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INTERFACE INC
Form 10-Q/A
August 16, 2002

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q/A

[X] Quarterly Report Pursuant to Section 13 or 15(d) of the Securities
Exchange Act of 1934

For Quarterly Period Ended June 30, 2002

Commission File Number 0-12016

INTERFACE, INC.

(Exact name of registrant as specified in its charter)

GEORGIA

58-1451243

(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer
Identification No.)

2859 PACES FERRY ROAD, SUITE 2000, ATLANTA, GEORGIA 30339

(Address of principal executive offices and zip code)

(770) 437-6800

(Registrant's telephone number, including area code)

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 [X] No[]

Shares outstanding of each of the registrant's classes of common stock at August 8, 2002:

| Class ----- | Number of Shares ----- |
|---|---------------------------|
| Class A Common Stock, \$.10 par value per share | 44,168,229 |
| Class B Common Stock, \$.10 par value per share | 7,024,698 |

INTERFACE, INC.

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

INTERFACE, INC. AND SUBSIDIARIES
CONSOLIDATED CONDENSED BALANCE SHEETS
(IN THOUSANDS)

| | JUNE 30, 2002 ---- (UNAUDITED) |
|---------------------------|---|
| ASSETS | |
| CURRENT ASSETS: | |
| Cash and Cash Equivalents | \$ 2,257 |
| Accounts Receivable | 156,635 |
| Inventories | 170,091 |

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| | |
|--|-----------|
| Prepaid Expenses | 28,772 |
| Deferred Tax Asset | 19,018 |
| | ----- |
| TOTAL CURRENT ASSETS | 376,773 |
| PROPERTY AND EQUIPMENT, less accumulated depreciation | 252,283 |
| GOODWILL | 205,080 |
| OTHER ASSETS | 72,254 |
| | ----- |
| | \$906,390 |
| | ===== |
| LIABILITIES AND SHAREHOLDERS' EQUITY | |
| CURRENT LIABILITIES: | |
| Accounts Payable | \$65,718 |
| Accrued Expenses | 91,917 |
| Current Maturities of Long-Term Debt | 5 |
| | ----- |
| TOTAL CURRENT LIABILITIES | 157,640 |
| LONG-TERM DEBT, less current maturities | 6,502 |
| SENIOR NOTES | 325,000 |
| SENIOR SUBORDINATED NOTES | 125,000 |
| DEFERRED INCOME TAXES and OTHER | 26,270 |
| | ----- |
| TOTAL LIABILITIES | 640,412 |
| | ----- |
| Minority Interest | 4,710 |
| | ----- |
| SHAREHOLDERS' EQUITY: | |
| Common Stock | 5,119 |
| Additional Paid-In Capital | 221,245 |
| Retained Earnings | 119,706 |
| Accumulated Other Comprehensive Income - Foreign Currency Translation | (73,741) |
| Minimum pension liability | (11,061) |
| | ----- |
| TOTAL SHAREHOLDERS' EQUITY | 261,268 |
| | ----- |
| | \$906,390 |
| | ===== |

See accompanying notes to consolidated condensed financial statements.

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INTERFACE, INC. AND SUBSIDIARIES
CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS
(UNAUDITED)

(IN THOUSANDS EXCEPT PER SHARE AMOUNTS)

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| | THREE MONTHS ENDED | |
|--|--------------------------|-----------------|
| | JUNE 30, 2002 | JULY 1, 2001 |
| NET SALES | \$240,593 | \$287,285 |
| Cost of Sales | 171,075 | 204,387 |
| GROSS PROFIT ON SALES | 69,518 | 82,898 |
| Selling, General and Administrative Expenses | 57,283 | 71,476 |
| OPERATING INCOME | 12,235 | 11,422 |
| Interest Expense | 10,848 | 9,298 |
| Other Expense | 190 | 2 |
| INCOME BEFORE TAXES ON INCOME | 1,197 | 2,122 |
| Income Tax Expense | 420 | 850 |
| INCOME BEFORE CHANGE IN ACCOUNTING PRINCIPLE | 777 | 1,272 |
| Cumulative Effect of Change in Accounting Principle (net of tax) | -- | -- |
| NET INCOME (LOSS) | \$ 777 | \$ 1,272 |
| Basic Earnings (Loss) Per Share | \$.02 | \$.03 |
| DILUTED EARNINGS (LOSS) PER SHARE | \$.02 | \$.03 |
| Average Shares Outstanding -- Basic | 50,158 | 49,822 |
| Average Shares Outstanding -- Diluted | 51,404 | 50,471 |

See accompanying notes to consolidated condensed financial statements.

INTERFACE, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(UNAUDITED)

(IN THOUSANDS)

| | THREE MONTHS ENDED | | S MO EN |
|--|--------------------------|-----------------|---------------|
| | JUNE 30, 2002 | JULY 1, 2001 | |
| Net Income (Loss) | \$ 777 | \$ 1,272 | \$ (54,709) |
| Other Comprehensive Income, Foreign Currency Translation Adjustment | 14,355 | (5,727) | 13,235 |
| Comprehensive Income (Loss) | \$15,132 | \$ (4,455) | \$ (41,474) |

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See accompanying notes to consolidated condensed financial statements.

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INTERFACE, INC. AND SUBSIDIARIES
 CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
 (UNAUDITED)
 (IN THOUSANDS)

| | JUNE 30, 2002 ----- | SIX MONTHS ENDED |
|--|---------------------------|------------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES: | \$13,598 | \$ (|
| INVESTING ACTIVITIES: | | |
| Capital expenditures | (4,690) | (|
| Other | (1,834) | - |
| | ----- | - |
| | (6,524) | (|
| | ----- | - |
| FINANCING ACTIVITIES: | | |
| Net borrowing (reduction) of long-term debt | (175,406) | - |
| Proceeds from issuance of bonds | 175,000 | - |
| Refinancing costs | (5,470) | - |
| Proceeds from issuance of common stock | 1,306 | - |
| Issuance/Repurchase of common stock | -- | - |
| Dividends paid | (1,532) | - |
| | ----- | - |
| | (6,102) | - |
| | ----- | - |
| Net cash provided by (used for) operating, investing and financing activities | 972 | - |
| Effect of exchange rate changes on cash | 492 | - |
| | ----- | - |
| CASH AND CASH EQUIVALENTS: | | |
| Net change during the period | 1,464 | - |
| Balance at beginning of period | 793 | - |
| | ----- | - |
| Balance at end of period | \$ 2,257 | \$ |
| | ===== | = |

See accompanying notes to consolidated condensed financial statements.

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NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

NOTE 1 - CONDENSED FOOTNOTES

As contemplated by the Securities and Exchange Commission (the "Commission") instructions to Form 10-Q, the following footnotes have been condensed and, therefore, do not contain all disclosures required in connection with annual financial statements. Reference should be made to the notes to the Company's year-end financial statements contained in its Annual Report on Form 10-K for the fiscal year ended December 30, 2001, as filed with the Commission.

The financial information included in this report has been prepared by the Company, without audit, and should not be relied upon to the same extent as audited financial statements. In the opinion of management, the financial information included in this report contains all adjustments (all of which are normal and recurring) necessary for a fair presentation of the results for the interim periods. Nevertheless, the results shown for interim periods are not necessarily indicative of results to be expected for the full year.

NOTE 2 - INVENTORIES

Inventories are summarized as follows:

| | June 30, 2002 ----- | (In |
|-----------------|-----------------------------|-----|
| Finished Goods | \$ 96,470 | |
| Work in Process | 36,825 | |
| Raw Materials | 36,796 | |
| | ----- \$170,091 ===== | |

NOTE 3 - RESTRUCTURING CHARGES

During 2001, the Company recorded a pre-tax restructuring charge of \$65.1 million. The charge reflected: (i) the withdrawal from the European broadloom market; (ii) the consolidation in the Company's raised/access flooring operations; (iii) the further rationalization of the U.S. broadloom operations; (iv) a worldwide workforce reduction of approximately 838 employees; and (v) the consolidation of certain non-strategic Re:Source Americas operations. The Company initially recorded a charge of \$62.2 million during the third quarter of 2001, and in the fourth quarter of 2001 recorded an additional \$2.9 million charge related to pension benefits for terminated European employees.

Specific elements of the restructuring activities, the related costs and current status of the plan are discussed below.

U.S.

Economic developments had caused a decline in demand for raised/access flooring, panel fabric and certain of the Company's other products. In order to better match the cost structure to the expected revenue base, the Company closed two raised/access flooring plants and one panel fabric plant, eliminated certain product lines, consolidated certain under-performing distribution locations and made other head-count reductions. A charge of approximately \$28.8 million was recorded representing the reduction of carrying value of the related property

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and equipment, impairment of intangible assets and other costs to close these operations. Additionally, the Company recorded approximately \$5.3 million of termination benefits associated with the facility closures and other head-count reductions.

Europe

For several years up through 2001, the Company's European broadloom operations had negative returns. The softening global economy during 2001, and the events of September 11, 2001 (which severely impacted consumers of broadloom carpet in the hospitality, leisure and airline businesses) led management to conclude that positive returns from this operation were unlikely for the near future. As a result, the Company elected to divest of this operation. The Company also elected to consolidate certain production and administrative facilities throughout Europe. A charge of approximately \$19.0 million was recorded representing the reduction of carrying value of the related property and equipment, impairment of intangible assets and other costs to close or dispose of these operations. Additionally, the Company recorded approximately \$12.0 million of termination benefits associated with the facility closures.

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A summary of the restructuring activities is presented below:

| | U.S. | EUR |
|-------------------------------|-----------|---------|
| | ----- | ----- |
| | | (IN THO |
| Facilities consolidation..... | \$ 5,889 | \$ 8 |
| Workforce reduction..... | 5,266 | 12 |
| Product rationalization..... | 15,735 | 1 |
| Other impaired assets..... | 6,997 | 9 |
| | ----- | ----- |
| | \$ 33,887 | \$ 31 |
| | ===== | ===== |

The restructuring charge was comprised of \$24.0 million of cash expenditures for severance benefits and other costs and \$41.1 million of non-cash charges, primarily for the write-down of carrying value and disposal of certain assets.

The termination benefits of \$17.3 million, primarily related to severance costs, are a result of aggregate reductions of approximately 838 employees. The staff reductions as originally planned were expected to be as follows:

| | U.S. | EUROP |
|---------------------------------|-------|-------|
| | ----- | ----- |
| Manufacturing..... | 243 | 436 |
| Selling and administrative..... | 62 | 97 |
| | ----- | ----- |
| | 305 | 533 |
| | ===== | ===== |

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As a result of the restructuring, approximately 800 employees were terminated through June 30, 2002. The charge for termination benefits and other costs to exit activities incurred during 2001 was reflected as a separately stated charge against operating income. The Company believes the remaining provisions are adequate to complete the plan.

The following table displays the activity within the accrued restructuring liability for the six-month period ended June 30, 2002:

Termination Benefits

| | U.S. | EURO |
|------------------------------------|----------|---------|
| | ----- | ----- |
| | | (IN THO |
| Balance, at December 30, 2001..... | \$ 1,971 | \$ 9, |
| Cash payments..... | (1,854) | (9, |
| | ----- | ----- |
| Balance, at June 30, 2002..... | \$ 117 | \$ |
| | ===== | ===== |

Other Costs to Exit Activities

| | U.S. | EUR |
|------------------------------------|----------|---------|
| | ----- | ----- |
| | | (IN THO |
| Balance, at December 30, 2001..... | \$ 1,199 | \$ 6 |
| Costs incurred..... | (1,015) | (1 |
| | ----- | ----- |
| Balance, at June 30, 2002..... | \$ 184 | \$ 4 |
| | ===== | ===== |

NOTE 4 - EARNINGS PER SHARE AND DIVIDENDS

Basic earnings per share is computed by dividing net income (or loss) to common shareholders by the weighted average number of shares of Class A and Class B Common Stock outstanding during the period. Shares issued or reacquired during the period have been weighted for the portion of the period that they were outstanding. Basic earnings per share has been computed based upon 50,098,000 shares and 49,920,000 shares outstanding for the six-month periods ended June 30, 2002 and July 1, 2001, respectively. Diluted earnings per share is calculated in a manner consistent with that of basic earnings per share while giving effect to all dilutive potential common shares that were outstanding during the period. Diluted earnings per share has been computed based upon 50,098,000 shares and 50,739,000 shares outstanding for the six-month periods ended June 30, 2002 and July 1, 2001, respectively. During the first six months of 2002, there were vested, unexercised, in the money stock options for 2,642,000 shares. These shares were not included in the computation of the diluted per share amount because the Company was in a net loss position and, thus, any potential common shares were anti-dilutive.

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The following is a reconciliation from basic earnings per share to diluted earnings per share for each of the periods presented:

| For the Six-Month Period Ended ----- | Net Income ----- | Average S Outstand ----- |
|--|----------------------|--------------------------------|
| June 30, 2002 | \$ (54,709) | 50, |
| Effect of Dilution: Options | -- | ----- |
| Diluted | \$ (54,709) ===== | 50, ===== |
| July 1, 2001 | \$ 5,702 | 49, |
| Effect of Dilution: Options | -- | ----- |
| Diluted | \$ 5,702 ===== | 50, ===== |

NOTE 5 - SEGMENT INFORMATION

Based on the quantitative thresholds specified in SFAS 131, the Company has determined that it has two reportable segments: Floorcovering Products/Services and Interior Fabrics. The Floorcovering Products/Services segment manufactures, installs and services commercial modular and broadloom carpet, and the Interior Fabrics segment manufactures panel and upholstery fabrics.

The accounting policies of the operating segments are the same as those described in the Summary of Significant Accounting Policies contained in the Company's Annual Report on Form 10-K for the fiscal year ended December 30, 2001, as filed with the Commission. Segment amounts disclosed are prior to any elimination entries made in consolidation. The chief operating decision maker evaluates performance of the segments based on operating income. Costs excluded from this profit measure primarily consist of interest/other expense and income taxes. Corporate expenses are primarily comprised of corporate overhead expenses. Assets not identifiable to any individual segment are corporate assets, which are primarily comprised of cash and cash equivalents, short-term investments, intangible assets and intercompany amounts, which are eliminated in consolidation.

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Segment Disclosures Summary information by segment follows:

| (in thousands) ----- | Floorcovering Products/Services ----- | Interior Fabrics ----- | Other (Includ Architectural Pro ----- |
|-------------------------|---|------------------------------|---|
|-------------------------|---|------------------------------|---|

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| | | | |
|-------------------------------|------------|------------|-----------|
| Six Months Ended | | | |
| June 30, 2002 | | | |
| Net Sales | \$ 355,792 | \$ 104,654 | \$ 14,572 |
| Depreciation and amortization | 10,223 | 5,357 | 409 |
| Operating Income | 20,066 | 3,555 | (954) |
| Total Assets | \$ 649,737 | \$ 250,027 | \$ 34,591 |

| | | | |
|-------------------------------|------------|------------|-----------|
| Six Months Ended | | | |
| July 1, 2001 | | | |
| Net Sales | \$ 445,676 | \$ 109,573 | \$ 38,547 |
| Depreciation and amortization | 15,319 | 5,985 | 938 |
| Operating Income | 23,088 | 5,107 | (1,117) |
| Total Assets | \$ 769,304 | \$ 224,170 | \$ 67,449 |

A reconciliation of the Company's total segment operating income, depreciation and amortization and assets to the corresponding consolidated amounts follows:

| | | |
|--|------------------|-------|
| (in thousands) | Six Months Ended | |
| | June 30, 2002 | July |
| | ----- | ----- |
| DEPRECIATION AND AMORTIZATION | | |
| Total segment depreciation and amortization | \$ 15,989 | \$ |
| Corporate depreciation and amortization | 2,820 | |
| | ----- | ----- |
| Reported depreciation and amortization | \$ 18,809 | \$ |
| | ===== | ===== |
| OPERATING INCOME | | |
| Total segment operating income | \$ 22,667 | \$ |
| Corporate expenses and other reconciling amounts | 44 | |
| | ----- | ----- |
| Reported operating income | \$ 22,711 | \$ |
| | ===== | ===== |
| ASSETS | | |
| Total segment assets | \$ 934,355 | \$1, |
| Corporate assets and eliminations | (27,965) | |
| | ----- | ----- |
| Reported total assets | \$ 906,390 | \$1, |
| | ===== | ===== |

NOTE 6 - LONG-TERM DEBT

On January 17, 2002, the Company amended and restated its revolving credit facility. The amendment and restatement, among other things, substituted certain lenders, changed certain covenants, and reduced the maximum borrowing amount to \$100 million. In connection with the amendment and restatement of the

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facility, the Company issued the 10.375% Senior Notes discussed below. The amended facility matures May 15, 2005, subject to a possible extension of that maturity date to January 17, 2007 if the Company meets certain conditions relating to the repayment of long-term debt. Interest is charged at varying rates based on the Company's ability to meet certain performance criteria.

On January 17, 2002, the Company also completed a private offering of \$175 million in 10.375% Senior Notes due 2010. Interest is payable semi-annually on February 1st and August 1st beginning August 1st, 2002. Proceeds from the issuance of these Notes were used to pay down the revolving credit facility. The Notes are guaranteed, jointly and severally, on an unsecured senior basis by certain of the Company's domestic subsidiaries. At any time prior to February 1, 2005, the Company may redeem up to 35% of the aggregate principal amount of the Notes with the proceeds of one or more equity offerings at a redemption price in cash equal to 110 3/8% of the principal amount thereof, plus accrued interest at the redemption date. On June 17, 2002, the Company completed an exchange offer pursuant to which the Notes were exchanged for substantially similar notes registered under the Securities Act.

NOTE 7 - CHATHAM ENVIRONMENTAL ACCRUAL

Two years ago, the Company acquired certain assets and assumed certain liabilities of the Chatham Manufacturing division ("Chatham") of CMI Industries, Inc. As part of the acquisition, the Company engaged environmental consultants to review potential environmental liabilities at all Chatham properties. Based on their review, the environmental consultants recommended certain environmental remedial actions, including groundwater monitoring, and estimated the costs thereof. Based upon the cost estimates provided by the environmental consultants, as of December 30, 2001, the Company estimated that the range of the net present value of reasonably predictable costs of groundwater monitoring and other remedial actions was between \$7.9 million and \$10.2 million.

There have been two developments which have substantially reduced the estimated cost of environmental remediation associated with Chatham. First, during the quarter ended June 30, 2002, the Company assigned to the Town of Elkin, North Carolina, the Company's right and obligation to acquire from CMI Industries the wastewater treatment facility serving the Chatham properties (although, pursuant to the assignment agreement, the Company still has certain rights and obligations concerning environmental remediation at this site). Second, in conjunction with the aforementioned assignment, the Company determined that the wastewater treatment facility site should be eligible for remediation under the State of North Carolina's "brownfield" program, which generally requires a less stringent degree of remedial action. Subsequently, the State confirmed in writing the site's eligibility under the brownfield program.

As a result, the Company now believes that the estimated range of the net present value of reasonably predictable costs of groundwater monitoring and other remedial actions at Chatham and the wastewater treatment facility is between \$4.0 million and \$6.3 million. As of December 30, 2001, the Company had accrued approximately \$9.0 million, which at that time represented the best estimate available of the net present value of the costs of remedial actions discounted at 6%. In light of the developments described above, the accrual has been reduced to \$5.1 million. The reduction of the accrual was recorded as a reduction of "other expense" in the Statement of Operations during the quarter ended June 30, 2002, as there was no goodwill associated with the Chatham acquisition.

NOTE 8 - WRITE-DOWN OF CERTAIN ASSETS

In the second quarter of 2002, the Company concluded that certain assets (specifically, accounts receivable and inventory) of Interface Americas Re:Source Technologies, Inc., a subsidiary of the Company which produces

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adhesives and certain specialty chemicals, were overstated by approximately \$3.9 million. As a result, the Company recorded an appropriate charge, which is included in the caption "other expense" in the Statement of Operations, in the second quarter to write down the carrying amount of those assets. The overstatement related to periods prior to the year 2000, and the Company currently is considering whether any such period should be adjusted rather than retaining the charge as taken in the period ended June 30, 2002.

NOTE 9 - SUPPLEMENTAL GUARANTOR FINANCIAL STATEMENTS

The Guarantor Subsidiaries, which consist of the Company's principal domestic subsidiaries, are guarantors of the Company's 10.375% senior notes due 2010, its 7.3% senior notes due 2008, and its 9.5% senior subordinated notes due 2005. The Supplemental Guarantor Financial Statements are presented herein pursuant to requirements of the Commission.

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INTERFACE, INC. AND SUBSIDIARIES

STATEMENT OF INCOME (LOSS) FOR THE SIX MONTHS ENDED JUNE 30, 2002

| | GUARANTOR SUBSIDIARIES | NON- GUARANTOR SUBSIDIARIES | INTERFACE, INC. (PARENT CORPORATION) |
|---|---------------------------|-----------------------------------|--|
| | ----- | ----- | ----- |
| | | | (IN THOUSANDS) |
| Net sales | \$ 393,554 | \$145,526 | \$ -- |
| Cost of sales | 303,026 | 100,195 | -- |
| | ----- | ----- | ----- |
| Gross profit on sales | 90,528 | 45,331 | -- |
| Selling, general and administrative expenses | 69,829 | 32,771 | 10,548 |
| | ----- | ----- | ----- |
| Operating income (loss) | 20,699 | 12,560 | (10,548) |
| Interest/Other expense | 8,279 | 1,991 | 11,452 |
| | ----- | ----- | ----- |
| Income (loss) before taxes on income and equity in income of subsidiaries | 12,420 | 10,569 | (22,000) |
| Income tax (benefit) expense | 4,821 | 3,615 | (8,118) |
| | ----- | ----- | ----- |
| Income (loss) before change in accounting principle | 7,599 | 6,954 | (13,882) |
| Cumulative effect of change in accounting principle (net of tax) | (33,480) | (21,900) | -- |
| Equity in income (loss) of subsidiaries | -- | -- | (40,827) |
| | ----- | ----- | ----- |
| Net income (loss) | \$ (25,881) | \$ (14,946) | \$ (54,709) |
| | ===== | ===== | ===== |

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BALANCE SHEET

JUNE 30, 2002

| | GUARANTOR SUBSIDIARIES ----- | NON- GUARANTOR SUBSIDIARIES ----- | INTERFACE, INC. (PARENT CORPORATION) ----- |
|---|------------------------------------|--|---|
| | | | (IN THOUSANDS) |
| ASSETS | | | |
| Current Assets: | | | |
| Cash and cash equivalents | \$ 3,918 | \$ 4,610 | \$ (6,271) |
| Accounts receivable | 115,038 | 67,649 | (26,052) |
| Inventories | 114,842 | 55,249 | --- |
| Prepays and Deferred Tax Assets | 10,651 | 10,875 | 26,264 |
| | ----- | ----- | ----- |
| Total current assets | 244,449 | 138,383 | (6,059) |
| Property and equipment | | | |
| less accumulated depreciation | 166,177 | 72,448 | 13,658 |
| Investment in subsidiaries | 133,136 | (45,437) | 830,048 |
| Goodwill | 131,849 | 72,020 | 1,211 |
| Other assets | 9,812 | 11,162 | 51,280 |
| | ----- | ----- | ----- |
| | \$ 685,423 | \$ 248,576 | \$ 890,138 |
| | ===== | ===== | ===== |
| LIABILITIES AND COMMON SHAREHOLDERS' EQUITY | | | |
| Current Liabilities: | | | |
| Accounts payable | \$ 36,093 | \$ 29,437 | \$ 188 |
| Accrued expenses | 27,932 | 42,155 | 21,835 |
| | ----- | ----- | ----- |
| Total current liabilities | 64,025 | 71,592 | 22,023 |
| Long-term debt, less | | | |
| current maturities | 6,420 | 82 | --- |
| Senior notes and senior | | | |
| subordinated notes | --- | --- | 450,000 |
| Deferred income taxes/other | 15,343 | (7,018) | 17,945 |
| | ----- | ----- | ----- |
| Total liabilities | 85,788 | 64,656 | 489,968 |
| Minority interests | | 4,710 | --- |
| | ----- | ----- | ----- |
| Redeemable preferred stock | 57,891 | --- | --- |
| Common stock | 94,145 | 102,199 | 5,119 |
| Additional paid-in capital | 191,411 | 12,525 | 220,141 |
| Retained earnings | 257,304 | 138,331 | 183,216 |
| Foreign currency translation adjustment | (1,116) | (62,784) | (8,306) |
| Minimum pension liability | -- | (11,061) | --- |
| | ----- | ----- | ----- |
| | \$ 685,423 | \$ 248,576 | \$ 890,138 |
| | ===== | ===== | ===== |

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STATEMENT OF CASH FLOWS
FOR THE SIX MONTHS
ENDED JUNE 30, 2002

| | GUARANTOR SUBSIDIARIES | NON- GUARANTOR SUBSIDIARIES | INTERFACE, INC. (PARENT CORPORATION) |
|---|---------------------------|-----------------------------------|--|
| | ----- | ----- | ----- |
| | | | (IN THOUSANDS) |
| Net cash provided by (used for) operating activities | \$ 16,932 | \$ 6,585 | \$ (9,919) |
| Cash flows from investing activities: | | | |
| Purchase of plant and equipment | (6,529) | 497 | 1,342 |
| Other assets | (1,603) | --- | (231) |
| | ----- | ----- | ----- |
| Net cash provided by (used for) investing activities | (8,132) | 497 | 1,111 |
| | ----- | ----- | ----- |
| Cash flows from financing activities: | | | |
| Net borrowings (repayments) | (8,882) | (9,406) | (157,118) |
| Proceeds from issuance of bonds | --- | --- | 175,000 |
| Refinancing costs | --- | --- | (5,470) |
| Proceeds from issuance/ repurchase of common stock | --- | --- | 1,306 |
| Cash dividends paid | --- | --- | (1,532) |
| | ----- | ----- | ----- |
| Net cash provided by (used for) financing activities | (8,882) | (9,406) | 12,186 |
| | ----- | ----- | ----- |
| Effect of exchange rate change on cash | 480 | 12 | --- |
| | ----- | ----- | ----- |
| Net increase (decrease) in cash | 398 | (2,312) | 3,378 |
| Cash at beginning of period | 5,846 | 4,596 | (9,649) |
| | ----- | ----- | ----- |
| Cash at end of period | \$ 6,244 | \$ 2,284 | \$ (6,271) |
| | ===== | ===== | ===== |

NOTE 10 - NEW ACCOUNTING PRONOUNCEMENTS

In June 2001, the Financial Accounting Standards Board finalized Statement of Financial Accounting Standards (SFAS) No. 141, "Business Combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets". SFAS 141 requires the use of the purchase method of accounting and prohibits the use of the pooling-of-interests method of accounting for business combinations. SFAS 141 also requires the recognition of acquired intangible assets apart from goodwill if the acquired intangible assets meet certain criteria. SFAS 141 applies to all business combinations initiated after June 30, 2001, and to purchase business combinations completed on or after July 1, 2001. It also requires, upon adoption of SFAS 142, the reclassification of the carrying amounts of intangible assets and goodwill based on the criteria in SFAS 141.

SFAS 142 requires, among other things, that companies no longer amortize goodwill, but instead test goodwill for impairment at least annually. In addition, SFAS 142 requires companies to identify reporting units for the

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purpose of assessing potential future impairments of goodwill, reassess the useful lives of other existing recognized intangible assets, and cease amortization of intangible assets with an indefinite useful life. An intangible asset with an indefinite useful life should be tested for impairment in accordance with the guidance in SFAS 142. SFAS 142 is required to be applied in fiscal years beginning after December 15, 2001 to all goodwill and other intangible assets recognized at that date, regardless of when those assets were initially recognized. SFAS 142 requires a transitional goodwill impairment test within six months from the date of adoption.

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The Company adopted the new standards on accounting for goodwill and other intangible assets beginning in the first quarter of fiscal 2002. In the second quarter of 2002, we completed the transitional goodwill impairment test required by SFAS 142. We used an outside consultant to help prepare valuations of our reporting units in accordance with the new standard, and we compared those valuations with the respective book values of the reporting units to determine whether any goodwill impairment existed. In preparing the valuations, we considered past, present and future expected performance, and applied several methods of using those inputs to arrive at the valuations. The test showed goodwill impairment in three of our overseas reporting units and five of our Americas reporting units. In all cases, the impairment primarily was attributable to actual and currently-forecasted revenue and profitability for the reporting unit being lower (consistent with the industry-wide decline in carpet sales and related services) than that anticipated at the time of the acquisition of the reporting unit. The effect of this accounting change (an after-tax charge of \$55.4 million, or \$1.11 per diluted share) has been recorded as the cumulative effect of a change in accounting principle effective the first quarter of fiscal 2002, as required by SFAS 142. The charge had no cash effect, and, as required, is presented net of tax.

In June 2001, the Financial Accounting Standards Board approved the issuance of SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS 143 establishes accounting standards for the recognition and measurement of legal obligations associated with the retirement of tangible long-lived assets and requires recognition of a liability for an asset retirement obligation in the period in which it is incurred. The provisions of this statement are effective for financial statements issued for fiscal years beginning after June 15, 2002. We are in the process of evaluating the impact this standard will have on our financial statements.

In October 2001, the Financial Accounting Standards Board issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS 144 addresses financial accounting for the impairment or disposal of long-lived assets. The provisions of this statement are effective for financial statements issued for fiscal years beginning after December 15, 2001. We are in the process of evaluating the impact this standard will have on our financial statements.

In April 2002, the Financial Accounting Standards Board issued SFAS No. 145, "Rescission of SFAS No. 4, 44, 64, Amendment of SFAS No. 13, and Technical Corrections." SFAS 4, which was amended by SFAS 64, required all gains and losses from the extinguishment of debt to be aggregated and, if material, classified as an extraordinary item, net of related income tax effect. As a result, the criteria in Opinion 30 will now be used to classify those gains and losses. SFAS 13 was amended to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. The adoption of SFAS 145 will not have a current

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impact on the Company's consolidated financial statements.

In July 2002, the Financial Accounting Standards Board issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." Generally, SFAS 146 provides that defined exit costs (including restructuring and employee termination costs) are to be recorded on an incurred basis rather than on a commitment basis as is presently required. SFAS 146 is effective for exit or disposal activities initiated after December 31, 2002. The Company currently anticipates that adoption of this statement will not have a material impact on its financial statements.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements

This report contains statements which may constitute "forward-looking statements" within the meaning of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended by the Private Securities Litigation Reform Act of 1995. Those statements include statements regarding the intent, belief or current expectations of the Company and members of its management team, as well as the assumptions on which such statements are based. Any forward-looking statements are not guarantees of future performance and involve a number of risks and uncertainties that could cause actual results to differ materially from those contemplated by such forward-looking statements. Important factors currently known to management that could cause actual results to differ materially from those in forward-looking statements include risks and uncertainties associated with economic conditions in the commercial interiors industry as well as the risks and uncertainties discussed under the heading "Safe Harbor Compliance Statement for Forward-Looking Statements" included in Item 1 of the Company's Annual Report on Form 10-K for the fiscal year ended December 30, 2001, which discussion is hereby incorporated by reference, including but not limited to the discussion of specific risks and uncertainties under the headings "We compete with a large number of manufacturers in the highly competitive commercial floorcovering products market, and some of these competitors have greater financial resources than we do," "Sales of our principal products may be affected by cycles in the construction and renovation of commercial and institutional buildings," "Our continued success depends significantly upon the efforts, abilities and continued service of our senior management executives and our design

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consultants," "Our substantial international operations are subject to various political, economic and other uncertainties," "Our Chairman, together with other insiders, currently has sufficient voting power to elect a majority of our Board of Directors," "Large increases in the cost of petroleum-based raw materials, which we are unable to pass through to our customers, could adversely affect us," "Unanticipated termination or interruption of our arrangement with our primary third-party supplier of synthetic fiber could have a material adverse effect on us," "Our Rights Agreement, which is triggered if a third party acquires beneficial ownership of 15% or more of our common stock without our consent, could discourage tender offers or other transactions that could result in shareholders receiving a premium over the market price for our stock." The Company undertakes no obligation to update or revise forward-looking statements to reflect changed assumptions, the occurrence of unanticipated events or changes to future operating results over time.

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General

The Company's revenues are derived from sales of commercial floorcovering products (primarily modular and broadloom carpet) and related services, interior fabrics, architectural products and other specialty products. During the six-month period ended June 30, 2002, the Company had revenues of \$475.0 million, compared with revenues of \$593.8 million in the comparable period last year. In the first six months of 2002, the Company's implementation of Statement of Financial Accounting Standards ("SFAS") No. 142, entitled "Goodwill and Other Intangible Assets," resulted in a \$55.4 million after-tax write-down, the equivalent of \$1.11 per diluted share, primarily related to the impairment of goodwill. After the cumulative effect of SFAS No. 142, net loss for the six-month period ended June 30, 2002, was \$54.7 million, or \$(1.09) per diluted share. Excluding the cumulative effect of SFAS No. 142, income for the six-month period ended June 30, 2002, was \$0.7 million, or \$0.02 per diluted share, compared with net income of \$5.7 million, or \$0.11 per diluted share, in the comparable period last year.

Results of Operations

For the three-month and six-month periods ended June 30, 2002, the Company's net sales decreased \$46.7 million (16.3%) and \$118.8 million (20.0%) compared with the same periods in 2001. The decreases were primarily attributable to (i) reduced corporate profits in general, which has led to decreased spending in the commercial interiors market; (ii) the decline of panel fabric sales to certain OEM furniture manufacturers as a result of reduced demand in the commercial interiors market; and (iii) reduced demand for steel panel products made by our raised/access flooring division.

Cost of sales, as a percentage of net sales, remained even at 71.1% for the three-month period ended June 30, 2002, compared with 71.1% in the comparable period in 2001. The Company was able to maintain a stable percentage year-over-year for the three-month period, despite a 16.3% year-over-year decline in net sales. For the six-month period ended June 30, 2002, cost of sales, as a percentage of net sales, increased slightly to 71.4%, compared with 71.1% in the same period in 2001. The stability of the percentage during the three-month period, as well as the slight percentage increase for the six-month period, reflect primarily (i) the under-absorption of fixed manufacturing costs due to lower volume levels, (ii) a flux in our relative sales mix from products which have had traditionally higher margins to those with traditionally lower margins, and (iii) other manufacturing costs associated with scaling production to meet current demand levels. The current year percentages also were favorably affected by the benefits of the 2001 restructuring activities.

Selling, general and administrative expenses, as a percentage of net sales, decreased to 23.8% and 23.8% for the three-month and six-month periods ended June 30, 2002, respectively, compared with 24.9% and 24.1% in the comparable periods in 2001. The percentage decrease primarily reflects benefits from the Company's 2001 restructuring activities, and also reflects an absolute dollar decrease in expenses compared with the same periods in 2001.

For the three-month and six-month periods ended June 30, 2002, interest expense increased \$1.6 million and \$2.4 million, respectively, compared with the same periods in 2001, due primarily to the Company's issuance of Senior Notes in January 2002 and higher interest rates on the Company's revolving credit facility (see below).

Liquidity and Capital Resources

On January 17, 2002, the Company amended and restated its revolving credit facility. The amendment and restatement, among other things, substituted certain lenders, changed certain covenants, and reduced the maximum borrowing

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amount to \$100 million. In connection with the amendment and restatement of the facility, the Company issued the 10.375% Senior Notes discussed below. The amended facility matures May 15, 2005, subject to a possible extension of that maturity date to January 17, 2007 if the Company

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meets certain conditions relating to the repayment of long-term debt. Interest is charged at varying rates based on the Company's ability to meet certain performance criteria.

On January 17, 2002, the Company also completed a private offering of \$175 million in 10.375% Senior Notes due 2010. Interest is payable semi-annually on February 1st and August 1st beginning August 1st, 2002. Proceeds from the issuance of these Notes were used to pay down the revolving credit facility. On June 17, 2002, the Company completed an exchange offer pursuant to which the Notes were exchanged for substantially similar notes registered under the Securities Act.

The Company's primary source of cash during the six months ended June 30, 2002 was \$13.6 million from operating activities. The primary uses of cash during the six month period ended June 30, 2002 were (i) costs associated with the aforementioned issuance of 10.375% Senior Notes in January 2002, (ii) an increase in prepaid expenses, (iii) \$4.7 million for additions to property and equipment in the Company's manufacturing facilities, and (iv) \$1.5 million for the payment of dividends on outstanding common stock. Management believes that cash provided by operations and long-term loan commitments (including the issue of senior notes) will provide adequate funds for current commitments and other requirements in the foreseeable future; however, certain factors could affect the Company's free cash flow, including, but not limited to, the following factors discussed under the heading "Safe Harbor Compliance Statement for Forward-Looking Statements" in Item 1 of the Company's Annual Report on Form 10-K for the fiscal year ended December 30, 2001: "Sales of our principal products may be affected by cycles in the construction and renovation of commercial and institutional buildings," "Our substantial international operations are subject to various political, economic and other uncertainties," "Large increases in the cost of petroleum-based raw materials, which we are unable to pass through to our customers, could adversely affect us," and "Unanticipated termination or interruption of our arrangement with our primary third-party supplier of synthetic fiber could have a material adverse effect on us."

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As a result of the scope and volume of its global operations, the Company is exposed to an element of market risk from changes in interest rates and foreign currency exchange rates. The Company's results of operations and financial condition could be impacted by this risk. The Company manages its exposure to market risk through its regular operating and financial activities and, to the extent appropriate, through the use of derivative financial instruments.

The Company employs derivative financial instruments as risk management tools and not for speculative or trading purposes. The Company monitors the use of derivative financial instruments through the use of objective measurable systems, well-defined market and credit risk limits, and timely reports to senior management according to prescribed guidelines. The Company has established strict counterparty credit guidelines and only enters into transactions with financial institutions with a rating of investment grade or

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better. As a result, the Company considers the risk of counterparty default to be minimal.

Interest Rate Market Risk Exposure. Changes in interest rates affect the interest paid on certain of the Company's debt. To mitigate the impact of fluctuations in interest rates, management of the Company has developed and implemented a policy to maintain the percentage of fixed and variable rate debt within certain parameters. The Company maintains the fixed/variable rate mix within these parameters either by borrowing on a fixed-rate basis or entering into interest rate swap transactions. In the interest rate swaps, the Company agrees to exchange, at specified intervals, the difference between fixed and variable interest amounts calculated by reference to an agreed-upon notional principal linked to LIBOR.

At June 30, 2002, the Company had utilized interest rate swap agreements to effectively convert approximately \$150 million of fixed rate debt into variable rate debt. The Company anticipates that for the remainder of fiscal 2002 it will not utilize swap agreements or other derivative financial instruments to convert variable rate to fixed rate debt, or vice versa.

Foreign Currency Exchange Market Risk Exposure. A significant portion of the Company's operations consists of manufacturing and sales activities in foreign jurisdictions. The Company manufactures its products in the U.S., Canada, England, Northern Ireland, the Netherlands, Australia and Thailand, and sells its products in more than 100 countries. As a result, the Company's financial results could be significantly affected by factors such as changes in foreign currency exchange rates or weak economic conditions in the foreign markets in which the Company distributes its products. The Company's operating results are exposed to changes in exchange rates between the U.S. dollar and many other currencies, including the euro, British pound sterling, Canadian dollar, Australian dollar, Thai baht, and Japanese yen. When the U.S. dollar strengthens against a foreign currency, the value of anticipated sales in those currencies decreases, and vice-versa. Additionally, to the extent the Company's foreign operations with functional currencies other than the U.S. dollar transact business in countries other than the U.S., exchange rate changes between two foreign currencies could

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ultimately impact the Company. Finally, because the Company reports in U.S. dollars on a consolidated basis, foreign currency exchange fluctuations can have a translation impact on the Company's financial position.

To mitigate the short-term effect of changes in currency exchange rates on the Company's sales denominated in foreign currencies, the Company regularly hedges by entering into currency swap contracts to hedge certain firm sales commitments denominated in foreign currencies. In these currency swap agreements, the Company and a counterparty financial institution exchange equal initial principal amounts of two currencies at the spot exchange rate. Over the term of the swap contract, the Company and the counterparty exchange interest payments in their swapped currencies. At maturity, the principal amount is re-swapped, at the contractual exchange rate.

The Company, as of June 30, 2002, recognized a \$13.2 million increase in its foreign currency translation adjustment account compared to December 30, 2001, primarily because of the weakening of the U.S. dollar against the euro.

Sensitivity Analysis. For purposes of specific risk analysis, the Company uses sensitivity analysis to measure the impact that market risk may

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have on the fair values of the Company's market sensitive instruments.

To perform sensitivity analysis, the Company assesses the risk of loss in fair values associated with the impact of hypothetical changes in interest rates and foreign currency exchange rates on market sensitive instruments. The market value of instruments affected by interest rate and foreign currency exchange rate risk is computed based on the present value of future cash flows as impacted by the changes in the rates attributable to the market risk being measured. The discount rates used for the present value computations were selected based on market interest and foreign currency exchange rates in effect at June 30, 2002. The market values that result from these computations are compared with the market values of these financial instruments at June 30, 2002. The differences in this comparison are the hypothetical gains or losses associated with each type of risk.

As of June 30, 2002, based on a hypothetical immediate 150 basis point increase in interest rates, with all other variables held constant, the market value of the Company's fixed rate long-term debt would be impacted by a net decrease of \$8.3 million. Conversely, a 150 basis point decrease in interest rates would result in a net increase in the market value of the Company's fixed rate long-term debt of \$9.2 million. At December 30, 2001, a 150 basis point movement would have resulted in the same approximate changes.

As of June 30, 2002, a 10% movement in the levels of foreign currency exchange rates against the U.S. dollar, with all other variables held constant, would result in a decrease in the fair value of the Company's financial instruments of \$6.7 million or an increase in the fair value of the Company's financial instruments of \$6.7 million. At December 30, 2001, a 10% movement would have resulted in the same changes. As the impact of offsetting changes in the fair market value of the Company's net foreign investments is not included in the sensitivity model, these results are not indicative of the Company's actual exposure to foreign currency exchange risk.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

None

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

- (a) The Company held its annual meeting of shareholders on May 21, 2002.

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- (b) Not applicable.

- (c) The matters considered at the annual meeting, and the votes cast for, against or withheld, as well as the number of abstentions and broker non-votes, relating to each matter, are

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as follows:

Election of the following directors:

| Class A | For |
|------------------------|------------|
| Dianne Dillon-Ridgley | 36,957,165 |
| June M. Henton | 36,970,389 |
| Christopher G. Kennedy | 36,934,211 |
| James B. Miller, Jr. | 36,630,137 |
| Thomas R. Oliver | 36,941,587 |

| Class B | For |
|---------------------------|-----------|
| Ray C. Anderson | 5,307,334 |
| Carl I. Gable | 5,307,334 |
| Daniel T. Hendrix | 5,307,334 |
| J. Smith Lanier, II | 5,307,334 |
| Leonard G. Saulter | 5,307,334 |
| Clarinus C. Th. van Andel | 5,307,334 |

(d) Not applicable.

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) The following exhibits are filed with this report:

| EXHIBIT NUMBER | DESCRIPTION OF EXHIBIT |
|-------------------|--|
| 3.1 | Restated Articles of Incorporation (included as Exhibit 3.1 to the Company's quarterly report on Form 10-Q for the quarter ended July 5, 1998, previously filed with the Commission and incorporated herein by reference). |
| 3.2 | Bylaws, as amended and restated (included as Exhibit 3.2 to the Company's quarterly report on Form 10-Q for the quarter ended April 1, 2001, previously filed with the Commission and incorporated hereby by reference). |
| 4.1 | See Exhibits 3.1 and 3.2 for provisions in the Company's Articles of Incorporation and Bylaws defining the rights of holders of Common Stock of the Company. |
| 4.2 | Rights Agreement between the Company and Wachovia Bank, N.A., dated as of March 4, 1998, with an effective date of March 16, 1998 (included as Exhibit 10.1A to the Company's registration |

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statement on Form 8-A/A dated March 12, 1998, previously filed with the Commission and incorporated herein by reference).

- 4.3 Indenture governing the Company's 9.5% Senior Subordinated Notes due 2005, dated as of November 15, 1995, among the Company, certain U.S. subsidiaries of the Company, as Guarantors, and First Union National Bank of Georgia, as Trustee (included as Exhibit 4.1 to the Company's registration statement on Form S-4, File No. 33-65201, previously filed with the Commission and incorporated herein by reference); and Supplement No. 1 to Indenture, dated as of December 27, 1996 (included as Exhibit 4.2(b) to the Company's Annual Report on Form 10-K for the year ended December 29, 1996, previously filed with the Commission and incorporated herein by reference).

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- 4.4 Form of Indenture governing the Company's 7.3% senior notes due 2008, among the Company, certain U.S. subsidiaries of the Company, as Guarantors, and First Union National Bank, as trustee (included as Exhibit 4.1 to the Company's registration statement on Form S-3/A, File No. 333-46611, previously filed with the Commission and incorporated herein by reference).
- 4.5 Indenture governing the Company's 10.375% Senior Notes due 2010, among the Company, certain U.S. subsidiaries of the Company, as Guarantors, and First Union National Bank, as Trustee (included as Exhibit 4.5 to the Company's Annual Report on Form 10-K for the year ended December 30, 2001 (the "2001 10-K"), previously filed with the Commission and incorporated herein by reference).
- 4.6 Registration Rights Agreement, dated as of January 17, 2002, among the Company, certain U.S. subsidiaries of the Company, as Guarantors, Salomon Smith Barney, Inc. and First Union Securities, Inc. (included as Exhibit 4.6 to the 2001 10-K, previously filed with the Commission and incorporated herein by reference).

- (b) No reports on Form 8-K were filed during the quarter ended June 30, 2002.

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SIGNATURE

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.

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INTERFACE, INC.

Date: August 16, 2002

By: /s/ Patrick C. Lynch

Patrick C. Lynch
Vice President
(Principal Financial Officer)

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