

INTERFACE INC
Form 10-Q
August 08, 2013
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For Quarterly Period Ended June 30, 2013

Commission File Number 001-33994

INTERFACE, INC.

(Exact name of registrant as specified in its charter)

GEORGIA 58-1451243
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) 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)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Shares outstanding of each of the registrant’s classes of common stock at August 2, 2013:

| <u>Class</u> | <u>Number of Shares</u> |
|---|-------------------------|
| Common Stock, \$.10 par value per share | 66,159,172 |

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, 2013 | DECEMBER 30, 2012 |
|--|----------------------|------------------------------|
| | (UNAUDITED) | |
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and Cash Equivalents | \$ 61,370 | \$ 90,533 |
| Accounts Receivable, net | 131,284 | 137,313 |
| Inventories | 157,730 | 141,176 |
| Prepaid Expenses and Other Current Assets | 43,780 | 51,358 |
| Deferred Income Taxes | 9,330 | 10,271 |
| TOTAL CURRENT ASSETS | 403,494 | 430,651 |
| PROPERTY AND EQUIPMENT, less accumulated depreciation | 184,447 | 165,725 |
| DEFERRED TAX ASSET | 59,653 | 62,856 |
| GOODWILL | 74,506 | 75,672 |
| OTHER ASSETS | 56,068 | 54,463 |
| TOTAL ASSETS | \$ 778,168 | \$ 789,367 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Accounts Payable | \$ 55,921 | \$ 56,292 |
| Accrued Expenses | 84,591 | 97,424 |
| Current Portion of Long-Term Debt | 8,130 | 8,110 |
| TOTAL CURRENT LIABILITIES | 148,642 | 161,826 |
| SENIOR NOTES | 275,000 | 275,000 |
| DEFERRED INCOME TAXES | 6,957 | 7,339 |
| OTHER | 45,399 | 49,500 |
| TOTAL LIABILITIES | 475,998 | 493,665 |
| Commitments and Contingencies | | |
| SHAREHOLDERS' EQUITY: | | |
| Preferred Stock | 0 | 0 |
| Common Stock | 6,618 | 6,606 |
| Additional Paid-In Capital | 369,838 | 366,677 |

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| | | | | |
|--|------------|---|------------|---|
| Retained Earnings (Deficit) | (2,093 |) | (16,746 |) |
| Accumulated Other Comprehensive Loss – Foreign Currency Translation Adjustment | (38,269 |) | (25,344 |) |
| Accumulated Other Comprehensive Loss – Pension Liability | (33,924 |) | (35,491 |) |
| TOTAL SHAREHOLDERS' EQUITY | 302,170 | | 295,702 | |
| | \$ 778,168 | | \$ 789,367 | |

See accompanying notes to consolidated condensed financial statements.

INTERFACE, INC. AND SUBSIDIARIES

CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS

(UNAUDITED)

(IN THOUSANDS EXCEPT PER SHARE AMOUNTS)

| | THREE MONTHS ENDED | | SIX MONTHS ENDED | |
|---|-------------------------------|-------------------------|-----------------------------|-------------------------|
| | JUNE 30, 2013 | JULY 1, 2012 | JUNE 30, 2013 | JULY 1, 2012 |
| NET SALES | \$243,483 | \$229,546 | \$453,852 | \$439,562 |
| Cost of Sales | 157,250 | 150,844 | 296,367 | 290,342 |
| GROSS PROFIT ON SALES | 86,233 | 78,702 | 157,485 | 149,220 |
| Selling, General and Administrative Expenses | 64,430 | 56,219 | 121,688 | 110,120 |
| Restructuring and Asset Impairment Charge | 0 | 0 | 0 | 16,316 |
| OPERATING INCOME | 21,803 | 22,483 | 35,797 | 22,784 |
| Interest Expense | 5,907 | 6,149 | 12,065 | 12,802 |
| Other Expense (Income) | (2) | 288 | 405 | 688 |
| INCOME BEFORE INCOME TAX EXPENSE | 15,898 | 16,046 | 23,327 | 9,294 |
| Income Tax Expense | 4,933 | 5,509 | 5,365 | 4,854 |
| Income from Continuing Operations | \$10,965 | \$10,537 | \$17,962 | \$4,440 |
| Loss from Discontinued Operations, Net of Tax | 0 | 279 | 0 | 116 |
| NET INCOME | \$10,965 | \$10,258 | \$17,962 | \$4,324 |
| Earnings Per Share – Basic | | | | |
| Continuing Operations | \$0.17 | \$0.16 | \$0.27 | \$0.07 |
| Discontinued Operations | 0.00 | 0.00 | 0.00 | 0.00 |
| Earnings Per Share – Basic | \$0.17 | \$0.16 | \$0.27 | \$0.07 |
| Earnings Per Share – Diluted | | | | |
| Continuing Operations | \$0.17 | \$0.16 | \$0.27 | \$0.07 |
| Discontinued Operations | 0.00 | 0.00 | 0.00 | 0.00 |
| Earnings Per Share – Diluted | \$0.17 | \$0.16 | \$0.27 | \$0.07 |
| Common Shares Outstanding – Basic | 66,180 | 65,952 | 66,148 | 65,701 |

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| | | | | |
|-------------------------------------|--------|--------|--------|--------|
| Common Shares Outstanding – Diluted | 66,329 | 66,128 | 66,297 | 65,868 |
|-------------------------------------|--------|--------|--------|--------|

See accompanying notes to consolidated condensed financial statements.

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INTERFACE, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(UNAUDITED)

(IN THOUSANDS)

| | THREE MONTHS ENDED | | SIX MONTHS ENDED | |
|--|-----------------------------------|-------------------------|-----------------------------|-------------------------|
| | JUNE 30, 2013 | JULY 1, 2012 | JUNE 30, 2013 | JULY 1, 2012 |
| Net Income | \$ 10,965 | \$ 10,258 | \$ 17,962 | \$ 4,324 |
| Other Comprehensive Income (Loss), Foreign Currency Translation Adjustment | (6,766) | (12,736) | (12,925) | (4,862) |
| Other Comprehensive Income (Loss), Pension Liability Adjustment | (318) | 857 | 1,567 | (34) |
| Comprehensive Income (Loss) | \$ 3,881 | \$ (1,621) | \$ 6,604 | \$ (572) |

See accompanying notes to consolidated condensed financial statements.

INTERFACE, INC. AND SUBSIDIARIES

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

(UNAUDITED)

(IN THOUSANDS)

| | SIX MONTHS ENDED | |
|---|-----------------------------|-------------------------|
| | JUNE 30, 2013 | JULY 1, 2012 |
| OPERATING ACTIVITIES: | | |
| Net Income | \$ 17,962 | \$ 4,324 |
| Loss from Discontinued Operations, Net of Tax | 0 | (116) |
| Income from Continuing Operations | 17,962 | 4,440 |
| Adjustments to Reconcile Net Income to Cash Provided by (Used in) Operating Activities: | | |
| Depreciation and Amortization | 13,021 | 12,650 |
| Stock Compensation Amortization Expense | 2,669 | 2,164 |
| Deferred Income Taxes and Other | 3,317 | (2,472) |
| Working Capital Changes: | | |
| Accounts Receivable | 2,575 | 14,751 |
| Inventories | (19,673) | (9,606) |
| Prepaid Expenses and Other Current Assets | (14,635) | (2,524) |
| Accounts Payable and Accrued Expenses | (14,272) | 4,026 |
| CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES: | (9,036) | 23,429 |
| INVESTING ACTIVITIES: | | |
| Capital Expenditures | (33,822) | (21,747) |
| Cash Received from Insurance Company | 19,774 | 0 |
| Other | (1,573) | (1,137) |
| CASH USED IN INVESTING ACTIVITIES: | (15,621) | (22,884) |
| FINANCING ACTIVITIES: | | |
| Repurchase of Senior Subordinated Notes | 0 | (11,477) |
| Proceeds from Issuance of Common Stock | 1,256 | 131 |
| Dividends Paid | (3,309) | (2,627) |
| CASH USED IN FINANCING ACTIVITIES: | (2,053) | (13,973) |
| Net Cash Used in Operating, Investing and Financing Activities | (26,710) | (13,428) |
| Effect of Exchange Rate Changes on Cash | (2,453) | (329) |

CASH AND CASH EQUIVALENTS:

| | | |
|--------------------------------|----------|----------|
| Net Change During the Period | (29,163) | (13,757) |
| Balance at Beginning of Period | 90,533 | 50,635 |
| Balance at End of Period | \$61,370 | \$36,878 |

See accompanying notes to consolidated condensed financial statements.

INTERFACE, INC. AND SUBSIDIARIES

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 Company's year-end audited consolidated financial statements and notes thereto contained in its Annual Report on Form 10-K for the fiscal year ended December 30, 2012, as filed with the Commission.

The financial information included in this report has been prepared by the Company, without audit. 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. The December 30, 2012, consolidated condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States.

As described below in Note 8, the Company has sold its Bentley Prince Street business segment. The results of operations and related disposal costs, gains and losses for this business are classified as discontinued operations, where applicable.

Certain prior period amounts have been reclassified to conform to the current period presentation.

NOTE 2 – INVENTORIES

Inventories are summarized as follows:

**June 30, December
2013 30, 2012
(In thousands)**

| | | |
|-----------------|------------|------------|
| Finished Goods | \$ 100,139 | \$ 87,094 |
| Work in Process | 10,245 | 7,030 |
| Raw Materials | 47,346 | 47,052 |
| | \$ 157,730 | \$ 141,176 |

NOTE 3 – EARNINGS PER SHARE

The Company computes basic earnings per share (“EPS”) by dividing net income by the weighted average common shares outstanding, including participating securities outstanding, during the period as discussed below. Diluted EPS reflects the potential dilution beyond shares for basic EPS that could occur if securities or other contracts to issue common stock were exercised, converted into common stock or resulted in the issuance of common stock that would have shared in the Company’s earnings.

The Company includes all unvested stock awards which contain non-forfeitable rights to dividends or dividend equivalents, whether paid or unpaid, in the number of shares outstanding in our basic and diluted EPS calculations when the inclusion of these shares would be dilutive. Unvested share-based awards of restricted stock are paid dividends equally with all other shares of common stock. As a result, the Company includes all outstanding restricted stock awards in the calculation of basic and diluted EPS. Distributed earnings include common stock dividends and dividends earned on unvested share-based payment awards. Undistributed earnings represent earnings that were available for distribution but were not distributed. The following tables show distributed and undistributed earnings:

| | Three Months Ended | | Six Months Ended | |
|---|-----------------------------------|-----------------------------|------------------------------|-----------------------------|
| | June 30, 2013 | July 1, 2012 | June 30, 2013 | July 1, 2012 |
| Earnings Per Share from Continuing Operations: | | | | |
| Basic Earnings Per Share Attributable to Common Stockholders: | | | | |
| Distributed Earnings | \$0.03 | \$0.02 | \$0.05 | \$0.04 |
| Undistributed Earnings | 0.14 | 0.14 | 0.22 | 0.03 |
| Total | \$0.17 | \$0.16 | \$0.27 | \$0.07 |
| Diluted Earnings Per Share Attributable to Common Stockholders: | | | | |
| Distributed Earnings | \$0.03 | \$0.02 | \$0.05 | \$0.04 |
| Undistributed Earnings | 0.14 | 0.14 | 0.22 | 0.03 |
| Total | \$0.17 | \$0.16 | \$0.27 | \$0.07 |
| Earnings (Loss) Per Share from Discontinued Operations: | | | | |
| Basic earnings (loss) per share attributable to Interface, Inc. common shareholders | | | | |
| Distributed earnings | \$0.00 | \$0.00 | \$0.00 | \$0.00 |
| Undistributed earnings | 0.00 | 0.00 | 0.00 | 0.00 |
| | \$0.00 | \$0.00 | \$0.00 | \$0.00 |
| Diluted earnings (loss) per share attributable to Interface, Inc. common shareholders | | | | |
| Distributed earnings | \$0.00 | \$0.00 | \$0.00 | \$0.00 |
| Undistributed earnings | 0.00 | 0.00 | 0.00 | 0.00 |
| | \$0.00 | \$0.00 | \$0.00 | \$0.00 |
| Basic earnings per share attributable to Interface, Inc. common shareholders | \$0.17 | \$0.16 | \$0.27 | \$0.07 |
| Diluted earnings per share attributable to Interface, Inc. common shareholders | \$0.17 | \$0.16 | \$0.27 | \$0.07 |

The following tables present net income that was attributable to participating securities:

| | Three Months Ended | | Six Months Ended | |
|------------|-----------------------------------|-----------------------------|------------------------------|-----------------------------|
| | June 30, 2013 | July 1, 2012 | June 30, 2013 | July 1, 2012 |
| | (In millions) | | | |
| Net Income | \$0.3 | \$0.3 | \$0.5 | \$0.1 |

The weighted average shares outstanding for basic and diluted EPS were as follows:

| | Three Months Ended | | Six Months Ended | |
|---------------------------------------|-------------------------------|-------------------------|------------------------------|-------------------------|
| | June 30, 2013 | July 1, 2012 | June 30, 2013 | July 1, 2012 |
| | (In thousands) | | | |
| Weighted Average Shares Outstanding | 64,486 | 63,927 | 64,453 | 63,676 |
| Participating Securities | 1,694 | 2,025 | 1,694 | 2,025 |
| Shares for Basic Earnings Per Share | 66,180 | 65,952 | 66,148 | 65,701 |
| Dilutive Effect of Stock Options | 149 | 176 | 149 | 167 |
| Shares for Diluted Earnings Per Share | 66,329 | 66,128 | 66,297 | 65,868 |

For the three-month period ended July 1, 2012, options to purchase 274,000 shares of common stock were not included in the computation of diluted EPS as their impact would be anti-dilutive. For the six-month period ended July 1, 2012, options to purchase 274,000 shares of common stock were not included in the computation of diluted EPS as their impact would be anti-dilutive.

NOTE 4 – LONG-TERM DEBT

7.625% Senior Notes

As of both June 30, 2013, and July 1, 2012, the Company had outstanding \$275 million in 7.625% Senior Notes due 2018 (the “7.625% Senior Notes”). The estimated fair value of the 7.625% Senior Notes as of June 30, 2013, and July 1, 2012, based on then current market prices, was \$291.5 million and \$292.2 million, respectively.

11.375% Senior Secured Notes

As of both June 30, 2013, and July 1, 2012, the Company had outstanding \$8.1 million in 11.375% Senior Secured Notes due 2013 (the “11.375% Senior Secured Notes”). The estimated fair value of the 11.375% Senior Secured Notes as of June 30, 2013, and July 1, 2012, based on then current market prices, was \$8.1 million and \$8.8 million, respectively.

Credit Facilities

The Company maintains a domestic revolving credit agreement (the “Facility”) that provides a maximum aggregate amount of \$100 million of loans and letters of credit available to us at any one time (subject to a borrowing base) with an option for us to increase that maximum aggregate amount to \$150 million (upon the satisfaction of certain conditions, and subject to a borrowing base). The Company is presently in compliance with all covenants under the Facility and anticipates that it will remain in compliance with the covenants for the foreseeable future. As of June 30, 2013, there were zero borrowings and \$3.6 million in letters of credit outstanding under the Facility. As of June 30, 2013, the Company could have incurred \$69.0 million of additional borrowings under the Facility.

Interface Europe B.V. (the Company’s modular carpet subsidiary based in the Netherlands) and certain of its subsidiaries maintain a Credit Agreement with The Royal Bank of Scotland N.V. (“RBS”). Under this Credit Agreement, RBS provides a credit facility, until further notice, for borrowings and bank guarantees of €20 million. As of June 30, 2013, there were no borrowings outstanding under this facility, and the Company could have incurred €20 million (approximately \$26.0 million) of additional borrowings under the facility.

Other non-U.S. subsidiaries of the Company have an aggregate of the equivalent of \$17.7 million of lines of credit available. As of June 30, 2013, there were no borrowings outstanding under these lines of credit.

NOTE 5 – STOCK-BASED COMPENSATION

Stock Option Awards

In accordance with accounting standards, the Company measures the cost of employee services received in exchange for an award of equity instruments based on the grant date fair value of the award. That cost will be recognized over the period in which the employee is required to provide the services – the requisite service period (usually the vesting period) – in exchange for the award. The grant date fair value for options and similar instruments will be estimated using option pricing models. Under accounting standards, the Company is required to select a valuation technique or option pricing model that meets the criteria stated in the standard. The Company uses the Black-Scholes model. Accounting standards require that the Company estimate forfeitures for stock options and reduce compensation expense accordingly. The Company has reduced its stock compensation expense by the assumed forfeiture rate and will evaluate experience against this forfeiture rate going forward.

During the first six months of 2013 and 2012, the Company recognized stock option compensation costs of \$0.1 million and \$0.4 million, respectively. In the second quarters of 2013 and 2012, the Company recognized stock option compensation costs of \$0.1 million and \$0.2 million, respectively. The remaining unrecognized compensation cost related to unvested awards at June 30, 2013, approximated \$0.1 million, and the weighted average period of time over which this cost will be recognized is approximately one year.

The following table summarizes stock options outstanding as of June 30, 2013, as well as activity during the six months then ended:

| | Shares | Weighted Average Exercise Price |
|----------------------------------|---------------|--|
| Outstanding at December 30, 2012 | 393,500 | \$ 9.12 |
| Granted | 0 | 0 |
| Exercised | 94,000 | 9.44 |
| Forfeited or canceled | 8,500 | 2.71 |
| Outstanding at June 30, 2013 | 291,000 | \$ 8.39 |
| Exercisable at June 30, 2013 | 286,000 | \$ 8.54 |

At June 30, 2013, the aggregate intrinsic value of in-the-money options outstanding and options exercisable was \$2.5 million and \$2.5 million, respectively (the intrinsic value of a stock option is the amount by which the market value of the underlying stock exceeds the exercise price of the option).

Cash proceeds and intrinsic value related to total stock options exercised during the first six months of fiscal years 2013 and 2012 are provided in the table below. The Company did not recognize any significant tax benefit with regard to stock options in either period presented.

| | Six Months Ended | |
|--|------------------------------|-----------------------------|
| | June 30, 2013 | July 1, 2012 |
| | (In thousands) | |
| Proceeds from stock options exercised | \$1,256 | \$131 |
| Intrinsic value of stock options exercised | 741 | 179 |

Restricted Stock Awards

During the six months ended June 30, 2013, and July 1, 2012, the Company granted restricted stock awards for 598,000 and 573,500 shares, respectively, of common stock. These awards (or a portion thereof) vest with respect to

each recipient over a two to five year period from the date of grant, provided the individual remains in the employment or service of the Company as of the vesting date. Additionally, awards (or a portion thereof) could vest earlier upon the attainment of certain performance criteria, in the event of a change in control of the Company, or upon involuntary termination without cause.

Compensation expense related to restricted stock grants was \$2.6 million and \$2.2 million for the six months ended June 30, 2013, and July 1, 2012, respectively. Accounting standards require that the Company estimate forfeitures for restricted stock and reduce compensation expense accordingly. The Company has reduced its expense by the assumed forfeiture rate and will evaluate experience against this forfeiture rate going forward.

The following table summarizes restricted stock activity as of June 30, 2013, and during the six months then ended:

| | Shares | Weighted Average Grant Date Fair Value |
|----------------------------------|---------------|---|
| Outstanding at December 30, 2012 | 1,973,500 | \$ 14.79 |
| Granted | 598,000 | 16.05 |
| Vested | 393,000 | 14.67 |
| Forfeited or canceled | 484,500 | 14.06 |
| Outstanding at June 30, 2013 | 1,694,000 | \$ 15.47 |

As of June 30, 2013, the unrecognized total compensation cost related to unvested restricted stock was approximately \$14.3 million. That cost is expected to be recognized by the end of 2016.

For the six months ended June 30, 2013, and July 1, 2012, the Company recognized tax benefits with regard to restricted stock of \$1.3 million and \$0.3 million, respectively.

NOTE 6 – EMPLOYEE BENEFIT PLANS

The following tables provide the components of net periodic benefit cost for the three-month and six-month periods ended June 30, 2013, and July 1, 2012, respectively:

| | Three Months Ended | | Six Months Ended | |
|---|---------------------------|---------------------|-------------------------|---------------------|
| | June 30, 2013 | July 1, 2012 | June 30, 2013 | July 1, 2012 |
| Defined Benefit Retirement Plan (Europe) | (In thousands) | | (In thousands) | |
| Service cost | \$209 | \$113 | \$420 | \$229 |
| Interest cost | 2,366 | 2,542 | 4,756 | 5,086 |
| Expected return on assets | (2,463) | (2,817) | (4,950) | (5,638) |
| Amortization of prior service costs | 22 | 13 | 44 | 26 |
| Recognized net actuarial losses | \$241 | 231 | 484 | 460 |
| Net periodic benefit cost | 375 | \$82 | \$754 | \$163 |

| | Three Months Ended | | Six Months Ended | |
|---------------------------------------|---------------------------|---------------------|-------------------------|---------------------|
| | June 30, 2013 | July 1, 2012 | June 30, 2013 | July 1, 2012 |
| Salary Continuation Plan (SCP) | (In thousands) | | (In thousands) | |
| Service cost | \$134 | \$113 | \$267 | \$226 |
| Interest cost | 249 | 254 | 499 | 507 |
| Amortization of prior service cost | 12 | 12 | 24 | 24 |
| Amortization of loss | 110 | 67 | 221 | 134 |
| Net periodic benefit cost | \$505 | \$446 | \$1,011 | \$891 |

NOTE 7 – RESTRUCTURING CHARGES

2012 Restructuring Charge

In the first quarter of 2012, the Company committed to a restructuring plan in its continuing efforts to reduce costs across its worldwide operations and more closely align its operations with reduced demand levels in certain markets. The plan primarily consisted of ceasing manufacturing and warehousing operations at its facility in Shelf, England. In connection with this restructuring plan, the Company incurred a pre-tax restructuring and asset impairment charge in the first quarter of 2012 in an amount of \$16.3 million. The charge was comprised of employee severance expenses of \$5.4 million, other related exit costs of \$1.6 million, and a charge for impairment of assets of approximately \$9.3 million. Approximately \$7 million of the charge will result in cash expenditures, primarily severance expense. In the third and fourth quarters of 2012, the Company recorded additional charges of \$0.8 million and \$2.3 million, respectively, of cash severance expenses related to the finalization of this plan for its European operations. As a result of these 2012 restructuring charges, a reduction of approximately 145 employees occurred.

A summary of these restructuring activities is presented below:

| | Total | Costs | Costs | Balance |
|--------------------------|-----------------------|-----------------|-----------------|----------------|
| | Restructuring | Incurred | Incurred | at |
| | Charge in 2012 | | in 2013 | June |
| | | | | 30, |
| | | | | 2013 |
| | (In thousands) | | | |
| Workforce Reduction | \$8,465 | \$ 5,205 | \$ 2,934 | \$ 326 |
| Fixed Asset Impairment | 9,364 | 9,364 | 0 | 0 |
| Other Related Exit Costs | 1,596 | 1,034 | 75 | 487 |

2011 Restructuring Charge

In the fourth quarter of 2011, the Company committed to a restructuring plan intended to reduce costs across its worldwide operations and more closely align its operations with reduced demand in certain markets. As a result of this plan, the Company incurred pre-tax restructuring and asset impairment charges of \$5.8 million in the fourth quarter of 2011. The majority of this charge (\$5.0 million) related to the severance of approximately 90 employees in Europe, Asia and the United States. The remainder of the charge (\$0.8 million) related to contract termination and fixed asset impairment costs. Approximately \$5.0 million of this charge will result in cash expenditures, primarily severance expenses. Actions and expenses related to this plan were substantially completed by the end of 2011.

A summary of these restructuring activities is presented below:

| | Costs Restructuring Charge in 2011 | Costs Incurred in 2012 | Costs Incurred in 2013 | Balance at June 30, 2013 |
|------------------------|---|---------------------------------------|---------------------------------------|---|
| | (In thousands) | | | |
| Workforce Reduction | \$4,979 | \$ 867 | \$ 3,450 | \$ 98 |
| Fixed Asset Impairment | 776 | 776 | 0 | 0 |

NOTE 8 – DISCONTINUED OPERATIONS

In the third quarter of 2012, the Company sold its Bentley Prince Street business segment, which is now reported in the results of operations as “discontinued operations,” where applicable.

Summary operating results for discontinued operations were as follows:

| | Three Months Ended | Six Months Ended |
|--|-----------------------------------|-----------------------------|
|--|-----------------------------------|-----------------------------|

| | JuneJuly 2, | | JuneJuly 2, | |
|--|--------------------|----------|--------------------|----------|
| | 30, 2012 | | 30, 2012 | |
| | 2013 | | 2013 | |
| | (In | | (In | |
| | thousands) | | thousands) | |
| Net sales | \$0 | \$25,061 | \$0 | \$47,805 |
| Income (Loss) on operations before taxes on income | 0 | (429) | 0 | (178) |
| Tax expense (Benefit) | 0 | (150) | 0 | (62) |
| Income (Loss) on operations, net of tax | 0 | (279) | 0 | (116) |

As of June 30, 2013 and December 30, 2012, there were no assets or liabilities related to the above-described discontinued operations that were held for sale.

NOTE 9 – SUPPLEMENTAL CASH FLOW INFORMATION

Cash payments for interest amounted to \$11.4 million and \$12.0 million for the six months ended June 30, 2013, and July 1, 2012, respectively. Income tax payments amounted to \$3.8 million and \$6.0 million for the six months ended June 30, 2013, and July 1, 2012, respectively.

NOTE 10 – RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In July 2013, the Financial Accounting Standards Board (“FASB”) issued an accounting standard regarding the presentation of unrecognized tax benefits when a net operating loss carryforward, or similar tax credit carryforward, exists. This standard clarifies that an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, if such settlement is required or expected in the event the uncertain tax benefit is disallowed. In situations where a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, is not available at the reporting date under the tax law of the applicable jurisdiction or the tax law of the jurisdiction does not require, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be netted with the deferred tax asset. The amendments in this standard are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The Company is currently evaluating the impact that adoption of this standard will have on the determination or reporting of its financial results.

NOTE 11 – INCOME TAXES

In the first quarter of 2013, the Company executed advance pricing agreements for tax years 2006 through 2011 with the Canada Revenue Agency and the U.S. Internal Revenue Service in relation to the U.S. bilateral advanced pricing agreement filed in 2008. As a result of executing the advance pricing agreements, the Company was able to reduce its liability for unrecognized tax benefits in the first quarter of 2013 by \$1.9 million. This benefit has been included in the “Income Tax Expense (Benefit)” line of the Company’s consolidated condensed statement of operations for the six months ended June 30, 2013.

Accounting standards require that all tax positions be analyzed using a two-step approach. The first step requires an entity to determine if a tax position is more-likely-than-not to be sustained upon examination. In the second step, the tax benefit is measured as the largest amount of benefit, determined on a cumulative probability basis, that is more-likely-than-not to be realized upon ultimate settlement. In the first six months of 2013, due largely to the resolution of the bilateral advanced pricing agreement discussed above, the Company decreased its liability for unrecognized tax benefits by \$2.2 million. As of June 30, 2013, the Company had accrued approximately \$23.0 million for unrecognized tax benefits.

NOTE 12 – FIRE AT AUSTRALIAN MANUFACTURING FACILITY

On July 20, 2012, a fire occurred at the Company's manufacturing facility in Picton, Australia. The facility's carpet production line, primarily comprised of tufting and backing machinery, sustained extensive damage and was rendered inoperable. The Picton facility served the Company's customers throughout Australia and New Zealand. Since the fire, the Company has utilized adequate production capacity at its manufacturing facilities in Thailand, China and elsewhere to meet customer demand typically serviced from Picton. The Company has business interruption and property damage insurance. The Company is in the process of building a new manufacturing facility in Minto, Australia and expects it to become operational in late 2013.

Since the fire, the Company has recorded charges of approximately \$24.9 million (\$2.6 million in 2013) for impairment of fixed assets related to the fire, and has incurred approximately \$27.5 million of excess production costs related to the fire, as it has utilized other facilities to service customers in the Australia and New Zealand markets. As of June 30, 2013, the Company has determined that the receipt of reimbursement of these expenses from its insurer is probable in accordance with its insurance policies and has therefore recorded a receivable for these items. As of June 30, 2013, the Company had received \$40.5 million of reimbursement from the insurance company related to the fire at the Picton facility. The table below details the nature of expenses as well as insurance receivables and amounts already received related to the fire:

| | |
|---|--------------------------|
| | <i>(In millions)</i> |
| Impairment of fixed assets at the Picton facility | \$ 24.9 |
| Incremental payroll costs | 7.3 |
| Incremental shipping costs | 17.2 |
| Other incremental costs | 3.0 |
| Total incurred costs through June 30, 2013 | \$ 52.4 |
| | |
| Insurance recovery receivable | \$ 11.9 |
| Insurance recoveries already received | \$ 40.5 |

The receivable related to this claim is included in prepaid expenses and other current assets in our consolidated condensed balance sheet.

The Company also has made an additional claim for loss of profits related to the fire. The amount of this claim is approximately \$5.2 million and relates to loss of profits from the date of the fire through the end of 2012. The Company continues to gather information related to additional insurance claims for loss of profits as a result of the fire. As of June 30, 2013, the Company had not recorded any receivables or amounts for loss of profits, but expects to do so at a later date as information and analysis become more complete and recovery becomes probable.

On July 25, 2013, subsequent to the end of the second quarter, the Company received an additional \$13.8 million from our insurance provider related to this claim.

NOTE 13 – ITEMS RECLASSIFIED FROM OTHER COMPREHENSIVE INCOME

During the first six months of 2013, the Company did not reclassify any significant amounts out of accumulated other comprehensive income. The reclassifications that occurred in that period were primarily comprised of \$0.7 million related to the Company's defined retirement benefit plan and salary continuation plan. These reclassifications were included in the selling, general and administrative expenses line item of the Company's consolidated condensed statement of operations.

NOTE 14 – SUPPLEMENTAL CONDENSED CONSOLIDATING GUARANTOR FINANCIAL STATEMENTS

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The Guarantor Subsidiaries, which consist of the Company's principal domestic subsidiaries and are 100% owned by the Company, are guarantors of the Company's 11.375% Senior Secured Notes due 2013 and its 7.625% Senior Notes due 2018. These guarantees are full and unconditional. The Supplemental Guarantor Financial Statements are presented herein pursuant to requirements of the Commission.

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INTERFACE, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS

FOR THE THREE MONTHS ENDED JUNE 30, 2013

| | GUARANTOR SUBSIDIARIES | NON-GUARANTOR SUBSIDIARIES | INTERFACE, INC. (PARENT CORPORATION) | CONSOLIDATION AND ELIMINATION ENTRIES | CONSOLIDATED TOTALS |
|--|-----------------------------------|---------------------------------------|---|--|--------------------------------|
| | (In thousands) | | | | |
| Net sales | \$165,446 | \$ 116,756 | \$ 0 | \$ (38,719) | \$ 243,483 |
| Cost of sales | 118,083 | 77,886 | 0 | (38,719) | 157,250 |
| Gross profit on sales | 47,363 | 38,870 | 0 | 0 | 86,233 |
| Selling, general and administrative expenses | 27,752 | 29,142 | 7,536 | 0 | 64,430 |
| Operating income (loss) | 19,611 | 9,728 | (7,536) | 0 | 21,803 |
| Interest/Other expense | 7,883 | 1,985 | (3,963) | 0 | 5,905 |
| Income before taxes on income and equity in income of subsidiaries | 11,728 | 7,743 | (3,573) | 0 | 15,898 |
| Income tax expense | 3,639 | 2,403 | (1,109) | 0 | 4,933 |
| Equity in income (loss) of subsidiaries | 0 | 0 | 13,429 | (13,429) | 0 |
| Net income (loss) | \$8,089 | \$ 5,340 | \$ 10,965 | \$ (13,429) | \$ 10,965 |

CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS

FOR THE SIX MONTHS ENDED JUNE 30, 2013

| | NON- GUARANTOR SUBSIDIARIES | NON- GUARANTOR SUBSIDIARIES | INTERFACE, INC. (PARENT CORPORATION) | CONSOLIDATION AND ELIMINATION ENTRIES | CONSOLIDATED TOTALS |
|---|-----------------------------------|-----------------------------------|---|--|------------------------|
| | (In thousands) | | | | |
| Net sales | \$296,154 | \$ 228,629 | \$ 0 | \$ (70,931) | \$ 453,852 |
| Cost of sales | 213,792 | 153,506 | 0 | (70,931) | 296,367 |
| Gross profit on sales | 82,362 | 75,123 | 0 | 0 | 157,485 |
| Selling, general and administrative expenses | 50,449 | 55,234 | 16,005 | 0 | 121,688 |
| Operating income (loss) | 31,913 | 19,889 | (16,005) | 0 | 35,797 |
| Interest/Other expense | 13,854 | 4,930 | (6,314) | 0 | 12,470 |
| Income (loss) before taxes on income and equity in income of subsidiaries | 18,059 | 14,959 | (9,691) | 0 | 23,327 |
| Income tax expense | 4,007 | 2,822 | (1,464) | 0 | 5,365 |
| Equity in income (loss) of subsidiaries | 0 | 0 | 26,189 | (26,189) | 0 |
| Net income (loss) | \$14,052 | \$ 12,137 | \$ 17,962 | \$ (26,189) | \$ 17,962 |

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CONSOLIDATED STATEMENT OF COMPREHENSIVE

INCOME FOR THE THREE MONTHS ENDED JUNE 30, 2013

| | NON- GUARANTOR GUARANTOR | | INTERFACE, INC. (PARENT CORPORATION) | CONSOLIDATION AND ELIMINATION ENTRIES | CONSOLIDATED TOTAL |
|------------------------------------|---|-----------|---|--|-------------------------------|
| | (In thousands) | | | | |
| Net Income (loss) | \$8,089 | \$ 5,340 | \$ 10,965 | \$ (13,429 |) \$ 10,965 |
| Currency Translation Adjustment | (208) | (6,610 |) 52 | 0 | (6,766) |
| Pension Liability Adjustment | 0 | (391 |) 73 | 0 | (318) |
| Comprehensive Income (Loss) | \$7,881 | \$ (1,661 |) \$ 11,090 | \$ (13,429 |) \$ 3,881 |

CONSOLIDATED STATEMENT OF COMPREHENSIVE
INCOME FOR THE SIX MONTHS ENDED JUNE 30, 2013

| | NON- GUARANTOR SUBSIDIARIES | | INTERFACE, INC. (PARENT CORPORATION) | CONSOLIDATION AND ELIMINATION ENTRIES | CONSOLIDATED TOTAL |
|------------------------------------|--|-----------|---|--|-------------------------------|
| | (In thousands) | | | | |
| Net Income (loss) | \$14,052 | \$ 12,137 | \$ 17,962 | \$ (26,189 |) \$ 17,962 |
| Currency Translation Adjustment | (215) | (12,924) | 214 | 0 | (12,925) |
| Pension Liability Adjustment | 0 | 1,421 | 146 | 0 | 1,567 |
| Comprehensive Income (Loss) | \$13,837 | \$ 634 | \$ 18,322 | \$ (26,189 |) \$ 6,604 |

CONDENSED CONSOLIDATING BALANCE SHEET

JUNE 30, 2013

| | GUARANTOR SUBSIDIARIES | NON-GUARANTOR SUBSIDIARIES | INTERFACE, INC. (PARENT CORPORATION) | CONSOLIDATION AND ELIMINATION ENTRIES | CONSOLIDATED TOTALS |
|---|---------------------------|-------------------------------|---|--|------------------------|
| | (In thousands) | | | | |
| ASSETS | | | | | |
| Current assets: | | | | | |
| Cash and cash equivalents | \$ 1,905 | \$ 30,966 | \$ 28,499 | \$ 0 | \$ 61,370 |
| Accounts receivable | 57,719 | 72,891 | 674 | 0 | 131,284 |
| Inventories | 72,391 | 85,339 | 0 | 0 | 157,730 |
| Prepays and deferred income taxes | 5,679 | 32,824 | 14,607 | 0 | 53,110 |
| Total current assets | 137,694 | 222,020 | 43,780 | 0 | 403,494 |
| Property and equipment less accumulated depreciation | 82,218 | 99,161 | 3,068 | 0 | 184,447 |
| Investment in subsidiaries | 566,538 | 182,666 | (107,973 |) (641,231 |) 0 |
| Goodwill | 6,542 | 67,964 | 0 | 0 | 74,506 |
| Other assets | 1,916 | 9,115 | 104,690 | 0 | 115,721 |
| | \$ 794,908 | \$ 580,926 | \$ 43,565 | \$ (641,231 |) \$ 778,168 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | | | |
| Current liabilities | | | | | |
| Senior notes | \$ 50,697 | \$ 71,578 | \$ 26,367 | \$ 0 | \$ 148,642 |
| Deferred income taxes | 0 | 10,406 | (3,449 |) 0 | 6,957 |
| Other | 13 | 419 | 44,967 | 0 | 45,399 |
| Total liabilities | 50,710 | 82,403 | 342,885 | 0 | 475,998 |
| Common stock | 94,145 | 102,199 | 6,618 | (196,344 |) 6,618 |
| Additional paid-in capital | 249,302 | 12,525 | 369,838 | (261,827 |) 369,838 |
| Retained earnings (deficit) | 402,909 | 443,478 | (665,420 |) (183,060 |) (2,093 |
| Foreign currency translation adjustment | (2,158 |) (29,615 |) (6,496 |) 0 | (38,269 |
| Pension liability | 0 | (30,064 |) (3,860 |) 0 | (33,924 |
| | \$ 794,908 | \$ 580,926 | \$ 43,565 | \$ (641,231 |) \$ 778,168 |

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS

FOR THE SIX MONTHS

ENDED JUNE 30, 2013

| | GUARANTOR SUBSIDIARIES | NON-GUARANTOR SUBSIDIARIES | INTERFACE, INC. (PARENT CORPORATION) | CONSOLIDATION AND ELIMINATION ENTRIES | CONSOLIDATED TOTALS |
|--|---------------------------|-------------------------------|---|--|------------------------|
| | (In thousands) | | | | |
| Net cash provided by (used in) operating activities | \$3,911 | \$ (14,112 |) \$ 1,910 | \$ (745 |) \$ (9,036 |
| Cash flows from investing activities: | | | | | |
| Purchase of plant and equipment | (13,188) | (20,569 |) (65 |) 0 | (33,822 |
| Other | (435 |) (456 |) (682 |) 0 | (1,573 |
| Cash received from insurance company | 0 | 19,774 | 0 | 0 | 19,774 |
| Net cash used for investing activities | (13,623) | (1,251 |) (747 |) 0 | (15,621 |
| Cash flows from financing activities: | | | | | |
| Other | 7,685 | 12,457 | (20,887 |) 745 | 0 |
| Proceeds from issuance of common stock | 0 | 0 | 1,256 | 0 | 1,256 |
| Dividends paid | 0 | 0 | (3,309 |) 0 | (3,309 |
| Net cash provided by (used for) financing activities | 7,685 | 12,457 | (22,940 |) 745 | (2,053 |
| Effect of exchange rate change on cash | 0 | (2,453 |) 0 | 0 | (2,453 |
| Net increase (decrease) in cash | (2,027 |) (5,359 |) (21,777 |) 0 | (29,163 |
| Cash at beginning of period | 3,932 | 36,325 | 50,276 | 0 | 90,533 |
| Cash at end of period | \$1,905 | \$ 30,966 | \$ 28,499 | \$ 0 | \$ 61,370 |

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

Our discussions below in this Item 2 are based upon the more detailed discussions about our business, operations and financial condition included in our Annual Report on Form 10-K for the fiscal year ended December 30, 2012, under Item 7 of that Form 10-K. Our discussions here focus on our results during the quarter and six months ended, or as of, June 30, 2013, and the comparable periods of 2012 for comparison purposes, and, to the extent applicable, any material changes from the information discussed in that Form 10-K or other important intervening developments or information since that time. These discussions should be read in conjunction with that Form 10-K for more detailed and background information.

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. 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 "Risk Factors" included in Item 1A of the Company's Annual Report on Form 10-K for the fiscal year ended December 30, 2012, which discussion is hereby incorporated by reference. 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.

2012 Restructuring Charge

In the first quarter of 2012, we committed to a restructuring plan in our continuing efforts to reduce costs across our worldwide operations and more closely align our operations with reduced demand levels in certain markets. The plan primarily consisted of ceasing manufacturing and warehousing operations at our facility in Shelf, England. In connection with this restructuring plan, we incurred a pre-tax restructuring and asset impairment charge in the first quarter of 2012 in an amount of \$16.3 million, as well as additional related charges of \$0.8 million in the third quarter of 2012 and \$2.3 million in the fourth quarter of 2012. These charges were comprised of severance expenses of \$8.5 million for a reduction of 145 employees, other related exit costs of \$1.6 million, and impairment of assets of \$9.4 million. Approximately \$10.1 million of the charge will result in cash expenditures, primarily severance expense.

Fire at Australia Facility

In July 2012, a fire occurred at our manufacturing facility in Picton, Australia. The fire caused extensive damage to the facility, as well as disruption to business activity in the region. We have taken steps towards re-adapting our supply chain with product from our manufacturing facilities in China, Thailand, the U.S. and Europe. While this is being executed with success, there were, as expected, delays in shipments that affected sales following the fire. For additional information on the fire, please see Note 12, entitled “Fire at Australian Manufacturing Facility,” in Part I, Item 1 of this Report.

Discontinued Operations

In 2012, we sold our Bentley Prince Street business segment. In accordance with applicable accounting standards, we have reported the results of operations for the former Bentley Prince Street business segment as “discontinued operations,” where applicable.

Our discontinued operations had no net sales and no net income or loss in the three-month or six-month periods ended June 30, 2013. For the three-month period ended July 1, 2012, our discontinued operations had net sales of \$25.1 million and net loss of \$0.3 million. For the six-month period ended July 1, 2012, our discontinued operations had net sales of \$47.8 million and net loss of \$0.1 million.

General

During the quarter ended June 30, 2013, we had net sales of \$243.5 million, compared with net sales of \$229.5 million in the second quarter last year. Fluctuations in currency exchange rates did not have a significant impact during the quarter compared with the prior year period. During the first six months of fiscal year 2013, we had net sales of \$453.9 million, compared with net sales of \$439.6 million in the first six months of last year. Fluctuations in currency exchange rates did not have a significant impact on this comparison.

During the second quarter of 2013, we had net income of \$11.0 million, or \$0.17 per diluted share, compared with net income of \$10.3 million, or \$0.16 per diluted share, in the second quarter of 2012. During the six months ended June 30, 2013, we had net income of \$18.0 million, or \$0.27 per diluted share, compared with net income of \$4.3 million, or \$0.07 per diluted share, in the first six months of 2012. Included in the results for the first six months of 2013 was a one-time tax dispute resolution benefit of \$1.9 million related to the execution of bilateral pricing agreements. See the discussion in Note 11 of Part I, Item 1 of this Report, entitled "Income Taxes," for further information. The results for the six months ended July 1, 2012 also include a restructuring and asset impairment charge of \$16.3 million, as described above.

Results of Operations

The following table presents, as a percentage of net sales, certain items included in our Consolidated Condensed Statements of Operations for the three-month and six-month periods ended June 30, 2013, and July 1, 2012, respectively:

| | Three Months Ended | | Six Months Ended | |
|--|-------------------------------|-----------------------------|------------------------------|-----------------------------|
| | June 30, 2013 | July 1, 2012 | June 30, 2013 | July 1, 2012 |
| Net sales | 100.0% | 100.0% | 100.0% | 100.0% |
| Cost of sales | 64.6 | 65.7 | 65.3 | 66.1 |
| Gross profit on sales | 35.4 | 34.3 | 34.7 | 33.9 |
| Selling, general and administrative expenses | 26.5 | 24.5 | 26.8 | 25.1 |
| Restructuring and asset impairment charge | 0.0 | 0.0 | 0.0 | 3.7 |
| Operating income | 9.0 | 9.8 | 7.9 | 5.2 |
| Interest/Other expenses | 2.4 | 2.8 | 2.7 | 3.1 |

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| | | | | |
|--|-----|--------|-----|--------|
| Income before tax expense | 6.5 | 7.0 | 5.1 | 2.1 |
| Income tax expense | 2.0 | 2.4 | 1.2 | 1.1 |
| Income from continuing operations | 4.5 | 4.6 | 4.0 | 1.0 |
| Income (loss) from discontinued operations, net of tax | 0.0 | (0.1) | 0.0 | (0.1) |
| Net income | 4.5 | 4.5 | 4.0 | 1.0 |

Below we provide information regarding net sales and analyze those results for the three-month and six-month periods ended June 30, 2013, and July 1, 2012, respectively.

| | Three Months Ended | | Percentage | |
|-----------|---------------------------|---------------------|-------------------|---|
| | June 30, 2013 | July 1, 2012 | Change | |
| | (In thousands) | | | |
| Net Sales | \$243,483 | \$229,546 | 6.1 | % |

| | Six Months Ended | | Percentage | |
|-----------|-------------------------|---------------------|-------------------|---|
| | June 30, 2013 | July 1, 2012 | Change | |
| | (In thousands) | | | |
| Net Sales | \$453,852 | \$439,562 | 3.3 | % |

Net Sales for the Three Months Ended June 30, 2013 Compared with the Prior Year Period

For the three months ended June 30, 2013, net sales increased \$13.9 million (6.1%) versus the comparable period of 2012. Currency translation did not have a significant impact on the comparison between periods. On a geographic basis, we experienced a sales increase of 11.6% in the Americas, a decrease of 3.2% (or 5.3% in local currency) in Europe and an increase of 4.1% in Asia-Pacific.

The sales increase in the Americas occurred across virtually all market segments, with only the retail segment remaining relatively flat in the second quarter of 2013 versus that of 2012. The growth was led by the corporate office segment (up 11%), primarily due to the continued economic rebound in the region. The residential segment (up 45%) also was a contributor to the growth, due to the continued roll out of the FLOR stores, which now number 20 stores in total, as well as increased website sales. The hospitality (up 63%), government (up 16%) and education (up 4%) segments also contributed to the year-over-year increase in the Americas.

The decrease in Europe was experienced across all market segments, due to the continued economic uncertainty in that region, and particularly in the U.K. The largest decline was in the education segment (down 31% in U.S. dollars, 33% in local currency), followed by the corporate office segment (down 2% in U.S. dollars, 4% in local currency). All other market segments experienced smaller declines during the quarter.

The increase in Asia-Pacific came mostly from the corporate office (up 4%), government (up 67%) and retail (up 28%) market segments. These increases were somewhat offset by declines in the education (down 12%) and healthcare (down 66%) segments. Within the geographic region, the increase was largely driven by growth in China and Southeast Asia, partially offset by a decline in Australia due to the continuing effects of the plant fire in July 2012. While sales in Australia remained down year-over-year, the gap narrowed versus the pre-fire sales level in the second quarter last year (down 3.4%, or 1.2% in local currency). We expect to commission our new manufacturing facility in Australia in the fourth quarter of 2013.

Net Sales for the Six Months Ended June 30, 2013 Compared with the Prior Year Period

For the six months ended June 30, 2013, sales increased \$14.3 million (3.3%) versus the comparable period of 2012. Currency translation did not have a significant impact on the comparison between the periods. On a geographic basis, we experienced a sales increase of 10.4% in the Americas, a decrease of 6.1% (or 7.5% in local currency) in Europe and a decrease of 1.8% in Asia-Pacific.

The sales increase in the Americas was primarily driven by the corporate office segment (up 15%), mostly as a result of the continued economic recovery in the region. The residential segment (up 34%) experienced strong growth as well, primarily related to FLOR store sales. We also experienced sales increases in the hospitality (up 65%) and government (up 10%) segments. Only the retail segment (down 15%) experienced a decline compared with the prior year period.

The decrease in Europe for the six months ended June 30, 2013 was due to the economic uncertainty in the region. We experienced sales declines across almost all market segments, with the corporate office segment being the largest (down 5% in U.S. dollars, 6% in local currency). Smaller declines occurred in the education (down 22% in U.S. dollars, 23% in local currency), government (down 11% in U.S. dollars, 12% in local currency) and retail (down 18% in U.S. dollars, 19% in local currency) segments. Only the hospitality segment (up 5% in U.S. dollars, 4% in local currency) experienced an increase compared with the prior year period.

The decline in Asia-Pacific was due to a softer start in the first three months of 2013, as sales in the second quarter rebounded and were up versus the comparable period of 2012 (see the discussion above). The six-month year-over-year decline was primarily related to the effects of the July 2012 fire at our Australian business, as well as slower sales in China at the beginning of 2013. The decreases occurred in the corporate office (down 4%), healthcare (down 54%) and education (down 9%) market segments, partially offset by increases in the retail (up 29%), government (up 41%) and hospitality (up 38%) segments.

Cost and Expenses

The following table presents, on a consolidated basis for our operations, our overall cost of sales and selling, general and administrative expenses for the three-month and six-month periods ended June 30, 2013, and July 1, 2012, respectively:

| <u>Cost and Expenses</u> | Three Months Ended | | Percentage Change | |
|--|---------------------------|---------------------|--------------------------|---|
| | June 30, 2013 | July 1, 2012 | | |
| | <i>(In thousands)</i> | | | |
| Cost of sales | \$157,250 | \$150,844 | 4.2 | % |
| Selling, general and administrative expenses | 64,430 | 56,219 | 14.6 | % |
| Total | \$221,680 | \$207,063 | 7.1 | % |

| <u>Cost and Expenses</u> | Six Months Ended | | Percentage Change | |
|--|-------------------------|---------------------|--------------------------|---|
| | June 30, 2013 | July 1, 2012 | | |
| | <i>(In thousands)</i> | | | |
| Cost of sales | \$296,367 | \$290,342 | 2.1 | % |
| Selling, general and administrative expenses | 121,688 | 110,120 | 10.5 | % |
| Total | \$418,055 | \$400,462 | 4.4 | % |

For the three months ended June 30, 2013, our cost of sales increased \$6.4 million (4.2%) versus the comparable period in 2012. Fluctuations in currency rates did not have a significant impact on this comparison. Our raw material prices were approximately flat with those in the second quarter of 2012. The increase in cost of sales is primarily attributable to higher material (approximately \$4 million) and labor (approximately \$0.6 million) costs associated with increased production from improved sales activity during the quarter. The percentage increase in costs of sales is lower than the percentage increase in sales during the quarter, due to both higher absorption of fixed costs from larger production volumes as well as the benefits realized in 2013 from our lean manufacturing initiatives, particularly in the Americas and in Europe. Due to these factors, as a percentage of sales, our cost of sales decreased to 64.6%, versus 65.7% in the second quarter of 2012.

For the six months ended June 30, 2013, our cost of sales increased \$6.0 million (2.1%) versus the comparable period in 2012. Fluctuations in currency rates did not have a significant impact on this comparison. This increase occurred primarily in the second quarter of 2013 (described above), as cost of sales remained relatively even in the first quarter of 2013 versus the first quarter of 2012. As a percentage of sales, cost of sales decreased to 65.3% for the six months ended June 30, 2013, from 66.1% in the comparable period of 2012. The percentage increase was due to improved sales and enhanced production volume in the second quarter of 2013 versus the prior year, as well as the benefits from our lean manufacturing procedures.

For the three-month period ended June 30, 2013, our selling, general and administrative expenses increased \$8.2 million (14.6%) versus the comparable period in 2012. Fluctuations in currency rates did not have a significant impact on this comparison. The primary drivers of the increase were selling and marketing costs related to new product introductions, FLOR store roll-outs and sales team additions. The majority of the increase was in the Americas region, related to FLOR store roll-outs (approximately \$1.7 million) as well as sales personnel additions and marketing initiatives in response to improving market conditions in this region (approximately \$3.0 million). Increases in Europe (approximately \$1.5 million) related to costs associated with headcount reductions in select countries as well as increased marketing initiatives in targeted end-user markets. The increase in Asia-Pacific (approximately \$0.9 million) related primarily to augmented sales activities in the region. Due to these items, as a percentage of sales, our selling, general and administrative expenses increased to 26.5% in the second quarter of 2013, versus 24.5% in the comparable period in 2012. As we begin to realize the benefits of our enhanced sales and marketing initiatives, we believe our selling, general and administrative expenses will decline as a percentage of sales during the second half of 2013.

For the six-month period ended June 30, 2013, our selling, general and administrative expenses increased \$11.6 million (10.5%) versus the comparable period in 2012. Fluctuations in currency rates did not have a significant impact on this comparison. As in the three-month period discussed above, the majority of this increase related to sales and marketing initiatives across our global business. Approximately \$8 million of the increase was due to these initiatives, primarily in the Americas, where approximately \$7.4 million of the increase took place. The FLOR store roll-out, sales personnel additions and enhanced marketing initiatives made up the majority of this increase. There were smaller increases in our other geographic regions, primarily in the second quarter of 2013, as discussed above. Our general and administrative costs increased by approximately \$3.0 million during the six months ended June 30, 2013, versus the comparable period in 2012. This increase related primarily to senior level staff additions as well as increased stock compensation expense. As a result of these factors, as a percentage of sales, our selling, general and administrative expenses increased to 26.8% versus 25.1% in the comparable period of 2012.

Interest Expense

For the three-month period ended June 30, 2013 our interest expense decreased by \$0.2 million to \$5.9 million from \$6.1 million in the comparable period of the prior year. For the six months ended June 30, 2013, interest expense decreased by \$0.7 million from \$12.8 million in the prior year to \$12.1 million. The primary reason for these decreases was the redemption of the remaining \$11.5 million of our 9.5% Senior Subordinated Notes early in the second quarter of 2012.

Liquidity and Capital Resources

General

At June 30, 2013, we had \$61.4 million in cash. At that date, we had no borrowings and \$3.6 million in letters of credit outstanding under our domestic revolving credit facility, and no borrowings outstanding under our European credit facility. As of June 30, 2013, we could have incurred \$69.0 million of additional borrowings under our domestic revolving credit facility and €20.0 million (approximately \$26.0 million) of additional borrowings under our European credit facility. In addition, we could have incurred an additional \$17.7 million of borrowings under our other credit facilities in place at other non-U.S. subsidiaries.

Analysis of Cash Flows

Our primary sources of cash during the six months ended June 30, 2013 were (1) \$19.8 million of proceeds received from our insurance company related to our continuing claim for the fire at our Australian manufacturing facility in July of 2012, and (2) \$1.3 million from the exercise of stock options under our employee stock plan. Our primary uses of cash during the six months ended June 30, 2013 were (1) \$33.8 million for capital expenditures, (2) \$19.7 million due to increased inventory levels, (3) \$14.6 million due to increases in prepaid expenses and other current assets, and (4) \$14.3 million due to a decrease in accounts payable and accrued expenses.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our discussion below in this Item 3 is based upon the more detailed discussions of our market risk and related matters included in our Annual Report on Form 10-K for the fiscal year ended December 30, 2012, under Item 7A of that Form 10-K. Our discussion here focuses on the period ended June 30, 2013, and any material changes from (or other important intervening developments since the time of) the information discussed in that Form 10-K. This discussion should be read in conjunction with that Form 10-K for more detailed and background information.

At June 30, 2013, we recognized a \$12.9 million decrease in our foreign currency translation adjustment account compared to December 30, 2012, primarily because of the strengthening of the U.S. dollar against certain foreign currencies.

Sensitivity Analysis. For purposes of specific risk analysis, we use sensitivity analysis to measure the impact that market risk may have on the fair values of our market sensitive instruments.

To perform sensitivity analysis, we assess 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, 2013. The values that result from these computations are compared with the market values of these financial instruments at June 30, 2013. The differences in this comparison are the hypothetical gains or losses associated with each type of risk.

As of June 30, 2013, based on a hypothetical immediate 150 basis point increase in interest rates, with all other variables held constant, the market value of our fixed rate long-term debt would be impacted by a net decrease of approximately \$12.7 million. Conversely, a 150 basis point decrease in interest rates would result in a net increase in the market value of our fixed rate long-term debt of approximately \$6.3 million.

As of June 30, 2013, a 10% decrease or increase 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 our financial instruments of \$8.8 million or an increase in the fair value of our financial instruments of \$7.2 million, respectively. As the impact of offsetting changes in the fair market value of our net foreign investments is not included in the sensitivity model, these results are not indicative of our actual exposure to foreign currency exchange risk.

ITEM 4. CONTROLS AND PROCEDURES

As of the end of the period covered by this Quarterly Report on Form 10-Q, an evaluation was performed under the supervision and with the participation of our management, including our President and Chief Executive Officer and our Senior Vice President and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the "Act"), pursuant to Rule 13a-14(c) under the Act. Based on that evaluation, our President and Chief Executive Officer and our Senior Vice President and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this Quarterly Report.

There were no changes in our internal control over financial reporting that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are subject to various legal proceedings in the ordinary course of business, none of which is required to be disclosed under this Item 1.

ITEM 1A. RISK FACTORS

There are no material changes in risk factors in the second quarter of 2013. For a discussion of risk factors, see Part I, Item IA in our Annual Report on Form 10-K for fiscal year 2012.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

The following exhibits are filed with this report:

EXHIBIT

NUMBER DESCRIPTION OF EXHIBIT

| | |
|---------|---|
| 31.1 | Section 302 Certification of Chief Executive Officer. |
| 31.2 | Section 302 Certification of Chief Financial Officer. |
| 32.1 | Certification of Chief Executive Officer pursuant to 18 U.S.C. § 1350. |
| 32.2 | Certification of Chief Financial Officer pursuant to 18 U.S.C. § 1350. |
| 101.INS | XBRL Instance Document (furnished electronically herewith) |
| 101.SCH | XBRL Taxonomy Extension Schema Document (furnished electronically herewith) |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document (furnished electronically herewith) |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document (furnished electronically herewith) |
| 101.PRE | XBRL Taxonomy Presentation Linkbase Document (furnished electronically herewith) |
| 101.DEF | XBRL Taxonomy Definition Linkbase Document (furnished electronically herewith) |

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.

INTERFACE, INC.

Date: August 8, 2013 By: /s/ Patrick C. Lynch
Patrick C. Lynch
Senior Vice President
(Principal Financial Officer)

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