131,113            | 35,166          |
| Other expense  | 9,777              | 6,688           |
| Other income   | (3,397)            | (4,162)         |
| U.S. Customs refund, net   | (15,066)           | -               |
| Earnings before income taxes   | 487,259            | 447,652         |
| Income taxes   | 122,427            | 37,692          |
| Net earnings   | \$ 326,342         | 287,505         |
| Basic earnings per share   | \$ 4.82            | 4.30            |
| Weighted-average common shares outstanding                               | 67,654             | 66,827          |
| Diluted earnings per share   | \$ 4.80            | 4.26            |
| Weighted-average common and dilutive potential common shares outstanding | 68,056             | 67,572          |

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 30, 2006 | October 1, 2005 |
| Cash flows from operating activities:   |                    |                 |
| Net earnings  | \$ 326,342         | 287,505         |
| Adjustments to reconcile net earnings to net cash provided by operating activities: |                    |                 |
| Depreciation and amortization   | 202,674            | 94,900          |
| Deferred income taxes   | (64,026)           | 8,387           |
| Loss on disposal of property, plant and equipment                                   | 5,895              | 1,312           |
| Tax benefit on exercise of stock awards   | -                  | 4,749           |
| Excess tax benefit from stock-based compensation                                    | (3,022)            | -               |
| Stock based compensation expense  | 9,028              | -               |
| Changes in operating assets and liabilities, net of effects of acquisition:         |                    |                 |
| Receivables   | (71,280)           | (141,544)       |
| Inventories   | (48,006)           | (81,498)        |
| Accounts payable and accrued expenses   | 165,244            | 150,940         |
| Other assets and prepaid expenses   | 18,642             | 4,527           |
| Other liabilities   | 4,750              | (1,245)         |
| Net cash provided by operating activities   | 546,241            | 328,033         |
| Cash flows from investing activities:   |                    |                 |
| Additions to property, plant and equipment, net                                     | (124,048)          | (150,801)       |
| Acquisitions  | (70,907)           | (50,606)        |
| Net cash used in investing activities   | (194,955)          | (201,407)       |
| Cash flows from financing activities:   |                    |                 |
| Net change in short term credit lines   | -                  | (23,215)        |
| Payments on revolving line of credit  | (1,290,746)        | -               |
| Proceeds from revolving line of credit  | 1,053,298          | -               |
| Repayment on bridge loan  | (1,400,000)        | -               |
| Proceeds from issuance of senior notes  | 1,386,841          | -               |
| Net change in asset securitization borrowings                                       | 110,000            | (90,000)        |
| Payments on term loan   | (239,220)          | -               |
| Payments of other debt  | (31,904)           | (9,447)         |
| Excess tax benefit from stock-based compensation                                    | 3,022              | -               |
| Change in outstanding checks in excess of cash                                      | (15,506)           | 2,506           |
| Acquisition of treasury stock   | (5,180)            | (15,448)        |
| Proceeds from stock option exercises  | 9,505              | 8,978           |
| Net cash used in financing activities   | (419,890)          | (126,626)       |
| Effect of exchange rate changes on cash and cash equivalents                        | 3,749              | -               |
| Net change in cash  | (64,855)           | -               |
| Cash, beginning of period   | 134,585            | -               |
| Cash, end of period   | \$ 69,730          | -               |

See accompanying notes to condensed consolidated financial statements.

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 2005 Annual Report on Form 10-K, as filed with the Securities and Exchange Commission.

2. Summary of Significant Accounting Policies

As of April 2, 2006, the Company changed the method of accounting for its inventory from the last-in, first-out ("LIFO") to the first-in, first-out ("FIFO") method for inventories not on FIFO within its Mohawk segment. All prior periods have been revised to reflect this change. See Note 6 for further discussion.

3. New Pronouncements

In July 2006, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 48 ("FIN 48"), "Accounting for Uncertainty in Income Taxes—an *Interpretation of FASB Statement No. 109*," which clarifies the accounting for uncertainty in income taxes. FIN 48 prescribes a recognition threshold and measurement criteria for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The provisions of FIN 48 are effective as of the beginning of the Company's 2007 fiscal year, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. The Company is currently evaluating the impact of FIN 48 on its consolidated financial statements.

In September 2006, FASB issued Statement of Financial Accounting Standards No. 157 ("SFAS No. 157"), "Fair Value Measurements." 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 its 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 157 is effective for the Company's fiscal year beginning January 1, 2008. The Company is currently evaluating the impact of SFAS No. 157 on its consolidated financial statements.

MOHAWK INDUSTRIES, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)  
(Unaudited)

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"). SFAS No. 158 requires an employer that sponsors one or more single-employer defined benefit plans to recognize the over-funded or under-funded status of a benefit plan in its statement of financial position, recognize as a component of other comprehensive income, net of tax, gains or losses and prior service costs or credits that arise during the period but are not recognized as components of net periodic benefit costs pursuant to SFAS No. 87, "Employers Accounting for Pensions," or SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," measure defined benefit plan assets and obligations as of the date of the employer's fiscal year-end, and disclose in the notes to financial statements additional information about certain effects on net periodic benefit cost for the next fiscal year that arise from delayed recognition of the gains or losses, prior service costs or credits, and transition assets or obligations. The recognition and disclosure provisions required by SFAS No. 158 are effective for the Company's fiscal year ending December 31, 2006. The measurement date provisions are effective for fiscal years ending after December 15, 2008. The Company is currently evaluating the impact of SFAS No. 158 on its consolidated financial statements.

In September 2006, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" ("SAB 108"). SAB 108 provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The SEC staff believes that registrants should quantify errors using both the balance sheet and income statement approach when quantifying a misstatement. SAB 108 is effective for the Company's fiscal year ending December 31, 2006. The Company is currently evaluating the impact of SAB 108 on the Company's consolidated financial statements.

#### 4. Acquisition

On October 31, 2005, the Company acquired all the outstanding shares of Unilin Holding NV by acquiring Unilin Flooring BVBA, which then purchased Unilin Holding NV. The Company simultaneously acquired all the outstanding shares of Unilin Holding Inc., and its subsidiaries (together with Unilin Flooring BVBA, "Unilin"). Unilin, together with its subsidiaries, is a leading manufacturer, distributor and marketer of laminate flooring in Europe and the United States. The total purchase price of acquiring Unilin, net of cash of \$165,709, was Euro 2,105,918, or \$2,540,949, based on the prevailing exchange rate at the closing. The acquisition was accounted for by the purchase method and, accordingly, the results of operations of Unilin have been included in the Company's consolidated financial statements from October 31, 2005. The purchase price has been allocated to the assets acquired and liabilities assumed based upon the estimated fair values at the date of acquisition. Intangibles and property, plant and equipment values were established with the assistance of an independent third party. The excess of the purchase price over the fair value of the net identifiable assets acquired of approximately \$1,247,155 was recorded as goodwill. The primary reason for the acquisition was to expand the Company's presence in the laminate flooring market.

The Company considered whether identifiable intangible assets existed during the purchase price negotiations and during the subsequent purchase price allocation period. Accordingly, the Company recognized trade names, patents, customer lists, contingent assets and backlogs.

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

MOHAWK INDUSTRIES, INC. AND SUBSIDIARIES  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)  
 (Unaudited)

The following table summarizes the fair values of the assets acquired and liabilities assumed at the date of acquisition, excluding cash of \$165,709. During October 2006, the Company finalized the allocation of the purchase price related to the Unilin acquisition.

|                               |    |           |
|-------------------------------|----|-----------|
| Current assets                | \$ | 389,923   |
| Property, plant and equipment |    | 752,892   |
| Goodwill                      |    | 1,247,155 |
| Intangible assets             |    | 882,886   |
| Other assets                  |    | 890       |
| Total assets acquired         |    | 3,273,746 |
| Current liabilities           |    | 277,337   |
| Long-term debt                |    | 32,027    |
| Other liabilities             |    | 423,433   |
| Total liabilities assumed     |    | 732,797   |
| Net assets acquired           | \$ | 2,540,949 |

Of the \$882,886 of acquired intangibles, \$356,521 was assigned to registered trade names that are not subject to amortization. The remaining acquired intangibles were assigned to customer relationships for \$270,709 (7 year weighted average useful life) and patents for \$255,656 (12 year weighted average useful life). The \$1,247,155 of goodwill is not deductible for tax purposes.

The following unaudited pro forma financial information presents the combined results of operations of the Company and Unilin as if the acquisition had occurred at the beginning of 2005, after giving effect to certain adjustments, including increased interest expense on debt related to the acquisition, and the amortization of intangible assets. The pro forma information does not necessarily reflect the results of operations that would have occurred had the Company and Unilin constituted a single entity during the period. The following table discloses the pro forma results for the three and nine month periods ended October 1, 2005:

|                            | Three Months Ended | Nine Months Ended |
|----------------------------|--------------------|-------------------|
| Net sales                  | \$ 1,997,690       | 5,672,680         |
| Net earnings               | 139,651            | 313,505           |
| Basic earnings per share   | 2.09               | 4.69              |
| Diluted earnings per share | 2.07               | 4.64              |

MOHAWK INDUSTRIES, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)  
(Unaudited)

## 5. Receivables

Receivables are as follows:

|  | September 30, 2006 | December 31, 2005 |
|--|--------------------|-------------------|
| Customers, trade   | \$ 1,030,378       | 925,714           |
| Other  | 36,695             | 25,662            |
|  | <b>1,067,073</b>   | <b>951,376</b>    |
| Less allowance for discounts, returns, claims<br>and doubtful accounts | 108,657            | 102,710           |
| Net receivables  | <b>\$ 958,416</b>  | <b>848,666</b>    |

## 6. Inventories

The components of inventories are as follows:

|                   | September 30, 2006  | December 31, 2005 |
|-------------------|---------------------|-------------------|
| Finished goods    | \$ 830,732          | 788,037           |
| Work in process   | 95,040              | 93,266            |
| Raw materials     | 349,663             | 334,124           |
| Total inventories | <b>\$ 1,275,435</b> | <b>1,215,427</b>  |

Effective April 2, 2006, the Company changed the method of accounting for all inventories not previously accounted for on the first-in, first-out ("FIFO") method from the last-in, first-out ("LIFO") method to the FIFO method. The Company believes the FIFO method of accounting for inventory costs is preferable because it provides a better measure of the current value of its inventory and provides a better matching of manufacturing costs with revenues. The change will also result in the application of a single costing method to all of the Company's inventories. As a result, all inventories are stated at the lower of cost, determined on a FIFO basis, or market. In accordance with SFAS No. 154, "Accounting Changes and Error Corrections," the Company has retrospectively applied this change in method of inventory costing. The impact of the change in method on certain financial statement line items is as follows:

MOHAWK INDUSTRIES, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)  
(Unaudited)

|   | Quarter<br>Ended<br>October 1,<br>2005 | Nine<br>Months Ended<br>October 1,<br>2005 | Year Ended<br>December 31,<br>2005 |
|---|--|--|------------------------------------|
| Statement of earnings data:             |  |  |                                    |
| As originally reported                  |  |  |                                    |
| Cost of sales                           | \$ 1,245,766                           | 3,547,469                                  | 4,896,965                          |
| Operating income                        | 177,816                                | 461,935                                    | 627,272                            |
| Income taxes                            | 58,789                                 | 151,760                                    | 198,826                            |
| Net earnings                            | \$ 108,652                             | 272,483                                    | 358,195                            |
| Basic earnings per share                | 1.62                                   | 4.07                                       | 5.35                               |
| Diluted earnings per share              | 1.61                                   | 4.03                                       | 5.30                               |
| Effect of Change-Increase<br>(decrease) |  |  |                                    |
| Cost of sales                           | \$ (11,086)                            | (23,409)                                   | (45,112)                           |
| Operating income                        | 11,086                                 | 23,409                                     | 45,112                             |
| Income taxes                            | 3,975                                  | 8,387                                      | 16,169                             |
| Net earnings                            | 7,111                                  | 15,022                                     | 28,943                             |
| Basic earnings per share                | 0.11                                   | 0.23                                       | 0.43                               |
| Diluted earnings per share              | 0.11                                   | 0.23                                       | 0.43                               |
| As revised                              |  |  |                                    |
| Cost of sales                           | \$ 1,234,680                           | 3,524,060                                  | 4,851,853                          |
| Operating income                        | 188,902                                | 485,344                                    | 672,384                            |
| Income taxes                            | 62,764                                 | 160,147                                    | 214,995                            |
| Net earnings                            | \$ 115,763                             | 287,505                                    | 387,138                            |
| Basic earnings per share                | 1.73                                   | 4.30                                       | 5.78                               |
| Diluted earnings per share              | 1.71                                   | 4.26                                       | 5.72                               |

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MOHAWK INDUSTRIES, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)  
(Unaudited)

|  | As of<br>December 31, 2005 | Statement of Cash Flows:<br>As originally reported | Nine Months Ended<br>October 1, 2005 |
|--|----------------------------|--|--------------------------------------|
| Balance sheet:                             |                            |  |                                      |
| As originally reported                     |                            |  |                                      |
| Inventory                                  | \$ 1,166,913               | Net earnings                                       | \$ 272,483                           |
| Total Assets                               | 7,991,523                  | Deferred taxes                                     | -                                    |
| Deferred income taxes                      | 625,887                    | Change in inventories                              | (58,089)                             |
| Total Liabilities                          | 4,964,403                  | Net cash provided by operating activities          | 328,033                              |
| Retained earnings                          | 2,268,578                  |  |                                      |
| Total liabilities and Shareholders' equity | 7,991,523                  |  |                                      |
| Effect of Change                           |                            |  |                                      |
| Inventory                                  | 48,514                     | Net earnings                                       | 15,022                               |
| Deferred income taxes                      | 17,396                     | Deferred taxes                                     | 8,387                                |
| Retained earnings                          | 31,118                     | Change in inventories                              | (23,409)                             |
| As revised                                 |                            | Net cash provided by operating activities          | -                                    |
| Inventory                                  | 1,215,427                  |  |                                      |
| Total Assets                               | 8,040,037                  | As revised   |                                      |
| Deferred income taxes                      | 643,283                    | Net earnings                                       | 287,505                              |
| Total Liabilities                          | 4,981,799                  | Deferred taxes                                     | 8,387                                |
| Retained earnings                          | 2,299,696                  | Change in inventories                              | (81,498)                             |
| Total liabilities and Shareholders' equity | \$ 8,040,037               | Net cash provided by operating activities          | \$ 328,033                           |

The amount of the accounting change prior to 2004 was not significant because FIFO approximated the inventory carrying value. Had the Company continued to apply the LIFO method of accounting, the impact on the statement of earnings would have resulted in an increase to operating income of \$2,427 (\$1,540, net of tax) and an increase in basic and diluted earnings per share of approximately \$0.02 per share for the current quarter and a decrease in operating income of \$3,724 (\$1,902 net of tax) and a decrease in basic and diluted earnings per share of approximately \$0.03 per share for the nine month period ended September 30, 2006.

7. Intangible assets and goodwill

Goodwill:

|   | Mohawk     | Dal-Tile  | Unilin    | Total     |
|---|------------|-----------|-----------|-----------|
| Balance as of January 1, 2006             | \$ 198,132 | 1,191,672 | 1,232,159 | 2,621,963 |
| Goodwill recognized during the period (1) | 1,000      | -         | (2,565)   | (1,565)   |
| Effect of translation during the period   | -          | -         | 64,694    | 64,694    |
| Balance as of September 30, 2006          | \$ 199,132 | 1,191,672 | 1,294,288 | 2,685,092 |

(1) The change in goodwill within the Unilin reporting unit resulted from adjustments to the opening balance sheet related to the Unilin acquisition. In addition, the Company recognized additional goodwill of \$1,000 related to an earn-out agreement entered into in 2003.

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## Intangible Assets:

## Indefinite Life Assets not

## Subject to Amortization:

|  |    | Mohawk  | Dal-Tile | Unilin   | Total    |
|--|----|---------|----------|----------|----------|
| Balance as of January 1, 2006, net         | \$ | 125,580 | 146,700  | 349,814  | 622,094  |
| Effect of translation during the period    |    | -       | -        | 24,839   | 24,839   |
| Balance as of September 30, 2006           | \$ | 125,580 | 146,700  | 374,653  | 646,933  |
| Intangible Assets Subject to Amortization: |    |         |          |          |          |
| Balance as of January 1, 2006, gross       | \$ | 53,360  | 2,570    | 519,119  | 575,049  |
| Less: Accumulated Amortization             |    | (7,710) | (751)    | (14,585) | (23,046) |
| Balance as of January 1, 2006, net         |    | 45,650  | 1,819    | 504,534  | 552,003  |
| Amortization during the period             |    | (2,651) | (644)    | (56,990) | (60,285) |
| Effect of translation during the period    |    | -       | -        | 30,088   | 30,088   |
| Balance as of September 30, 2006           | \$ | 42,999  | 1,175    | 477,632  | 521,806  |

Amortization expense for the three and nine month periods ended September 30, 2006 and October 1, 2005, respectively, is as follows:

| Amortization expense:          | Three Months Ended |       | Nine Months Ended |       |
|--------------------------------|--------------------|-------|-------------------|-------|
|                                | 2006               | 2005  | 2006              | 2005  |
| Aggregate Amortization Expense | \$ 20,472          | 1,000 | 60,285            | 3,002 |

## 8. Accounts payable and accrued expenses

Accounts payable and accrued expenses are as follows:

|   | September 30, 2006 | December 31, 2005 |
|---|--------------------|-------------------|
| Outstanding checks in excess of cash        | \$ 81,883          | 97,389            |
| Accounts payable, trade                     | 411,728            | 401,543           |
| Accrued expenses                            | 298,580            | 240,827           |
| Income taxes payable                        | 165,435            | 121,533           |
| Accrued compensation                        | 167,348            | 136,813           |
| Total accounts payable and accrued expenses | \$ 1,124,974       | 998,105           |

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9. Product Warranties

The Company warrants certain qualitative attributes of its products for up to 20 years. The Company records a liability for estimated warranty and related costs, based on historical experience and periodically adjusts these liabilities to reflect actual experience. The warranty obligation is as follows:

|                                | Three Months Ended    |                    | Nine Months Ended     |                    |
|--------------------------------|-----------------------|--------------------|-----------------------|--------------------|
|                                | September 30,<br>2006 | October 1,<br>2005 | September 30,<br>2006 | October 1,<br>2005 |
| Balance at beginning of period | \$ 24,824             | 24,054             | 25,988                | 23,473             |
| Warranty claims paid           | (11,676)              | (10,815)           | (36,481)              | (35,058)           |
| Warranty expense               | 12,418                | 10,996             | 36,059                | 35,820             |
| Balance at end of period       | \$ 25,566             | 24,235             | 25,566                | 24,235             |

10. Comprehensive income

Comprehensive income is as follows:

|   | Three Months Ended    |                    | Nine Months Ended     |                    |
|---|-----------------------|--------------------|-----------------------|--------------------|
|   | September 30,<br>2006 | October 1,<br>2005 | September 30,<br>2006 | October 1,<br>2005 |
| Net earnings  | \$ 127,708            | 115,763            | 326,342               | 287,505            |
| Other comprehensive income:   |                       |                    |                       |                    |
| Foreign currency translation  | (16,619)              | 56                 | 132,044               | (517)              |
| Unrealized (loss) gain on derivative instruments, net of income taxes | (388)                 | 3,206              | (2,893)               | 4,898              |
| Comprehensive income  | \$ 110,701            | 119,025            | 455,493               | 291,886            |

11. Stock compensation

Prior to January 1, 2006, the Company accounted for its stock compensation plans under the recognition and measurement provisions of APB Opinion No. 25, "Accounting for Stock Issued to Employees," and related Interpretations, as permitted by FASB No. 123, "Accounting for Stock-Based Compensation." Accordingly, no stock-based employee compensation cost related to stock options was recognized in the Consolidated Statement of Earnings as all options granted under the plans had an exercise price equal to the market value of the underlying common stock on the date of grant. Effective January 1, 2006, the Company adopted the fair value recognition provisions of FASB No. 123(R), "Share-Based Payment," using the modified-prospective-transition method. Under that transition method, compensation cost includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of, January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of FASB No. 123, and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of FASB No. 123(R). Results for prior periods have not been restated.

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Prior to the adoption of FASB No. 123(R), the Company presented all tax benefits of deductions resulting from the exercise of stock options as operating cash flows in the Consolidated Statement of Cash Flows. FASB No. 123(R) requires the cash flows resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as financing cash flows. Accordingly, the Company has classified the excess tax benefit as a financing cash inflow.

Under the Company's 2002 Long-Term Incentive Plan ("Plan"), the Company's principal stock compensation plan, stock options may be granted to directors and key employees through 2012 to purchase a maximum of 3,200 shares of common stock. 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. Those option awards generally vest between three and five years and have a 10-year contractual term. In addition, the Company maintains an employee incentive program that awards restricted stock on the attainment of certain service criteria. The outstanding awards related to these restricted stock programs and related compensation expenses were not significant for the quarters ended September 30, 2006 and October 1, 2005.

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

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of FASB No. 123(R) to options granted under the Plan in the period presented. For purposes of this pro forma disclosure, the value of the options is estimated using a Black-Scholes-Merton option-pricing formula and amortized to expense over the options' vesting periods.

|   | Three Months<br>Ended October 1,<br>2005 | Nine Months<br>Ended October 1,<br>2005 |
|---|--|---|
| Net earnings as reported  | \$ 115,763                               | 287,505                                 |
| Add: Stock-based employee compensation included in reported net earnings, net of related tax effects                                  | -  | -                                       |
| Deduct: Stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects | (2,188)                                  | (6,366)                                 |
| Pro forma net earnings  | \$ 113,575                               | 281,139                                 |
| Net earnings per common share (basic):  |  |   |
| As reported   | \$ 1.73                                  | 4.30                                    |
| Pro forma   | \$ 1.70                                  | 4.21                                    |
| Net earnings per common share (diluted):  |  |   |
| As reported   | \$ 1.71                                  | 4.26                                    |
| Pro forma   | \$ 1.69                                  | 4.17                                    |

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The fair value of the option award is estimated on the date of grant using the Black-Scholes-Merton valuation model that uses the assumptions noted in the following table. Expected volatility is based on the historical volatility of the Company's common stock and other factors. The Company uses historical data to estimate option exercise and forfeiture rates within the valuation model. Optionees that exhibit similar option exercise behavior are segregated into separate groups within the valuation model. The expected term of options granted represents the period of time that options granted are expected to be outstanding. The risk-free rate is based on U.S. Treasury yields in effect at the time of the grant for the expected term of the award. There were no options granted during the third quarter of 2006.

|                         | Three Months Ended<br>October 1,<br>2005 | Nine Months Ended<br>September 30,<br>2006 | October 1,<br>2005 |
|-------------------------|--|--|--------------------|
| Dividend yield          | -  | -  | -                  |
| Risk-free interest rate | 4.3 %                                    | 4.6 %                                      | 3.9 %              |
| Expected volatility     | 37.9 %                                   | 35.3 %                                     | 38.0 %             |
| Expected term (years)   | 6.0                                      | 5.6  | 6.0                |

The summary of the Company's Plan as of September 30, 2006, and changes during the nine month period then ended is presented as follows:

|   | Shares | Weighted Average<br>Exercise Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Term (years) | Average<br>Intrinsic<br>Value |
|---|--------|------------------------------------|---|-------------------------------|
| Options outstanding, beginning of year            | 2,276  | \$ 59.60                           |   |                               |
| Granted   | 144    | 83.74                              |   |                               |
| Exercised   | (263)  | 36.92                              |   |                               |
| Forfeited and expired                             | (31)   | 75.00                              |   |                               |
| Options outstanding, end of period                | 2,126  | 63.83                              | 6.6   | \$ 30,062                     |
| Vested and expected to vest at September 30, 2006 | 2,046  | \$ 63.20                           | 6.6   | \$ 29,869                     |
| Exercisable at September 30, 2006                 | 1,073  | \$ 51.53                           | 5.5   | \$ 25,438                     |

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The weighted-average grant-date fair value of options granted during the nine months ended September 30, 2006 and October 1, 2005, was \$33.89 and \$38.28, respectively. The total intrinsic value of options exercised during the nine months ended September 30, 2006, was \$11,861. Total compensation expense recognized for the nine months ended September 30, 2006, was \$9,028 or \$5,701 net of tax, which was allocated to selling, general and administrative expenses. The remaining unamortized expense for non-vested compensation expense at September 30, 2006, was \$21,424 with a weighted average remaining life of 2.4 years. If the Company had continued to account for share-based compensation under APB Opinion No. 25, basic and diluted net earnings per share for the three and nine months ended September 30, 2006 would have been \$1.91 and \$1.90 and \$4.91 and \$4.88, respectively.

The following table summarizes information about the Company's stock options outstanding at September 30, 2006:

| Exercise price range | Outstanding      |              |                 | Exercisable      |                 |
|----------------------|------------------|--------------|-----------------|------------------|-----------------|
|                      | Number of Shares | Average Life | Average Price   | Number of Shares | Average Price   |
| Under \$42.86        | 359              | 3.73         | \$ 28.99        | 356              | \$ 28.88        |
| \$48.50-58.00        | 365              | 6.29         | 50.39           | 243              | 50.24           |
| \$61.33-63.90        | 370              | 5.49         | 63.33           | 273              | 63.37           |
| \$65.02-73.45        | 381              | 7.28         | 72.31           | 133              | 72.03           |
| \$73.54-88.33        | 641              | 8.66         | 85.88           | 67               | 86.66           |
| \$89.46-90.97        | 10               | 8.40         | 90.47           | 1                | 90.54           |
| <b>Total</b>         | <b>2,126</b>     | <b>6.62</b>  | <b>\$ 63.83</b> | <b>1,073</b>     | <b>\$ 51.53</b> |

12. Earnings per share

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

Dilutive common stock options are included in the diluted EPS calculation using the treasury stock method. Options to purchase common stock excluded from the computation of diluted earnings per share because their effect would have been anti-dilutive were 1,547 shares and 981 shares for the third quarter of 2006 and 2005, respectively, and 1,316 shares and 909 shares for the nine month periods ended September 30, 2006 and October 1, 2005, respectively.

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|  | Three Months Ended    |                    | Nine Months Ended     |                    |
|--|-----------------------|--------------------|-----------------------|--------------------|
|  | September 30,<br>2006 | October 1,<br>2005 | September 30,<br>2006 | October 1,<br>2005 |
| <b>Net earnings</b>  | \$ 127,708            | 115,763            | 326,342               | 287,505            |
| Weighted-average common and dilutive potential common shares outstanding:                      |                       |                    |                       |                    |
| Weighted-average common shares outstanding   | 67,704                | 66,865             | 67,654                | 66,827             |
| Add weighted-average dilutive potential common shares - options to purchase common shares, net | 317                   | 654                | 402                   | 745                |
| Weighted-average common and dilutive potential common shares outstanding                       | 68,021                | 67,519             | 68,056                | 67,572             |
| <b>Basic earnings per share</b>  | \$ 1.89               | 1.73               | 4.82                  | 4.30               |
| Diluted earnings per share   | \$ 1.88               | 1.71               | 4.80                  | 4.26               |

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

|                                      | Nine Months Ended  |                 |
|--------------------------------------|--------------------|-----------------|
|                                      | September 30, 2006 | October 1, 2005 |
| Net cash paid during the period for: |                    |                 |
| Interest                             | \$ 79,626          | 31,806          |
| Income taxes                         | \$ 166,108         | 148,691         |

## 14. Segment reporting

The Company has three reporting segments, the Mohawk segment, the Dal-Tile segment and the Unilin segment. The Mohawk segment (an aggregation of the Mohawk Flooring reporting unit and the Mohawk Home reporting unit) designs, manufactures, sources, markets and distributes its product lines, which include carpet, rugs, pad, ceramic tile, hardwood, resilient and laminate through independent floor covering retailers, home centers, mass merchandisers, department stores, commercial dealers and commercial end users. The Dal-Tile segment designs, manufactures, sources, markets and distributes its product lines which include ceramic tile, porcelain tile and stone products sold through tile and flooring retailers, contractors, independent distributors and home centers. The Unilin segment which is headquartered in Belgium, designs, manufactures and markets laminate flooring products, which are distributed through separate distribution channels consisting of independent distributors (who sell through retailers) and home centers. The business is organized to address the specific customer needs of each distribution channel.

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Except as described in Notes 2 and 6 above, the accounting policies for each operating segment are consistent with the Company's policies described in the footnotes to the consolidated financial statements included in the Company's Annual Report filed on Form 10-K. 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 30,<br>2006 | October 1,<br>2005 | September 30,<br>2006 | October 1,<br>2005   |
| Net sales:  |                       |                    |                       |                      |
| Mohawk  | \$ 1,233,833          | 1,248,216          | 3,626,371             | 3,524,477            |
| Dal-Tile  | 501,241               | 449,418            | 1,482,065             | 1,291,071            |
| Unilin  | 292,924               | -                  | 909,319               | -                    |
| Corporate, Eliminations and<br>Intersegment Sales | (3,979)               | -                  | (10,507)              | -                    |
|   | <b>\$ 2,024,019</b>   | <b>1,697,634</b>   | <b>6,007,248</b>      | <b>4,815,548</b>     |
| Operating income:                                 |                       |                    |                       |                      |
| Mohawk  | \$ 110,505            | 121,940            | 275,111               | 295,631              |
| Dal-Tile  | 69,642                | 69,137             | 213,286               | 196,898              |
| Unilin  | 49,748                | -                  | 149,424               | -                    |
| Corporate and Eliminations                        | (7,155)               | (2,175)            | (28,135)              | (7,185)              |
|   | <b>\$ 222,740</b>     | <b>188,902</b>     | <b>609,686</b>        | <b>485,344</b>       |
|   |                       |                    | As of                 |                      |
|   |                       |                    | September 30,<br>2006 | December 31,<br>2005 |
| Assets:   |                       |                    |                       |                      |
| Mohawk  |                       |                    | \$ 2,597,805          | 2,473,497            |
| Dal-Tile  |                       |                    | 2,294,118             | 2,207,514            |
| Unilin  |                       |                    | 3,239,804             | 3,263,248            |
| Corporate and Eliminations                        |                       |                    | 102,914               | 95,778               |
|   |                       |                    | <b>\$ 8,234,641</b>   | <b>8,040,037</b>     |

15. 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 to be contemplated to which the Company is a party or to which any of its property is subject.

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In *Shirley Williams, et al vs. Mohawk Industries, Inc.*, four plaintiffs filed a purported 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 permitted to work in this country, have damaged them and the other members of the purported 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 Northern District in April 2004. The Company then sought and obtained permission to file an immediate appeal of the Northern District's decision to the United States Court of Appeals for the 11th Circuit. In June 2005, the 11th Circuit reversed in part and affirmed in part the lower court's decision (*Williams v. Mohawk Industries, Inc.*, 411 F.3d 1252 (11th Cir. 2005)). In June 2005, the Company filed a motion requesting review by the full 11th Circuit, which was denied in August 2005. In October 2005, the Company filed a petition for certiorari with the United States Supreme Court, which petition was granted in December of 2005. The case was argued before the Supreme Court on April 26, 2006. On June 5, 2006, the Supreme Court vacated the 11th Circuit ruling and ordered the 11th Circuit to reconsider its vacated ruling. On September 27, 2006, the 11th Circuit issued a second decision reversing in part and affirming in part the lower court's decision. On October 18, 2006, the Company filed a motion requesting review of this decision by the full 11th Circuit. The Company will continue to vigorously defend itself against this action.

The Company believes that adequate provisions for resolution of all 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 effect on its results of operations in a given quarter or annual period.

On January 17, 2006, the Company issued \$500,000 aggregate principal amount of 5.750% notes due 2011 and \$900,000 aggregate principal amount of 6.125% notes due 2016. The net proceeds from the issuance of these notes were used to pay off a \$1,400,000 bridge credit facility entered into in connection with the Unilin acquisition. Interest payable on each series of the notes is subject to adjustment if either Moody's Investor Service, Inc. or Standard & Poor's Ratings Services, or both, downgrades the Company's debt rating. 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 Company's debt rating improves, then the interest rates would be reduced accordingly. The provision for increasing the interest rate will no longer apply if the Company's debt rating from both rating agencies improves above the debt rating in effect at the time of the issuance of the notes.

The Company has received partial refunds from the United States government in reference to settling customs disputes dating back to 1982. Accordingly, the Company recorded a net gain of \$8,834 (\$5,615, net of taxes) in other income (expense) for the three months ended September 30, 2006 and \$15,066 (\$9,518 net of taxes) in other income (expense) for the nine months ended September 30, 2006. Additional future recoveries will be recorded as realized.

#### 16. Subsequent Event

On October 16, 2006, the Company made the decision to permanently close its Jackson, Tennessee mosaic tile plant due to demand and production realignment. The Company will incur approximately \$4,000 in costs associated with this restructuring. Of this amount, approximately \$2,700 is a non-cash asset impairment charge and the remaining \$1,300 will be costs incurred for severance and other closure activities. In addition, the Company anticipates approximately \$2,000 in other costs related to other restructurings within the Dal-Tile segment.

## 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 United States and Europe with net sales in 2005 in excess of \$6.6 billion. The Company is the second largest carpet and rug manufacturer, and a leading manufacturer, marketer and distributor of ceramic tile and natural stone, in the United States and a leading producer of laminate flooring in the United States and Europe.

The Company has three reporting segments, the Mohawk segment, the Dal-Tile segment and the Unilin segment. The Mohawk segment distributes its product lines, which include carpet, rugs, pad, ceramic tile, hardwood, resilient and laminate, through its network of approximately 50 regional distribution centers and satellite warehouses using its fleet of company-operated trucks, common carriers or rail transportation. The Mohawk segment product lines are purchased by independent floor covering retailers, home centers, mass merchandisers, department stores, independent distributors, commercial dealers and commercial end users. The Dal-Tile segment product lines include ceramic tile, porcelain tile and stone products distributed through approximately 274 company-operated sales service centers and regional distribution centers using primarily common carriers and rail transportation. The Dal-Tile segment product lines are purchased by tile specialty dealers, tile contractors, floor covering retailers, commercial end users, independent distributors and home centers. The Unilin segment manufactures and markets laminate flooring products, which are distributed through separate distribution channels consisting of independent distributors (who sell through retailers) and home centers. The business is organized to address the specific customer needs of each distribution channel.

The Company reported net earnings of \$127.7 million or diluted earnings per share ("EPS") of \$1.88, up 10.3% for the third quarter of 2006 compared to net earnings of \$115.8 million or \$1.71 EPS for the third quarter of 2005. The increase in EPS resulted from the Unilin acquisition, hard surface sales growth, price increases and U.S. customs refunds. The increase was offset by increased raw material costs, increased distribution, energy costs and the expensing of stock options.

The Company reported net earnings of \$326.3 million or EPS of \$4.80, up 13.5% for the first nine months of 2006 compared to net earnings of \$287.5 million or \$4.26 EPS for the first nine months of 2005. The increase in EPS resulted primarily from the Unilin acquisition, hard surface sales growth, price increases and U.S. customs refunds. The increase was offset by increased raw material costs, higher energy costs, increased distribution costs and the expensing of stock options.

During the third quarter of 2006, the Company's results were impacted by a slowing U.S. economy which impacted demand within certain categories within its segments. The Company anticipates continued slow sales in the fourth quarter that will result in unfavorable manufacturing overhead costs impacting margins, especially within its Mohawk and Dal-Tile segments.

### Results of Operations

#### Quarter Ended September 30, 2006, as Compared with Quarter Ended October 1, 2005

Net sales for the quarter ended September 30, 2006 were \$2,024.0 million, reflecting an increase of \$326.4 million, or approximately 19.2%, from the \$1,697.6 million reported in the quarter ended October 1, 2005. The increased net sales are primarily attributable to the Unilin acquisition, hard surface sales growth and selling price increases. The Mohawk segment recorded net sales of \$1,233.8 million in the current quarter compared to \$1,248.2 million in the third quarter of 2005, representing a decrease of \$14.4 million or approximately 1.2%. The decrease was primarily attributable to both new and residential replacement demand slowing within its soft surface product categories offset by growth within commercial soft surface product categories. The Dal-Tile segment recorded net sales of \$501.2 million in the current quarter, reflecting an increase of \$51.8 million or approximately 11.5%, from the \$449.4 million reported in the third quarter of 2005. The increase was primarily attributable to internal growth, acquisitions and selling price increases. The Unilin segment recorded net sales of \$292.9 million in the current quarter.

Gross profit for the third quarter of 2006 was \$568.5 million (28.1% of net sales) and represented an increase of \$105.5 million from gross profit of \$463.0 million (27.3% of net sales) for the prior year's third quarter. Gross profit as a percentage of net sales in the current period was favorably impacted by the Unilin acquisition, internal growth and acquisitions in the Dal-Tile segment. The increase was offset by increased raw material, distribution and start up costs when compared to the third quarter of 2005.

Selling, general and administrative expenses for the third quarter of 2006 were \$345.8 million (17.1% of net sales) compared to \$274.1 million (16.1% of net sales) for the prior year's third quarter. The increase in selling, general and administrative expenses as a percentage of net sales was attributable to the Unilin acquisition, higher selling expense within the Mohawk segment and the expensing of stock options during the current quarter.

Operating income for the third quarter of 2006 was \$222.7 million (11.0% of net sales) compared to \$188.9 million (11.1% of net sales) in the third quarter of 2005. Operating income as a percentage of net sales in the current quarter was unfavorably impacted by slower new and residential replacement demand, an increase in raw material costs, the expensing of stock options, offset by selling price increases and internal growth within the hard surface product categories. Operating income attributable to the Mohawk segment was \$110.5 million (9.0% of segment net sales) in the third quarter of 2006 compared to \$121.9 million (9.8% of segment net sales) in the third quarter of 2005. Operating income as a percentage of net sales in the current quarter was unfavorably impacted by slower new and replacement residential demand, an increase in raw material costs and distribution costs resulting from increases in energy costs. Operating income attributable to the Dal-Tile segment was \$69.6 million (13.9% of segment net sales) in the third quarter of 2006 compared to \$69.1 million (15.4% of segment net sales) for the third quarter of 2005. Operating income as a percentage of net sales was unfavorably impacted by higher distribution costs and start up costs at its Muskogee location. Operating income attributable to the Unilin segment was \$49.7 million (17.0% of segment net sales) in the third quarter of 2006.

Interest expense for the third quarter of 2006 was \$44.7 million compared to \$10.8 million in the third quarter of 2005. The increase in interest expense was attributable to higher average debt levels as a result of the Unilin acquisition in the current quarter when compared to the third quarter of 2005. In addition, interest rates in the third quarter of 2006 were higher when compared to the third quarter of 2005.

Income tax expense was \$59.2 million, or 31.7% of earnings before income taxes for the third quarter of 2006 compared to \$62.8 million or 35.2% of earnings before income taxes for the prior year's third quarter. The decrease in the tax rate is due to the combination of domestic and international tax rates resulting from the Unilin acquisition in the current quarter when compared to the quarter ended October 1, 2005.

**Nine Months Ended September 30, 2006, as Compared with Nine Months Ended October 1, 2005**

Net sales for the nine months ended September 30, 2006 were \$6,007.2 million, reflecting an increase of \$1,191.7 million, or approximately 24.7%, from the \$4,815.5 million reported in the nine months ended October 1, 2005. The increased net sales are primarily attributable to the Unilin acquisition, internal growth and selling price increases. The Mohawk segment recorded net sales of \$3,626.4 million in the current nine months compared to \$3,524.5 million in the nine months of 2005, representing an increase of \$101.9 million or approximately 2.9%. The increase was primarily attributable to price increases and growth of its hard surface product categories partially offset by slower new and residential replacement demand within its soft surface product categories. The Dal-Tile segment recorded net sales of \$1,482.1 million in the current nine months ended September 30, 2006, reflecting an increase of \$191.0 million or approximately 14.8%, from the \$1,291.1 million reported in the nine months of 2005. The increase was primarily attributable to internal growth, acquisitions and selling price increases. The Unilin segment recorded net sales of \$909.3 million for the nine months ended September 30, 2006.

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Gross profit for the nine months ended September 30, 2006 was \$1,677.2 million (27.9% of net sales) and represented an increase of \$385.7 million from gross profit of \$1,291.5 million (26.8% of net sales) for the nine months ended October 1, 2005. Gross profit as a percentage of net sales in the current period was favorably impacted by the Unilin acquisition and increased selling prices. The increase was offset by an increase in raw material, energy, distribution, and start up costs when compared to the first nine months of 2005.

Selling, general and administrative expenses for the first nine months of 2006 were \$1,067.5 million (17.8% of net sales) compared to \$806.1 million (16.7% of net sales) for the prior year's nine months. The percentage increase was attributable to the Unilin segment, increased selling and distribution costs, and the expensing of stock options during the first nine months of 2006.

Operating income for the first nine months of 2006 was \$609.7 million (10.1% of net sales) compared to \$485.3 million (10.1% of net sales) in the first nine months of 2005. Operating income as a percentage of net sales in the first nine months of 2006 was favorably impacted by the Unilin acquisition, selling price increases and internal growth within the hard surface product categories, offset by the expensing of stock options, an increase in raw material costs and higher energy costs. Operating income attributable to the Mohawk segment was \$275.1 million (7.6% of segment net sales) in the first nine months of 2006 compared to \$295.6 million (8.4% of segment net sales) in the first nine months of 2005. Operating income as a percentage of net sales in the first nine months of 2006 was unfavorably impacted by slower new and residential replacement demand within soft surface product categories, an increase in raw material and energy costs, and increased selling and distribution costs, offset by selling price increases and internal growth within its hard surface product categories. Operating income attributable to the Dal-Tile segment was \$213.3 million (14.4% of segment net sales) in the first nine months of 2006 compared to \$196.9 million (15.3% of segment net sales) for the first nine months of 2005. Operating income as a percentage of net sales was unfavorably impacted by higher distribution costs and start up costs at its Muskogee location. Operating income attributable to the Unilin segment was \$149.4 million (16.4% of segment net sales) in the first nine months of 2006.

Interest expense for the first nine months of 2006 was \$131.1 million compared to \$35.2 million in the first nine months of 2005. The increase in interest expense was attributable to higher average debt levels as a result of the Unilin acquisition in the first nine months of 2006 when compared to the first nine months of 2005. In addition, interest rates in the first nine months of 2006 were higher when compared to the first nine months of 2005.

Income tax expense was \$160.9 million, or 33.0% of earnings before income taxes for the first nine months of 2006 compared to \$160.1 million, or 35.8% of earnings before income taxes for the nine months ended October 1, 2005. The decrease in the tax rate is due to the combination of domestic and international tax rates resulting from the Unilin acquisition in the first nine months of 2006 when compared to the nine months ended October 1, 2005.

### **Liquidity and Capital Resources**

The Company's primary capital requirements are for working capital, capital expenditures and acquisitions. The Company's capital needs are met primarily through a combination of internally generated funds, bank credit lines, term and senior notes, the sale of trade receivables and credit terms from suppliers.

Cash flows generated by operations for the first nine months of 2006 were \$546.2 million compared to \$328.0 million for the first nine months of 2005. Contributing to the improved cash flow was higher net earnings after adjusting for the incremental depreciation and amortization expense resulting from the Unilin acquisition and improved inventory turns when compared to the prior year's first nine months.

Net cash used in investing activities, acquisitions and capital expenditures for the first nine months of 2006 was \$195.0 million compared to \$201.4 million for the first nine months of 2005. The decrease is due to lower capital spending partially offset by higher acquisition investments within the Mohawk segment. Capital spending during the remainder of 2006 for the Mohawk, Dal-Tile and Unilin segments combined, excluding acquisitions, is expected to range from \$95 million to \$109 million, and will be used primarily to purchase equipment and to add manufacturing capacity.

Net cash used in financing activities for the first nine months of 2006 was \$419.9 million compared to \$126.6 million for the same period in 2005. The primary reason for the change was an increase in debt payments during the first nine months of 2006 compared to the same period in 2005.

At September 30, 2006, the Company had a total commitment of approximately \$1.4 billion under its senior unsecured credit facilities and a Euro revolving credit facility. A total of approximately \$742.4 million was available under these facilities at September 30, 2006. The amount used under the senior unsecured credit facilities at September 30, 2006 was \$702.8 million. The amount used under these facilities is composed of \$620.5 million in borrowings, \$55.6 million in letters of credit guaranteeing the Company's industrial revenue bonds and \$26.7 million in standby letters of credit related to various insurance contracts and foreign vendor commitments.

On January 17, 2006, the Company issued \$500 million aggregate principal amount of 5.750% notes due 2011 and \$900 million aggregate principal amount of 6.125% notes due 2016. The net proceeds from the issuance of these notes were used to pay off a \$1.4 billion bridge credit facility entered into in connection with the Unilin acquisition. Interest payable on each series of the notes is subject to adjustment if either Moody's Investor Service, Inc. or Standard & Poor's Ratings Services, or both, downgrades the Company's debt rating. 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 Company's debt rating improves, then the interest rates would be reduced accordingly. The provision for increasing the interest rate will no longer apply if the Company's debt rating from both rating agencies improves above the debt rating in effect at the time of the issuance of the notes.

The Company has an on-balance sheet trade accounts receivable securitization agreement ("Securitization Facility"). The Securitization Facility allows the Company to borrow up to \$350 million based on available accounts receivable. At September 30, 2006, the Company had approximately \$150.0 million outstanding secured by trade receivables.

#### **Contractual Obligations**

There have been no significant changes to the Company's contractual obligations as disclosed in the Company's 2005 Annual Report filed on Form 10-K.

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

The Company's critical accounting policies and estimates are described in the Company's 2005 Annual Report filed on Form 10-K, except that as of April 2, 2006, the Company changed the method of accounting for its inventory from the last-in, first-out ("LIFO") to the first-in, first-out ("FIFO") method for inventories not on FIFO within its Mohawk segment.

#### **New Pronouncements**

In July 2006, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 48 ("FIN 48"), "Accounting for Uncertainty in Income Taxes-an *Interpretation of FASB Statement No. 109*," which clarifies the accounting for uncertainty in income taxes. FIN 48 prescribes a recognition threshold and measurement criteria for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The provisions of FIN 48 are effective as of the beginning of the Company's 2007 fiscal year, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. The Company is currently evaluating the impact of FIN 48 on its consolidated financial statements.

In September 2006, FASB issued Statement of Financial Accounting Standards No. 157 ("SFAS No. 157"), "Fair Value Measurements." 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 its 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 157 is effective for the Company's fiscal year beginning January 1, 2008. The Company is currently evaluating the impact of SFAS No. 157 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"). SFAS No. 158 requires an employer that sponsors one or more single-employer defined benefit plans to recognize the over-funded or under-funded status of a benefit plan in its statement of financial position, recognize as a component of other comprehensive income, net of tax, gains or losses and prior service costs or credits that arise during the period but are not recognized as components of net periodic benefit costs pursuant to SFAS No. 87, "Employers Accounting for Pensions," or SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," measure defined benefit plan assets and obligations as of the date of the employer's fiscal year-end, and disclose in the notes to financial statements additional information about certain effects on net periodic benefit cost for the next fiscal year that arise from delayed recognition of the gains or losses, prior service costs or credits, and transition assets or obligations. The recognition and disclosure provisions required by SFAS No. 158 are effective for the Company's fiscal year ending December 31, 2006. The measurement date provisions are effective for fiscal years ending after December 15, 2008. The Company is currently evaluating the impact of SFAS No. 158 on its consolidated financial statements.

In September 2006, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" ("SAB 108"). SAB 108 provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The SEC staff believes that registrants should quantify errors using both the balance sheet and income statement approach when quantifying a misstatement. SAB 108 is effective for the Company's fiscal year ending December 31, 2006. The Company is currently evaluating the impact of SAB 108 on the Company's consolidated financial statements.

#### **Subsequent Event**

On October 16, 2006, the Company made the decision to permanently close its Jackson, Tennessee mosaic tile plant due to demand and production realignment. The Company will incur approximately \$4.0 million in costs associated with this restructuring. Of this amount, approximately \$2.7 million is a non-cash asset impairment charge and the remaining \$1.3 million will be costs incurred for severance and other closure activities. In addition, the Company anticipates approximately \$2.0 million in other costs related to other restructurings within the Dal-Tile segment.

### **Impact of Inflation**

Inflation affects the Company's manufacturing costs, distribution costs and operating expenses. The carpet, tile and laminate industry have experienced significant inflation in the prices of raw materials and fuel-related costs beginning in the first quarter of 2005. For the period from 1999 through 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.

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

The Company's exposures to market risk have not changed significantly since December 31, 2005.

### **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.

## **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 to be contemplated to which the Company is a party or to which any of its property is subject.

In *Shirley Williams, et al vs. Mohawk Industries, Inc.*, four plaintiffs filed a purported 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 permitted to work in this country, have damaged them and the other members of the purported 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 Northern District in April 2004. The Company then sought and obtained permission to file an immediate appeal of the Northern District's decision to the United States Court of Appeals for the 11th Circuit. In June 2005, the 11th Circuit reversed in part and affirmed in part the lower court's decision (*Williams v. Mohawk Industries, Inc.*, 411 F.3d 1252 (11th Cir. 2005)). In June 2005, the Company filed a motion requesting review by the full 11th Circuit, which was denied in August 2005. In October 2005, the Company filed a petition for certiorari with the United States Supreme Court, which petition was granted in December of 2005. The case was argued before the Supreme Court on April 26, 2006. On June 5, 2006, the Supreme Court vacated the 11th Circuit ruling and ordered the 11th Circuit to reconsider its vacated ruling. On September 27, 2006, the 11th Circuit issued a second decision reversing in part and affirming in part the lower court's decision. On October 18, 2006, the Company filed a motion requesting review of this decision by the full 11th Circuit. The Company will continue to vigorously defend itself against this action.

The Company believes that adequate provisions for resolution of all 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 effect on its results of operations in a given quarter or annual period.

**Item 1A. Risk Factors**

There have been no significant changes to the Company's risk factors as disclosed in the Company's 2005 Annual Report filed on Form 10-K.

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

**Mohawk Industries, Inc. Purchases of Equity Securities**

| Period  | Total Number of Shares Purchased (1) | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs |
|---|--------------------------------------|------------------------------|--|--|
| Opening balance                                 | 11,437,564                           | \$ 28.81                     | 11,437,564   | 3,562,436  |
| Month #1 (July 2, 2006-August 5, 2006)          | -                                    | -                            | -  | -  |
| Month #2 (August 6, 2006-September 2, 2006)     | 74,365                               | 69.66                        | 74,365   | (74,365)   |
| Month #3 (September 3, 2006-September 30, 2006) | -                                    | -                            | -  | -  |
| <b>Total</b>                                    | <b>11,511,929</b>                    | <b>\$ 29.08</b>              | <b>11,511,929</b>  | <b>3,488,071</b>   |

(1) The total number of shares repurchased includes an aggregate of 44,874 shares surrendered to the Company to satisfy the exercise price and tax withholding obligations in connection with the exercise of stock options.

On September 29, 1999, the Company announced that its Board of Directors authorized the repurchase of up to 5 million shares of the Company's common stock. On December 16, 1999, the Company announced that the Company's Board of Directors authorized the repurchase of an additional 5 million shares of its common stock under the existing repurchase plan. On May 18, 2000, the Company announced that the Company's Board of Directors authorized the repurchase of an additional 5 million shares of its common stock under the existing repurchase plan. The Company purchased 74,365 shares of its common stock during the third quarter of 2006.

**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**

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.

**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.

Dated: November 3, 2006

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

Dated: November 3, 2006

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