



**Carolina Mills, Inc.
1985 Annual Report**

Corporate Information

Officers

Edward P. Schrum
*President, Assistant Treasurer and
Chief Executive Officer*

Thomas P. Pruitt, Jr.
Vice President - Weaving Operations

Jerry G. Harbinson
*Vice President - Administration and
Assistant Secretary*

George A. Moretz
Vice President - Sales Yarn Operations

Kenneth C. Isaac
Vice President - Knit Finishing Operations

Stephen G. Dobbins, Jr.
Vice President - Sales Yarn Manufacturing

J. L. Thompson, Jr.
Secretary and Treasurer

Carolina Mills, Inc.

Maiden, North Carolina

General Administrative Offices
Data Processing Center
Central Warehouse for finished goods
and raw materials
Trucking Department
Laboratory

Plant No. 1 (Julius W. Abernethy
Plant) **Jim Bean**, Plant Manager,
Spun yarns from man-made fibers

Plant No. 8 - J. V. Randall,
Plant Manager

Open-end spun yarns for knitting

Statesville, North Carolina

Plant No. 12 - Bob Cook,
Plant Manager

Fine count spun polyester yarns

Newton, North Carolina

Plant No. 2 - Kermit Goodson,
Plant Manager

Coarse open-end spun yarns

Plant No. 3 - Jim Harwell,
Plant Manager

Woven canton flannel for work glove
industry

Plant No. 4 - Robert Bristow,
Plant Manager

Commission finishing of tubular knit
goods

Hickory, North Carolina

Plant No. 14 - Ernest Whitener,
Plant Manager

Woven upholstery fabrics

Lincolnton, North Carolina

Plant No. 5 - Fred Hoffman,
Plant Manager

Spun yarns for the knitting trade

Plant No. 6 - Fred Hoffman,
Plant Manager

Spun polyester blend yarns

Ranlo, North Carolina

Plant No. 21 - J. C. Bridgeman
Plant Manager

Spun polyester yarns

Plant No. 22 - J. C. Bridgeman
Plant Manager

Combed cotton/polyester yarns

Plant No. 24 - Jim McRainey
Plant Manager

Carpet yarns

Subsidiary - (Wholly Owned)

Carolina Maiden Corporation,
Maiden, N. C. and New York, N. Y.

Edward L. Strauss, President
Yarn sales agency

Subsidiary - (Wholly Owned)

**Carolina Mills Domestic International
Sales Corporation (DISC)**

Maiden, N. C.

Subsidiary - (Wholly Owned)

Null Manufacturing, Maiden, N. C.

Philip Null, President

Exposed wood and fully upholstered
furniture; selected case goods.

Total Employees:
2,329 Active
370 Retired
978 Female
1,351 Male
Average Age: 38

Dear Shareholders,

1985 was a difficult year for the textile industry. Imports continued to flood our markets and selling our products became more difficult. During the year, our net sales dropped from \$160,845,000 in 1984 to \$151,956,000. This amounted to a 5½% decrease. During this same period, our net profits decreased by 30% from \$5,523,000 to \$4,249,000. Even with sales and earnings decreasing to this extent, we feel fortunate considering the number of textile operations that are operating at a loss as well as many who have closed their doors. Without changes in U. S. Government trade policies, we will most likely see additional plant closings as well as loss of jobs in the industry.

Legislation has been passed by both the U. S. House of Representatives and U. S. Senate to limit and control the growth of textile imports into this country. This legislation was passed by large majorities in both Houses but faces very stiff opposition from the presidential administration. If the President elects to veto this bill, it will cause a large number of the 3,000,000 letters written to him in support of this bill to become votes against the Republican party in future elections. This could easily bring about the loss of control of the Senate as well as loss of the next presidential election.

At this time we have accelerated our sales and quality efforts. Billings are 25% ahead of last year and our plants are running on a much fuller schedule. Prices are still depressed and margins are very low but with a full running schedule, a dedicated work force, and a determination to win, we will have a better year in 1986.

Yours very truly,



Edward P. Schrum
President

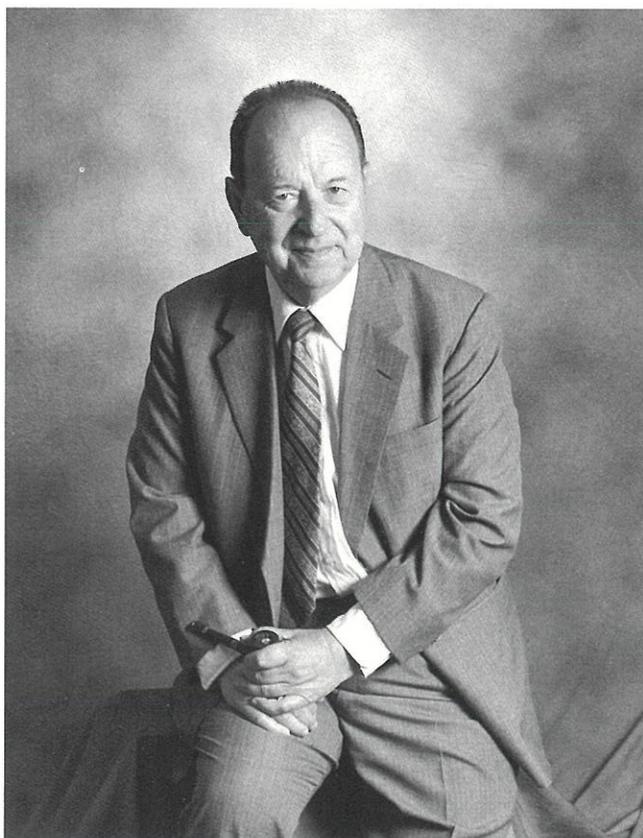


Highlights of The Year

Carolina Mills, Inc. and Wholly Owned Subsidiaries

Fiscal Year Ended

	September 28 1985	September 29 1984
Operations:		
Sale of Products	\$158,120,387	\$166,627,353
Earnings Before Income Taxes	6,829,725	10,266,128
Net Income After Taxes	4,249,498	5,522,672
Depreciation and Amortization	5,368,381	5,131,180
Cash Flow	9,617,879	10,653,852
Financial Position:		
Working Capital	23,730,034	29,799,983
Long-Term Debt	13,663,052	21,710,391
Total Assets	82,436,881	83,787,946
Stockholders' Equity	48,199,901	46,533,628
Shares Outstanding End of Year	3,936,859	3,998,393
Per Share of Common Stock:		
(1) Earnings After Taxes	\$ 1.07	\$ 1.38
Cash Flow	\$ 2.44	\$ 2.66
Cash Dividends	\$.52	\$.54
Book Value at End of Year	\$12.24	\$11.64
(1) Computed Based Upon Average Shares Outstanding		



J. L. Thompson, Jr., Secretary and Treasurer

Highlight Notes

Carolina Mills' financial position remains very strong in spite of poor operating results obtained the past year.

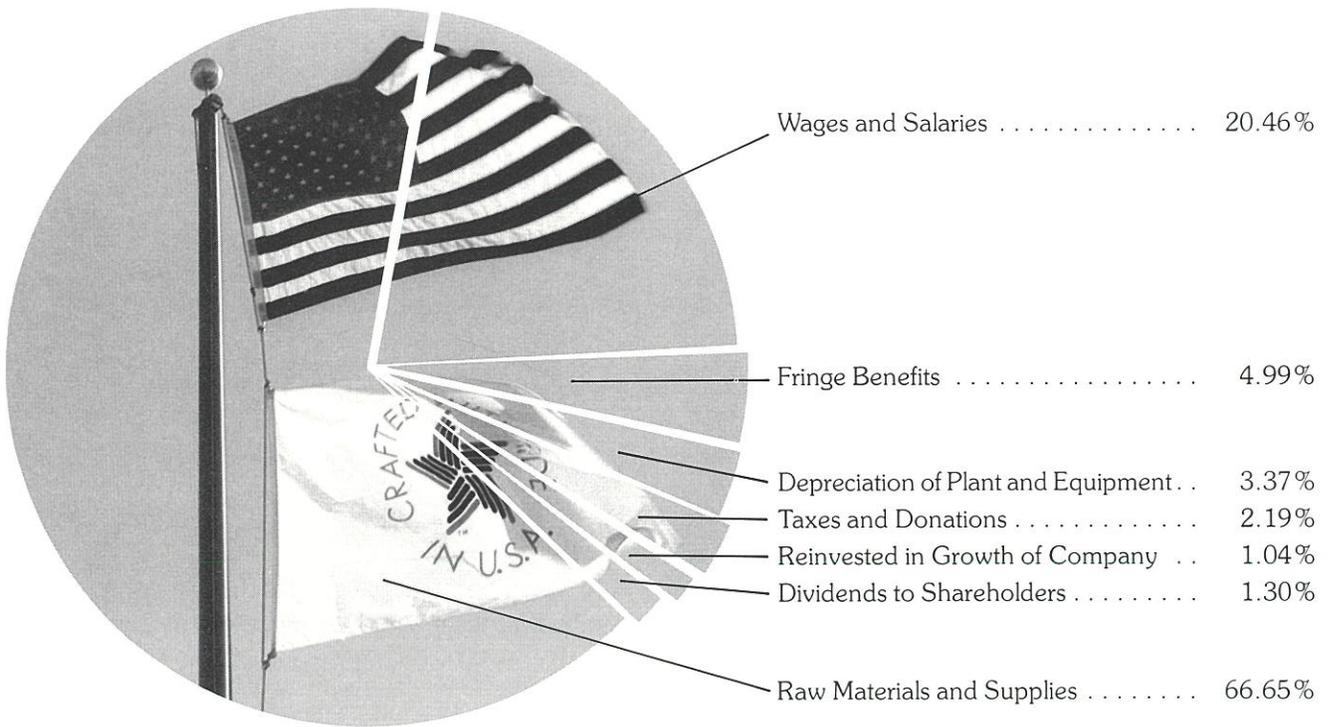
Our working capital is ample with a current ratio better than two to one. Our long term debt was in part converted to short term debt in a tax saving plan.

Our net worth (stockholder's equity) has grown to an excess of \$48 million and the book value per share is now \$12.24.

Distribution of Each Dollar of Income

Carolina Mills, Inc. and Wholly Owned Subsidiaries

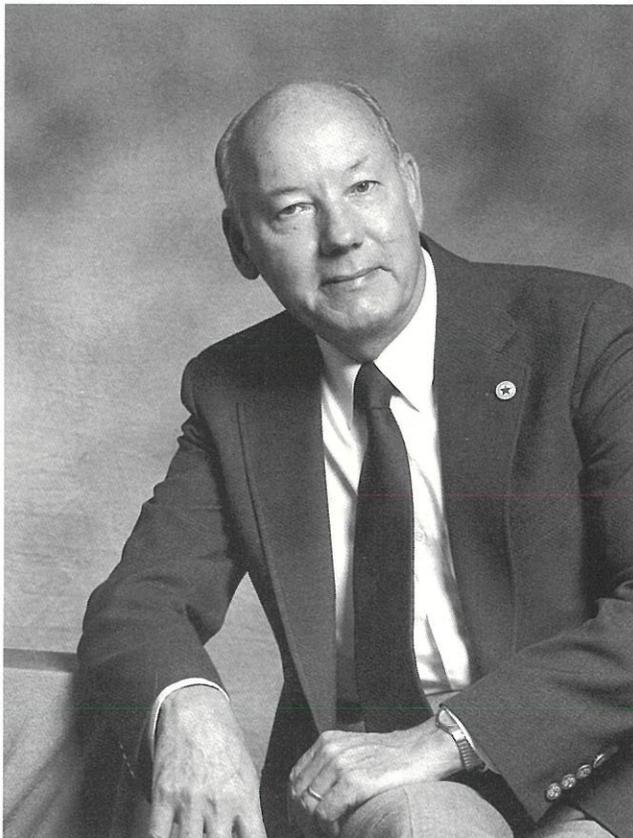
	Year Ended September 28, 1985	
Total Income	\$159,281,374	<u>100.00%</u>
Wages and Salaries	32,596,087	20.46%
Fringe Benefits	7,941,992	4.99%
Raw Materials and Supplies	106,154,155	66.65%
Depreciation of Plant & Equipment	5,368,381	3.37%
Taxes and Donations	3,485,123	2.19%
Reinvested in Growth of Company	1,664,100	1.04%
Dividends to Shareholders	2,071,536	<u>1.30%</u>
Total	\$159,281,374	100.00%



The Year In Review

Employee involvement was at an all-time high this year. Carolina Mills people joined thousands of fellow textile employees in a massive letter-writing campaign to the President of the United States, urging him to help stop the flood of imports. We exceeded our company goal of 10,000 by mailing 48,464 letters to the President, with a Ranlo employee, Don Sisk, turning in 10,065 letters. Other employees set up tables in supermarkets, urging shoppers to write; still others visited schools and neighbors, encouraging their participation.

Employees also signed a giant billboard which was delivered to the President stressing the need to keep our jobs at home. In addition, we mailed "Share the Pride" cards to friends and neighbors in other states and cities, reminding them to "Buy American".



Jerry G. Harbinson, Vice President - Administration and Assistant Secretary

We watched in awe as other companies, such as Coca-Cola, Duke Power, Harris-Teeter, Hardees, banking institutions and radio stations joined in the Crafted With Pride campaign. Pride in our own industry was increased when super stars donated their time and talents to film ads encouraging the public to Buy American by stating "It Matters to Me."

Governor James Martin launched a major program to unite North Carolina behind the "Share the Pride in American Quality" campaign. Carolina Mills representatives joined over 400 business and governmental people to hear the governor, North Carolina Textile Manufacturers Association president Ed Schrum, and state Textile Week chairperson Nancy Schrum outline the Share the Pride program for North Carolina.

In addition to serving as president of NCTMA, our own

chief executive officer, Ed Schrum, was named Man of the Year in Textiles by the Kappa Tau Beta Leadership Fraternity of the School of Textiles at North Carolina State University.

For all four years that Carolina Mills has sponsored a Junior Achievement company, Carolina Creations, they have been named Company of the Year. This year's JA group was also named Best Managed Company and Area Company of the Year . . . the first time our region has won this award for record systems. In addition, Carolina Creations was selected as one of the top 15 companies in the Atlantic Coast region, and is ranked in the top 48 out of 8,000 companies in the nation. This recognition is based on record-keeping, sales, attendance, retention and products.

Regular health maintenance is continuously provided to employees through our seven registered nurses on staff, however during the past year additional tests were conducted. Throughout the company, employees were checked for glaucoma, high blood pressure, diabetes, tuberculosis, and were given the Lipids Profile (to determine the triglyceride level, cholesterol level and calculated heart attack risk factor.)

We have been very busy in the administrative area of the company this year, working on some major projects which will make significant contributions to improved management information for the future.

A review of our computer based management information system last summer revealed the need for a more powerful computer and one that would better accommodate departmental user applications. After examining the systems available in the market today, we selected an IBM Model 4361/L04 processor, with four million K of memory, along with three disk drives of 800 megabytes of storage each. This is the fourth upgrade of our mainframe computer since the first in 1966, and is by far the most powerful. We are now in the process of converting the approximately 400 programs that make up the management information system to run on the new computer. The accompanying new operating systems and software are equally powerful and user friendly, and will provide the means to make more information available to all our departments in a more timely and useful fashion. We are very excited about our potential for the future.

The Credit Union purchased an IBM-AT in-house computer system with CRUISE software which was installed and ready for operation beginning October 1, 1984. The hardware consists of a central processing unit with 512 thousand bytes internal memory, a full functioning terminal, an inquiry terminal which will be multi-user/multi-tasking at a later date, two typewriter keyboards, a 200 character report printer, and a check printer. CRUISE is a sophisticated computer system designed to provide the widest range of credit union information processing. This system is comprehensive in that it addresses all functions associated with the operations of a credit union from processing a member share withdrawal to summarizing daily journal entries to amortizing prepaid accounts to projecting dividend expenses. CRUISE is versatile in that the system may be easily customized to meet the exact needs of the credit union.

Our Credit Union was chartered November 4, 1974. Since that time assets have grown to \$3,548,877.78, with 1,934 members.

New offices have been constructed to house our purchasing department consisting of five people. Their proximity to the central supply warehouse will provide better

management and improved handling of purchased supplies for the total company. The offices (in the main building) vacated by this group will be utilized by production planning and the customer service department, providing better communication and coordination of activities in this area. This is consistent with the company's increased emphasis on serving our customers.

Weaving Division

Our customers for flannel in the work glove industry continue to be adversely affected by increasing imports of low cost gloves primarily from the Far East.

To offset this shrinking demand in the glove business, Carolina Mills installed new looms two years ago to make specialty fabrics for other industries. This move enabled us to keep our sales strong and to keep plant #3 running a full production schedule throughout the year.

Our wide range of products makes it possible for customers to purchase most of their flannel requirements from Carolina Mills. This "one-stop" shopping concept coupled with our history of great service allows us to acquire and keep top flannel customers.



Thomas P. Pruitt, Jr., Vice President - Weaving Operations

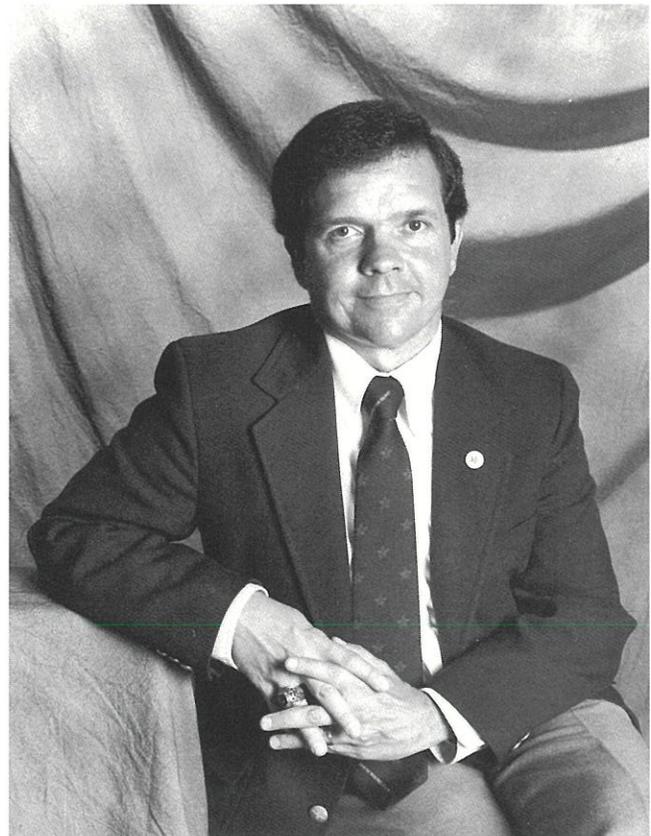
1985 has been a year of many changes at plant #14. Our activity has been centered on design and sales of our constantly growing product line. The addition of seven new yarn programs, each with a complete colorline, resulted in an increase of approximately 50% in the number of yarns available to our design department. Over seventy-five new patterns were introduced to our two primary markets, contract seating and residential upholstered furniture manufacturers. This increased effort was well-accepted and created such demand for sample cards and swatches that we added two people to our sample department.

Though our plant facility and labor force remained basically unchanged, efforts to improve the utilization of both our space and our people resulted in the highest production efficiency we've had in many years.

During the year we targeted several specialty markets such as retail fabric jobbers, van conversion companies, and auto seat cover manufacturers. Our success in penetrating those markets helped offset softening in sales to furniture manufacturers. We believe that our continuing efforts in new pattern design will stimulate an improvement in sales to furniture companies.

Yarn Division — Manufacturing

Our division actively promoted the Crafted With Pride program during the year. Early in the year we instituted a campaign to send postcards to President Reagan expressing workers' concern with the plight of the textile industry. Over 1,200 cards, individually written and signed by employees, were sent to Washington.



Stephen G. Dobbins, Jr., Vice President - Sales Yarn Manufacturing

We emphasized employee awareness of what actions they could take to help the situation. They were encouraged to examine their own shopping habits, and to express their desire to retail merchants to purchase U.S. made apparel. They were asked to keep informed about national and local activities affecting textiles, and to express their views to family, friends and the community in general.

Phase one of our campaign involved employee awareness. Phase two was an effort to improve quality in any way possible. It was stressed that if we are asking customers to purchase our products, we must guarantee that our quality is the best we can achieve. We personalized this objective by emphasizing that everyone, from the sweeper to the plant manager, must contribute.

Several projects were initiated using computers as part of a Statistical Process Control system. SPC is designed to monitor production data which is available on the plant floor. This data is available on the spot to employees to help correct problems more efficiently and with employee involvement.

Plant #1 was a hub of activity. We installed new Frontier electric blending equipment which is tied to an IBM computer. This system insures proper fiber blending and optimum fiber utilization.

We also installed a new automated packing station incorporating electronic scales and an IBM computer system to print packing tickets.

Eight new Schlafhorst winders were installed. These state-of-the-art winders feature air splicing and automatic doffing.

New automatic Fiber Controls "Snowflaker" chute feeds were installed to improve fiber feeding uniformity and overall sliver quality.

A building of 2400 square feet was constructed on the north end of plant #1 for staging and loading cases of yarns.

Plant #2 installed twelve automatic Fiber Controls "Snowflaker" chute feed systems. We purchased an Epson portable computer and electronic scale for sliver monitoring. This will enable us to monitor the operation more closely and collect data to determine immediately what corrective measures need to be taken as the yarn is being processed.

All of these changes are part of our Quality Emphasis program, and plants #5, #6 and #8 were brought into the program throughout the year.

A new 40,000 square foot addition was constructed adjacent to plant #8 and the warehouses in Maiden. This facility will enable the yarn division to bring all yarns, except carpet yarns, into Maiden to consolidate shipments to customers and significantly improve our overall yarn handling and customer service.

Plant #12 and plant #21 each installed seven new model 138 Schlafhorst winders which will eventually be tied to computers. Plant #21 also installed a new in-plant testing lab.

Plant #24 installed an additional spinning frame to increase production. They also installed new Schlumberger chain gills for increased production and improved sliver quality.

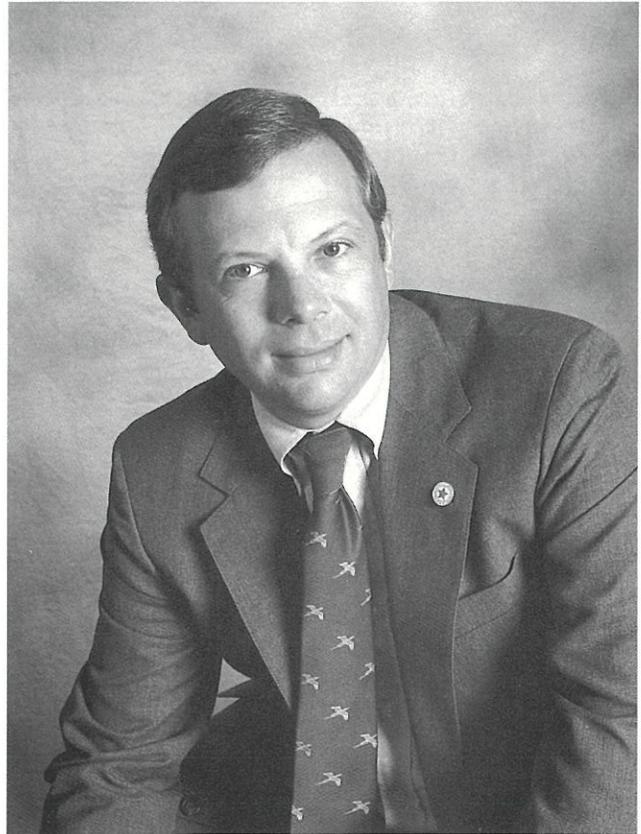
Yarn Division — Sales

As is the case with the industry in general, our markets were adversely affected by imported apparel in 1985. That combined with inventory adjustments at the retail level caused our year to start off very, very slowly. Shipments picked up some at mid year, however we finished the year with shipments down 9% compared to 1984.

Throughout the year customers were very cautious about making purchasing commitments. It was virtually a day-to-day situation. We attempted to gear our operation to be as flexible as possible in order to react quickly. The by-word was "service." We know that we produce top quality products; therefore, one of the few weapons in our arsenal is service. So we've tried to "out service" the imports to maintain our position in the market.

One area of customer service which we are working on is customer information. We've improved in this area with new data processing equipment which will allow us to provide customers with instant access to the status of their orders.

We've also worked with the sales group to develop ways to improve customer service and to aggressively promote



George A. Moretz, Vice President - Sales Yarn Division

Carolina Mills' commitment to service and quality.

In spite of the tough competition an attitude of cooperativeness prevails among yarn manufacturers, customers and suppliers. The Crafted With Pride program has helped us all focus on the fact that we're all in this struggle together. We hope that the industry's national campaign will begin to pressure retailers to respond to the problems we all face.

Furniture Division

This has been a year of resurgent retail trade activity in the furniture industry. We've done everything possible to get our share. Our year-end results show an 18% increase over last year. To accomplish this we held our own in the table market while doubling production in upholstered furniture. We are gratified with this performance in view of the increased import activity in evidence at this year's High Point market.

Null has established itself as a significant leader in the styling of tables. In this rapidly changing market segment, the current trend is to "motion" designs — occasional tables that are sectional or designed with moving sections often having dual functions such as concealed storage.

In upholstered furniture, consumers are excited about the European look. We have incorporated several "Euro-styles" into our line which have gained great acceptance among buyers.

In all areas of our business we have worked to establish brand recognition of the Null name with the consumer through advertising and other promotional efforts.

Expansion and development inevitably produce some growing pains, especially in the fashion sensitive furniture industry. To prevent system bottle necks in our manufacturing process we have instituted new programs for improvement with the following objectives:

1. Improved internal information.
2. Better quality analysis and control.
3. Improved plant engineering to maximize speed and productivity.
4. Improved manufacturing control systems.

Taking affirmative steps in these areas now will prevent larger problems in the future.



Philip Null, President - Null Manufacturing

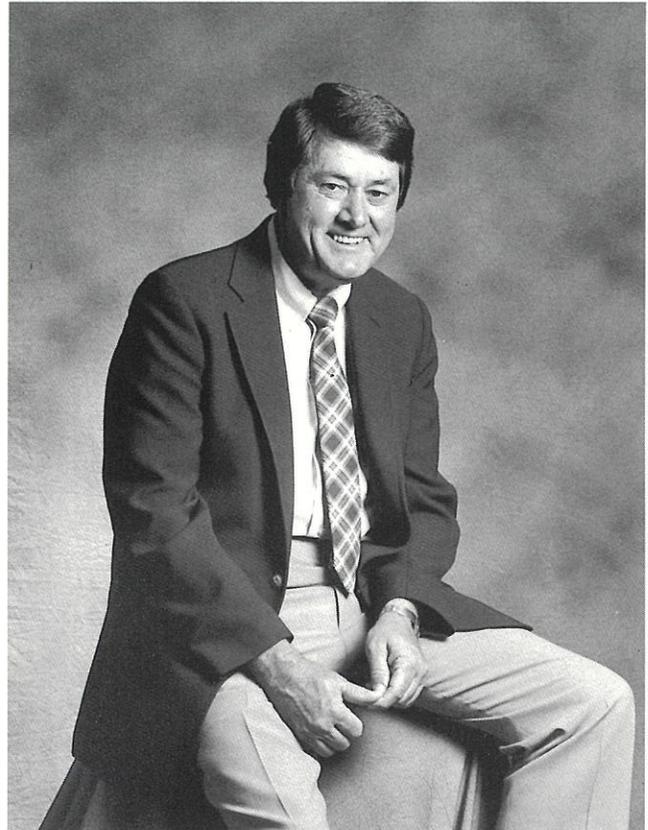
Our new showroom space in the Furniture Plaza building in High Point has been well-received. The professionalism with which it has been designed has helped position us as a serious contender in the competitive furniture marketplace.

Knit Finishing Division

Our first quarter of the fiscal year was slow. This was unusual for us; however, the second quarter was good, the third quarter was very good, and the fourth quarter good. This made our year very satisfactory and we are pleased. It now appears that our first quarter of fiscal 1986 will be good and business looks good into the second quarter of 1986.

Being commission dyeing and finishing of tubular knit goods for the knitters and cutters makes our business more than selling. We have to provide a service for these customers. We must become a part of their operation, helping engineer fabrics, helping keep quality in line, evaluating and testing fabrics. We must also schedule and maintain a production flow so that deliveries will not be missed by our customers. In the future, we must expand these services. We must provide our customers with that little extra that will allow them to get the order ahead of their competition. In this way, we can stay in business for years to come.

On market demand and the advice of our customers, we decided to go into napping of fleece goods early in the year. We bought two twenty-four roll, ninety-six inch Gessner Hi-torque nappers equipped to do body size and thirty-inch tubular goods. We started the first machine in July and the second machine in September. We are running them twenty-four hours per day, seven days per week and our customers want more. We are very pleased with the success of this program.



Kenneth C. Isaac, Vice President - Knit Finishing Operations

Another program that is a success story is the operation of our new dye equipment by micro-processors. This enables us to repeat the same cycle every time and have the machine do what our dyer wants done. This improves quality.

We continue to look at new machinery and processes that help reduce energy, water, and labor or improve quality. More improvements are ahead.

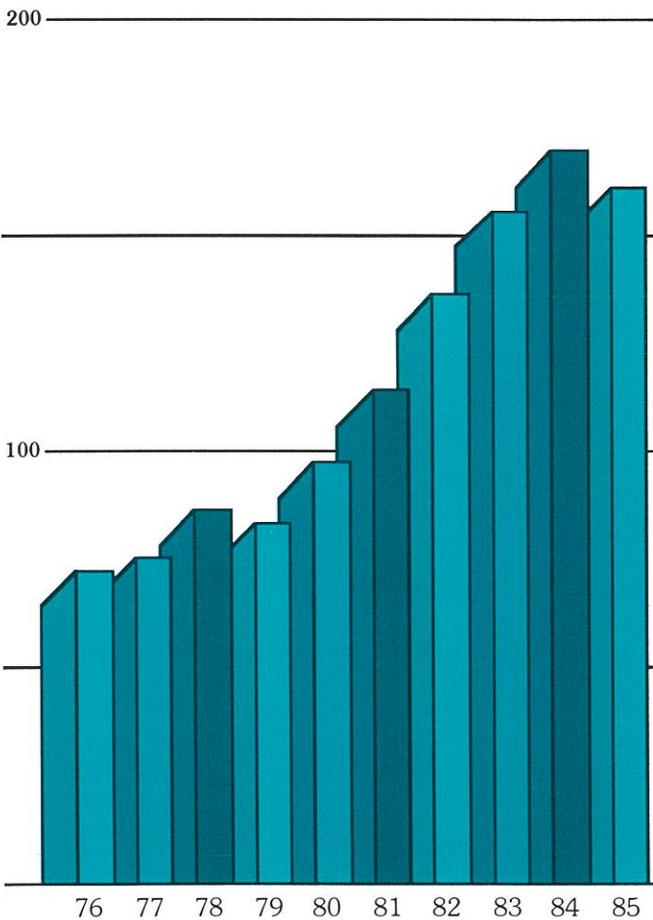
In our business, it is necessary to be able to run six days per week, and in peak times, seven days. In order to insure that we could maintain a schedule like this and have good people on the jobs, some time ago we adopted a work schedule consisting of two night shifts and two day shifts each working three days a week, twelve hours per day. This year was our tenth year in the program. We have the best work force in our history, low absenteeism and a low turnover rate. This program is a real success for our people.

We have a first class operation. We feel that we have a place in the future of knit goods in this country.

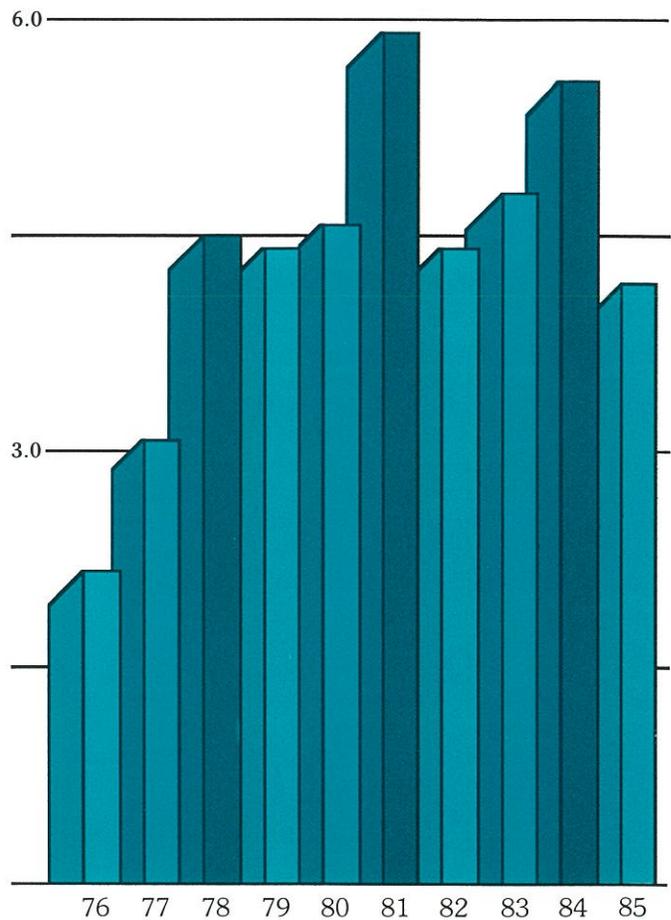
Ten Years in Review

	1985	1984	1983
Net Sales	\$158,120,387	\$166,627,353	\$154,490,368
Net Earnings Before Income Taxes	\$ 6,829,725	10,266,128	8,167,165
Income Taxes	2,580,227	4,743,456	3,323,239
Net Earnings	4,249,498	5,522,672	4,843,926
Dividends Paid	\$ 2,071,535	2,158,867	1,997,832
Earnings Retained in Business	39,767,004	37,589,041	34,225,236
Working Capital	23,730,034	29,799,983	26,531,627
Plant and Equipment - Less Depreciation	\$ 37,101,087	38,014,653	39,794,301
Stockholders' Equity	48,199,901	46,533,628	43,160,340
Shares of Stock Outstanding	3,936,859	3,998,393	3,995,798
Book Value Per Share	\$ 12.24	\$ 11.64	\$ 10.80
Per Share of Stock			
Net Earnings	\$1.07	\$1.38	\$1.21
Dividends - Cash	\$.52	\$.54	\$.50
Cash Flow	\$2.44	\$2.66	\$2.34

Net Sales (\$ Millions)

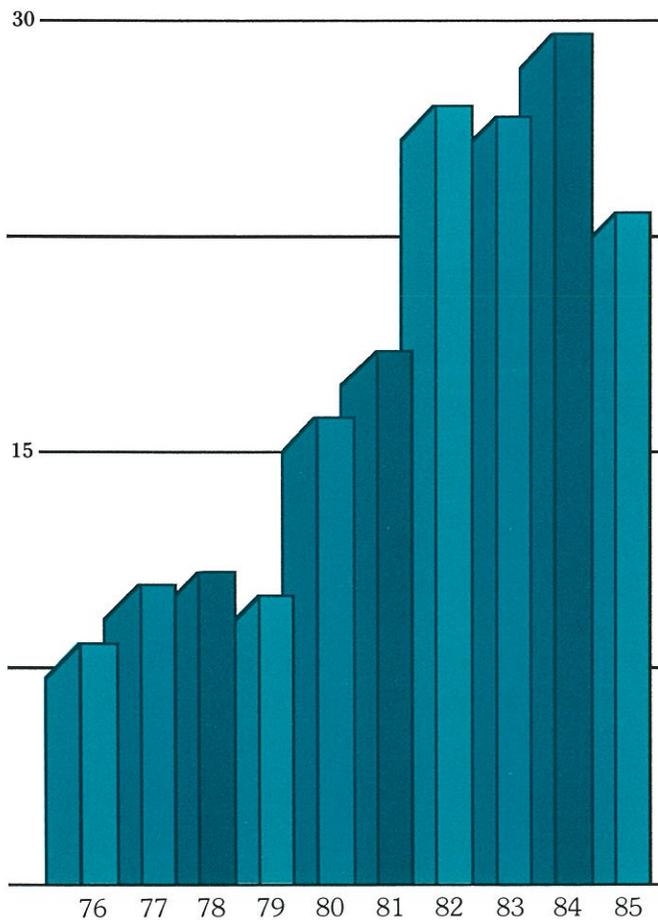


Net Earnings (\$ Millions)

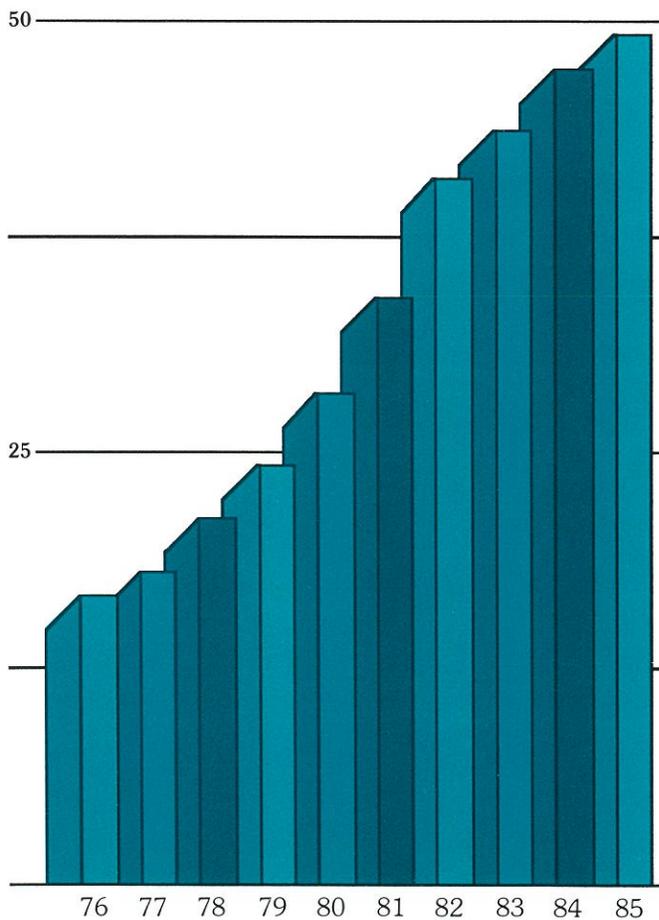


1982	1981	1980	1979	1978	1977	1976
\$134,733,139	\$113,943,593	\$93,363,384	\$80,925,750	\$82,470,935	\$73,921,334	\$70,817,799
6,491,624	10,982,477	8,269,717	7,614,133	8,486,566	5,812,349	3,099,159
2,151,305	5,102,916	3,676,568	3,328,748	3,967,462	2,682,130	1,165,983
4,340,319	5,879,561	4,593,149	4,285,385	4,519,104	3,130,219	1,993,176
1,999,961	1,653,534	1,468,589	1,363,840	1,158,826	874,487	370,416
31,379,142	26,074,428	21,848,401	18,723,841	15,802,296	12,442,018	10,140,272
26,952,039	18,017,838	16,166,995	9,693,813	11,120,418	10,796,050	8,233,344
33,777,397	23,381,463	17,398,621	16,104,085	14,987,691	14,368,017	15,908,635
40,344,791	32,243,191	28,065,843	24,734,217	21,912,564	18,343,106	16,050,735
3,999,900	3,444,581	3,452,815	3,399,046	3,417,619	3,363,412	3,363,412
\$ 10.09	\$ 9.36	\$ 8.13	\$ 7.28	\$ 6.41	\$ 5.46	\$ 4.77
\$1.11	\$1.71	\$1.35	\$1.26	\$1.32	93.14¢	57.48¢
\$.50	\$.48	\$.43	\$.40	\$.34	26.00¢	11.00¢
\$2.04	\$2.43	\$2.34	\$2.18	\$2.10	166.67¢	116.85¢

Working Capital (\$ Millions)



Stockholders' Equity (\$ Millions)



Statement of Condition

Carolina Mills, Inc. and Wholly Owned Subsidiaries

Fiscal Year Ended

Assets	September 28 1985	September 29 1984
Current Assets:		
Cash	\$ 3,073,636	\$ 2,303,223
Notes Receivable	104,576	196,183
Accounts Receivable, Less Allowance of \$373,500 for 1985; \$353,500 for 1984	20,738,054	20,950,439
Inventories	17,693,078	19,656,819
Temporary Investments	2,288,409	2,003,409
Prepaid Expenses	92,134	233,837
Refundable Federal Income Taxes	314,075	-0-
Total Current Assets	<u>\$44,303,962</u>	<u>\$45,343,910</u>
Investments at Cost	3,050	3,050
Property, Plant and Equipment - at Cost		
Land	490,988	490,988
Buildings and Equipment	75,536,050	72,083,391
Total	<u>\$76,027,038</u>	<u>\$72,574,379</u>
Less Accumulated Depreciation	<u>38,990,558</u>	<u>34,650,176</u>
Depreciated Cost	<u>\$37,036,480</u>	<u>\$37,924,203</u>
Leased Property Under Capital Leases, Less Accumulated Amortization	64,607	90,450
Total	<u>\$37,101,087</u>	<u>\$38,014,653</u>
Other Assets:		
Other Notes and Accounts Receivable	\$ 31,263	\$ 78,724
Deferred Long-Term Loan Expense	9,500	11,500
Deferred Charges - Other	665,210	336,109
Cash Value Life Insurance	322,809	-0-
	<u>\$ 1,028,782</u>	<u>\$ 426,333</u>
Total Assets	<u><u>\$82,436,881</u></u>	<u><u>\$83,787,946</u></u>

Liabilities and Stockholders' Equity

Current Liabilities:		
Notes Payable:		
Installment Loans - Current	\$ 1,610,000	\$ 3,764,000
Short Term - Banks	8,376,000	-0-
Obligations Under Capital Leases	32,558	28,176
Accounts Payable	7,417,326	7,438,781
Accrued Accounts	3,045,947	3,704,314
Federal and State Income Taxes	92,097	608,656
Total Current Liabilities	<u>\$20,573,928</u>	<u>\$15,543,927</u>
Deferred and Long-Term Liabilities	<u>13,663,052</u>	<u>21,710,391</u>
Total Liabilities	<u>\$34,236,980</u>	<u>\$37,254,318</u>
Stockholders' Equity:		
Capital Stock - Common		
Authorized 5,000,000 Shares - \$1.00 Par Issued and Outstanding 3,936,859 in 1985 and 3,998,393 in 1984	\$ 3,936,859	\$ 3,998,393
Capital Surplus	4,496,038	4,946,194
Retained Earnings	39,767,004	37,589,041
Total Stockholders' Equity	<u>\$48,199,901</u>	<u>\$46,533,628</u>
Totals	<u><u>\$82,436,881</u></u>	<u><u>\$83,787,946</u></u>

Condensed Statement of Changes in Financial Position

Carolina Mills, Inc. and Wholly Owned Subsidiaries

Fiscal Year Ended

Sources of Working Capital	Fiscal Year Ended	
	September 28 1985	September 29 1984
Earnings for the Year	\$ 4,249,498	\$ 5,522,672
Depreciation and Amortization	<u>5,368,381</u>	<u>5,131,180</u>
Working Capital Provided From Operations	\$ 9,617,879	\$10,653,852
Book Value of Fixed Assets Disposed	178,962	180,401
Proceeds of Common Stock Issue	2,172	28,247
Increase in Deferred Income Tax	410,197	1,052,200
Increase in Deferred Compensation & Other	911,022	182,493
Decrease in Investments	<u>-0-</u>	<u>11,350</u>
Total	<u>\$11,120,232</u>	<u>\$12,108,543</u>

Disposition of Working Capital

Acquisition of Plant and Equipment	\$ 4,631,776	\$ 3,529,934
Cash Dividends Paid	2,071,536	2,158,867
Purchase and Retirement of Treasury Stock	513,862	18,763
Curtailment and Reclassification of Long-Term Debt	9,368,558	2,733,165
Increase in Other Assets	<u>604,449</u>	<u>399,458</u>
Total	\$17,190,181	\$ 8,840,187
Increase (Decrease) in Working Capital	<u>(6,069,949)</u>	<u>3,268,356</u>
	<u>\$11,120,232</u>	<u>\$12,108,543</u>

Changes in Components of Working Capital

Increase (Decrease) in Current Assets:		
Cash	\$ 770,413	(\$ 419,582)
Notes and Accounts Receivable	(303,992)	(1,612,397)
Inventories	(1,963,741)	414,204
Temporary Investments	285,000	1,065,861
Deferred Charges	(141,703)	162,409
Overpayment Federal Income Taxes	<u>314,075</u>	<u>(388,162)</u>
	<u>(\$ 1,039,948)</u>	<u>(\$ 777,667)</u>
Increase (Decrease) in Current Liabilities:		
Notes Payable	\$ 6,222,000	(\$ 1,293,064)
Obligations Payable	4,382	5,837
Accounts Payable	(21,455)	(3,421,415)
Accrued Accounts	<u>(1,174,926)</u>	<u>662,619</u>
	<u>\$ 5,030,001</u>	<u>(\$ 4,046,023)</u>
Increase (Decrease) in Working Capital	<u>(\$ 6,069,949)</u>	<u>\$ 3,268,356</u>

Statement of Earnings and Retained Earnings

Carolina Mills, Inc. and Wholly Owned Subsidiaries	Fiscal Year Ended	
	September 28 1985	September 29 1984
Year Ended September 28, 1985 With Comparative Figures for 1984		
Statement of Earnings:		
Net Sales	\$158,120,387	\$166,627,353
Cost of Sales	<u>150,077,319</u>	<u>153,819,753</u>
	\$ 8,043,068	\$ 12,807,600
Other Income (Deductions) Net	(<u>1,213,343</u>)	(<u>2,541,472</u>)
Net Income Before Taxes	\$ 6,829,725	\$ 10,266,128
Provision for Income Taxes	<u>2,580,227</u>	<u>4,743,456</u>
Net Earnings	\$ 4,249,498	\$ 5,522,672
Retained Earnings at Beginning of Year	<u>37,589,041</u>	<u>34,225,236</u>
	\$ 41,838,539	\$ 39,747,908
Dividends Paid	<u>2,071,535</u>	<u>2,158,867</u>
Retained Earnings at End of Year	\$ 39,767,004	\$ 37,589,041
Net Earnings Per Share	\$ 1.07	\$ 1.38

Notes to Financial Statements

Carolina Mills, Inc. and Wholly Owned Subsidiary Corporations
Maiden, N. C.

September 28, 1985

Note A.

Summary of Significant Accounting Policies

1. *Principles of Consolidation*

All subsidiaries of the Company are wholly owned and are included in the consolidated financial statements. At September 28, 1985, the consolidation includes the parent Company, Carolina Maiden Corporation, and Null Manufacturing Corporation.

2. *Accounts Receivable*

Accounts are charged to income when considered uncollectible by the management. In addition, a reasonable reserve for doubtful accounts is carried on the books.

3. *Inventories*

Inventories, stated at the lower of cost or market, with cost determined by the last-in, first-out (LIFO), first-in, first-out (FIFO) or average cost method, are summarized below:

Finished Products:

LIFO Cost	\$ 3,718,307
FIFO Cost	1,179,823
Average Cost	3,821,165

Work-In-Process:

LIFO Cost	2,079,997
FIFO Cost	1,741,513
Average Cost	561,791

Raw Materials & Supplies:

LIFO Cost	3,313,954
FIFO Cost	<u>1,276,528</u>

\$17,693,078

Notes to Financial Statements (continued)

4. Depreciation

Depreciation is computed using the straight-line method for financial statements and the accelerated method for income tax returns.

5. Income Taxes

The Company files with its subsidiaries a consolidated Federal income tax return. Investment tax credits are accounted for by the flow-through method, and accordingly, the provision for income taxes is reduced in the year the credit arises.

Note B.

Inventories - \$17,693,078

The parent Company uses the last-in, first-out (LIFO) method of inventory valuation of raw material fibers. Accordingly, the financial statements for the fifty-two week period ended September 28, 1985 and September 29, 1984 reflect the LIFO method of valuation. Raw materials so priced include cotton and manmade synthetic fibers such as rayon, polyester and acrylics. Stock-in-process and finished goods are priced using the LIFO method for valuation of raw material component and average standard cost for labor and factory burden. The inventories at September 28, 1985 and September 29, 1984 are lower by \$1,766,185 and \$3,483,437 respectively, than they would have been had the first-in, first-out (FIFO) method of pricing been employed. Subsidiary Corporations use the first-in, first-out (FIFO) method of valuation of all inventories:

Finished Yarn and Cloth	\$ 8,719,295
Stock-In-Process	4,383,301
Raw Materials	4,142,135
Supplies and Chemicals	448,347
	<u>\$17,693,078</u>

Note C.

Long-Term Debt Other Than Capital Lease Obligations

Catawba County Industrial Revenue Bonds \$8,500,000

The Company has borrowed \$8,500,000 by loan agreement with Catawba County. The bonds bear interest at a rate equal to sixty (60) percent of the prime rate not to exceed 10.2%. The loan requires repayment, in forty consecutive quarterly installments, the first twenty of which are in the amount of \$215,000 and the second twenty in the amount of \$210,000. The quarterly installments are due commencing October 1, 1981 and ending July 1, 1991. The unpaid principal balance at September 28, 1985 was \$4,845,000.

The Industrial Revenue Bond Note is secured by a deed of trust on all real and personal property located in Catawba County, N. C. being constructed or purchased with these funds. As of September 28, 1985, the Company was in compliance with the provisions of the loan agreement.

Gaston County Industrial Revenue Bond \$6,000,000

The Company entered into a loan agreement dated December 1, 1982, in the amount of \$6,000,000 with the Gaston County Industrial Facilities and Pollution Control Financing Authority. The loan is payable in thirty-two equal quarterly installments of \$187,500 each commencing on April 1, 1983. Interest is payable quarterly at 70% of the prime rate in effect on the first day of each month to remain in effect for such month. The interest rate shall not exceed 12.25 percent per annum, or be less than 6.3% per annum. The loan is unsecured. The unpaid balance at September 28, 1985 amounted to \$3,937,500.

Notes to Financial Statements (continued)

Note D. Leases

Capital Leases

The Company leases certain machinery under leases classified as capital leases. Leased machinery included in plant property at September 28, 1985 totaled \$64,607 net of accumulated depreciation.

The following is an analysis of the leased property under capital lease by major classes:

	Asset Balance At	
	September 28 1985	September 29 1984
Classes of Property		
Manufacturing Textile Machinery and Equipment	\$200,659	\$200,659
Total	\$200,659	\$200,659
Less Accumulated Amortization	136,052	110,209
	<u>\$ 64,607</u>	<u>\$ 90,450</u>

The following is a schedule by years of future minimum lease payments under capital leases:

1986	\$44,192
1987	44,192
1988	25,779

The present value of total minimum lease payments as of September 28, 1985 was \$94,773 of which \$62,215 is included in long-term debt and \$32,258 is included in current liabilities.

Operating Leases

The Company is obligated under noncancelable long-term operating leases for manufacturing equipment which provide for payment of taxes, insurance, and maintenance in addition to annual rental payments.

Annual fiscal rental payments under these leases are as follows:

1986	\$ 475,771
1987	475,771
1988	475,771
1989	390,308
	<u>\$1,817,621</u>

Note E. Income Taxes

The provision for taxes on income consisted of the following:

	1985	1984
Current:		
States	\$ 384,105	\$ 540,721
Federal	1,785,925	3,150,535
	\$2,170,030	\$3,691,256
Deferred:		
States	\$ 54,200	\$ 126,200
Federal	\$597,877	
Less Effect of the Deficit Reduction Act of 1984	241,880	926,000
	355,997	926,000
	<u>\$ 410,197</u>	<u>\$1,052,200</u>
	<u>\$2,580,227</u>	<u>\$4,743,456</u>

Deferred U.S. Federal taxes have been reduced in 1985 by \$241,880 resulting from the enactment of the Deficit Reduction Act of 1984 which forgives income taxes on the undistributed earnings of Domestic International Sales Corporations.

Notes to Financial Statements (continued)

The major elements contributing to the difference between the U.S. Federal statutory tax rate and the effective tax rate were:

	<u>1985</u>	<u>1984</u>
Federal Statutory Tax Rate	46.0	46.0
Increase (Decrease) in Taxes Resulting from:		
Investment Tax Credits	(4.6)	(2.4)
Domestic Dividend Exclusions	(1.2)	(.7)
Bad Debt Reserves	(2.3)	
State Income Taxes	3.5	3.5
Other, Net	(.1)	(.2)
	<u>41.3</u>	<u>46.2</u>
Effect of the Deficit Reduction Act of 1984, Nonrecurring	(3.5)	
Effective Tax Rate	<u>37.8</u>	<u>46.2</u>

Income Tax returns have been examined and settled by the Internal Revenue Service for the fiscal years ended September 30, 1974, 1975, and 1976. All adjustments arising from the Federal examination have been reflected in the financial statements. Income tax returns for the fiscal years ended September 30, 1982, 1983 and 1984 are subject to examination and adjustment by the Internal Revenue Service.

The Company has adopted the flow-through method of accounting for the 10% investment tax credit. Accordingly, the provision for income taxes has been reduced in the amount of \$310,888 for the current year, and \$248,380 for the year ended September 29, 1984.

Note F. Pension Plan

The Company and its subsidiary have a pension plan covering all employees with five (5) years service. The plan is self-administered with an independent trustee and an independent actuary. The Company's accounting and funding policy is to fund the current year's cost as computed by the independent actuary. In addition to the current year's pension cost, the Company pays an interest factor of 6 percent on the past service cost.

The following provides certain information for Carolina Mills, Inc. pension plan according to the most recent actuarial computation available.

<u>Date of Latest Actuarial Report</u>	<u>October 1 1984</u>	<u>October 1 1983</u>
Actuarial present value of Vested Accumulated Plan Benefits*	\$ 6,911,363	\$ 6,069,773
Actuarial present value of Nonvested Accumulated Plan Benefits*	<u>1,192,875</u>	<u>1,149,284</u>
Total	<u>\$ 8,104,238</u>	<u>\$ 7,219,057</u>
Plans applicable Market Value	<u>\$13,665,629</u>	<u>\$13,149,475</u>

*The applicable values at October 1, 1984 and October 1, 1983 are based on an assumed rate of 7%.

Notes to Financial Statements (continued)

Note G. Contingencies and Commitments

The Company has entered into contractual purchase commitments for the acquisition of machinery and equipment in the approximate amount of \$161,533 at September 28, 1985.

The Company is obligated under certain written contracts with former employees and others to be payable as follows:

Fiscal Year	
1986	\$ 65,000
1987	65,000
1988	65,000
1989	65,000
1990-1992	108,750

Accountant's Opinion

I have examined the consolidated balance sheets of Carolina Mills, Inc. and Wholly Owned Subsidiaries, Maiden, N. C., as of September 28, 1985 and September 29, 1984, and the related consolidated statements of earnings, retained earnings and changes in financial position for the years (fifty-two weeks) then ended. My examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as I considered necessary in the circumstances.

In my opinion, the accompanying consolidated balance sheets and consolidated statement of earnings, retained earnings and changes in financial position, including notes, present fairly the financial position of Carolina Mills, Inc. and its Wholly Owned Subsidiaries, Maiden, N. C., at September 28, 1985 and September 29, 1984, and the results of its operations for the years (fifty-two weeks) then ended are in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Very truly yours,



Owen H. Whitfield
Certified Public Accountant



Seated: (left to right) Caldwell Ragan, Sr., Mark Boyd, III, Ed Schrum, J. W. Abernethy, III, George Moretz, Tom Pruitt, Jr.
 Standing (left to right) Charles Long Sigmon, Claude Abernethy, Jr., J. L. Thompson, Jr., Robert Ragan, J. W. Abernethy, Jr., Hershell Keener.

Directors

***Julius W. Abernethy, Jr.**

*President, Carolina Glove Company,
 Newton, N. C.; age 63; joined board 10/28/47.*

Julius W. Abernethy, III

*Vice President, Carolina Glove,
 Newton, N. C.; age 38; joined board 11/23/76.*

***Claude S. Abernethy, Jr.**

*Vice President, Interstate Securities Corporation,
 Newton, N. C.; age 58; joined board 5/24/72.*

D. Mark Boyd, III

*President, Times Oil Corporation,
 Lincolnton, N. C.; age 47; joined board 11/23/76.*

***Hurshell H. Keener**

*Investor,
 Hickory, N. C.; age 55; joined board 11/16/66.*

George A. Moretz

*Vice President, Carolina Mills, Inc.,
 Maiden, N. C.; age 43; joined board 11/23/76.*

***Thomas P. Pruitt, Jr.**

*Vice President, Carolina Mills, Inc.,
 Maiden, N. C.; age 63; joined board 11/02/55.*

Robert A Ragan

*Investments,
 Charlotte, N. C.; age 47; joined board 11/22/77.*

***Edward P. Schrum**

*President Carolina Mills, Inc.,
 Maiden, N. C.; age 58; joined board 11/19/58.*

Charles Long Sigmon

*Retired Banker,
 Hickory, N. C.; age 71; joined board 11/25/75.*

J. L. Thompson, Jr.

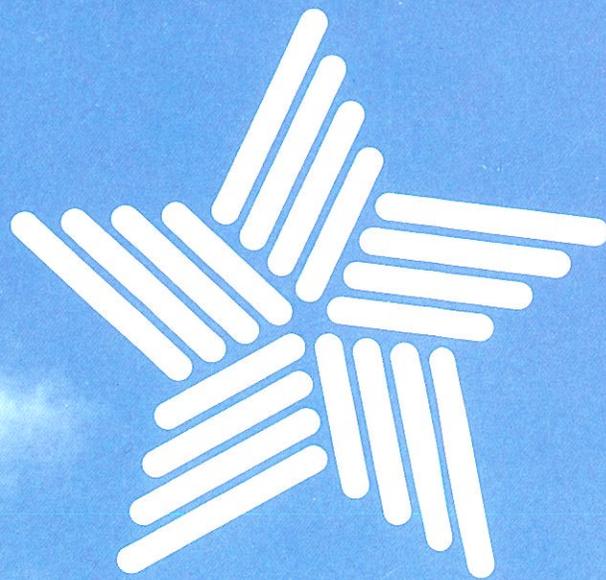
*Secretary-Treasurer, Carolina Mills, Inc.,
 Maiden, N. C.; age 67; joined board 11/12/59.*

*(Members of executive committee)

Director Emeritus:

Caldwell Ragan, Sr.

*Retired Textile Executive,
 Gastonia, N. C.; age 87; joined board 4/25/61.*



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