UNIFI INC
Form 10-K
September 08, 2006

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended June 25, 2006

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to

Commission file number 1-10542

Unifi, Inc.
(Exact name of registrant as specified in its charter)

New York	**11-2165495**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*
P.O. Box 19109 7201 West Friendly Avenue Greensboro, NC	**27419-9109**
(Address of principal executive offices)	*(Zip Code)*

Registrant s telephone number, including area code:
(336) 294-4410

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	**Name of Each Exchange on Which Registered**
Common Stock	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by checkmark if the registrant is a well-know seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes o No þ

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 þ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

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

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes o No þ

As of December 23, 2005, the aggregate market value of the registrant s voting common stock held by non-affiliates of the registrant was $145,387,494. The Registrant has no non-voting stock.

As of September 5, 2006, the number of shares of the Registrant s common stock outstanding was 52,208,467.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Definitive Proxy Statement to be filed with the Securities and Exchange Commission (the SEC) in connection
with the solicitation of proxies for the Annual Meeting of Shareholders of Unifi, Inc., to be held on October 25, 2006, are incorporated by reference into Part III. (With the exception of those portions which are specifically incorporated by reference in this Form 10-K, the Proxy Statement is not deemed to be filed or incorporated by reference as part of this report.)

UNIFI, INC.
ANNUAL REPORT ON FORM 10-K

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PART I

Item 1. *Business*

Unifi, Inc., a New York corporation formed in 1969 (together with its subsidiaries the Company or Unifi), is a diversified North American producer and processor of multi-filament polyester and nylon yarns, including specialty yarns with enhanced performance characteristics. The Company manufactures partially oriented, textured, dyed, twisted and beamed polyester yarns as well as textured nylon and nylon covered spandex products. The Company sells its products to other yarn manufacturers, knitters and weavers that produce fabrics for the apparel, hosiery, home furnishings, automotive, industrial and other end-use markets. The Company maintains one of the industry s most comprehensive product offerings and emphasizes quality, style and performance in all of its products. The Company s net sales and net loss for fiscal year 2006 were $738.8 million and $14.4 million, respectively.

The Company works across the supply chain to develop and commercialize specialty yarns that provide performance, comfort, aesthetic and other advantages that enhance demand for its products. The Company has branded the premium portion of its specialty value-added yarns in order to distinguish its products in the marketplace. The Company currently has more than 20 premium value-added yarns in its portfolio, commercialized under several brand names, including Sorbtek®, A.M.Y.®, Mynx® UV, Reflexx®, MicroVista®, aio® and Repreve®.

A significant number of customers, particularly in the apparel market, produce finished goods that they seek to make eligible for duty-free treatment in the regions covered by the North American Free Trade Agreement (NAFTA), the U.S. Dominican Republic Central American Free Trade Agreement (CAFTA), the Caribbean Basin Initiative (CBI) and the Andean Trade Preferences Act (ATPA) (collectively, the regional free-trade markets). When U.S.-origin partially oriented yarn (POY) is used to produce finished goods in these regional free-trade markets, and other origin criteria are met, then the finished goods are eligible for duty-free treatment. The Company uses advanced production processes to manufacture its high-quality yarns cost-effectively. The Company believes that its flexibility and experience in producing specialty yarns provides important development and commercialization advantages. The Company has state-of-the-art manufacturing operations in North and South America and participates in joint ventures in China, Israel and the United States.

Recent Developments

On May 26, 2006, the Company consummated a series of refinancing transactions pursuant to which it issued and sold $190 million in aggregate principal amount of 11.5% senior secured notes due 2014 (the 2014 notes) and amended its existing senior secured asset-based revolving credit facility (the old credit facility) to extend its maturity to 2011, permit the issuance and sale of the 2014 notes, give the Company the ability to request that the borrowing capacity be increased up to $150 million under certain circumstances and revise some of its other terms and covenants (such facility as so amended, the amended revolving credit facility). The Company used the proceeds from the 2014 notes offering, cash on hand of $55.7 million and borrowings of $3.0 million under its amended revolving credit facility to fund the purchase price of $248.7 million in aggregate principal amount of its 6.5% senior unsecured notes due 2008 (the 2008 notes) that had been tendered into a tender offer for all such notes launched by the Company on April 28, 2006. 99.5% of the then outstanding principal amount of the 2008 notes was tendered in the tender offer and substantially all of the restrictive covenants and certain events of default were removed from the indenture governing the 2008 notes. The Company paid a total consideration of $253.9 million for the tendered 2008 notes. The 2008 notes that were not tendered and purchased in the tender offer remain outstanding in accordance with their amended terms. The offering of the 2014 notes, the tender offer for the 2008 notes, the execution of the amended revolving credit facility and the use of proceeds from the 2014 notes offering, cash on hand and borrowings under the amended

revolving credit facility to pay the consideration of the tender offer and all associated fees and expenses are collectively referred to throughout this Annual Report on Form 10-K as the refinancing transactions.

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Industry Overview

The textile and apparel market consists of natural and synthetic fibers used for apparel and non-apparel applications. The industry is characterized by dependence upon a wide variety of end-markets which primarily include apparel, home textiles, industrial and consumer products, floor coverings, fiber fill and tires. The apparel and hosiery markets account for 25% of total production, the floor covering market accounts for 32%, the industrial and consumer markets account for 20%, the home textiles market accounts for 13% and other end-uses account for 10%.

According to the National Council of Textile Organizations, the U.S. textile market s total shipments were $75.1 billion for the twelve month period ended November 2005. Approximately $30 billion of capital expenditures has been invested in the textile industry over the past ten years. In calendar year 2005, the U.S. textile and apparel market employed more than 650,000 workers.

Textiles and apparel goods are made from natural fiber, such as cotton and wool, or synthetic fiber, such as polyester and nylon. Since 1980, global demand for polyester has grown steadily, and in calendar year 2003, polyester replaced cotton as the fiber with the largest percentage of sales worldwide. In calendar year 2005, global polyester accounted for an estimated 40% of global fiber consumption and demand is projected to increase by 6% to 7% annually through 2009. In the U.S., the synthetic fiber sector accounts for approximately 55% of the textile and apparel market.

The synthetic filament industry includes petrochemical and raw material producers, fiber and yarn manufacturers (like Unifi), fabric and product producers, retailers and consumers. Among synthetic filament yarn producers, pricing is highly competitive, with innovation, product quality and customer service being essential for differentiating the competitors within the industry. Both product innovation and product quality are particularly important, as product innovation gives customers competitive advantages and product quality provides for improved manufacturing efficiencies.

The North American synthetic yarn market has contracted since 1999, primarily as a result of intense foreign competition in finished goods on the basis of price. In addition, due to consumer preferences, demand for sheer hosiery products has declined in recent years, which negatively impacts nylon manufacturers. Despite this decline, U.S. retailers and other end-users have consistently expressed their need for a balanced procurement strategy with both global and regional production to satisfy their need for readily available production capacity, quick response times, specialized products, product changes based on customer feedback and more customized orders. As a result, the contraction in the U.S. synthetic yarn market continues; however, the Company expects a lesser rate of decline in the future as regional manufacturers continue to demand U.S. manufactured synthetic yarn. There has also been growing emphasis domestically towards premium value-added yarns as consumers, retailers and manufacturers demand products with enhanced performance characteristics. This emphasis on incorporating specialty synthetic yarn in finished goods has greatly increased domestic demand for value-added synthetic fibers. The U.S. government has attempted to regulate the growth of certain textile and apparel imports by establishing quotas and duties on imports from countries that historically account for significant shares of U.S. imports. Under the January 1995 Agreement on Textiles and Clothing, the World Trade Organization (WTO) began implementing a phased-in elimination of import quotas and a reduction of duties among its members, which culminated with the elimination of all remaining quotas for all members of WTO on January 1, 2005. After extensive negotiations, the United States and China entered into a bilateral agreement in November 2005, reinstating quotas on a number of categories of Chinese textile and apparel products. These quotas under this agreement will end on December 31, 2008. Nevertheless, duties on imported textile and apparel products, including textile and apparel products from China, remain in effect. The Company believes that duties are a more effective method than quotas in providing protection for the U.S. textile and apparel industry.

In the Americas region, regional free-trade agreements, such as NAFTA and CAFTA, and U.S. unilateral duties preference programs, such as ATPA and CBI, have a significant impact on the flow of goods among the region and the relative costs of production. The cost advantages offered by these regional free-trade agreements and duties preference programs on finished goods which incorporate U.S.-origin synthetic fiber and the desire for quick inventory turns have enabled regional synthetic yarn producers to effectively compete with imported finished goods from lower wage-based countries. The Company estimates that the duty-free benefit of processing synthetic textiles

and apparel finished goods under the terms of these regional free-trade agreements and duties preference programs typically represents a wholesale cost advantage up to 30% on these finished goods. As a result of such cost advantages, it is expected that these regions will continue to grow in their supply of textiles to the United States.

Products

The Company manufactures polyester POY and synthetic polyester and nylon yarns for a wide range of end-uses. The Company processes and sells POY, as well as high-volume commodity yarns and specialty yarns, domestically and internationally.

Polyester POY is used to make polyester yarn. Polyester yarn products include textured, dyed, twisted and beamed yarns. The Company sells its polyester yarns to other yarn manufacturers, knitters and weavers that produce fabrics for the apparel, automotive and furniture upholstery, home furnishings, industrial, military, medical and other end-use markets. Nylon products include textured nylon and covered spandex products, which the Company sells to other yarn manufacturers, knitters and weavers that produce fabrics for the apparel, hosiery, sock and other end-use markets.

In addition to producing high-volume yarns, the Company develops, manufactures and commercializes specialty yarns that provide performance, comfort, aesthetic and other advantages. For example, it has developed a line of products that are made from recycled materials in order to appeal to environmentally conscious consumers. The Company has branded the premium portion of its specialty value-added yarns in order to distinguish its products in the marketplace and it currently has more than 20 premium value-added yarn products in its portfolio. Such branded yarn products include:

Sorbtek®, a permanent moisture management yarn primarily used in performance base layer applications, compression apparel, athletic bras, sports apparel, socks and other non-apparel related items;

A.M.Y. ®, a yarn with permanent antimicrobial and odor control;

Mynx® UV, an ultraviolet protective yarn;

Reflexx®, a family of stretch yarns, that can be found in a wide array of end-use applications from home furnishings to performance wear and from hosiery and socks to workwear and denim;

MicroVista®, a family of microfiber yarns;

aio®, all-in-one performance yarns, which combine multiple performance properties into a single yarn; and

Repreve®, an eco-friendly yarn made from 100% recycled materials.

The Company s net sales of polyester and nylon accounted for 77% and 23% of total net sales, respectively, for fiscal year 2006.

Sales and Marketing

The Company employs a sales force of approximately 30 persons operating out of sales offices in the United States, Brazil and Colombia. The Company relies on independent sales agents for sales in several other countries. The Company seeks to create strong customer relationships and continually seeks ways to build and strengthen those relationships throughout the supply chain. Through frequent communications with customers, partnering with customers in product development and engaging key downstream brands and retailers, Unifi has created significant

pull-through sales and brand recognition for its products. For example, the Company works with brands and retailers to educate and create demand for its value-added products. The Company then works with key fabric mill partners assisting in the development of fabrics for those brands and retailers utilizing these value-added products. Based on many commercial and branded programs, this strategy has proven to be successful for Unifi. Examples include:

Sorbtek®, which is used in many well-known apparel brands and retailers, including Wal-Mart, Reebok, the U.S. military, Dick s Sporting Goods, Duofold, Hind and Icy Hot. Today Sorbtek® can be found in over 2,500 Wal-Mart stores under the Athletic Works brand;

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A.M.Y.®, which can be found in many apparel brands, including Reebok, Eastern Mountain Sports, the U.S. military, Everlast, Duofold, Jerzees Socks and Russell Athletics;

Mynx® UV, which can be found in Asics Running Apparel and Terry Cycling; and

Reflexx®, which can be found in major brands, including VF Corporation s Wrangler and Red Kap, Dockers and Majestic Athletic (a maker of uniforms for several major league baseball teams, including the New York Yankees).

Customers

The Company sells its polyester yarns to approximately 900 customers and its nylon yarns to approximately 200 customers in a variety of geographic markets. In fiscal year 2006, the Company s nylon segment had sales to Sara Lee Branded Apparel of $76.4 million which is in excess of 10% of its consolidated revenues. The loss of this customer would have a material adverse effect on the Company s nylon segment.

Products are generally sold on an order-by-order basis for both the polyester and nylon segments, even for premium value-added yarn with enhanced performance characteristics. For substantially all customer orders, including those involving more customized yarns, the manufacture and shipment of yarn is in accordance with firm orders received from customers specifying yarn type and delivery dates. The Company does not currently provide raw yarn consignment arrangements to any customers.

Customer payment terms are generally consistent for both the polyester and nylon reporting segments and are usually based on prevailing industry practices for the sale of yarn domestically or internationally. In certain cases, payment terms are subject to further negotiation between the Company and individual customers based on specific circumstances impacting the customer and may include the extension of payment terms or negotiation of situation specific payment plans. The Company does not believe that any such deviations from normal payment terms are significant to either of its reporting segments or the Company taken as a whole. See Item 1A Risk Factors The Company s business could be negatively impacted by the financial condition of its customers.

Manufacturing

Polyester POY is made from petroleum-based chemicals such as terephthalic acid (TPA) and monoethylene glycol (MEG). The production of polyester POY consists of two primary processes, polymerization (performed at the Company s Kinston facility) and spinning (performed at the Company s Yadkinville and Kinston facilities). The polymerization process is the production of polymer by a chemical reaction involving TPA and MEG, which are combined to form chip. The spinning process involves the extrusion of molten polymer, directly from polymerization or using polyester polymer beads (chip) into polyester POY. The molten polymer is extruded through spinnerettes to form continuous multi-filament raw yarn.

The Company s polyester and nylon yarns can be sold externally or further processed internally. Additional processing of polyester products includes texturing, package dyeing, twisting and beaming. The texturing process, which is common to both polyester and nylon, involves the processing of polyester POY, which is either natural or solution-dyed raw polyester or natural nylon filament fiber. Texturing polyester POY involves the use of high-speed machines to draw, heat and twist the polyester POY to produce yarn having various physical characteristics, depending on its ultimate end-use. This process gives the yarn greater bulk, strength, stretch, consistent dyeability and a softer feel, thereby making it suitable for use in knitting and weaving of fabrics.

Package dyeing allows for matching of customer specific color requirements for yarns sold into the automotive, home furnishings and apparel markets. Twisting incorporates real twist into the filament yarns, which can be sold for such uses as sewing thread, home furnishings and apparel. Beaming places both textured and covered yarns on beams to be used by customers in knitting and weaving applications. Warp drawing converts polyester POY into flat yarn, also packaged on beams.

Additional processing of nylon products mostly includes covering, which involves the wrapping or air entangling of filament or spun yarn around a core yarn. This process enhances a fabric s ability to stretch, recover its original shape and resist wrinkles.

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The Company works closely with its customers to develop yarns using a research and development staff that evaluates trends and uses the latest technology to create innovative, premium value-added yarns reflecting current consumer preferences.

Suppliers

The primary raw material suppliers for the polyester segment are Nanya Plastics Corp. of America (Nanya) for chip, DAK Americas LLC (DAK) for TPA and E.I. DuPont de Nemours (DuPont) for MEG. The primary suppliers of nylon POY to the nylon segment are U.N.F. Industries Ltd. (UNF), Invista S.a.r.l., Sara Lee Nilit Fibers, Ltd and Universal Premier Fibers, LLC (formerly Cookson Fibers, Inc.). UNF is a 50/50 joint venture with Nilit Ltd. (Nilit), located in Israel. The joint venture produces nylon POY at Nilit s manufacturing facility in Migdal Ha Emek, Israel. The nylon POY production is being utilized in the domestic nylon texturing operations. The Company has entered into long-term supply agreements with each of Nanya, DAK, DuPont and UNF. The agreement with Nanya will expire in October 2007 and may otherwise be terminated earlier upon six months prior notice. The agreements with DAK can be terminated upon two years prior notice. The agreement with DuPont will terminate on December 31, 2006 and the agreement with UNF will terminate in April 2008. The supply agreements typically provide for formula-driven pricing. Although the Company does not generally expect having any significant difficulty in obtaining raw nylon POY or chemical and other raw materials used to manufacture polyester POY, the Company has in the past and may in the future experience interruptions or limitations in supply which could materially and adversely affect its operations. See Item 1A Risk Factors The Company depends upon limited sources for raw materials, and interruptions in supply could increase its costs of production and cause its operations to suffer.

Joint Ventures and Other Equity Investments

The Company participates in joint ventures in China, Israel and the United States. See Management s Discussion and Analysis of Financial Condition and Results of Operation Joint Ventures and Other Equity Investments for a more detailed description of its joint ventures.

Competition

The industry in which the Company currently operates is highly competitive. The Company processes and sells both high-volume commodity products and more specialized yarns both domestically and internationally into many end-use markets, including the apparel, automotive upholstery and home furnishing markets. The Company competes with a number of other foreign and domestic producers of polyester and nylon yarns as well as with imports of textile and apparel products.

The polyester segment s major regional competitors are Nanya, Dillon Yarn Corporation (Dillon), O Mara, Inc., Spectrum Yarns, Inc. (Spectrum), KOSA and AKRA, S.A. de C.V. The nylon segments major regional competitors are Sapona Manufacturing Company, Inc., McMichael Mills, Inc. and Worldtex, Inc.

The Company also competes against a number of foreign competitors that not only sell polyester and nylon yarns in the United States but also import foreign sourced fabric and apparel into the United States and other countries in which it does business, which adversely impacts the sale of its polyester and nylon yarns.

The Company s foreign competitors include yarn manufacturers located in the regional free-trade markets who also benefit from the NAFTA, CAFTA, CBI and ATPA trade agreements which provide for duty-free treatment of most apparel and textiles between the signatory (and qualifying) countries. The cost advantages offered by these trade agreements and the desire for quick inventory turns have enabled commodity yarn producers from these regions to effectively compete. As a result of such cost advantages, the Company expects that the CAFTA and ATPA regions

will continue to grow in their supply to the United States. The Company is the largest of only a few significant producers of eligible yarn under these trade agreements. As a result, one of the Company s business strategies is to leverage its eligibility status to increase its share of business with regional fabric producers and domestic producers who ship their products into the region for further processing.

On a global basis, the Company competes not only as a yarn producer but also as part of a supply chain. As one of the many participants in the textile industry supply chain, its business and competitive position are directly impacted by the business, financial condition and competitive position of the several other participants in the supply chain in which it operates.

In the apparel market, a significant source of overseas competition comes from textile and apparel manufacturers that operate in lower labor and lower raw materials cost countries such as China. The primary competitive factors in the textile industry include price, quality, product styling and differentiation, flexibility of production and finishing, delivery time and customer service. The needs of particular customers and the characteristics of particular products determine the relative importance of these various factors. Several of the Company s foreign competitors have significant competitive advantages, including lower wages, lower raw materials and energy costs and favorable currency exchange rates against the U.S. dollar, which could make the Company s products less competitive and may cause its sales and profits to decrease. In addition, while traditionally these foreign competitors have focused on commodity production, they are now increasingly focused on premium value-added products where the Company continues to generate higher margins. In recent years, international imports of fabric and finished goods in the United States have significantly increased, resulting in a significant reduction in the Company s customer base. The primary drivers for that growth are the reduction in equipment costs which have reduced barriers to entry in the market, the currency devaluation of Asian currencies following the Asian financial crisis, the entry of China into the free-trade markets and the staged elimination of all textile and apparel quotas. In May 2005, the U.S. government imposed safeguard quotas on various categories of Chinese-made products, citing market disruption. Following extensive negotiations, the United States and China entered into a bilateral agreement in November 2005 resulting in the imposition of annually decreasing quotas on a number of categories of Chinese textile and apparel products until December 31, 2008. The Company expects competitive pressures to intensify as a result of the gradual elimination of trade protections. See Trade Regulation.

The U.S. automotive upholstery market has been less susceptible to import penetration because of the exacting specifications and quality requirements often imposed on manufacturers of automotive upholstery and the often short time frame for deliveries. Effective customer service and prompt response to customer feedback are logistically more difficult for an importer to provide. Nevertheless, to the extent the U.S. automotive industry itself faces competition from imports, the U.S. automotive upholstery industry is also affected by imports.

The nylon hosiery market has been experiencing a decline in recent years due to changing consumer preferences, but is expected to decline at a much lower rate compared to previous years. The Company supplies the largest domestic ladies hosiery producer, Sara Lee Branded Apparel.

General economic conditions, such as raw material prices, interest rates, currency exchange rates and inflation rates that exist in different countries have a significant impact on competitiveness, as do various country-to-country trade agreements and restrictions.

The Company believes that the continuing development and marketing of new and improved products, the growing need for quick response, speed to market, quick inventory turns and cost of capital will continue to require a sizable portion of the textile industry to remain based in North America. The Company s success will continue to be primarily based on its ability to improve the mix of product offerings to more premium value-added products, to implement cost saving strategies and to pass along raw material price increases, which will improve its financial results, and to strategically penetrate growth markets such as China.

See Item 1A Risk Factors The Company faces intense competition from a number of domestic and foreign yarn producers and importers of textile and apparel products.

Backlog and Seasonality

The Company generally sells products on an order-by-order basis for both the polyester and nylon reporting segments, even for premium value-added yarns. Changes in economic indicators and consumer confidence levels can have a significant impact on retail sales. Deviations between expected sales and actual consumer demand result in significant adjustments to desired inventory levels and, in turn, replenishment orders placed with suppliers. This changing demand ultimately works its way through the supply chain and impacts the Company. As a result, the

Company does not track unfilled orders for purposes of determining backlog but will routinely reconfirm or update the status of potential orders. Consequently, backlog is generally not applicable to the Company and it does not consider its products to be seasonal.

Intellectual Property

The Company has a limited number of patents and approximately 26 U.S. registered trademarks, 4 trademark applications and several foreign trademark registrations, none of which is material to any of the Company s reporting segments or its business taken as a whole. The Company does license certain trademarks, including Dacron® and Softec™ from INVISTA S.a.r.l. (INVISTA).

Employees

The Company employs approximately 3,300 employees of which approximately 3,275 are full-time and approximately 25 are part-time employees. Approximately 2,500 employees are employed in the polyester segment, approximately 700 employees are employed in the nylon segment and approximately 100 employees are employed in corporate offices. While employees of the Company s foreign operations are generally unionized, none of the domestic employees are currently covered by collective bargaining agreements. The Company believes that its relations with its employees are good.

Trade Regulation

Increases in capacity and imports of foreign-made textile and apparel products are a significant source of competition for the Company. The U.S. government attempts to regulate the growth of certain textile and apparel imports by establishing quotas and duties on imports from countries that historically account for significant shares of U.S. imports. Although imported apparel represents a significant portion of the U.S. apparel market, in recent years, a significant portion of import growth has been attributable to imports of apparel products manufactured outside the United States of (or using) domestic textile components. In addition, imports of certain textile products into the United States have increased in recent years as a result of significant depreciation of the currencies of other textile producing countries, particularly within Asia, against the U.S. dollar, and perhaps as a result of unfair trade practices.

The extent of import protection afforded by the U.S. government to domestic textile producers has been, and is likely to remain, subject to considerable domestic political deliberation and foreign considerations. In January 1995, a multilateral trade organization, the WTO, was formed by the members of the General Agreement on Tariffs and Trade (GATT), to replace GATT. The WTO has set forth the mechanisms by which world trade in textiles and clothing will be progressively liberalized through the elimination of quotas and the reduction of duties. The implementation began in January 1995 with the phasing-out of quotas and the gradual reduction of duties to take place over a 10-year period. All textile and apparel quotas expired on January 1, 2005. In May 2005, however, the U.S. government imposed safeguard quotas on various categories of Chinese-made products, citing market disruption. Following extensive negotiations, the United States and China entered into a bilateral agreement in November 2005 resulting in the imposition of annually increasing quotas on a number of categories of Chinese textile and apparel products that will remain in effect until December 31, 2008.

NAFTA, which is a free trade agreement between the United States, Canada and Mexico that became effective on January 1, 1994, has created the world s largest free-trade area. The agreement contains safeguards sought by the U.S. textile industry, including certain rules of origin for textile and apparel products that must be met for these products to receive benefits under NAFTA. Under these rules of origin, to receive NAFTA benefits, the textile and apparel products must be produced from yarn or fabric made in the NAFTA region, and all subsequent processing must occur in the NAFTA region. Thus, in general, not only must eligible apparel be made from North American

fabric, but the fabric must be woven from North American spun yarn. Based on experience to date, NAFTA has had a favorable impact on the Company s business.

In 2000, the United States passed the United States-Caribbean Basin Trade Partnership Act, which was amended by the Trade Act of 2002, and allows apparel products manufactured in the Caribbean region using yarns or fabrics produced in the United States to be imported into the United States duty and quota free. Also in 2000, the

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United States passed the African Growth and Opportunity Act (AGOA), which was amended by the Trade Act of 2002, and allows apparel products manufactured in the sub-Saharan African region using yarns or fabrics produced in the United States to be imported to the United States duty and quota free.

On August 2, 2005, the United States passed CAFTA, which is a free trade agreement between seven signatory countries: the United States, the Dominican Republic, Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua. Qualifying textile and apparel products that are produced in any of the seven signatory countries from fabric, yarn or fibers that are also produced in any of the seven signatory countries may be imported into the United States duty-free.

The Andean Trade Promotion and Drug Eradication Act was passed on August 6, 2002 to renew and enhance the ATPA. Under the enhanced ATPA, apparel manufactured in Bolivia, Colombia, Ecuador and Peru using yarns and fabrics produced in the United States, or in these four Andean countries, may be imported into the United States duty and quota free through December 31, 2006. This legislation effectively granted these four countries the favorable trade terms afforded Mexico and the Caribbean region. A free trade agreement was recently completed with Peru and Colombia which follows, for the most part, the same yarn forward rules of origin as the ATPA. These agreements require congressional action which is expected by early 2007.

The Deficit Reduction Act of 2005, which was signed into law on February 8, 2006, contains statutory changes to the Step 2 cotton program and export credit guarantee programs to comply with parts of a WTO ruling against U.S. cotton subsidies. The legislative changes eliminate the Step 2 program, which provides for payments to U.S. cotton and textile producers. The measure, part of an agriculture budget reconciliation process, does away with the subsidy program as of August 1, 2006. Parkdale America, LLC (PAL), the Company s joint venture with Parkdale Mills, Inc., will no longer receive payments under the Step 2 program after August 1, 2006. Measures such as additional quotas for foreign cotton are under discussion to help ease the transition.

Environmental Matters

The Company is subject to various federal, state and local environmental laws and regulations limiting the use, storage, handling, release, discharge and disposal of a variety of hazardous substances and wastes used in or resulting from its operations and potential remediation obligations thereunder, particularly the Federal Water Pollution Control Act, the Clean Air Act, the Resource Conservation and Recovery Act (including provisions relating to underground storage tanks) and the Comprehensive Environmental Response, Compensation, and Liability Act, commonly referred to as Superfund or CERCLA and various state counterparts. The Company has obtained, and is in compliance in all material respects with, all significant permits required to be issued by federal, state or local law in connection with the operation of its business as described in this Annual Report on Form 10-K.

The Company s operations are also governed by laws and regulations relating to workplace safety and worker health, principally the Occupational Safety and Health Act and regulations thereunder which, among other things, establish exposure standards regarding hazardous materials and noise standards, and regulate the use of hazardous chemicals in the workplace.

The Company believes that the operation of its production facilities and the disposal of waste materials are substantially in compliance with applicable federal, state and local laws and regulations and that there are no material ongoing or anticipated capital expenditures associated with environmental control facilities necessary to remain in compliance with such provisions. However, the Company is evaluating several options with respect to the upgrade of its industrial boilers at the Kinston site. The estimated investment ranges from $0 to $2.0 million. No determination has been made with respect to which alternative to pursue, if any. The Company incurs normal operating costs associated with the discharge of materials into the environment but does not believe that these costs are material or inconsistent with other domestic competitors.

The land associated with the Company s Kinston facility in North Carolina (the Kinston Site) is leased pursuant to a 99 year ground lease (the Ground Lease) with DuPont. Since 1993, DuPont has been investigating and cleaning up the Kinston Site under the supervision of the U.S. Environmental Protection Agency (the EPA) and the North Carolina Department of Environment and Natural Resources pursuant to the Resource Conservation

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and Recovery Act Corrective Action Program. The Corrective Action Program requires DuPont to identify all potential areas of environmental concern, known as solid waste management units or areas of concern, assess the extent of contamination at the identified areas and clean them up to applicable regulatory standards. Under the terms of the Ground Lease, upon completion by DuPont of required remedial action, ownership of the Kinston Site will pass to the Company. Thereafter, the Company will have responsibility for future remediation requirements, if any, at the solid waste management units and areas of concern previously addressed by DuPont and at any other areas at the plant. At this time the Company has no basis to determine if and when it will have any responsibility or obligation with respect to the solid waste management units and areas of concern or the extent of any potential liability for the same. Accordingly, the possibility that the Company could face material clean-up costs in the future relating to the Kinston Site cannot be eliminated.

Available Information

The Company s Internet address is: www.unifi.com. Copies of the Company s reports, including annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports, that the Company files with or furnishes to the SEC pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and beneficial ownership reports on Forms 3, 4, and 5, are available as soon as practicable after such material is electronically filed with or furnished to the SEC and maybe obtained without charge by accessing the Company s web site or by writing Mr. William M. Lowe, Jr. at Unifi, Inc. P.O. Box 19109, Greensboro, North Carolina 27419-9109.

Item 1A. ***Risk Factors***

The Company s substantial level of indebtedness could adversely affect its financial condition.

The Company has substantial indebtedness. As of June 25, 2006, the Company had a total of $204.0 million of debt outstanding, including $190.0 million outstanding in aggregate principal amount of 2014 notes, $1.3 million outstanding in aggregate principal amount of 2008 notes, $10.5 million outstanding in loans relating to a Brazilian government tax program and $2.2 million outstanding on a sales leaseback obligation. There were no amounts outstanding under the Company s amended revolving credit facility.

The Company s outstanding indebtedness could have important consequences to investors, including the following:

- high level of indebtedness could make it more difficult for the Company to satisfy its obligations with respect to its outstanding notes, including its repurchase obligations;

- the restrictions imposed on the operation of its business may hinder its ability to take advantage of strategic opportunities to grow its business;

- its ability to obtain additional financing for working capital, capital expenditures, acquisitions or general corporate purposes may be impaired;

- the Company must use a substantial portion of its cash flow from operations to pay interest on its indebtedness, which will reduce the funds available to the Company for operations and other purposes;

- its high level of indebtedness could place the Company at a competitive disadvantage compared to its competitors that may have proportionately less debt;

- its flexibility in planning for, or reacting to, changes in its business and the industry in which it operates may be limited; and

its high level of indebtedness makes the Company more vulnerable to economic downturns and adverse developments in its business.

Any of the foregoing could have a material adverse effect on the Company s business, financial condition, results of operations, prospects and ability to satisfy its obligations under its indebtedness.

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Despite its current indebtedness levels, the Company may still be able to incur substantially more debt. This could exacerbate further the risks associated with its substantial leverage.

The Company and its subsidiaries may be able to incur substantial additional indebtedness, including additional secured indebtedness, in the future. The terms of its current debt restrict, but do not completely prohibit, the Company from doing so. The Company s amended revolving credit facility permits up to $100 million of borrowings, which the Company can request be increased to $150 million under certain circumstances, with a borrowing base specified in the credit facility as equal to specified percentages of eligible accounts receivable and inventory. In addition, the indenture for its 2014 notes allows the Company to issue additional notes under certain circumstances and to incur certain other additional secured debt, and allows its foreign subsidiaries to incur additional debt. The indenture for its 2014 notes does not prevent the Company from incurring other liabilities that do not constitute indebtedness. If new debt or other liabilities are added to its current debt levels, the related risks that the Company now faces could intensify

The Company will require a significant amount of cash to service its indebtedness and its ability to generate cash depends on many factors beyond its control.

For fiscal year 2006, after giving effect to the refinancing transactions, interest expense, net, would have been approximately $24.2 million. The Company s principal sources of liquidity are cash flow generated from operations and borrowings under its amended revolving credit facility. The Company s ability to make payments on and to refinance its indebtedness and to fund planned capital expenditures will depend on its ability to generate cash in the future. This, to a certain extent, is subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond its control.

The business may not generate cash flow from operations, and future borrowings may not be available to the Company under its amended revolving credit facility in an amount sufficient to enable the Company to pay its indebtedness and to fund its other liquidity needs. If the Company is not able to generate sufficient cash flow or borrow under its amended revolving credit facility for these purposes, the Company may need to refinance or restructure all or a portion of its indebtedness, on or before maturity, reduce or delay capital investments or seek to raise additional capital. The Company may not be able to implement one or more of these alternatives on terms that are acceptable or at all. The terms of its existing or future debt agreements may restrict the Company from adopting any of these alternatives. The failure to generate sufficient cash flow or to achieve any of these alternatives could materially adversely affect the Company s financial condition.

In addition, without such refinancing, the Company could be forced to sell assets to make up for any shortfall in its payment obligations under unfavorable circumstances. The Company s amended revolving credit facility and the indenture for its 2014 notes limit its ability to sell assets and also restrict the use of proceeds from any such sale. Furthermore, the 2014 notes and its amended revolving credit facility are secured by substantially all of its assets. Therefore, the Company may not be able to sell its assets quickly enough or for sufficient amounts to enable the Company to meet its debt service obligations.

The terms of the Company s outstanding indebtedness impose significant operating and financial restrictions, which may prevent the Company from pursuing certain business opportunities and taking certain actions.

The terms of the Company s outstanding indebtedness impose significant operating and financial restrictions on its business. These restrictions will limit or prohibit, among other things, its ability to:

- incur and guarantee indebtedness or issue preferred stock;
- repay subordinated indebtedness prior to its stated maturity;

pay dividends or make other distributions on or redeem or repurchase the Company s stock;

issue capital stock;

make certain investments or acquisitions;

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- create liens;
- sell certain assets or merge with or into other companies;
- enter into certain transactions with stockholders and affiliates;
- make capital expenditures; and
- restrict dividends, distributions or other payments from its subsidiaries.

In addition, the Company s amended revolving credit facility also requires the Company to meet a minimum fixed charge ratio test if borrowing capacity is less than $25 million at any time during the quarter and restricts its ability to make capital expenditures or prepay certain other debt. The Company may not be able to maintain this ratio. These restrictions could limit its ability to plan for or react to market conditions or meet its capital needs. The Company may not be granted waivers or amendments to its amended revolving credit facility if for any reason the Company is unable to meet its requirements or the Company may not be able to refinance its debt on terms that are acceptable, or at all.

The breach of any of these covenants or restrictions could result in a default under the indenture for its 2014 notes or its amended revolving credit facility. An event of default under its debt agreements would permit some of its lenders to declare all amounts borrowed from them to be due and payable.

The Company faces intense competition from a number of domestic and foreign yarn producers and importers of textile and apparel products.

The Company s industry is highly competitive. The Company competes not only against domestic and foreign yarn producers, but also against importers of foreign sourced fabric and apparel into the United States and other countries in which the Company does business. The Company s major regional competitors are Nanya, Dillon, O Mara, Inc., Spectrum, KOSA and AKRA, S.A. de C.V. in the polyester yarn segment and Sapona Manufacturing Company, Inc., McMichael Mills, Inc. and Worldtex, Inc. in the nylon yarn segment. The importation of garments and fabrics from lower wage-based countries and overcapacity throughout the world has resulted in lower net sales, gross profits and net income for both its polyester and nylon segments. The primary competitive factors in the textile industry include price, quality, product styling and differentiation, flexibility of production and finishing, delivery time and customer service. The needs of particular customers and the characteristics of particular products determine the relative importance of these various factors. Because the Company, and the supply chain in which the Company operates, do not typically operate on the basis of long-term contracts with textile and apparel customers, these competitive factors could cause the Company s customers to rapidly shift to other producers. A large number of the Company s foreign competitors have significant competitive advantages, including lower labor costs, lower raw materials and energy costs and favorable currency exchange rates against the U.S. dollar. If any of these advantages increase, the Company s products could become less competitive, and its sales and profits may decrease as a result. In addition, while traditionally these foreign competitors have focused on commodity production, they are now increasingly focused on value-added products, where the Company continues to generate higher margins. Competitive pressures may also intensify as a result of the gradual elimination of quotas and the potential elimination of duties. See Changes in the trade regulatory environment could weaken the Company s competitive position dramatically and have a material adverse effect on its business, net sales and profitability. The Company, and the supply chain in which the Company operates, may therefore not be able to continue to compete effectively with imported foreign-made textile and apparel products, which would materially adversely affect its business, financial condition, results of operations or cash flows.

Changes in the trade regulatory environment could weaken the Company s competitive position dramatically and have a material adverse effect on its business, net sales and profitability.

A number of sectors of the textile industry in which the Company sells its products, particularly apparel and home furnishings, are subject to intense foreign competition. Other sectors of the textile industry in which the Company sells its products may in the future become subject to more intense foreign competition. There are currently a number of trade regulations, quotas and duties in place to protect the U.S. textile industry against competition from low-priced foreign producers, such as China. Changes in such trade regulations, quotas and duties

may make its products less attractive from a price standpoint than the goods of its competitors or the finished apparel products of a competitor in the supply chain, which could have a material adverse effect on the Company s business, net sales and profitability. In addition, increased foreign capacity and imports that compete directly with its products could have a similar effect. Furthermore, one of the Company s key business strategies is to expand its business within countries that are parties to free-trade agreements with the United States. Any relaxation of duties or other trade protections with respect to countries that are not parties to those free-trade agreements could therefore decrease the importance of the trade agreements and have a material adverse effect on its business, net sales and profitability. See Item 1 Business Trade Regulation.

The significant price volatility of many of the Company s raw materials and rising energy costs may result in increased production costs, which the Company may not be able to pass on to its customers, which could have a material adverse effect on its business, financial condition, results of operations or cash flows.

A significant portion of the Company s raw materials are petroleum-based chemicals and a significant portion of its costs are energy costs. The prices for petroleum and petroleum-related products and energy costs are volatile and have recently increased significantly. While the Company frequently enters into raw material supply agreements, as is the general practice in its industry, these agreements typically provide for formula-based pricing. Therefore, its supply agreements provide only limited protection against price volatility. As a result, its production costs have increased significantly in recent times. While the Company has in the past matched cost increases with corresponding product price increases, the Company may not always be able to immediately raise product prices, and, ultimately, pass on underlying cost increases to its customers. The Company has in the past lost and expects that it will continue to lose, customers to its competitors as a result of these price increases. In addition, its competitors may be able to obtain raw materials at a lower cost due to market regulations. Additional raw material and energy cost increases that the Company is not able to fully pass on to customers or the loss of a large number of customers to competitors as a result of price increases could have a material adverse effect on its business, financial condition, results of operations or cash flows.

The Company depends upon limited sources for raw materials, and interruptions in supply could increase its costs of production and cause its operations to suffer.

The Company depends on a limited number of third parties for certain raw material supplies, such as chip, TPA and MEG. Although alternative sources of raw materials exist, the Company may not continue to be able to obtain adequate supplies of such materials on acceptable terms, or at all, from other sources when its existing supply agreements expire. In addition, the Company has in the past and may in the future experience interruptions or limitations in the supply of its raw materials, which would increase its product costs and could have a material adverse effect on its business, financial condition, results of operations or cash flows. For example, in the Louisiana area in 2005, Hurricane Katrina created shortages in the supply of paraxlyene, a feedstock used in polymer production, because refineries diverted production to mixed xylene to increase the supply of gasoline. As a result, supplies of paraxlyene were reduced, and prices increased. Additionally, five of the six refineries in Texas that produce MEG shut down, including the supplier to the Company s Kinston operation due to Hurricane Rita. The supply of MEG was reduced, and prices increased as well. These disruptions had an adverse effect on the Company s net sales and product costs. Any future disruption or curtailment in the supply of any of its raw materials could cause the Company to reduce or cease its production in general or require the Company to increase its pricing, which could have a material adverse effect on its business, financial condition, results of operations or cash flows. See The significant price volatility of many of the Company s raw materials and rising energy costs may result in increased production costs, which the Company may not be able to pass on to its customers, which could have a material adverse effect on its business, financial condition, results of operations or cash flows.

A decline in general economic or political conditions and changes in consumer spending could cause the Company s sales and profits to decline.

The Company s products are used in the production of fabrics primarily for the apparel, hosiery, home furnishing, automotive, industrial and other similar end-use markets. Demand for furniture and durable goods, such as automobiles, is often affected significantly by economic conditions. Demand for a number of categories of

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apparel also tends to be tied to economic cycles. Domestic demand for textile products therefore tends to vary with the business cycles of the U.S. economy as well as changes in global economic and political conditions. Future armed conflicts, terrorist activities or natural disasters in the United States or abroad and any consequent actions on the part of the U.S. government and others may cause general economic conditions in the United States to deteriorate or otherwise reduce U.S. consumer spending. A decline in general economic conditions or consumer confidence may also lead to significant changes to inventory levels and, in turn, replenishment orders placed with suppliers. These changing demands ultimately work their way through the supply chain and could adversely affect demand for the Company s products and have a material adverse effect on its business, net sales and profitability.

Failure to successfully reduce the Company s production costs may adversely affect its financial results.

A significant portion of the Company s strategy relies upon its ability to successfully rationalize and improve the efficiency of its operations. In particular, the Company s strategy relies on its ability to reduce its production costs in order to remain competitive. Over the past three years, the Company has consolidated multiple unprofitable businesses and production lines in an effort to match operating rates to the market; reduced overhead and supply costs; focused on optimizing the product mix amongst its reorganized assets; and made significant capital expenditures to more completely automate its production facilities, lessen the dependence on labor and decrease waste. If the Company is not able to continue to successfully implement cost reduction measures, or if these efforts do not generate the level of cost savings that it expects going forward or result in higher than expected costs, there could be a material adverse effect on its business, financial condition, results of operations or cash flows.

Changes in customer preferences, fashion trends and end-uses could have a material adverse effect on the Company s business, net sales and profitability and cause inventory build-up if the Company is not able to adapt to such changes.

The demand for many of the Company s products depends upon timely identification of consumer preferences for fabric designs, colors and styles. In the apparel sector, a failure by the Company or its customers to identify fashion trends in time to introduce products and fabrics consistent with those trends could reduce its sales and the acceptance of its products by its customers and decrease its profitability as a result of costs associated with failed product introductions and reduced sales. The Company s nylon segment has been adversely affected by changing customer preferences that have reduced demand for sheer hosiery products. In all sectors, changes in customer preferences or specifications may cause shifts away from the products which the Company provides, which can also have an adverse effect on its business, net sales and profitability.

The Company has significant foreign operations and its results of operations may be adversely affected by currency fluctuations.

The Company has a significant operation in Brazil, operations in Colombia and joint ventures in China and Israel. The Company serves customers in Canada, Mexico, Israel and various countries in Europe, Central America, South America and South Africa. Foreign operations are subject to certain political, economic and other uncertainties not encountered by its domestic operations that can materially affect sales, profits, cash flows and financial position. The risks of international operations include trade barriers, duties, exchange controls, national and regional labor strikes, social and political risks, general economic risks, required compliance with a variety of foreign laws, including tax laws, the difficulty of enforcing agreements and collecting receivables through foreign legal systems, taxes on distributions or deemed distributions to the Company or any of its U.S. subsidiaries, maintenance of minimum capital requirements and import and export controls. Through its foreign operations, the Company is also exposed to currency fluctuations and exchange rate risks. Because a significant amount of its costs incurred to generate the revenues of its foreign operations are denominated in local currencies, while the majority of its sales are in U.S. dollars, the Company has in the past been adversely impacted by the appreciation of the local currencies relative to the U.S. dollar, and

currency exchange rate fluctuations could have a material adverse effect on its business, financial condition, results of operations or cash flows. The Company has translated its revenues and expenses denominated in local currencies into U.S. dollars at the average exchange rate during the relevant period and its assets and liabilities denominated in local currencies into U.S. dollars at the exchange rate at the end of the relevant period. Fluctuations in the foreign exchange rates will affect period-to-period comparisons of its reported

results. Additionally, the Company operates in countries with foreign exchange controls. These controls may limit its ability to repatriate funds from its international operations and joint ventures or otherwise convert local currencies into U.S. dollars. These limitations could adversely affect the Company s ability to access cash from these operations.

The Company may be exposed to liabilities under the Foreign Corrupt Practices Act and any determination that the Company violated the Foreign Corrupt Practices Act could have a material adverse effect on its business.

To the extent that the Company operates outside the United States, it is subject to the Foreign Corrupt Practices Act (the FCPA) which generally prohibits U.S. companies and their intermediaries from bribing foreign officials for the purpose of obtaining or keeping business or otherwise obtaining favorable treatment. In particular, the Company may be held liable for actions taken by its strategic or local partners even though such partners are foreign companies that are not subject to the FCPA. Any determination that the Company violated the FCPA could result in sanctions that could have a material adverse effect on its business.

The Company s business could be negatively impacted by the financial condition of its customers.

The U.S. textile and apparel industry faces many challenges. Overcapacity, volatility in raw material pricing, and intense pricing pressures has led to the closure of many domestic textile and apparel plants. Continued negative industry trends may result in the deteriorating financial condition of its customers. Certain of the Company s customers are experiencing financial difficulties. The loss of any significant portion of its sales to any of these customers could have a material adverse impact on its business, results of operations, financial condition or cash flows. In addition, any receivable balances related to its customers would be at risk in the event of their bankruptcy.

As one of the many participants in the U.S. and regional textile and apparel supply chain, the Company s business and competitive position are directly impacted by the business and financial condition of the other participants across the supply chain in which it operates, including other regional yarn manufacturers, knitters and weavers. If other supply chain participants are unable to access capital, fund their operations and make required technological and other investments in their businesses or experience diminished demand for their products, there could be a material adverse impact on the Company s business, financial condition, results of operations or cash flows.

Failure to implement future technological advances in the textile industry or fund capital expenditure requirements could have a material adverse effect on the Company s competitive position and net sales.

The Company s operating results depend to a significant extent on its ability to continue to introduce innovative products and applications and to continue to develop its production processes to be a competitive producer. Accordingly, to maintain its competitive position and its revenue base, the Company must continually modernize its manufacturing processes, plants and equipment. To this end, the Company has made significant investments in its manufacturing infrastructure over the past fifteen years and does not currently anticipate any significant additional capital expenditures to replace or expand its production facilities over the next five years. Accordingly, the Company expects its capital requirements in the near term will be used primarily to maintain its manufacturing operations, but the Company may nevertheless require significant capital expenditures for expansion purposes. Future technological advances in the textile industry may result in the availability of new products or increase the efficiency of existing manufacturing and distribution systems, and the Company may not be able to adapt to such technological changes or offer such products on a timely basis or establish or maintain competitive positions. Existing, proposed or yet undeveloped technologies may render its technology less profitable or less viable, and the Company may not have available the financial and other resources to compete effectively against companies possessing such technologies. To the extent sources of funds are insufficient to meet its ongoing capital improvement requirements, the Company would need to seek alternative sources of financing or curtail or delay capital spending plans. The Company may not be able to obtain the necessary financing when needed or on terms acceptable to us. The Company is unable to predict which

of the many possible future products and services will meet the evolving industry standards and consumer demands. If the Company fails to make the capital

improvements necessary to continue the modernization of its manufacturing operations and reduction of its costs, its competitive position may suffer, and its net sales may decline.

Unforeseen or recurring operational problems at any of the Company s facilities may cause significant lost production, which could have a material adverse effect on its business, financial condition, results of operations and cash flows.

The Company s manufacturing process could be affected by operational problems that could impair its production capability. Each of its facilities contains complex and sophisticated machines that are used in its manufacturing process. Disruptions at any of its facilities could be caused by maintenance outages; prolonged power failures or reductions; a breakdown, failure or substandard performance of any of its machines; the effect of noncompliance with material environmental requirements or permits; disruptions in the transportation infrastructure, including railroad tracks, bridges, tunnels or roads; fires, floods, earthquakes or other catastrophic disasters; labor difficulties; or other operational problems. Any prolonged disruption in operations at any of its facilities could cause significant lost production, which would have a material adverse effect on its business, financial condition, results of operations and cash flows.

The Company has made and may continue to make investments in entities that it does not control.

The Company has established joint ventures and made minority interest investments designed to increase its vertical integration, increase efficiencies in its procurement, manufacturing processes, marketing and distribution in the United States and other markets. The Company s principal joint ventures and minority investments include UNF, Unifi-SANS Technical Fibers, LLC (USTF), PAL and Yihua Unifi Fibre Industry Company Limited (YUFI). See Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Joint Ventures and Other Equity Investments. The Company s inability to control entities in which it invests may affect its ability to receive distributions from those entities or to fully implement its business plan. The incurrence of debt or entry into other agreements by an entity not under its control may result in restrictions or prohibitions on that entity s ability to pay dividends or make other distributions. Even where these entities are not restricted by contract or by law from making distributions, the Company may not be able to influence the occurrence or timing of such distributions. In addition, if any of the other investors in these entities fails to observe its commitments, that entity may not be able to operate according to its business plan or the Company may be required to increase its level of commitment. If any of these events were to occur, its business, results of operations, financial condition or cash flows could be adversely affected. Because the Company does not own a majority or maintain voting control of these entities, the Company does not have the ability to control their policies, management or affairs. The interests of persons who control these entities or partners may differ from the Company s, and they may cause such entities to take actions which are not in its best interest. If the Company is unable to maintain its relationships with its partners in these entities, the Company could lose its ability to operate in these areas which could have a material adverse effect on its business, financial condition, results of operations or cash flows.

The Company s acquisition strategy may not be successful, which could adversely affect its business.

The Company has expanded its business partly through acquisitions and anticipates that it will continue to make selective acquisitions. The Company s acquisition strategy is dependent upon the availability of suitable acquisition candidates, obtaining financing on acceptable terms, and its ability to comply with the restrictions contained in its debt agreements. Acquisitions may divert a significant amount of management s time away from the operation of its business. Future acquisitions may also have an adverse effect on its operating results, particularly in the fiscal quarters immediately following their completion while the Company integrates the operations of the acquired business. Growth by acquisition involves risks that could have a material adverse effect on business and financial results, including difficulties in integrating the operations and personnel of acquired companies and the potential loss of key employees

and customers of acquired companies. Once integrated, acquired operations may not achieve the levels of revenues, profitability or productivity comparable with those achieved by its existing operations, or otherwise perform as expected. While the Company has experience in identifying and integrating acquisitions, the Company may not be able to identify suitable acquisition candidates, obtain the capital necessary

to pursue its acquisition strategy or complete acquisitions on satisfactory terms or at all. Even if the Company successfully completes an acquisition, it may not be able to integrate it into its business satisfactorily or at all.

Increases of illegal transshipment of textile and apparel goods into the United States could have a material adverse effect on the Company s business.

There has been a significant increase recently in illegal transshipments of apparel products into the United States. Illegal transshipment involves circumventing quotas by falsely claiming that textiles and apparel are a product of a particular country of origin or include yarn of a particular country of origin to avoid paying higher duties or to receive benefits from regional free-trade agreements, such as NAFTA and CAFTA. If illegal transshipment is not monitored and enforcement is not effective, these shipments could have a material adverse effect on its business.

The Company is subject to many environmental and safety regulations that may result in significant unanticipated costs or liabilities or cause interruptions in its operations.

The Company is subject to extensive federal, state, local and foreign laws, regulations, rules and ordinances relating to pollution, the protection of the environment and the use or cleanup of hazardous substances and wastes. The Company may incur substantial costs, including fines, damages and criminal or civil sanctions, or experience interruptions in its operations for actual or alleged violations of or compliance requirements arising under environmental laws, any of which could have a material adverse effect on its business, financial condition, results of operations or cash flows. The Company s operations could result in violations of environmental laws, including spills or other releases of hazardous substances to the environment. In the event of a catastrophic incident, the Company could incur material costs.

In addition, the Company could incur significant expenditures in order to comply with existing or future environmental or safety laws. For example, the land associated with the Kinston acquisition is leased pursuant to a 99 year Ground Lease with DuPont. Since 1993, DuPont has been investigating and cleaning up the Kinston Site under the supervision of the EPA and the North Carolina Department of Environment and Natural Resources pursuant to the Resource Conservation and Recovery Act Corrective Action Program. The Corrective Action Program requires DuPont to identify all potential areas of environmental concern, known as solid waste management units or areas of concern, assess the extent of contamination at the identified areas and clean them up to applicable regulatory standards. Under the terms of the Ground Lease, upon completion by DuPont of required remedial action, ownership of the Kinston Site will pass to the Company. Thereafter, the Company will have responsibility for future remediation requirements, if any, at the solid waste management units and areas of concern previously addressed by DuPont and at any other areas at the plant. At this time, the Company has no basis to determine if and when it will have any responsibility or obligation with respect to contaminated solid waste management units and areas of concern or the extent of any potential liability for the same. Accordingly, the possibility that the Company could face material clean-up costs in the future relating to the Kinston facility cannot be eliminated. Capital expenditures and, to a lesser extent, costs and operating expenses relating to environmental or safety matters will be subject to evolving regulatory requirements and will depend on the timing of the promulgation and enforcement of specific standards which impose requirements on its operations. Therefore, capital expenditures beyond those currently anticipated may be required under existing or future environmental or safety laws. See Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Environmental Liabilities.

Furthermore, the Company may be liable for the costs of investigating and cleaning up environmental contamination on or from its properties or at off-site locations where the Company disposed of or arranged for the disposal or treatment of hazardous materials or from disposal activities that pre-dated the purchase of its businesses. If significant previously unknown contamination is discovered, existing laws or their enforcement change or its indemnities do not cover the costs of investigation and remediation, then such expenditures could have a material adverse effect on the Company s business, financial condition, results of operations or cash flows.

Health and safety regulation costs could increase.

The Company s operations are also subject to regulation of health and safety matters by the United States Occupational Safety and Health Administration and comparable statutes in foreign jurisdictions where the

Company operates. The Company believes that it employs appropriate precautions to protect its employees and others from workplace injuries and harmful exposure to materials handled and managed at its facilities. However, claims that may be asserted against the Company for work-related illnesses or injury, and changes in occupational health and safety laws and regulations in the United States or in foreign jurisdictions in which the Company operates could increase its operating costs. The Company is unable to predict the ultimate cost of compliance with these health and safety laws and regulations. Accordingly, the Company may become involved in future litigation or other proceedings or be found to be responsible or liable in any litigation or proceedings, and such costs may be material to us.

The Company s business may be adversely affected by adverse employee relations.

The Company employs approximately 3,300 employees, approximately 2,900 of which are domestic employees and approximately 400 of which are foreign employees. While employees of its foreign operations are generally unionized, none of its domestic employees are currently covered by collective bargaining agreements. The failure to renew collective bargaining agreements with employees of the Company s foreign operations and other labor relations issues, including union organizing activities, could result in an increase in costs or lead to a strike, work stoppage or slow down. Such labor issues and unrest by its employees could have a material adverse effect on the Company s business.

The Company depends on the continued services of key managers and employees.

The Company s ability to maintain its competitive position is dependent to a large degree on the services of its senior management team, including its Chief Executive Officer, Mr. Parke, and its Chief Operating Officer and Chief Financial Officer, Mr. Lowe. The Company currently does not have any employment agreements with its senior management team other than Mr. Parke and Mr. Lowe, and cannot assure investors that any of these individuals will remain with it. The Company currently does not have a life insurance policy on any of the members of the senior management team. The death or loss of the services of any of its senior managers or the inability to attract and retain additional senior management personnel could have a material adverse effect on its business.

The Company s future financial results could be adversely impacted by asset impairments or other charges.

Under Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, the Company is required to assess the impairment of the Company s long-lived assets, such as plant and equipment, whenever events or changes in circumstances indicate that the carrying value may not be recoverable as measured by the sum of the expected future undiscounted cash flows. When the Company determines that the carrying value of certain long-lived assets may not be recoverable based upon the existence of one or more impairment indicators, the Company then measures any impairment based on a projected discounted cash flow method using a discount rate determined by management to be commensurate with the risk inherent in its current business model. In accordance with SFAS No. 144, any such impairment charges will be recorded as operating losses. See Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies Impairment of Long-Lived Assets.

In addition, the Company evaluates the net values assigned to various equity investments it holds, such as its investment in YUFI, PAL, USTF and UNF, in accordance with the provisions of Accounting Principles Board Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock. APB No. 18 requires that a loss in value of an investment, which is other than a temporary decline, should be recognized as an impairment loss. Any such impairment losses will be recorded as operating losses. See Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Joint Ventures and Other Equity Investments for more information regarding the Company s equity investments.

Any operating losses resulting from impairment charges under SFAS No. 144 or APB No. 18 could have an adverse effect on its net income and therefore the market price of its securities, including its common stock.

The Company s business could be adversely affected if the Company fails to protect its intellectual property rights.

The Company s success depends in part on its ability to protect its intellectual property rights. The Company relies on a combination of patent, trademark, and trade secret laws, licenses, confidentiality and other agreements to

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protect its intellectual property rights. However, this protection may not be fully adequate: its intellectual property rights may be challenged or invalidated, an infringement suit by the Company against a third party may not be successful and/or third parties could design around its technology or adopt trademarks similar to its own. In addition, the laws of some foreign countries in which its products are manufactured and sold do not protect intellectual property rights to the same extent as the laws of the United States. Although the Company routinely enters into confidentiality agreements with its employees, independent contractors and current and potential strategic and joint venture partners, among others, such agreements may be breached, and the Company could be harmed by unauthorized use or disclosure of its confidential information. Further, the Company licenses trademarks from third parties, and these agreements may terminate or become subject to litigation. Its failure to protect its intellectual property could materially and adversely affect its competitive position, reduce revenue or otherwise harm its business. The Company may also be accused of infringing or violating the intellectual property rights of third parties. Any such claims, whether or not meritorious, could result in costly litigation and divert the efforts of its personnel. Should the Company be found liable for infringement, the Company may be required to enter into licensing arrangements (if available on acceptable terms or at all) or pay damages and cease selling certain products or using certain product names or technology. The Company s failure to prevail in any intellectual property litigation could materially adversely affect its competitive position, reduce revenue or otherwise harm its business.

Forward-Looking Statements

Forward-looking statements are those that do not relate solely to historical fact. They include, but are not limited to, any statement that may predict, forecast, indicate or imply future results, performance, achievements or events. They may contain words such as believe, anticipate, expect, estimate, intend, project, plan, will, or words or similar meaning. They may relate to, among other things, the risks described under the caption Item 1A Risk Factors above and:

- the competitive nature of the textile industry and the impact of worldwide competition;
- changes in the trade regulatory environment and governmental policies and legislation;
- the availability, sourcing and pricing of raw materials;
- general domestic and international economic and industry conditions in markets where the Company competes, such as recession and other economic and political factors over which the Company has no control;
- changes in consumer spending, customer preferences, fashion trends and end-uses;
- its ability to reduce production costs;
- changes in currency exchange rates, interest and inflation rates;
- the financial condition of its customers;
- technological advancements and the continued availability of financial resources to fund capital expenditures;
- the operating performance of joint ventures, alliances and other equity investments;
- the impact of environmental, health and safety regulations; and
- employee relations.

These forward-looking statements reflect the Company s current views with respect to future events and are based on assumptions and subject to risks and uncertainties that may cause actual results to differ materially from trends, plans or expectations set forth in the forward-looking statements. These risks and uncertainties may include those discussed above or in Item 1A Risk Factors. New risks can emerge from time to time. It is not possible for the Company to predict all of these risks, nor can it assess the extent to which any factor, or combination of factors, may cause actual results to differ from those contained in forward-looking statements. The Company will not update these forward-looking statements, even if its situation changes in the future, except as required by federal securities laws.

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Item 1B. ***Unresolved Staff Comments***

None.

Item 2. ***Properties***

Following is a summary of principal properties owned or leased by the Company as of June 25, 2006:

Location	Description
Polyester Segment Properties:	
Domestic:	
Yadkinville, NC	Five plants and three warehouses
Kinston, NC	One plant and one warehouse
Reidsville, NC	One plant
Mayodan, NC	One plant
Staunton, VA	One plant and one warehouse
Foreign:	
Alfenas, Brazil	One plant and one warehouse
Sao Paulo, Brazil	One corporate office
Nylon Segment Properties:	
Domestic	
Madison, NC	One plant
Fort Payne, AL	One central distribution center
Foreign:	
Bogota, Colombia	One plant

In addition to the above properties, the corporate administrative office for each of its segments is located at 7201 West Friendly Ave. in Greensboro, North Carolina. Such property consists of a building containing approximately 100,000 square feet located on a tract of land containing approximately 9 acres.

All of the above facilities are owned in fee simple, with the exception of a plant in Mayodan, North Carolina which is leased from a financial institution pursuant to a sale-leaseback agreement entered into on May 20, 1997, as amended; one warehouse in Staunton, Virginia, one warehouse in Kinston, North Carolina and one office in Sao Paulo, Brazil. Management believes all the properties are well maintained and in good condition. In fiscal year 2006, the Company s manufacturing plants in the U.S. and Brazil operated below capacity. Accordingly, management does not perceive any capacity constraints in the foreseeable future.

In March 2006 the Company classified several properties as assets held for sale. During the fourth quarter of fiscal year 2006, the Company sold an idle manufacturing facility in Staunton, Virginia and a central distribution center in Madison, North Carolina. The remaining assets held for sale are not included in the property listing table above.

The Company also leases two manufacturing facilities to other manufacturers, one of which is leased to USTF, a joint venture in which the Company is a 50% owner.

Item 3. ***Legal Proceedings***

There are no pending legal proceedings, other than ordinary routine litigation incidental to the Company s business, to which the Company is a party or of which any of its property is the subject.

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

No matters were submitted to a vote of security holders during the fourth quarter for the fiscal year ended June 25, 2006.

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EXECUTIVE OFFICERS OF THE COMPANY

The following is a description of the name, age, position and offices held, and the period served in such position or offices for each of the executive officers of the Company.

Chairman of the Board and Chief Executive Officer

BRIAN R. PARKE Age: 58 Mr. Parke has been the Chief Executive Officer of the Company since January 2000 and the President of the Company since 1999. Mr. Parke has also been the Chairman of the Board of Directors since 2004. Prior to that, Mr. Parke had been the President and Chief Operating Officer of the Company since January 1999 and the Manager or President of its former Irish subsidiary (Unifi Textured Yarns Europe Limited) since its acquisition by the Company in 1984. Additionally, Mr. Parke had been a Vice President of the Company since October 1993. Mr. Parke was elected to the Company s Board of Directors in July 1999.

Vice Presidents

WILLIAM M. LOWE, JR. Age: 53 Mr. Lowe has been Vice President and Chief Financial Officer of the Company since January 2004 and Chief Operating Officer of the Company since April 2004. Prior to being employed by the Company, Mr. Lowe was Executive Vice President and Chief Financial Officer of Metaldyne Corporation, an automotive component and systems manufacturer from 2001 to 2003. From 1991 to 2001 Mr. Lowe held various financial positions at Arvinmeritor, Inc. a diversified manufacturer of automotive components and systems.

R. ROGER BERRIER Age: 37 Mr. Berrier has been the Vice President of Commercial Operations of the Company since April 2006. Prior to that, Mr. Berrier had been the Commercial Operations Manager responsible for Corporate Product Development, Marketing and Brand Sales Management since April 2004. Mr. Berrier joined the Company in 1991 and has held various management positions within operations, including International Operations, Machinery Technology, Research & Development and Quality Control.

THOMAS H. CAUDLE, JR. Age: 54 Mr. Caudle has been the Vice President of Global Operations of the Company since April 2003. Prior to that, Mr. Caudle had been Senior Vice President in charge of manufacturing for the Company since July 2000 and Vice President of Manufacturing Services of the Company since January 1999. Mr. Caudle has been an employee of the Company since 1982.

BENNY L. HOLDER Age: 44 Mr. Holder has been the Vice President and Chief Information Officer of the Company since January 2001, and has been an employee of the Company since January 1995. Mr. Holder has held various management positions within the Company s information technology group since joining the Company, overseeing all of the Company s information technology operations as Managing Director from June 1999 until January 2001. Prior to joining the Company, Mr. Holder held various management positions in the information technology departments of Memorex Telex from 1990 until 1994 and Revlon, Inc. from 1994 until 1995.

WILLIAM L. JASPER Age: 53 Mr. Jasper has been the Vice President of Sales since April 2006. Prior to that, Mr. Jasper was the General Manager of the Polyester segment, having responsibility for all natural polyester businesses. He joined the Company with the purchase of the Kinston polyester POY assets from INVISTA in September 2004. Prior to joining the Company, he was the Director of INVISTA s Dacron® polyester filament business. Prior to that, Mr. Jasper held various management positions in Operations, Technology, Sales and Business for DuPont since 1980.

CHARLES F. MCCOY Age: 42 Mr. McCoy has been the Vice President, Secretary and General Counsel of the Company since October 2000, the Corporate Compliance Officer of the Company since 2002 and the Corporate

Governance Officer of the Company since 2004. Mr. McCoy became an employee of the Company in January 2000, when he joined the Company as its Assistant Secretary and General Counsel. Prior to that, Mr. McCoy was a partner with the law firm of Frazier, Frazier & Mahler, LLP, the firm serving as outside counsel to the Company.

These executive officers, unless otherwise noted, were elected by the Board of Directors of the Registrant at the Annual Meeting of the Board of Directors held on October 19, 2005. Each executive officer was elected to serve until the next Annual Meeting of the Board of Directors or until his successor was elected and qualified. No executive officer has a family relationship as close as first cousin with any other executive officer or director.

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PART II

Item 5. ***Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities***

The Company s common stock is listed for trading on the New York Stock Exchange (NYSE) under the symbol UFI. The following table sets forth the high and low sales prices of the Company s common stock as reported on the NYSE Composite Tape for the Company s two most recent fiscal years.

	High	Low
Fiscal year 2005:		
First quarter ended September 26, 2004	$ 3.24	$ 1.80
Second quarter ended December 26, 2004	4.05	2.00
Third quarter ended March 27, 2005	4.55	3.02
Fourth quarter ended June 26, 2005	4.12	2.75
Fiscal year 2006:		
First quarter ended September 25, 2005	$ 4.49	$ 3.33
Second quarter ended December 25, 2005	3.49	2.33
Third quarter ended March 26, 2006	3.37	2.82
Fourth quarter ended June 25, 2006	3.76	2.84

As of September 5, 2006 there were approximately 515 record holders of the Company s common stock. A significant number of the outstanding shares of common stock which are beneficially owned by individuals and entities are registered in the name of Cede & Co. Cede & Co. is a nominee of The Depository Trust Company, a securities depository for banks and brokerage firms. The Company estimates that there are approximately 4,200 beneficial owners of its common stock.

No dividends were paid in the past two fiscal years and none are expected to be paid in the foreseeable future. The indenture governing the 2014 notes and the Company s amended revolving credit facility restrict its ability to pay dividends or make distributions on its capital stock. See Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Long-Term Debt Senior Secured Notes and Amended Revolving Credit Facility.

The following table summarizes information as of June 25, 2006 regarding the number of shares of common stock that may be issued under the Company s equity compensation plans:

	(a)	(b)	(c)
	Number of Shares to be Issued Upon Exercise of Outstanding Options,	Weighted-Average Exercise Price of	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities

Plan Category	Warrants and Rights	Outstanding Options, Warrants and Rights	Reflected in Column (a))
Equity compensation plans approved by shareholders	3,946,341	$ 6.85	2,218,460
Equity compensation plans not approved by shareholders			
Total	3,946,341	$ 6.85	2,218,460

Under the terms of the 1999 Unifi Inc. Long-Term Incentive Plan (1999 Long-Term Incentive Plan), the maximum number of shares to be issued was approved at 6,000,000. Of the 6,000,000 shares approved for issuance, no more than 3,000,000 may be issued as restricted stock. To date, 258,466 shares have been issued as restricted stock and are deemed to be outstanding. Any option or restricted stock that is forfeited may be reissued under the terms of the plan. The amount forfeited or canceled is included in the number of securities remaining available for future issuance in column (c) in the above table.

During the fiscal quarter ended June 25, 2006, the maximum number of shares available for purchase under Company plans or programs were 6,807,241. The Company did not make any repurchases under such plans or programs during this time.

On April 25, 2003, the Company announced that its Board of Directors had reinstituted the Company s previously authorized stock repurchase plan at its meeting on April 24, 2003. The plan was originally announced by the Company on July 26, 2000 and authorized the Company to repurchase of up to 10.0 million shares of its common stock. During fiscal years 2004 and 2003, the Company repurchased approximately 1.3 million and 0.5 million shares, respectively. The repurchase program was suspended in November 2003 and the Company has no immediate plans to reinstitute the program. There is remaining authority for the Company to repurchase approximately 6.8 million shares of its common stock under the repurchase plan. The repurchase plan has no stated expiration or termination date.

For information regarding the Company s equity compensation plans, see Item 12 Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

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Item 6. ***Selected Financial Data***

	June 25, 2006 (52 Weeks)	June 26, 2005 (52 Weeks)	June 27, 2004 (52 Weeks)	June 29, 2003 (52 Weeks)	June 30, 2002 (53 Weeks)
	(Amounts in thousands, except per share data)				
Summary of Operations:					
Net sales	$ 738,825	$ 793,796	$ 666,383	$ 747,681	$ 813,635
Cost of sales	696,055	762,717	625,983	675,829	739,623
Selling, general and administrative expenses	41,534	42,211	45,963	48,182	44,707
Provision for bad debts	1,256	13,172	2,389	3,812	6,285
Interest expense	19,247	20,575	18,698	19,736	22,948
Interest income	(4,489)	(2,152)	(2,152)	(1,420)	(2,260)
Other (income) expense, net	(3,118)	(2,300)	(2,590)	(115)	4,129
Equity in (earnings) losses of unconsolidated affiliates	(825)	(6,938)	6,877	(10,728)	1,659
Minority interest (income) expense		(530)	(6,430)	4,769	
Restructuring charges (recovery)(1)	(254)	(341)	8,229	10,597	
Arbitration costs and expenses(2)			182	19,185	1,129
Alliance plant closure costs (recovery)(3)			(206)	(3,486)	
Write down of long-lived assets(4)	2,366	603	25,241		
Goodwill impairment(5)			13,461		
Loss on early extinguishment of debt(6)	2,949				
Loss from continuing operations before income taxes and extraordinary item	(15,896)	(33,221)	(69,262)	(18,680)	(4,585)
Benefit for income taxes	(1,170)	(13,483)	(25,113)	(2,590)	(2,132)
Loss from continuing operations before extraordinary Item	(14,726)	(19,738)	(44,149)	(16,090)	(2,453)
Income (loss) from discontinued operations, net of tax	360	(22,644)	(25,644)	(11,087)	(3,621)
Loss before extraordinary item and cumulative effect of accounting change	(14,366)	(42,382)	(69,793)	(27,177)	(6,074)
Extraordinary gain net of taxes of $0(7)		1,157			
Cumulative effect of accounting change, net of tax(8)					(37,851)

Net loss	$	(14,366)	$	(41,225)	$	(69,793)	$	(27,177)	$	(43,925)
Per Share of Common Stock: (basic and diluted)										
Loss from continuing operations	$	(.28)	$	(.38)	$	(.85)	$	(.30)	$	(.05)
Income (loss) from discontinued operations, net of tax				(.43)		(.49)		(.21)		(.06)
Extraordinary gain net of taxes of $0				.02						
Cumulative effect of accounting change, net of tax										(.71)
Net loss	$	(.28)	$	(.79)	$	(1.34)	$	(.51)	$	(.82)

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	June 25, 2006 (52 Weeks)	June 26, 2005 (52 Weeks)	June 27, 2004 (52 Weeks)	June 29, 2003 (52 Weeks)	June 30, 2002 (53 Weeks)
	(Amounts in thousands, except per share data)				
Balance Sheet Data:					
Working capital	$ 179,540	$ 242,440	$ 236,881	$ 183,973	$ 167,469
Gross property, plant and equipment	916,337	955,459	943,555	978,200	961,327
Total assets	732,637	845,375	872,535	1,002,201	1,019,555
Long-term debt and other obligations	202,110	259,790	263,779	259,395	280,267
Shareholders equity	382,953	383,575	401,901	479,748	498,040

(1) During fiscal year 2003, the Company developed a plan of reorganization that resulted in the termination of management and production level employees. In fiscal year 2004, the Company recorded a restructuring charge which consisted of severance and related employee termination costs and facility closure costs.

(2) The arbitration costs and expenses include the award owed by the Company to DuPont as a result of an arbitration panel ruling in June 2003 and professional fees incurred.

(3) In fiscal year 2001, the Company recorded its share of the anticipated costs of closing DuPont s Cape Fear, North Carolina facility which was in accordance with the Company s manufacturing alliance with DuPont. During fiscal year 2003, the project was substantially complete; and as a result, the Company obtained updated cost estimates which resulted in reductions to the reserve.

(4) In fiscal year 2004, management performed impairment testing for the domestic textured polyester business due to the continued challenging business conditions and reduction in volume and gross profit. As a result, management determined that the assets were in fact impaired, resulting in a charge of $25.2 million.

(5) In fiscal year 2004, management performed an impairment test for the entire domestic polyester segment. As a result of the testing, the Company recorded a goodwill impairment charge of $13.5 million to reduce the segment s goodwill to $0.

(6) In April 2006, the Company commenced a tender offer for all of its outstanding 2008 notes. In May 2006, the Company issued $190 million of notes due in 2014. The $2.9 million charge related to the fees associated with the tender offer as well as the unamortized bond issuance costs on the 2008 notes.

(7) In fiscal year 2005, the Company completed its acquisition of the INVISTA polyester POY manufacturing assets located in Kinston, North Carolina, including inventories, valued at $24.4 million. As part of the acquisition, the Company announced its plans to curtail two production lines and downsize the workforce at its newly acquired manufacturing facility. At that time, the Company recorded a reserve of $10.7 million in related severance costs and $0.4 million in restructuring costs which were recorded as assumed liabilities in purchase accounting; and therefore, had no impact on the Consolidated Statements of Operations. As of March 27, 2005, both lines were successfully shut down and a reduction in the original restructuring estimate for severance was recorded. As a result of the reduction to the restructuring reserve, a $1.2 million extraordinary gain, net of tax, was recorded.

(8) The 2002 fiscal year cumulative effect of accounting change represents the write-off of goodwill associated with the nylon reporting segment. Upon adoption of Financial Accounting Standard No. 142, Goodwill and Other Intangible Assets (SFAS 142), the Company wrote off $46.3 million ($37.9 million after tax) or $.71 per diluted share of the unamortized balance of the goodwill associated with the nylon business segment as of June 25, 2001, as a cumulative effect of an accounting change.

Item 7. ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

The following discussion of management s views on the financial condition and results of operations of the Company should be read in conjunction with the Consolidated Financial Statements and Notes included elsewhere in this Annual Report on Form 10-K. The discussion contains forward-looking statements that reflect management s current expectations, estimates and projections. Actual results for the Company could differ materially from those discussed in the forward-looking statements. Factors that could cause such differences are discussed in Forward-Looking Statements above in Item 1A Risk Factors and elsewhere in this Annual Report on Form 10-K.

Business Overview

The Company is a diversified producer and processor of multi-filament polyester and nylon yarns, including specialty yarns with enhanced performance characteristics. Unifi adds value to the supply chain and enhances consumer demand for its products through the development and introduction of branded yarns that provide unique performance, comfort and aesthetic advantages. The Company manufactures partially oriented, textured, dyed, twisted and beamed polyester yarns as well as textured nylon and nylon covered spandex products. Unifi sells its products to other yarn manufacturers, knitters and weavers that produce fabrics for the apparel, hosiery, home furnishings, automotive, industrial and other end-use markets. The Company maintains one of the industry s most comprehensive product offerings and emphasizes quality, style and performance in all of its products.

Polyester Segment. The polyester segment manufactures partially oriented, textured, dyed, twisted and beamed yarns with sales to other yarn manufacturers, knitters and weavers that produce fabrics for the apparel, automotive and furniture upholstery, hosiery, home furnishings, automotive, industrial and other end-use markets. The polyester segment primarily manufactures its products in Brazil, Colombia and the United States, which has the largest operations and number of locations. For fiscal years 2006, 2005, and 2004 polyester segment net sales were $566.4 million, $587.0 million, and $481.9 million, respectively.

Nylon Segment. The nylon segment manufactures textured nylon and covered spandex products with sales to other yarn manufacturers, knitters and weavers that produce fabrics for the apparel, hosiery, sock and other end-use markets. The nylon segment consists of operations in the United States and Colombia. For fiscal years 2006, 2005, and 2004 nylon segment net sales were $172.5 million, $206.8 million, and $184.5 million, respectively.

Sourcing Segment. In July 2005, the Company announced its decision to exit the sourcing business, and as of the end of fiscal year 2006 the Company had fully liquidated the business. All periods have been presented as discontinued operations in accordance with generally accepted accounting principles in the United States (GAAP).

The Company s fiscal year is the 52 or 53 weeks ending in the last Sunday in June. Fiscal years 2006, 2005 and 2004 had 52 weeks.

Line Items Presented

Net sales. Net sales include amounts billed by the Company to customers for products, shipping and handling, net of allowances for rebates. Rebates may be offered to specific large volume customers for purchasing certain quantities of yarn over a prescribed time period. The Company provides for allowances associated with rebates in the same accounting period the sales are recognized in income. Allowances for rebates are calculated based on sales to customers with negotiated rebate agreements with the Company. Non-defective returns are deducted from revenues in the period during which the return occurs. The Company records allowances for customer claims based upon its estimate of known claims and its past experience for unknown claims.

Cost of sales. The Company s cost of sales consists of direct material, delivery and other manufacturing costs, including labor and overhead, depreciation and amortization expense with respect to manufacturing assets, fixed asset depreciation, amortization of intangible assets and reserves for obsolete and slow-moving inventory. Cost of sales also includes amounts directly related to providing technological support to the Company s Chinese joint venture discussed below.

Selling, general and administrative expenses. The Company s selling, general and administrative expenses consist of selling expense (which includes sales staff salaries and bonuses), advertising and promotion (which includes direct marketing expenses) and administrative expense (which includes corporate expenses and bonuses). In addition,

selling, general and administrative expenses also include depreciation and amortization with respect to certain corporate administrative assets.

Recent Developments and Outlook

Although the global textile and apparel industry continues to grow, the U.S. textile and apparel industry has contracted since 1999, caused primarily by intense foreign competition in finished goods on the basis of price,

resulting in ongoing U.S. domestic overcapacity, many producers moving their operations offshore and the closure of many domestic textile and apparel plants. More recently, the U.S. textile and apparel industry has continued to decline although it has been experiencing low negative growth rates. In addition, due to consumer preferences, demand for sheer hosiery products has declined significantly in recent years, which negatively impacts nylon manufacturers. Because of these general industry trends, the Company s net sales, gross profits and net income have been trending downward for the past several years. These challenges continue to impact the U.S. textile and apparel industry, and the Company expects that they will continue to impact the U.S. textile and apparel industry for the foreseeable future. The Company believes that its success going forward is primarily based on its ability to improve the mix of its product offerings to shift to more premium value-added products, to exploit the free-trade agreements to which the United States is a party and to implement cost saving strategies which will improve its operating efficiencies. The continued viability of the U.S. domestic textile and apparel industry is dependent, to a large extent, on the international trade regulatory environment. For the most part, because of protective duties currently in place and NAFTA, CAFTA, CBI, ATPA and other free-trade agreements or duties preference programs, the Company has not experienced significant declines in its market share due to the importation of Asian products.

The Company is also highly committed and dedicated to identifying strategic opportunities to participate in the Asian textile market, specifically China, where the growth rate is estimated to be within a range of 7% to 9%. As further discussed below in Joint Ventures and Other Equity Investments, the Company has invested $30.0 million in a joint venture in China to manufacture, process and market polyester filament yarn.

During fiscal year 2006, the Company continued its focus away from selling large volumes of products in order to focus on making each product line profitable. The Company has identified unprofitable product lines and raised sales prices accordingly. In some cases, this strategy has resulted in reduced sales of these products or even the elimination of the unprofitable product lines. The Company expects that the reduction of these unprofitable businesses will improve its future operating results. This program has resulted in significant restructuring charges in recent periods, and additional losses of volume associated with these actions may require additional plant consolidations in the future, which may result in further restructuring charges.

The Company entered into a manufacturing alliance with DuPont in June 2000 to produce polyester POY at DuPont s facility in Kinston and at the Company s facility in Yadkinville, North Carolina. DuPont later transferred its interest in this alliance to Invista, Inc. This alliance resulted in significant annual benefits to the Company of approximately $30 million, consisting of reductions in fixed costs, variable costs savings and product development enrichment. On September 30, 2004, the Company acquired the Kinston facility, including inventories, for approximately $24.4 million, in the form of a note payable to Invista (the Kinston acquisition). The Company closed two of the Kinston facility s four production lines, increased efficiency and automation and reduced the workforce. See Corporate Restructurings. The acquisition resulted in the termination of the Company s alliance with DuPont. As a result of the Kinston acquisition, the Company s results for periods subsequent to the Kinston acquisition will not be fully comparable to its results for the prior periods, which include the annual benefit of the alliance.

The impact of Hurricane Katrina on the oil refineries in the Louisiana area in August 2005 created shortages of supply of gasoline and as a result a shortage of paraxlyene, a feedstock used in polymer production in its polyester segment, because producers diverted production to mixed xlyene to increase the supply of gasoline. As a result, while supplies were tight, paraxlyene continued to be available at a much higher price. During September 2005, the Company received notices from several raw material suppliers declaring force majeure under its contracts and increasing the price the Company paid under those contracts effective September 1, 2005. As a result of this increase, and other energy-related cost increases, the Company imposed a 14 cents per pound surcharge on its polyester products in an effort to maintain its margins. Throughout the second quarter of fiscal year 2006, the surcharge stayed in effect at different levels as raw material prices declined. In other operations that have a high usage of natural gas, the Company also increased sales prices effective November 1, 2005 to compensate for the increase in utility costs.

Though polyester raw material prices declined during the end of the second quarter of fiscal year 2006, a different set of paraxylene industry dynamics emerged during the third quarter of fiscal year 2006 that led to further increases of raw material prices. Polyester raw material prices once again increased during the last two quarters of

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fiscal year 2006 and continue to be steady. The belief is that the pressure from strong gasoline demand coupled with the phase out of Methyl Tert-butyl Ether (MTBE) from gasoline has had an impact on paraxylene pricing as it has raised the value of mixed xylenes (feedstock to paraxylene) as a blend component for gasoline, as xylenes are diverted into gasoline as a replacement for MTBE.

Hurricane Rita shut down five of the six refineries in Texas that produce MEG in September 2005, including the supplier to the Company s Kinston polyester filament manufacturing operation. In addition, an unrelated accident closed one of the supplier s facilities in early October 2005. With five of the six facilities closed, the supply of MEG in the marketplace became temporarily tight, and MEG became unavailable at historical prices. At the time of Hurricane Rita, the Company had approximately 22 days of inventory of MEG. The Company started purchasing MEG on the spot market and trucking the MEG to Kinston, which increased its costs compared to its more economical method of transportation by railroad.

The Company successfully managed through these transportation and access issues to meet its delivery commitments. As of the close of the second quarter of fiscal year 2006, the availability of raw materials had returned to normal levels, but pricing had not returned to pre-hurricane levels. Effective January 1, 2006, the Company removed the surcharge on its products and instituted a price increase to maintain its margins.

In spite of the Company s ability to pass to its customers nearly all of the cost increases resulting from the 2005 hurricanes and the associated supply shortages, revenues in the polyester segment for the second and third quarters of fiscal year 2006 were lower than for the comparable period in fiscal year 2005 due to lower overall purchases by its customers because of the increased prices. The polyester segment revenues lost during the second and third quarters of fiscal year 2006 have not been fully offset by increased orders in subsequent periods. In addition to the decrease in overall polyester segment revenues, increased prices also resulted in smaller order size for the polyester segment products during the second quarter of fiscal year 2006, as customers sought to purchase only their minimum requirements during the supply disruption period. Smaller order sizes affected margins negatively during that period, as repeated changes in production lines increased per-unit costs for smaller orders. As a result, in February 2006, the Company instituted small order pricing surcharges to offset this effect on margins.

On April 28, 2006, the Company commenced a tender offer for all of its then outstanding $250 million in aggregate principal amount of 2008 notes simultaneously with a consent solicitation from the holders of the 2008 notes to remove substantially all of the restrictive covenants and certain events of default under the indenture governing the 2008 notes. The tender offer expired on May 25, 2006, and $248.7 million in aggregate principal amount of 2008 notes were tendered in the tender offer, representing 99.5% of the then outstanding aggregate principal amount of 2008 notes. The tender consideration was 100% of the principal amount of 2008 notes validly tendered plus accrued but unpaid interest to, but not including, May 26, 2006. The Company paid a total consideration of $253.9 million for the tendered 2008 notes and accrued interest. The proceeds from the sale of the 2014 notes were used to fund, in part, the purchase price for the tendered 2008 notes. The $1.3 million in aggregate principal amount of 2008 notes that were not tendered and purchased in the tender offer remain outstanding in accordance with their amended terms.

On May 26, 2006 the Company issued $190 million in aggregate principal amount of 2014 notes. Interest is payable on the notes on May 15 and November 15 of each year, beginning on November 15, 2006. The 2014 notes are unconditionally guaranteed on a senior, secured basis by each of the Company s existing and future restricted domestic subsidiaries. The 2014 notes and guarantees are secured by first-priority liens, subject to permitted liens, on substantially all of the Company s and the Company s subsidiary guarantors assets (other than the assets securing the Company s obligations under its amended revolving credit facility on a first-priority basis, which consist primarily of accounts receivable and inventory), including, but not limited to, property, plant and equipment, the capital stock of the Company s domestic subsidiaries and certain of the Company s joint ventures and up to 65% of the voting stock of the Company s first-tier foreign subsidiaries, whether now owned or hereafter acquired, except for certain excluded

assets. The 2014 notes and guarantees are secured by second-priority liens, subject to permitted liens, on the Company and its subsidiary guarantors assets that secure the Company s amended revolving credit facility on a first-priority basis. In connection with the issuance, the Company incurred $6.8 million in professional fees and other expenses which will be amortized to expense over the life of the 2014 notes. The estimated fair value of the 2014 notes, based on quoted market prices, at June 25, 2006 was approximately $182.4 million.

Concurrently with the closing of the offering of the 2014 notes, the Company amended its existing senior secured asset-based revolving credit facility to extend its maturity to 2011, permit the 2014 notes offering, give the Company the ability to request that the borrowing capacity be increased up to $150 million under certain circumstances and revise some of its other terms and covenants. The Company drew $3.0 million under its amended revolving credit facility to fund, in part, the purchase price of the tendered 2008 notes. The remainder of the purchase price of the tender 2008 notes was funded with cash on hand of $55.7 million.

Key Performance Indicators

The Company continuously reviews performance indicators to measure its success. The following are the indicators management uses to assess performance of the Company s business:

- sales volume, which are an indicator of demand;
- margins, which are an indicator of product mix and profitability;
- net loss before interest, taxes, depreciation and amortization and loss or income from discontinued operations (EBITDA), which is an indicator of its ability to pay debt; and
- working capital of each business unit as a percentage of sales, which is an indicator of its production efficiency and ability to manage its inventory and receivables.

Corporate Restructurings

Over the last three fiscal years, the Company has focused on reducing costs throughout its operations and continuing to improve working capital. The Company closed one of its air-jet texture operations in Altamahaw, North Carolina in mid-2004. The Company closed its dyed facility in Manchester, England, in June 2004. On July 28, 2004, the Company announced the closing of its European manufacturing operations and associated sales offices. The Company ceased its manufacturing operations in Ireland on October 31, 2004. The Company ceased all other European operations by June 2005 and sold the real property, plant and equipment of its European division in fiscal year 2005 and 2006 for total proceeds of $38.0 million that resulted in a net gain of approximately $4.6 million. In connection with these closings and consolidations, the Company significantly reduced its workforce. As a result, the Company incurred a restructuring charge of $27.7 million in fiscal year 2004 for employee severance costs, fixed asset write-offs associated with the closure of the dyed facility in Manchester and lease related costs associated with the closure of the air-jet texture operation in North Carolina. All payments, excluding lease related payments which continue until May 2008, have been paid and the Company reclassified the financial results of its UK and Ireland facilities as discontinued operations for all periods prescribed in its financial statements.

On October 19, 2004, the Company announced plans to close two production lines and downsize its facility in Kinston, North Carolina, which had been acquired in September 2004. During the second quarter of fiscal year 2005, the Company recorded a severance reserve of $10.7 million for approximately 500 production level employees and a restructuring reserve of $0.4 million for the cancellation of certain warehouse leases. The entire restructuring reserve was recorded as assumed liabilities in purchase accounting; and accordingly, was not recorded as a restructuring expense in the Company s consolidated statements of operations. During the third quarter of fiscal year 2005, the Company completed the closure of both production lines as scheduled, which resulted in an actual reduction of 388 production level employees and a reduction to the initial restructuring reserve. Since no long-term assets or intangible assets were recorded in purchase accounting, the net reduction of $1.2 million was recorded as an extraordinary gain in fiscal year 2005. During the first quarter of fiscal year 2006, the Company determined that there were additional costs relating to the termination of two warehouse leases which resulted in a $0.2 million extraordinary loss. During

the second quarter of fiscal year 2006, the Company negotiated a favorable settlement on the two warehouse leases that resulted in a reduction to the reserve and the recognition of an extraordinary gain of $0.2 million.

In fiscal year 2005, the Company closed its central distribution center in Mayodan, North Carolina, and moved the operations to its warehouse and logistics facilities in Yadkinville, North Carolina, and relocated one of its plants from Mayodan to Madison, North Carolina. In connection with this initiative, the Company determined to offer for

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sale a plant, a warehouse and a central distribution center (CDC) located in Mayodan. Based on appraisals received in September 2005, the Company determined that the warehouse was impaired and recorded an impairment charge of $1.5 million, which included $0.2 million in estimated selling costs that will be paid from the proceeds of the sale when it occurs. On March 13, 2006, the Company entered into a contract to sell the CDC and related land located in Mayodan, North Carolina. The terms of the contract call for a sale price of $2.7 million, which was approximately $0.7 million below the property s carrying value. In accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, (SFAS No. 144) the Company recorded an impairment charge of approximately $0.8 million during the third quarter of fiscal year 2006 which included selling costs of $0.1 million. The sale of the CDC closed in the fourth quarter of fiscal 2006 with no further expense to the Company.

On July 28, 2005, the Company announced its decision to discontinue the operations of its external sourcing business, Unimatrix Americas, and as of the end of the third quarter fiscal year 2006, the Company had substantially liquidated the business resulting in the reclassification of the sourcing segment s losses for the current and prior periods as discontinued operations. The sourcing segment was completely liquidated as of June 25, 2006.

On April 20, 2006, the Company re-organized its domestic business operations, and as a result, recorded a restructuring charge for severance of approximately $0.8 million in the fourth quarter of fiscal 2006. Approximately 45 management level salaried employees were affected by the plan of reorganization.

The table below summarizes changes to the accrued severance and accrued restructuring accounts for fiscal years 2006, 2005 and 2004 (in thousands):

	Balance at June 26, 2005	Additional Charges	Adjustments	Amounts Used	Balance at June 25, 2006
Accrued severance	$ 5,252	$ 812	$ 44	$ (5,532)	$ 576
Accrued restructuring	5,053		(195)	(1,308)	3,550

	Balance at June 27, 2004	Additional Charges	Adjustments	Amounts Used	Balance at June 26, 2005
Accrued severance	$ 2,949	$ 10,701	$ (834)	$ (7,564)	$ 5,252
Accrued restructuring	6,654	391	(695)	(1,297)	5,053

	Balance at June 29, 2003	Additional Charges	Adjustments	Amounts Used	Balance at June 27, 2004
Accrued severance	$ 13,893	$ 7,847	$ (10)	$ (18,781)	$ 2,949
Accrued restructuring		6,739		(85)	6,654

Joint Ventures and Other Equity Investments

YUFI. In August 2005, the Company formed YUFI, a 50/50 joint venture with Sinopec Yizheng Chemical Fiber Co., Ltd., or (YCFC), to manufacture, process and market polyester filament yarn in YCFC s facilities in Yizheng, Jiangsu Province, China. YCFC is a publicly traded (listed in Shanghai and Hong Kong) enterprise with approximately $1.3 billion in annual sales. The Company believes that the addition of a high-quality, globally cost competitive operation in China allows the Company to pursue long-term, profitable revenue growth in Asia. By forming a joint venture with a long-established and highly respected fiber industry leader like YCFC, the Company also has an immediately accessible customer base in Asia at lower start-up costs and with fewer execution risks. The principal goal of YUFI is to supply premium value-added products to the Chinese market, which is currently an importer of such products. On August 4, 2005, the Company contributed to YUFI its initial capital contribution of $15.0 million in cash. On October 12, 2005, the Company transferred an additional $15.0 million in the form of shareholder loan with a thirteen month term to complete the capitalization of the joint venture. Effective July 25, 2006, the shareholder loan was converted to registered capital of the joint venture. During fiscal year 2006, the Company recognized equity losses relating to YUFI of $3.2 million which is reported net of elimination of intercompany support provided . The Company expects that YUFI will continue to incur losses for at least the next six months as it continues to transition the business from the sale of commodity products to value-added products which have a higher gross margin. In addition, the Company recognized $2.7 million in operating expenses for

fiscal year 2006, which were primarily reflected on the Cost of sales line item in the consolidated statements of operations, directly related to providing technological support in accordance with the Company s joint venture contract. The Company has granted YUFI an exclusive, non-transferable license to certain of its branded product technology (including Mynx®, Sorbtek®, Reflexx®, dye springs and other products) in China for a license fee of $6.0 million that is payable over four years.

PAL. In June 1997, the Company contributed all of the assets of its spun cotton yarn operations, utilizing open-end and air jet spinning technologies, into PAL, a joint venture with Parkdale Mills, Inc. in exchange for a 34% ownership interest in the joint venture. PAL is a producer of cotton and synthetic yarns for sale to the textile and apparel industries primarily within North America. PAL has 14 manufacturing facilities primarily located in central and western North Carolina. The Company s investment in PAL at June 25, 2006 was $140.9 million. For the fiscal years 2006, 2005, and 2004, the Company reported equity income (loss) of $3.8 million, $6.4 million, and $(6.9) million, respectively, from PAL. The Company is currently exploring ways to monetize its interest in PAL.

USTF. On September 13, 2000, the Company formed USTF a 50/50 joint venture with SANS Fibres of South Africa (SANS Fibres), to produce low-shrinkage high tenacity nylon 6.6 light denier industrial, or LDI yarns in North Carolina. The business is operated in its plant in Stoneville, North Carolina. The Company manages the day-to-day production and shipping of the LDI produced in North Carolina and SANS Fibres handles technical support and sales. Sales from this entity are primarily to customers in the Americas. For the fiscal years 2006, 2005, and 2004, the Company reported equity income (loss) of $0.8 million, $(0.1) million and $(1.3) million, respectively, from USTF. The Company has a put right under this agreement to sell its entire interest in the joint venture at fair market value and the related Stoneville, North Carolina manufacturing facility for $3.0 million (or fair market value if the sale is consummated after March 2011) in cash to SANS Fibres. This right can be exercised beginning on December 31, 2006 upon one year s prior written notice. SANS Fibres has a call option upon the same terms as the Company s put right.

UNF. On September 27, 2000, The Company formed UNF a 50/50 joint venture with Nilit, which produces nylon POY at Nilit s manufacturing facility in Migdal Ha-Emek, Israel, that is its primary source of nylon POY for its texturing and covering operations. The Company has entered into a supply agreement, on customary terms, with UNF which expires in April 2008 pursuant to which the Company has agreed to purchase from UNF all of the nylon POY produced from three dedicated production lines at a rate determined by index prices, subject to certain adjustments for market downturns. This vertical integration allows the Company to realize advantageous raw material pricing in its domestic nylon operations. The Company s investment in UNF at June 25, 2006 was $6.3 million. For the fiscal years 2006, 2005, and 2004, the Company reported income (losses) in equity investees of $(0.8) million, $0.7 million, and $1.1 million, respectively, from UNF.

Condensed balance sheet information as of June 25, 2006 and June 26, 2005, and income statement information for fiscal years 2006, 2005 and 2004, of combined unconsolidated equity affiliates were as follows (in thousands):

	June 25, 2006	June 26, 2005
Current assets	$ 149,278	$ 127,188
Noncurrent assets	217,955	176,265
Current liabilities	48,334	28,235
Noncurrent liabilities	44,460	18,840
Shareholders equity and capital accounts	274,439	256,378

	Fiscal Years Ended		
	June 25, 2006	June 26, 2005	June 27, 2004
Net sales	$ 567,223	$ 471,786	$ 469,512
Gross profit	31,853	40,312	7,880
Income (loss) from continuing operations	8,435	16,991	(15,928)
Net income (loss)	6,279	14,003	(20,183)

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UTP. Minority interest (income) expense was $0.0 million, $(0.5) million and $(6.4) million, respectively, for fiscal year 2006, 2005 and 2004. The minority interest (income) expense recorded in the consolidated statements of operations for the fiscal year 2006, 2005 and 2004 primarily relates to the minority owner s share of the earnings of UTP. The Company had an 85.4% ownership interest in UTP and Burlington Industries, LLC had a 14.6% interest in UTP. In April 2005, the Company acquired ITG s ownership interest in UTP for $0.9 million in cash.

Review of Fiscal Year 2006 Results of Operations (52 Weeks) Compared to Fiscal Year 2005 (52 Weeks)

The following table sets forth the loss from continuing operations components for each of the Company s business segments for fiscal year 2006 and fiscal year 2005. The table also sets forth each of the segments net sales as a percent to total net sales, the net income components as a percent to total net sales and the percentage increase or decrease of such components over the prior year:

	Fiscal Year 2006		Fiscal Year 2005		
		% to Total		% to Total	% Inc. (Dec.)
	(Amounts in thousands, except percentages)				
Consolidated					
Net sales					
Polyester	$ 566,367	76.7	$ 587,008	73.9	(3.5)
Nylon	172,458	23.3	206,788	26.1	(16.6)
Total	$ 738,825	100.0	$ 793,796	100.0	(6.9)

		% to Net Sales		% to Net Sales	
Cost of sales					
Polyester	$ 527,354	71.4	$ 558,498	70.4	(5.6)
Nylon	168,701	22.8	204,219	25.7	(17.4)
Total	696,055	94.2	762,717	96.1	(8.7)
Selling, general and administrative					
Polyester	32,771	4.4	30,291	3.8	8.2
Nylon	8,763	1.2	11,920	1.5	(26.5)
Total	41,534	5.6	42,211	5.3	(1.6)
Restructuring charges (recovery)					
Polyester	533	0.1	(212)		(351.4)
Nylon	(787)	(0.1)	(129)		510.1
Total	(254)	0.0	(341)		(25.5)
Write down of long-lived assets					
Polyester	51				100.0
Nylon	2,315	0.3	603	0.1	283.9

Total	2,366	0.3	603	0.1	292.4
Other (income) expenses	15,020	2.0	21,827	2.7	(31.2)
Loss from continuing operations before income taxes	(15,896)	(2.1)	(33,221)	(4.2)	(52.2)
Benefit for income taxes	(1,170)	(0.2)	(13,483)	(1.7)	(91.3)
Loss from continuing operations	(14,726)	(1.9)	(19,738)	(2.5)	(25.4)
Income (loss) from discontinued operations, net of tax	360		(22,644)	(2.9)	(101.6)
Extraordinary gain net of taxes of $0			1,157	0.1	(100.0)
Net loss	$ (14,366)	(1.9)	$ (41,225)	(5.2)	(65.2)

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For the fiscal year 2006, the Company recognized a $15.9 million loss from continuing operations before income taxes which was a $17.3 million improvement from the prior year. The improvement in continuing operations was primarily attributable to increased polyester conversion margins, decreased selling, general and administrative expenses, reduced charges of $11.9 million for bad debt expenses offset by asset impairment charges and debt extinguishment expenses. The last-in, first-out (LIFO) reserve increased $3.9 million for fiscal year 2006 compared to $2.4 million for the prior fiscal year. During fiscal year 2006 raw material prices increased for polyester ingredients in POY whereas in fiscal year 2005 the primary drivers to the LIFO reserve were increases in nylon raw material prices and higher values in the nylon inventories due to the product mix.

Consolidated net sales from continuing operations decreased from $793.8 million to $738.8 million, or 6.9%, for the current fiscal year. For the fiscal year 2006, the weighted average price per pound for the Company s products on a consolidated basis increased 6.1% compared to the prior year. Unit volume from continuing operations decreased 13.0% for the fiscal year primarily due to management s decision to focus on profitable business as well as market conditions.

At the segment level, polyester dollar net sales accounted for 76.7% in fiscal year 2006 compared to 73.9% in fiscal year 2005. Nylon accounted for 23.3% of dollar net sales for fiscal year 2006 compared to 26.1% for the prior fiscal year.

Gross profit from continuing operations increased $11.7 million to $42.8 million for fiscal year 2006. This increase is primarily attributable to higher average selling prices for both the polyester and nylon segments.

Selling, general, and administrative expenses decreased by 1.6% or $0.7 million for the fiscal year. The decrease in selling, general, and administrative expenses is due to the downsizing of the Company s corporate departments and their related costs. During the fiscal year 2005, the Company incurred approximately $1.1 million in professional fees associated with its efforts in becoming compliant with the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley). During the fiscal year 2006, the Company incurred $0.3 million in professional fees associated with Sarbanes-Oxley 404.

For the fiscal year 2006, the Company recorded a $1.3 million provision for bad debts. This compares to $13.1 million recorded in the prior fiscal year. The decrease relates to the Company s domestic operations and is primarily due to the write off of one customer who filed bankruptcy in May 2005 resulting in $8.2 million in additional bad debt expense. Although the Company experienced significant improvements in its collections during fiscal year 2006, the financial viability of certain customers continue to require close management scrutiny. Management believes that its reserve for uncollectible accounts receivable is adequate.

Interest expense decreased from $20.6 million in fiscal year 2005 to $19.2 million in fiscal year 2006. The decrease in interest expense is primarily due to the payment by the Company of a notes payable relating to the Kinston acquisition. The Company had no outstanding borrowings under its amended revolving credit facility as of June 25, 2006 or its old credit facility as of June 26, 2005. The weighted average interest rate of Company debt outstanding at June 25, 2006 and June 26, 2005 was 6.9% and 6.7%, respectively. Interest income increased from $2.1 million in fiscal year 2005 to $4.5 million in fiscal year 2006 which was due to the increased cash position that the Company maintained throughout most of fiscal year 2006.

Other (income) expense increased from $2.3 million of income in fiscal year 2005 to $3.1 million of income in fiscal year 2006. Fiscal year 2006 other income includes net gains from the sale of property and equipment of $1.8 million, offset by charges relating to currency translations and other expenses of $0.7 million. Fiscal year 2005 other income includes net gains from the sale of property and equipment of $1.8 million and net unrealized gains on hedging contracts of $1.7 million; offset by charges relating to currency translations and other expenses of $0.9 million.

Equity in the net income of its equity affiliates, PAL, USTF, UNF, and YUFI was $0.8 million in fiscal year 2006 compared to equity in net income of $6.9 million in fiscal year 2005. The decrease in earnings is primarily attributable to the $3.2 million loss that the Company incurred on its newly acquired investment in YUFI as discussed above. The Company s share of PAL s earnings decreased from a $6.4 million income in fiscal year 2005 to $3.8 million of income in fiscal year 2006. PAL realized net losses on cotton futures contracts of $1.4 million for

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fiscal year 2006 compared to $1.4 million in realized net gains for fiscal year 2005. The Company expects to continue to receive cash distributions from PAL.

The Company recorded no minority interest income for fiscal year 2006 compared to minority interest income of $0.5 million in the fiscal year 2005. Minority interest recorded in the Company s Consolidated Statements of Operations primarily relates to the minority owner s share of the earnings of UTP. The Company had an 85.4% ownership interest and ITG, had a 14.6% interest in UTP. In April 2005, the Company acquired ITG s ownership interest for $0.9 million in cash.

In fiscal year 2006, the Company s nylon segment recorded charges of $2.3 million to write down to fair value less cost to sell a nylon manufacturing plant and a nylon warehouse. In the fourth quarter of fiscal year 2005, the Company s nylon segment recorded a $0.6 million charge to write down to fair value less cost to sell 166 textile machines that are held for sale.

The Company has established a valuation allowance against its deferred tax assets relating primarily to North Carolina income tax credits. The valuation allowance decreased $1.7 million in fiscal year 2006 compared to a decrease of $2.2 million in fiscal year 2005. The gross decrease of $3.6 million in fiscal year 2006 consisted of the expiration of unused North Carolina income tax credits. The gross decrease of $3.0 million in fiscal year 2005 consisted of the expiration of unused North Carolina income tax credits of $2.2 million and the expiration of a long-term capital loss carryforward of $0.8 million. Due to lower estimates of future state taxable income, the portion of the valuation allowance that relates to North Carolina income tax credits increased $1.9 million and $0.8 million in fiscal years 2006 and 2005, respectively. The net impact of changes in the valuation allowance to the effective tax rate reconciliation for fiscal years 2006 and 2005 were 11.9% and 2.5%, respectively. The percentage increase from fiscal year 2006 to fiscal year 2005 was primarily attributable to lower forecasted state taxable income.

The Company recognized an income tax benefit in fiscal year 2006, at a 7.4% effective tax rate, compared to an income tax benefit, at a 40.6% effective tax rate, in fiscal year 2005. The fiscal year 2006 effective rate was negatively impacted by foreign losses for which no tax benefit was recognized, the change in the deferred tax valuation allowance and tax expense not previously accrued for repatriation of foreign earnings. In fiscal year 2006, the Company recognized a state income tax benefit net of federal income tax of 10.4% as compared to 4.2% in fiscal year 2005. The increase in fiscal year 2006 was primarily attributable to the pass through of $1.2 million of state income tax credits from an equity affiliate.

With respect to repatriation of foreign earnings, the American Jobs Creation Act of 2004 (the AJCA) created a temporary incentive for U.S. multinational corporations to repatriate accumulated income earned outside the U.S. by providing an 85% dividend received deduction for certain dividends from controlled foreign corporations. According to the AJCA, the amount of eligible repatriation was limited to $500 million or the amount described as permanently reinvested earnings outside the U.S. in the most recent audited financial statements filed with the SEC on or before June 30, 2003. Dividends received must be reinvested in the U.S. in certain permitted uses. The Company repatriated $31 million in fiscal year 2006 resulting from approximately $45 million of proceeds from the liquidation of its European manufacturing operations less approximately $30 million re-invested in YUFI as well as $16 million of accumulated income earned by its Brazilian manufacturing operation. The Company has not made any changes to its position on the reinvestment of other foreign earnings.

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The following summarizes the results of the above and the prior year after restatements:

	Fiscal Year 2006	Fiscal Year 2005
Loss from continuing operations before extraordinary item	$ (14,726)	$ (19,738)
Income (loss) from discontinued operations, net of tax	360	(22,644)
Loss before extraordinary item	(14,366)	(42,382)
Extraordinary gain net of taxes of $0		1,157
Net loss	$ (14,366)	$ (41,225)
Income (losses) per common share (basic and diluted):		
Loss from continuing operations before extraordinary item	$ (.28)	$ (.38)
Loss from discontinued operations, net of tax		(.43)
Extraordinary gain net of taxes of $0		.02
Net loss per common share	$ (.28)	$ (.79)

Polyester Operations

The following table sets forth the segment operating gain (loss) components for the polyester segment for fiscal year 2006 and fiscal year 2005. The table also sets forth the percent to net sales and the percentage increase or decrease over the prior year:

	Fiscal Year 2006		Fiscal Year 2005		
		% to Net Sales		% to Net Sales	% Inc. (Dec.)
	(Amounts in thousands, except percentages)				
Net sales	$ 566,367	100.0	$ 587,008	100.0	(3.5)
Cost of sales	527,354	93.1	558,498	95.1	(5.6)
Selling, general and administrative expenses	32,771	5.8	30,291	5.2	8.2
Restructuring charges (recovery)	533	0.1	(212)		(351.4)
Write down of long-lived assets	51				
Segment operating income (loss)	$ 5,658	1.0	$ (1,569)	(0.3)	(460.6)

Fiscal year 2006 polyester net sales decreased $20.6 million, or 3.5% compared to fiscal year 2005. The Company s polyester segment sales volumes decreased approximately 11.8% while the weighted-average unit prices increased approximately 8.3%.

Domestically, polyester sales volumes decreased 15.2% while average unit prices increased approximately 8.7%. Sales from the Company s Brazilian texturing operation, on a local currency basis, decreased 11.2% over fiscal year

2005 due primarily to the devaluation of the U.S. dollar against the Brazilian Real. The Brazilian texturing operation predominately purchased all of its fiber in U.S. dollars. The impact on net sales from this operation on a U.S. dollar basis as a result of the change in currency exchange rate was an increase of $17.2 million in fiscal year 2006.

Gross profit on sales for the polyester operations increased $10.5 million, or 36.8%, over fiscal year 2005, and gross margin (gross profit as a percentage of net sales) increased from 4.9% in fiscal year 2005 to 6.9% in fiscal year 2006. The increase from the prior year is primarily attributable to an increase in higher average selling prices as well as costs savings realized from the consolidation of warehousing and transportation services, and the curtailment of two POY production lines at the Kinston facility. In addition, fiber cost decreased as a percent of net sales from 54.8% in fiscal year 2005 to 52.4% in fiscal year 2006.

Selling, general and administrative expenses for the polyester segment increased $2.5 million from fiscal years 2005 to 2006. While the methodology to allocate domestic selling, general and administrative costs remained consistent between fiscal year 2005 and fiscal year 2006, the percentage of such costs allocated to each segment are determined at the beginning of every year based on specific cost drivers. The polyester segment had a higher percentage in fiscal year 2006 compared to fiscal year 2005 due to the addition of the Kinston manufacturing operations to the polyester segment.

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The polyester segment net sales, gross profit and selling, general and administrative expenses as a percentage of total consolidated amounts were 73.9%, 91.7% and 71.8% for fiscal year 2005 compared to 76.7%, 91.2% and 78.9% for fiscal year 2006, respectively.

Restructuring charges of $0.5 million in fiscal year 2006 were related to adjustments for severance, retiree reserves and charges related to the polyester segment of Unifi Latin America.

The Company s international polyester pre-tax results of operations for the polyester segment s Brazilian location increased $0.2 million in fiscal year 2006 over fiscal year 2005. This increase is primarily due to a $0.9 million increase in interest income, a $0.2 million reduction in bad debt expense, a $1.1 million increase in Other (income) expense, net offset by a $0.9 million reduction in gross margin and a $1.1 million increase in selling, general and administrative costs.

Nylon Operations

The following table sets forth the segment operating loss components for the nylon segment for fiscal year 2006 and fiscal year 2005. The table also sets forth the percent to net sales and the percentage increase or decrease over fiscal year 2005:

	Fiscal Year 2006	% to Net Sales	Fiscal Year 2005	% to Net Sales	% Inc. (Dec.)
	(Amounts in thousands, except percentages)				
Net sales	$ 172,458	100.0	$ 206,788	100.0	(16.6)
Cost of sales	168,701	97.8	204,219	98.8	(17.4)
Selling, general and administrative expenses	8,763	5.1	11,920	5.8	(26.5)
Restructuring charges (recovery)	(787)	(0.4)	(129)	(0.1)	510.1
Write down of long-lived assets	2,315	1.3	603	0.3	283.9
Segment operating loss	$ (6,534)	(3.8)	$ (9,825)	(4.8)	(33.5)

Fiscal year 2006 nylon net sales decreased $34.3 million, or 16.6% compared to fiscal year 2005. Unit volumes for fiscal year 2006 decreased 23.4% while the average selling price increased 6.9%. Weighted-average selling prices increased in fiscal year 2006 due to a greater percentage of higher priced products being sold and to sales price increases instituted during the third quarter.

Gross profit increased $1.2 million, or 46.2% in fiscal year 2006 and gross margin increased from 1.2% in fiscal year 2005 to 2.2% in fiscal year 2006. This was primarily attributable to higher per unit sales prices, cost savings associated with closing a central distribution center, and closing two nylon manufacturing facilities. Fiber costs decreased from 64.5% of net sales in fiscal year 2005 to 60.1% of net sales in fiscal year 2006 due to the incremental change in product mix driven by the Company s supply agreement with Sara Lee Branded Apparel and the continued price increases. Fixed and variable manufacturing costs increased as a percentage of sales from 30.6% in fiscal year 2005 to 35.5% in fiscal year 2006.

Selling, general and administrative expenses for the nylon segment decreased $3.1 million in fiscal year 2006. This decrease as a percentage of net sales is primarily due to a reduced allocation percentage of selling, general and administrative expenses to the nylon segment due to additional business from the polyester Kinston manufacturing operation.

The nylon segment net sales, gross profit and selling, general and administrative expenses as a percentage of total consolidated amounts were 26.1%, 8.3% and 28.2% for fiscal year 2005 compared to 23.3%, 8.8% and 21.1% for fiscal year 2006, respectively.

Restructuring recoveries of $0.8 million in fiscal year 2006 were related to adjustments for severance, retiree reserves and recoveries of 2001 reserves related to the nylon segment of Unifi Latin America.

See Corporate Restructurings above for a discussion of the Company s restructurings of its nylon facilities in North Carolina.

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Review of Fiscal Year 2005 Results of Operations (52 Weeks) Compared to Fiscal Year 2004 (52 Weeks)

The following table sets forth the loss from continuing operations components for each of the Company s business segments for fiscal year 2005 and fiscal year 2004. The table also sets forth each of the segments net sales as a percent to total net sales, the net income components as a percent to total net sales and the percentage increase or decrease of such components over the prior year:

	Fiscal Year 2005		Fiscal Year 2004		
		% to Total		% to Total	% Inc. (Dec.)
	(Amounts in thousands, except percentages)				
Consolidated					
Net sales					
Polyester	$ 587,008	73.9	$ 481,847	72.3	21.8
Nylon	206,788	26.1	184,536	27.7	12.1
Total	$ 793,796	100.0	$ 666,383	100.0	19.1
		% to Net Sales		% to Net Sales	
Cost of sales					
Polyester	$ 558,498	70.4	$ 449,121	67.4	24.4
Nylon	204,219	25.7	176,862	26.5	15.5
Total	762,717	96.1	625,983	93.9	21.8
Selling, general and administrative					
Polyester	30,291	3.8	34,835	5.2	(13.0)
Nylon	11,920	1.5	11,128	1.7	7.1
Total	42,211	5.3	45,963	6.9	(8.2)
Restructuring charges (recovery)					
Polyester	(212)		7,591	1.1	
Nylon	(129)		638	0.1	
Total	(341)		8,229	1.2	
Arbitration costs and expense					
Polyester			182		
Alliance plant closure costs (recovery)					
Polyester			(206)		
Write down of long-lived assets					
Polyester			25,241	3.8	
Nylon	603	0.1			

Total	603	0.1	25,241	3.8	(97.6)
Goodwill impairment					
Polyester			13,461	2.0	
Other (income) expenses	21,827	2.7	16,792	2.5	30.0
Loss from continuing operations before income taxes	(33,221)	(4.2)	(69,292)	(10.4)	(52.0)
Benefit for income taxes	(13,483)	(1.7)	(25,113)	(3.8)	(46.3)