# FORM 10-K405

Annual report pursuant to section 13 and 15(d), Regulation S-K Item 405

Filing Date: **1999-03-26** | Period of Report: **1998-12-31**
**SEC Accession No.** 0001047469-99-011457



## FILER

**SHELBY WILLIAMS INDUSTRIES INC**

CIK:**730564**| IRS No.: **620974443** | State of Incorp.:**DE** | Fiscal Year End: **1231**
Type: **10-K405** | Act: **34** | File No.: **001-09457** | Film No.: **99573281**
SIC: **2590** Miscellaneous furniture & fixtures

Mailing Address
*1348 MERCHANDISE MART*
*CHICAGO IL 60654*

Business Address
*11-111 MERCHANDISE MART*
*CHICAGO IL 60654*
*3125273593*

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

/X/ Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended December 31, 1998
or
/ / Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
Commission file number 1-9457

[LOGO]
SHELBY WILLIAMS INDUSTRIES, INC.

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Delaware | 62-0974443 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| 11-111 Merchandise Mart<br>Chicago, Illinois | 60654 |
| (Address of principal executive offices) | (Zip Code) |

Registrant's telephone number, including area code:
(312) 527-3593

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

| TITLE OF EACH CLASS | NAME OF EACH EXCHANGE ON WHICH REGISTERED |
|---|---|
| Common Stock, $.05 par value | New York Stock Exchange |

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes_X_ No__

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. _X_

At March 1, 1999, there were 8,761,417 shares of the registrant's common stock outstanding. As of said date the aggregate market value of the voting stock held by non-affiliates of the registrant (computed by reference to the closing sale price on such date) was approximately $77,081,150.

Documents incorporated by reference:

| DOCUMENT | PART OF FORM 10-K INTO WHICH DOCUMENT IS INCORPORATED |
|---|---|
| Registrant's annual report to stockholders for 1998............................................. | Part II, Items 5-8 |
| Registrant's definitive proxy statement to be filed for 1999 annual meeting................... | Part III, Items 10-13 |

PART I

ITEM 1. BUSINESS

The registrant, Shelby Williams Industries, Inc. ("Shelby Williams" or the

"Company"), a Delaware corporation incorporated in February, 1976, is the successor to a business formed in Chicago, Illinois in 1954. Its principal executive offices are located at 11-111 Merchandise Mart, Chicago, Illinois 60654, telephone (312) 527-3593. The Company has additional executive, operational and administrative offices at 150 Shelby Williams Drive, Morristown, Tennessee 37813, telephone (423) 586-7000.

In the third quarter of 1996, the Company sold the business and related manufacturing facility of its "Preview" line of contemporary upholstered seating products at its approximate carrying value. See "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Note to Consolidated Financial Statements captioned "Restructuring Charge."

On July 14, 1998, the Company's Board of Directors approved management's plan to discontinue the Company's distribution operation of textile and floor covering products manufactured by outside suppliers. The plan was completed in December, 1998. During the second quarter 1998, the Company recorded a loss on the disposition of these operations of approximately $9.7 million, or $7.1 million after taxes. The losses recorded on the disposition of these operations were not materially different from those incurred on the actual amounts realized in the sale and liquidation process. See "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Note to Consolidated Financial Statements captioned "Discontinued Operations."

INDUSTRY

The contract furniture industry in which Shelby Williams primarily operates serves the hospitality (including lodging, gaming, interval vacation and country club), food service, university, healthcare and other institutional markets. Approximately 82% of the Company's 1998 net sales were to the hospitality and food service markets.

Shelby Williams estimates, based upon its experience and knowledge of its markets, that demand for seating products in the hospitality and food service industries is primarily for the refurbishment of existing facilities rather than seating in new facilities. Shelby Williams estimates that food service seating (including seating for food service facilities in hotels) is replaced approximately every eight to 12 years and seating for hotel guest rooms every ten to 15 years. The hospitality, food service, and leisure industries continued to expand in 1998 providing opportunities for additional contract seating sales. Despite ongoing economic difficulties in the export markets served by the Company, the Company's position as market leader abroad leaves management confident that it will garner a significant share of export business as the international situation normalizes, although there can be no assurance in this regard.

The markets for the seating products in which Shelby Williams competes are served by a small number of relatively large, privately-held companies and divisions of publicly-held companies and a large number of relatively small, privately-held regional manufacturers. Shelby Williams believes that its size provides it with certain advantages relative to its competitors.

GENERAL

Shelby Williams is the leading designer, manufacturer and distributor of seating products used in the hospitality (including lodging, gaming, interval vacation and country club) and food service industries. The Company produces and markets under the SHELBY WILLIAMS brand name an extensive line of seating products including wood, metal and rattan chairs, barstools, sofas and sleep sofas and stacking chairs, as well as banquet-related products under the KING ARTHUR brand name including folding tables, food service carts and portable dance floors. In addition, Shelby Williams designs and manufactures seating products under the THONET brand name for the university, healthcare and other institutional markets. The Company also manufactures vinyl wallcovering products for residential, hotel and office use. The Company markets these products under the brand name SELLERS & JOSEPHSON. Shelby Williams manufactures approximately 350



standard furniture products for the hospitality and food service industries, and approximately 200 standard products for the university, healthcare and other institutional markets. The majority of these products are supplied under special order and finished and upholstered to customer specifications.

Shelby Williams estimates that, of its 1998 net sales of $165.9 million, approximately 82% were to the hospitality and food service industries and approximately 14% were to university, healthcare and other institutional markets. Representative users of the Company's products are listed under the heading "Customers and End Users." The Company's ten largest customers accounted for approximately 19% of 1998 net sales, and no single customer accounted for more than 5% of 1998 net sales.

The Company's sales and marketing staff consists of approximately 103 full-time employees, of which 68 are field sales personnel. The Company's products are marketed to hospitality and food service chains or their buying agencies and to other customers through interior designers, architects, contract furniture, food service and office furniture dealers. Shelby Williams markets its products through 13 showrooms and sales offices in the United States and approximately 40 distributors internationally. In addition, Shelby Williams publishes four extensive catalog systems displaying the Company's products. Customers may order standard products directly from these catalogs or request changes to meet their design specifications.

Shelby Williams believes that the following factors distinguish it from its competitors and have contributed to its leading position:

BREADTH OF PRODUCTS. Management believes that Shelby Williams offers the widest range of seating products in the contract furniture industry for the hospitality and food service markets. Shelby Williams believes that its ability to provide a customer with all of its seating requirements (i.e., banquet, guest room, casino, restaurant and public spaces) from a single source provides it with a competitive advantage. In addition, Shelby Williams believes that it is uniquely positioned to take advantage of the trend among large national hospitality and food service companies to consolidate supplier relationships.

CUSTOMER SERVICE. Management believes that Shelby Williams offers a superior level of customer service resulting in a high level of customer satisfaction and enhanced opportunities for repeat business. As part of its customer service program, Shelby Williams employs a dedicated sales force of 68 field sales personnel knowledgeable about Shelby Williams' products and attuned to customers' requirements. Shelby Williams believes that its sales force and the high quality of ongoing service and support it provides have enabled it to establish strong relationships with its customers.

QUALITY AND RELIABILITY. Shelby Williams' strong reputation for product quality, reliability and timely delivery has been an important factor in its success and positions the Company favorably in competing for business. Moreover, Shelby Williams' reputation for quality has enabled the Company to lead the industry in setting standards for safety, quality and durability. Management believes that its SHELBY WILLIAMS, THONET and KING ARTHUR brands are leading tradenames in their respective markets.

DESIGN AND MANUFACTURING CAPABILITIES. Shelby Williams distinguishes itself from other industry participants based on its manufacturing flexibility and its ability to customize orders to customer specifications. Approximately 90% of the Company's products are catalog items, finished and upholstered to customer specifications. In addition, Shelby Williams often works with designers and architects to design new products and customize standard products on behalf of end users.

PRODUCTS

Shelby Williams' product lines consist primarily of: (i) seating for dining, gaming, guest room, conference and banquet facilities, (ii) healthcare and university seating, and (iii) seating for other institutional use. To complement its major product lines, Shelby Williams also manufactures and distributes banquet folding tables, portable dance floors and platforms, food service carts and other function room furniture, as well as a full range of vinyl wallcoverings. Shelby Williams' products are primarily sold: (i) directly to hospitality and food service providers, gaming establishments, universities and other institutions, (ii) to interior designers, architects and



other buying agencies that in turn sell the products to the end users, and (iii) to rental companies that store Company products and rent them to their customers.

Approximately 350 standard furniture products are marketed to the hospitality and food service industries; approximately 200 standard furniture products are marketed for healthcare, university and other institutional use; and approximately 25 standard furniture products are marketed for office use. In addition to offering a standard line of products, Shelby Williams focuses on the specific requirements of its customers and end users and has considerable customization capabilities. Substantially all products are supplied under special order and are finished and upholstered to customers' specifications. Shelby Williams' products are marketed through an extensive catalog system, through which customers may order standard Company products or devise custom designs to suit their specific needs.

Shelby Williams' products are manufactured in hardwoods, such as maple, elm and beech, as well as in rattan and metal, and are available in a wide variety of finishes. Products are made of solid wood or a combination of woods, and many are constructed with bentwood components, which provides extended durability. All wooden products are finished on a conveyorized line which incorporates forced drying cycles. The sealer coat and final conversion varnish coats are applied by means of a state-of-the-art electrostatic finishing system which insures uniform application resulting in a durable chip-resistant finish. Chairs may be covered with fabric upholstery or vinyl, pursuant to customer design and specification. Metal products are also produced in a wide variety of styles and finishes.

In addition to its seating products, Shelby Williams produces and distributes certain function-room furniture items, such as banquet and conference tables, stages and food service equipment. Shelby Williams also designs, produces and distributes furniture utilized by private healthcare practitioners, such as reclining chairs, as well as standard dormitory furniture utilized by universities.

Management believes that it provides one of the widest ranges of seating products in the contract furniture industry, as well as superior custom-design capabilities. Due to its component-manufacturing facility in Zacatecas, Mexico, its 200,000 square foot storage warehouse in Morristown, Tennessee, and its considerable in-house production capabilities, the Company believes it is able to provide a shorter lead time on orders than many of its competitors, most of whom import components from European sources. Shelby Williams believes that all of these qualities are instrumental in attracting the large orders of hotels, restaurants and casinos that seek the convenience and pricing of a single-source provider.

MARKETING

The Company's marketing strategy is based upon a higher degree of direct sales relative to its competitors which tend to conduct sales through factory representatives and with minimal sales forces. The Company's sales and marketing staff consists of approximately 103 full-time employees, approximately 68 of which are exclusively involved in field sales. This dedicated sales force is an integral component of the Company's customer service and support strategy. Management believes the high quality of ongoing service and support provided by the sales force results in strong customer relationships and enhanced opportunities for repeat business. Each of the Company's sales persons sells products and services customers within an assigned territory. The Company's sales persons promote customer satisfaction with periodic service calls in addition to scheduled follow-up visits. Sales persons receive a base salary, plus commissions based on net sales. All orders are subject to acceptance by the Company's management.

Shelby Williams markets its products to a wide variety of customers including: (i) hospitality and food service chains or their buying agencies and (ii) other users through interior designers, architects, contract furniture, food service and furniture dealers. Shelby Williams markets its products through advertising in major trade publications and illustrating the Company's products in its catalogs. Shelby Williams publishes four extensive catalogs displaying its products and distributes catalogs to architects, designers and dealers. Catalogs are periodically supplemented as new products are introduced. Customers may order standard products directly from these catalogs or request changes to meet their design specifications.

DISTRIBUTION

Shelby Williams distributes its products both domestically and internationally. Shelby Williams has showrooms and sales offices in 13 cities in the United States, as well as distributors in 33 foreign countries. Many of these distributors are concentrated in Europe and Asia. In addition, Shelby Williams utilizes its local facilities and existing distribution channels to assemble and distribute products in the United States imported from European sources. Shelby Williams also exhibits at major national and international trade shows.

CUSTOMERS AND END USERS

Some of the Company's major hospitality and food service customers and end users:

HOTELS
Bass Hotels & Resorts
Boykin Lodging Co.
Bristol Hotel Co.
Ciga Hotels
Davidson Hotels
Doubletree Hotel Corp.
Extended Stay America
Four Seasons Hotel, Inc.
John Q. Hammons Hotel, Inc.
Hilton Hotel Corp.
Hyatt Hotel Co.
Intercontinental Hotels
Interstate Hotel Corp.
La Quinta Inns, Inc.
Loews Hotel Corp.
Marcus Corp. (Budgetel Inns)
Marriott Hotel Corp.
MeriStar Hotels
Prime Hospitality Corp.
Promus Hotel Corp. (Embassy Suites, Hampton Inns Homewood Suites)
Renaissance Hotel Corp.
The Ritz Carlton Hotel Co.
The Sheraton Corp.
Starwood Lodging Corp.
Westin Hotels
Wyndham Hotels

RESTAURANTS
Applebees Restaurants
Au Bon Pain Restaurants
Brinker International Inc. (The Corner Bakery, Macaroni Grill, Maggiano's)
Champs Restaurants
Club Corporation of America
Copper Cellar Corp.
Darden Restaurants Inc. (The Olive
Garden and Red Lobster Restaurants)
The Hard Rock Cafe
LaMadeleine
Luby's Cafeteria Inc.
Morton's of Chicago Restaurant
Nick's Fishmarkets
Palomino
Pizza Hut Inc.
Planet Hollywood Int'l Inc.
Sirloin Stockade
Starbucks Coffee Company
Sullivan Steak Houses
T.G.I. Friday's
Veladi Ranch Steakhouses
Wendy's International Inc.

GAMING
Boyd Gaming Corp.
(Stardust Resort & Casino)
Bally's Casino Resort
Bellagio Hotel & Casino
Carnival Hotel & Casino

Caesars Palace
Circus Circus Enterprises, Inc.
Cow Creek Indian Gaming Center
Churchill Downs Race Track
The Desert Inn
Delaware Park Race Track & Casino
Grand Casino
Harrah's Entertainment Inc.
Menominee Tribal Gaming
MGM Grand Hotel & Casino
The Mirage Resorts
Muckleshoot Tribal Gaming
Rio Suite Hotel & Resort
Sheraton Casino
Showboat Marina Casino
Soaring Eagle Indian Casino
Sun International Hotels

INTERVAL VACATION (TIME SHARE)
Embassy Vacation Resort Properties, Inc.
Fairfield Communities, Inc.
Hilton Grand Vacations
Hyatt Vacation Club
Marriott Vacation Club Int'l.
Nevada Resort Properties
Orange Lake Resort & Club
The Shell Group
Signature Resorts Inc.
Trendwest Resorts, Inc.
Vacation Break USA, Inc.
Vistana Resorts

Some of the Company's major healthcare and university, wallcovering and other customers and end users:

HEALTHCARE AND UNIVERSITIES
Albert Einstein Medical Center
Assisted Living Concepts
Carson Newman College
Columbia/HCA Hospitals
Eby Development Company
Geisinger Medical Center
Georgia Institute of Technology
Health Systems of Tennessee, L.L.C.
Kaiser Foundation Hospitals
Michigan State University
Purdue University
Roosevelt University
Rutgers University
Sterling House
The University of Chicago Hospitals
University of Michigan
University of Tennessee
WALLCOVERING
Duron Paints
Patton Wallcoverings, Inc.
Seabrook Wallcoverings Co. Inc.
Thybony Wallcoverings Co. Inc.
The Warner Company
OTHER
Allstate Insurance Co.
AFNAF (Air Force Non- Appropriated Funds)
Clinique Cosmetics Departments
The Eckerd Corporation
The General Services Administration
May Department Stores
J.C. Penney Company
Profitt's Department Stores
Sears, Roebuck & Co.
The Walgreen Co.

The Company's past business relationship with the above customers and end users is not intended to imply that such relationship will continue in the future.



In 1998, the Company also sold products to over 350 country clubs in 34 states.

The Company's ten largest customers accounted for approximately 19% of net sales in 1998, and no single customer accounted for more than 5% of 1998 net sales. Approximately 90% of the Company's products are manufactured to fill specific orders.

TRADEMARKS AND TRADENAMES

The Company sells its hospitality and food service products under the trademarks Shelby Williams-Registered Trademark-, King Arthur-Registered Trademark- and Sterno-Registered Trademark- and its healthcare, dormitory and other institutional furniture under the trademark Thonet-Registered Trademark-. The Company markets cutting room tables and accessories under the Phillocraft-Registered Trademark- name, and wallcoverings under the Sellers & Josephson-Registered Trademark- name.

BACKLOG

The Company's backlog of orders at December 31, 1998, was $34.2 million, a year-end record level, as compared to $31.8 million at December 31, 1997. The Company expects to ship substantially all of its backlog by the end of 1999.

RAW MATERIALS AND SUPPLIES

The Company manufactures most of its products to customer order from basic raw materials. The Company utilizes a wide variety of raw materials in the manufacture of its products including lumber, plywood, rattan, metal tubing, and other frame components, foam cushioning, vinyl and textiles, all of which the Company believes to be in abundant supply and available from a variety of different sources. The Company has no long-term supply contracts with any of its suppliers and it has experienced no significant problems in obtaining raw materials in adequate amounts for its operations.

MANUFACTURING AND ASSEMBLY

The following table summarizes the products manufactured and assembled at each of the Company's manufacturing facilities (as of January 1, 1999):

<TABLE>
<CAPTION>

| LOCATION | PRODUCTS |
|---|---|
| Morristown, TN..................................... | Hospitality, food service and gaming seating, banquet seating (1) |
| Statesville, NC.................................... | Healthcare and university seating; banquet seating and products |
| Canton, MS......................................... | Upholstered products |
| Zacatecas, MX...................................... | Furniture components |
| Englewood, NJ...................................... | Wallcoverings |
| Carlstadt, NJ...................................... | Wallcoverings |

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(1) Product information is summarized for two manufacturing facilities located in Morristown, Tennessee.

Shelby Williams operations primarily consist of wood bending, wood working and finishing, assembly, metal forming and fabrication, electrostatic wood and metal finishing. Shelby Williams also prints and laminates vinyl wallcoverings. For certain chair styles, Shelby Williams purchases components manufactured by other companies. These components, which are manufactured to the Company's specifications, are assembled, finished and upholstered by Shelby Williams. All outsourced components are available domestically except for rattan, which is indigenous to the Philippines and Indonesia. For many of its standard product offerings, Shelby Williams optimizes its production costs by sourcing the components produced at its Zacatecas, Mexico, facility.

All manufacturing operations emphasize quality control during the various production processes. To provide consistency and speed to the finishing process, the Company utilizes conveyorized paint lines with spray booths and drying ovens positioned to allow proper drying times between finishing steps. In addition,



Shelby Williams has electrostatic wood-finishing systems which provide superior finishing qualities and are advantageous from an environmental standpoint. The Company has recently invested in powder-coating lines which provide similar advantages for the metal products. Management expects to continue to invest in automated machinery and equipment. The Company also plans to add a state-of-the-art aluminum production facility and a new wood-finishing system.

COMPETITION

All aspects of the Company's business are highly competitive. The Company competes at some level with Falcon Products, Inc., Gasser Chair Co., L & B Contract Industries, Inc., WinsLoew Furniture Inc., Virco Manufacturing Corporation and MTS Seating. The Company competes primarily on the basis of design, quality, service, product pricing and speed of delivery.

The Company believes that none of its principal competitors offers the complete range of seating products that the Company offers. There can be no assurance that the Company's principal competitors will not offer a greater range of seating products or that new entrants will not enter the market.

EMPLOYEES

As of December 31, 1998, the Company had 1,720 full-time employees. Of these, 1,513 were engaged in manufacturing, 104 in administrative and clerical positions, and 103 in sales and marketing. Those engaged in manufacturing included 251 employees in Mexico.

Hourly manufacturing employees at both Morristown, Tennessee, and Canton, Mississippi, are represented by separate bargaining agreements with contracts expiring in November 1999 (covering approximately 600 employees) and November 2000 (covering approximately 200 employees), respectively. The Company believes that its relations with its employees are good.

ITEM 2: PROPERTIES

At January 1, 1999, the Company maintained facilities with an aggregate of approximately 1,800,000 square feet of space for its operations. The Company considers all of its facilities to be in good operating condition. Currently, the Company's manufacturing facilities are operating at approximately 87% of capacity, with wood products facilities operating at over 90% of capacity. The following table summarizes the principal physical properties, both owned and leased, used by the Company in its operations:

<TABLE>
<CAPTION>

| LOCATION | USE | APPROXIMATE SQUARE FOOTAGE | OWNED/LEASED | EXPIRATION DATE |
|---|---|---|---|---|
| <S> | <C> | <C> | <C> | <C> |
| Chicago, IL....................... | Showroom/Offices | 6,750 | Leased | July, 2000 |
| Morristown, TN.................... | Mfg./Offices | 515,960 | Owned | -- |
| Morristown, TN.................... | Mfg./Warehousing | 228,000 | Owned | -- |
| Canton, MS........................ | Mfg./Warehousing | 406,000 | Owned/Leased(1) | May, 2005(1) |
| Statesville, NC................... | Mfg./Warehousing | 326,670 | Owned | -- |
| Zacatecas, MX..................... | Mfg./Warehousing | 90,000 | Owned | -- |
| Englewood, NJ..................... | Mfg./Warehousing | 68,000 | Leased | Dec., 2003(2) |
| Carlstadt, NJ..................... | Mfg./Warehousing | 35,000 | Leased | April, 2004 |

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(1) Approximately 238,100 square feet are owned and 167,900 are leased.

(2) The Company has an option to renew the lease for 10 additional years at a nominal rental increase.

The Company has showrooms and sales offices in 13 United States cities, including Atlanta, Chicago, Dallas, Los Angeles, New York and Plantation, Florida.



ITEM 3. LEGAL PROCEEDINGS

The Company is a defendant in various product liability lawsuits arising in the normal course of business. Management believes that the Company's insurance is adequate to cover its potential liability under all pending and threatened litigation. The Company believes, after consultation with counsel, that allegations of punitive damages, which are alleged in certain cases, are without merit.

In February, 1997, the Company's King Arthur division received a complaint, addressed to King Arthur, Inc., in a case pending in the Superior Court of New Jersey, Camden County, Law Division, entitled Pennsauken Solid Waste Management Authority, et al., vs. Ward Sand & Material Co., Inc. and a large number of other defendants. The complaint, which identifies King Arthur, Inc. as one of the defendants, alleges, among other things, that during the operation of a landfill from the 1960's to 1984, the defendants improperly generated, transported and/or disposed of certain hazardous waste materials, and that defendants are jointly and severally liable to plaintiffs for all costs and damages incurred by plaintiffs for remediation of the landfill and any surrounding areas which are found to be contaminated. The complaint does not specify any dollar amount of damages. The Company acquired certain assets of King Arthur, Inc. in 1986. The Company believes, based on its present knowledge, that it has valid defenses to the allegations in the complaint, and that the Company's liability, if any, is not material. The Company has put its insurers on notice of the complaint.

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

None.

ITEM 4A. EXECUTIVE OFFICERS OF THE REGISTRANT.

<TABLE>
<CAPTION>

| NAME | AGE AT 2-1-99 | PRINCIPAL OCCUPATION DURING PAST FIVE YEARS AND POSITION AND OFFICE WITH REGISTRANT |
|---|---|---|
| <S> | <C> | <C> |
| Paul N. Steinfeld............................ | 44 | Chairman of the Board of Directors and Chief Executive Officer since January, 1996; Vice Chairman of the Board and Chief Executive Officer from May, 1991 to January, 1996; Vice Chairman of the Board and Chief Administrative Officer prior to May, 1991. Director during past five years. |
| Robert P. Coulter............................ | 56 | President and Chief Operating Officer since May, 1990; prior thereto President and Treasurer. Director during past five years. |
| Manfred Steinfeld............................ | 74 | Chairman of Executive Committee and chairman of executive compensation committee since January, 1996; Chairman of the Board and chairman of executive compensation committee from May, 1991 to January, 1996; prior thereto Chairman of the Board and Chief Executive Officer. Director during past five years. |
| Peter W. Barile.............................. | 56 | Executive Vice President since May, 1990. |
| Sam Ferrell.................................. | 57 | Vice President, Finance, Treasurer and Chief Financial Officer and Assistant Secretary since May, 1990. |

</TABLE>

The executive officers of the registrant are elected annually by the Board of Directors, hold office until their successors are chosen and qualify, and may be removed at any time by the affirmative vote of a majority of the Board. There are no written employment agreements with any executive officers. Manfred Steinfeld is the



father of Paul N. Steinfeld; there is no other family relationship between any director or executive officer of the Company.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

The information under the heading "Common Stock Information (Unaudited)" on page 20 of the Company's 1998 Annual Report to Stockholders is hereby incorporated by reference.

ITEM 6. SELECTED FINANCIAL DATA.

The information under the heading "Five Year Summary of Selected Financial Data" on page 15 of the Company's 1998 Annual Report to Stockholders is hereby incorporated by reference.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The information under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations" on pages 24-25 of the Company's 1998 Annual Report to Stockholders is hereby incorporated by reference.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Not applicable.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

The information contained on pages 16 (Consolidated Statements of Income), 17 (Consolidated Balance Sheets), 18 (Consolidated Statements of Cash Flows), 19 (Consolidated Statements of Stockholders' Equity), 20-23 (Notes to Consolidated Financial Statements) and 24 (Report of Independent Auditors) of the Company's 1998 Annual Report to Stockholders is hereby incorporated by reference.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

Not applicable.

PART III

The information called for by Part III (Item 10 (Directors and Executive Officers of the Registrant), Item 11 (Executive Compensation), Item 12 (Security Ownership of Certain Beneficial Owners and Management), and Item 13 (Certain Relationships and Related Transactions)) is incorporated by reference, to the extent required, from the Company's definitive proxy statement to be filed pursuant to Regulation 14A not later than 120 days after December 31, 1998.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a) List of financial statements and schedules.

(1) Financial statements. The following financial statements are incorporated by reference in Part II, Item 8 of this report:

Consolidated Statements of Income for the years ended December 31, 1998, 1997, and 1996

Consolidated Balance Sheets at December 31, 1998 and 1997

Consolidated Statements of Cash Flows for the years ended December 31, 1998, 1997 and 1996



Consolidated Statements of Stockholders' Equity for the years ended December 31, 1998, 1997 and 1996

Notes to Consolidated Financial Statements

Report of Independent Auditors

(2) Financial statement schedules:

None since the required information is not present or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the consolidated financial statements or notes thereto.

(b) Report on Form 8-K for an event dated December 14, 1998, reporting disposition of certain assets constituting the Company's "Pacific Home Furnishings" division.

(c) List of exhibits: See Exhibit Index immediately preceding exhibits



[LOGO]
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Corporate Offices
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Executive and Administrative Offices
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PHONE: (423) 586-7000
FAX: (423) 586-2260

SHELBY WILLIAMS IS THE LEADING MANUFACTURER OF SEATING PRODUCTS FOR THE HOSPITALITY AND FOOD SERVICE MARKETS.

THE COMPANY IS A MAJOR PROVIDER OF SEATING PRODUCTS FOR UNIVERSITY, HEALTHCARE AND OTHER INSTITUTIONAL FACILITIES.

SHELBY WILLIAMS ALSO MANUFACTURES AND DISTRIBUTES WALLCOVERINGS.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: March 23, 1999

SHELBY WILLIAMS INDUSTRIES, INC.

--------------------------------------

(Registrant)

By PAUL N. STEINFELD

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Paul N. Steinfeld
Chairman of the Board

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| NAME | TITLE | DATE |
|---|---|---|
| PAUL N. STEINFELD<br>(Paul N. Steinfeld) | Chairman of the Board and Director (Principal Executive Officer) | March 23, 1999 |
| ROBERT P. COULTER*<br>(Robert P. Coulter) | President and Director | March 23, 1999 |
| MANFRED STEINFELD*<br>(Manfred Steinfeld) | Chairman of the Executive Committee and Director | March 23, 1999 |
| SAM FERRELL*<br>(Sam Ferrell) | Vice President of Finance, Treasurer and Assistant Secretary (Principal Financial and Accounting Officer) | March 23, 1999 |
| WILLIAM B. KAPLAN*<br>(William B. Kaplan) | Director | March 23, 1999 |
| ROBERT E. LOWE*<br>(Robert E. Lowe) | Director | March 23, 1999 |
| DOUGLAS A. PARKER*<br>(Douglas A. Parker) | Director | March 23, 1999 |
| TRISHA WILSON*<br>(Trisha Wilson) | Director | March 23, 1999 |

*By PAUL N. STEINFELD

Paul N. Steinfeld, Attorney-in-fact



EXHIBIT INDEX

| EXHIBIT NO. | DESCRIPTION |
|---|---|
| 2.1 | Asset Purchase Agreement dated September 16, 1996 between Preview Furniture Corporation, the Registrant and Ferguson Copeland, LLC, filed as Exhibit 2.1 to Registrant's annual report on Form 10-K for 1996 and hereby incorporated by reference. |
| 2.2 | Asset Purchase Agreement dated December 2, 1998 by and between the Registrant and PHF Hawaii, Incorporated, filed as Exhibit 10.1 to Registrant's report on Form 8-K filed December 22, 1998, and hereby incorporated by reference. |
| 3(i) | Registrant's Certificate of Incorporation and all amendments thereto, filed as Exhibit 3.1 to Registrant's annual report on Form 10-K for 1987 and hereby incorporated by reference. |
| 3(ii) | Registrant's By-Laws, as amended, filed as Exhibit 3(ii) to Registrant's annual report on Form 10-K for 1995 and hereby incorporated by reference. |
| 4.0 | The Registrant agrees to furnish a copy of the capital lease referred to in the Registrant's Consolidated Financial Statements to the Commission upon request. |

| | |
|---|---|
| 4.1 | The Registrant agrees to furnish a copy of the 7.8% note agreement dated July 31, 1992 and payable in quarterly installments of $1,000,000 beginning in October 1997, for $8,000,000, to the Commission upon request. |
| *10.1 | 1997 Senior Management Incentive Plan, filed as Exhibit 10.3 to Registrant's annual report on Form 10-K for 1996 and hereby incorporated by reference. |
| *10.2 | 1998 Senior Management Incentive Plan, filed as Exhibit 10.3 to Registrant's annual report on Form 10-K for 1997 and hereby incorporated by reference. |
| *10.3 | 1999 Senior Management Incentive Plan. |
| *10.4 | Registrant's 1992 Key Employees' Incentive Stock Option Plan, filed as Exhibit 10.6 to Registrant's annual report on Form 10-K for 1991 and hereby incorporated by reference. |
| *10.5 | Registrant's 1995 Directors' Stock Option Plan, filed as Exhibit 10.1 to Registrant's Form 10-Q for quarter ended March 31, 1995 and hereby incorporated by reference. |
| 10.6 | Underwriting agreement dated March 26, 1997, filed as Exhibit 1 to Amendment No. 4 to Schedule 13D of Manfred Steinfeld filed April 8, 1997 and hereby incorporated by reference. |
| 13.1 | Portions of Registrant's annual report to stockholders for 1998. |
| 21.1 | Subsidiaries of the Registrant, filed as Exhibit 21.1 to Registrant's annual report on Form 10-K for 1996 and hereby incorporated by reference. |
| 23.1 | Consent of independent auditors to incorporation by reference in Form 10-K. |
| 23.2 | Consent of independent auditors to incorporation by reference in Form S-8. |
| 24.1 | Power of Attorney. |
| 27.1 | Financial Data Schedule (EDGAR only). |

</TABLE>

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* Compensation plan.

EXHIBIT 10.3

1999

SENIOR MANAGEMENT INCENTIVE PLAN

For Fiscal 1999, incentive will be determined by Corporate Earnings per Share as follows:

| EARNING PER SHARE | BONUS AWARD AS A PERCENT OF BASE SALARY |
|---|---|
| $ 1.22-1.25 | 30 |
| 1.26-1.33 | 40 |
| 1.34+ | 50 |

If unusual major factors significantly change Fiscal 1999 Earnings, decisions regarding any adjustments will be made by the Compensation Committee of the Board of Directors.

The Company's 1999 Senior Management Incentive Plan shall be governed by the following rules:

A. The incentive compensation for the 1999 fiscal year computed as provided for in the Plan, shall be divided into two (2) equal installments, one payable on the first day of February 2000, and the other on the first day of February 2001 (the "Payment Dates").

B. A participant shall become entitled to the installment payable on each Payment Date, on that date, if and only if, he then continues to be in the employ of the company, or if not, that the termination of his employment by the Company was caused by death, complete disability, retirement after age sixty (60) or discharged by the Company without cause.

C. Should any installment be payable to a Participant who is not entitled thereto on any Payment Date as provided for above, such installment shall not revert to the Company but shall be reallocated and paid to the other Participants proportionate to the amounts to which they are otherwise entitled to receive under the plan.

D. All determinations arising under the Plan shall be determined by the Compensation Committee of the Board of Directors of the Company, whose decision thereon shall be final, conclusive and binding.

E. Employees participating in a commission override program will participate at the rate of one half of the amount of scheduled amount called for.

F. Any senior management employees participating in any other division/local incentive plans, shall not participate in the foregoing plan.

FIVE YEAR SUMMARY OF SELECTED FINANCIAL DATA
SHELBY WILLIAMS INDUSTRIES, INC.

<TABLE>
<CAPTION>

| | December 31 and year then ended (In thousands except for per share amounts) | | | | |
|---|---|---|---|---|---|
| | 1998 | 1997 | 1996 | 1995 | 1994 |
| <S> | <C> | <C> | <C> | <C> | <C> |
| OPERATING RESULTS | | | | | |
| Net sales | $ 165,937 | $ 157,779 | $ 149,481 | $ 144,525 | $ 135,011 |
| Cost of goods sold | 126,388 | 120,849 | 114,998 | 112,412 | 107,635 |
| Restructuring charge | -- | -- | -- | -- | 5,575 |
| Selling, general and administrative expenses | 22,994 | 22,268 | 22,100 | 22,301 | 21,683 |
| Interest expense | 391 | 622 | 969 | 1,257 | 1,207 |
| Interest income | (539) | (614) | (18) | (9) | -- |
| Miscellaneous expense (income) | (102) | (89) | (44) | 37 | 106 |
| Income (loss) from continuing operations before income taxes | 16,805 | 14,743 | 11,476 | 8,527 | (1,195) |
| Income taxes | 6,191 | 5,066 | 3,720 | 2,330 | (575) |
| Income (loss) from continuing operations | 10,614 | 9,677 | 7,756 | 6,197 | (620) |
| PER SHARE DATA | | | | | |
| Net sales per share | $ 18.28 | $ 17.15 | $ 16.98 | $ 16.14 | $ 14.92 |
| Income (loss) per share from continuing operations-basic and diluted | 1.17 | 1.05 | 0.88 | 0.69 | (0.07) |
| Cash dividends per share | 0.36 | 0.32 | 0.30 | 0.28 | 0.28 |
| Equity per share | 7.31 | 7.68 | 6.38 | 5.81 | 5.41 |
| Weighted average number of common shares outstanding | 9,078 | 9,198 | 8,805 | 8,955 | 9,049 |
| Weighted average number of common shares outstanding-assuming dilution | 9,108 | 9,250 | 8,838 | 8,981 | 9,070 |
| CHANGES IN FINANCIAL POSITION | | | | | |
| Cash provided by operating activities | $ 12,136 | $ 10,088 | $ 8,069 | $ 9,199 | $ 4,953 |
| Capital expenditures | 3,919 | 3,557 | 1,189 | 2,250 | 2,183 |
| Depreciation and amortization | 2,478 | 2,298 | 2,457 | 2,629 | 2,511 |
| Cash dividends | 3,293 | 2,944 | 2,643 | 2,511 | 2,533 |
| FINANCIAL POSITION | | | | | |
| Stockholders' equity | $ 64,695 | $ 71,772 | $ 55,970 | $ 51,724 | $ 48,658 |
| Long-term debt (including current portion) | 3,000 | 7,000 | 8,000 | 8,895 | 8,944 |
| Total assets | 89,633 | 97,238 | 83,213 | 87,613 | 86,306 |
| Working capital | 39,164 | 48,494 | 37,606 | 32,016 | 28,092 |
| Current assets | 62,111 | 68,929 | 55,712 | 56,962 | 54,865 |
| Net investment in plant and equipment | 25,985 | 24,611 | 23,476 | 26,547 | 26,989 |
| FINANCIAL RATIOS | | | | | |
| Continuing operations: | | | | | |
| Gross margin as percent of sales | 23.8% | 23.4% | 23.1% | 22.2% | 20.3% |
| Pre-tax return on net sales | 10.1% | 9.3% | 7.7% | 5.9% | -- |
| Effective income tax rate | 36.8% | 34.4% | 32.4% | 27.3% | -- |

| | | | | | |
|---|---|---|---|---|---|
| After-tax return on net sales | 6.4% | 6.1% | 5.2% | 4.3% | -- |
| Dividend payout ratio | 31% | 30% | 34% | 41% | -- |
| Current ratio | 2.7 | 3.4 | 3.1 | 2.3 | 2.1 |
| Debt as percent of total invested capital | 4% | 9% | 13% | 15% | 16% |
| Current assets as percent of total assets | 69% | 71% | 67% | 65% | 64% |
| PRODUCTIVITY STATISTICS | | | | | |
| Average inventory turnover | 6.3X | 6.4X | 5.6X | 5.3X | 5.0X |
| Average receivable turnover | 6.1X | 6.4X | 6.5X | 6.5X | 6.2X |

</TABLE>

CONSOLIDATED STATEMENTS OF INCOME

<TABLE>
<CAPTION>

| Years Ended December 31, 1998, 1997 and 1996 | 1998 | 1997 | 1996 |
|---|---|---|---|
| <S> | <C> | <C> | <C> |
| NET SALES | $ 165,937,000 | $ 157,779,000 | $ 149,481,000 |
| Cost of goods sold | 126,388,000 | 120,849,000 | 114,998,000 |
| Selling, general and administrative expenses | 22,994,000 | 22,268,000 | 22,100,000 |
| | 16,555,000 | 14,662,000 | 12,383,000 |
| OTHER DEDUCTIONS (INCOME): | | | |
| Interest expense | 391,000 | 622,000 | 969,000 |
| Interest income | (539,000) | (614,000) | (18,000) |
| Miscellaneous income | (102,000) | (89,000) | (44,000) |
| | (250,000) | (81,000) | 907,000 |
| INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES | 16,805,000 | 14,743,000 | 11,476,000 |
| INCOME TAXES: | | | |
| Current | 7,626,000 | 4,926,000 | 3,247,000 |
| Deferred | (1,435,000) | 140,000 | 473,000 |
| | 6,191,000 | 5,066,000 | 3,720,000 |
| Income from continuing operations | 10,614,000 | 9,677,000 | 7,756,000 |
| DISCONTINUED OPERATIONS: | | | |
| Income (loss) from discontinued operations, net of taxes | (48,000) | 915,000 | 661,000 |
| Loss on disposal of discontinued operations, net of taxes | (7,081,000) | | |
| NET INCOME | $ 3,485,000 | $ 10,592,000 | $ 8,417,000 |
| INCOME PER SHARE: | | | |
| Continuing operations | $ 1.17 | $ 1.05 | $ 0.88 |
| Income (loss) from discontinued operations, net of taxes | (0.01) | 0.10 | 0.08 |
| Loss on disposal of discontinued operations, net of taxes | (0.78) | -- | -- |
| Net income | $ 0.38 | $ 1.15 | $ 0.96 |
| INCOME PER SHARE-ASSUMING DILUTION: | | | |
| Continuing operations | $ 1.17 | $ 1.05 | $ 0.88 |
| Income (loss) from discontinued operations, net of taxes | (0.01) | 0.10 | 0.07 |
| Loss on disposal of discontinued operations, net of taxes | (0.78) | -- | -- |

| | | | |
|---|---|---|---|
| Net income | $ 0.38 | $ 1.15 | $ 0.95 |
| Weighted average number of common shares outstanding | 9,078,000 | 9,198,000 | 8,805,000 |
| Weighted average number of common shares outstanding-assuming dilution | 9,108,000 | 9,250,000 | 8,838,000 |

</TABLE>

See accompanying notes.

CONSOLIDATED BALANCE SHEETS
SHELBY WILLIAMS INDUSTRIES, INC.

<TABLE>
<CAPTION>

| December 31, 1998 and 1997 <S> | 1998 <C> | 1997 <C> |
|---|---|---|
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | $ 6,355,000 | $11,124,000 |
| Accounts receivable, less allowance for doubtful accounts of $375,000 in 1998 and $325,000 in 1997 | 28,025,000 | 26,165,000 |
| Inventories: | | |
| Raw materials | 11,818,000 | 8,147,000 |
| Work in process | 5,492,000 | 4,978,000 |
| Finished goods | 5,234,000 | 4,643,000 |
| | 22,544,000 | 17,768,000 |
| Prepaid expenses | 5,187,000 | 5,015,000 |
| Net assets of discontinued operations | -- | 8,857,000 |
| TOTAL CURRENT ASSETS | 62,111, 000 | 68,929,000 |
| NET ASSETS OF DISCONTINUED OPERATIONS | -- | 2,335,000 |
| EXCESS OF COST OVER NET ASSETS OF ACQUIRED COMPANIES | 151,000 | 160,000 |
| PROPERTY, PLANT AND EQUIPMENT, AT COST: | | |
| Land and land improvements | 2,560,000 | 2,392,000 |
| Buildings and leasehold improvements | 20,974,000 | 20,176,000 |
| Machinery and equipment | 26,746,000 | 22,720,000 |
| Construction in progress | -- | 1,690,000 |
| | 50,280,000 | 46,978,000 |
| Less accumulated depreciation and amortization | 24,295,000 | 22,367,000 |
| | 25,985,000 | 24,611,000 |
| OTHER ASSETS | 1,386,000 | 1,203,000 |
| | $89,633,000 | $97,238,000 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Accounts payable | $ 7,063,000 | $ 4,730,000 |
| Customer deposits on orders in process | 5,717,000 | 4,225,000 |
| Accrued liabilities | 6,278,000 | 5,629,000 |
| Income taxes | 889,000 | 1,851,000 |
| Current portion of long-term debt | 3,000,000 | 4,000,000 |
| TOTAL CURRENT LIABILITIES | 22,947,000 | 20,435,000 |

| | | |
|---|---|---|
| LONG-TERM DEBT | -- | 3,000,000 |
| DEFERRED INCOME TAXES | 1,991,000 | 2,031,000 |
| COMMITMENTS (SEE NOTES) | | |
| STOCKHOLDERS' EQUITY: | | |
| Common stock, $.05 par value; authorized 30,000,000 shares; issued 11,876,000 shares (1997-11,848,000) | 593,000 | 592,000 |
| Capital in excess of par value | 10,128,000 | 9,837,000 |
| Retained earnings | 77,012,000 | 76,820,000 |
| | 87,733,000 | 87,249,000 |
| Less common stock held in treasury; 3,025,000 shares at cost (1997-2,500,000) | 23,038,000 | 15,477,000 |
| TOTAL STOCKHOLDERS' EQUITY | 64,695,000 | 71,772,000 |
| | $89,633,000 | $97,238,000 |

</TABLE>

See accompanying notes.

CONSOLIDATED STATEMENTS OF CASH FLOWS

<TABLE>
<CAPTION>

| Years Ended December 31, 1998, 1997 and 1996 | 1998 | 1997 | 1996 |
|---|---|---|---|
| <S> | <C> | <C> | <C> |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | |
| Net income | $ 3,485,000 | $ 10,592,000 | $ 8,417,000 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation and amortization | 2,478,000 | 2,298,000 | 2,457,000 |
| Provision for losses on accounts receivable | 207,000 | 110,000 | 136,000 |
| Change in net assets of discontinued operations | 9,692,000 | (468,000) | (314,000) |
| Changes in assets and liabilities net of effects from sale of facility: | | | |
| Accounts receivable | (2,067,000) | (2,953,000) | (540,000) |
| Inventories | (4,776,000) | 2,380,000 | (640,000) |
| Prepaid expenses | (172,000) | (2,051,000) | (267,000) |
| Accounts payable and accrued liabilities | 4,474,000 | (818,000) | (2,706,000) |
| Income taxes payable | (962,000) | 147,000 | 921,000 |
| Increase (decrease) in deferred taxes | (40,000) | (106,000) | 34,000 |
| Pension liability adjustment | -- | 789,000 | 119,000 |
| Other | (183,000) | 168,000 | 452,000 |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | 12,136,000 | 10,088,000 | 8,069,000 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | |
| Proceeds from sale of business and facility | 1,500,000 | -- | 2,000,000 |
| Proceeds from disposal of property, plant and equipment | 76,000 | 133,000 | 5,000 |
| Capital expenditures | (3,919,000) | (3,557,000) | (1,189,000) |
| NET CASH PROVIDED (USED) BY INVESTING ACTIVITIES | (2,343,000) | (3,424,000) | 816,000 |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | | |
| Sale of treasury stock at public offering | -- | 7,953,000 | -- |

| | | | |
|---|---|---|---|
| Repayment of short-term borrowings | -- | -- | (5,900,000) |
| Principal payments of long-term debt | (4,000,000) | (1,000,000) | (32,000) |
| Sale of common stock under stock option plan | 292,000 | 296,000 | 290,000 |
| Purchase of common stock for the treasury | (7,561,000) | (884,000) | (1,937,000) |
| Dividends declared and paid | (3,293,000) | (2,944,000) | (2,643,000) |
| NET CASH PROVIDED (USED) BY FINANCING ACTIVITIES | (14,562,000) | 3,421,000 | (10,222,000) |
| Net increase (decrease) in cash and cash equivalents | (4,769,000) | 10,085,000 | (1,337,000) |
| Cash and Cash Equivalents at Beginning of Year | 11,124,000 | 1,039,000 | 2,376,000 |
| CASH AND CASH EQUIVALENTS AT END OF YEAR | $ 6,355,000 | $ 11,124,000 | $ 1,039,000 |
| Supplemental cash flow information: | | | |
| Cash paid during the year for: | | | |
| Interest | $ 447,000 | $ 632,000 | $ 969,000 |
| Income taxes | 4,557,000 | 6,104,000 | 3,277,000 |
| | $ 5,004,000 | $ 6,736,000 | $ 4,246,000 |

</TABLE>

See accompanying notes.

<TABLE>
<CAPTION>

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
SHELBY WILLIAMS INDUSTRIES, INC.

Years Ended December 31, 1998, 1997 and 1996

| <S> | Common Stock Shares issued <C> | Amount <C> | Capital in excess of par value <C> | Retained earnings <C> | Accumulated other comprehensive income <C> |
|---|---|---|---|---|---|
| BALANCE AT DECEMBER 31, 1995 | 11,779,000 | $ 589,000 | $ 7,855,000 | $ 63,398,000 | $ (908,000) |
| Net income | | | | 8,417,000 | |
| Other comprehensive income: | | | | | |
| Pension liability adjustment | | | | | 198,000 |
| Tax expense | | | | | (79,000) |
| Comprehensive income | | | | 8,417,000 | 119,000 |
| Sale of common stock under stock option plan | 35,000 | 2,000 | 288,000 | | |
| Common stock purchased for treasury (168,000 shares) | | | | | |
| Cash dividends-$.30 per share | | | | (2,643,000) | |
| BALANCE AT DECEMBER 31, 1996 | 11,814,000 | 591,000 | 8,143,000 | 69,172,000 | (789,000) |
| Net income | | | | 10,592,000 | |
| Other comprehensive income: | | | | | |
| Pension liability adjustment | | | | | 1,315,000 |
| Tax expense | | | | | (526,000) |
| Comprehensive income | | | | 10,592,000 | 789,000 |
| Sale of treasury stock at public offering (619,000 shares) | | | 1,399,000 | | |
| Sale of common stock under stock option plan | 34,000 | 1,000 | 295,000 | | |

| | | | | | |
|---|---|---|---|---|---|
| Common stock purchased for treasury (72,000 shares) | | | | | |
| Cash dividends-$.32 per share | | | | (2,944,000) | |
| BALANCE AT DECEMBER 31, 1997 | 11,848,000 | 592,000 | 9,837,000 | 76,820,000 | 0 |
| Net income and comprehensive income | | | | 3,485,000 | |
| Sale of common stock under stock option plan | 28,000 | 1,000 | 291,000 | | |
| Common stock purchased for treasury (525,000 shares) | | | | | |
| Cash dividends-$.36 per share | | | | (3,293,000) | |
| BALANCE AT DECEMBER 31, 1998 | 11,876,000 | $ 593,000 | $ 10,128,000 | $ 77,012,000 | $ 0 |

</TABLE>

<TABLE>
<CAPTION>

| <S> | Treasury other stock, at cost <C> | Total <C> |
|---|---|---|
| BALANCE AT DECEMBER 31, 1995 | $(19,210,000) | $ 51,724,000 |
| Net income | | 8,417,000 |
| Other comprehensive income: | | |
| Pension liability adjustment | | 198,000 |
| Tax expense | | (79,000) |
| Comprehensive income | | 8,536,000 |
| Sale of common stock under stock option plan | | 290,000 |
| Common stock purchased for treasury (168,000 shares) | (1,937,000) | (1,937,000) |
| Cash dividends-$.30 per share | | (2,643,000) |
| BALANCE AT DECEMBER 31, 1996 | (21,147,000) | 55,970,000 |
| Net income | | 10,592,000 |
| Other comprehensive income: | | |
| Pension liability adjustment | | 1,315,000 |
| Tax expense | | (526,000) |
| Comprehensive income | | 11,381,000 |
| Sale of treasury stock at public offering (619,000 shares) | 6,554,000 | 7,953,000 |
| Sale of common stock under stock option plan | | 296,000 |
| Common stock purchased for treasury (72,000 shares) | (884,000) | (884,000) |
| Cash dividends-$.32 per share | | (2,944,000) |
| BALANCE AT DECEMBER 31, 1997 | (15,477,000) | 71,772,000 |
| Net income and comprehensive income | | 3,485,000 |
| Sale of common stock under stock option plan | | 292,000 |
| Common stock purchased for treasury (525,000 shares) | (7,561,000) | (7,561,000) |
| Cash dividends-$.36 per share | | (3,293,000) |

| | | |
|---|---|---|
| Balance at December 31, 1998 | $(23,038,000) | $ 64,695,000 |

</TABLE>

See accompanying notes.

December 31, 1998, 1997 and 1996

Summary of Significant Accounting Policies

DESCRIPTION OF BUSINESS

Shelby Williams designs, manufactures and distributes products for the contract furniture market. The Company has a significant position in the hospitality and food service markets through its "Shelby Williams" seating line, "King Arthur" line of function room furniture and "Sterno" accessories. It serves the health care, university, and other institutional markets through its "Thonet" division with health care and university furniture, including chairs, tables, and other institutional products. The Company also processes and distributes vinyl wallcoverings for residential, hotel and office use under the name "Sellers & Josephson."

PRINCIPLES OF CONSOLIDATION

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany items and transactions are denominated in U.S. dollars and have been eliminated in consolidation.

REVENUE RECOGNITION

Sales are recognized when the products are shipped.

INCOME TAXES

Income tax expense includes Federal and state income taxes currently payable and deferred taxes arising from temporary differences between the tax bases of assets or liabilities and their reported amounts in the financial statements.

CASH AND CASH EQUIVALENTS

Cash equivalents include highly liquid investments, with original maturities of three months or less, that are readily convertible to known amounts of cash.

INVENTORIES

Inventories are carried at the lower of cost or market, determined by the last-in, first-out (LIFO) method. The current replacement cost of inventories exceeded carrying value by approximately $ 10,828,000 at December 31, 1998 and $9,997,000 at December 31, 1997.

As a result of the difference between the method of allocating the cost of acquisitions in 1976, 1987 and 1988 for financial reporting purposes, and the method used for income tax purposes, the Company's tax basis in the inventories is approximately $ 20,204,000 at December 31, 1998 and $ 22,278,000 at December 31, 1997. Related 1998 disposition cost of $ 616,000 was not a deduction for tax.

PROPERTY, PLANT AND EQUIPMENT

Depreciation and amortization of property, plant and equipment is provided using the straight-line method over the estimated useful lives of the respective assets.

POSTEMPLOYMENT BENEFITS

The Company provides certain postemployment benefits. Payments of these benefits in the past have been infrequent and are not estimable, thus the Company records these benefits on an event basis.

OTHER SIGNIFICANT ACCOUNTING POLICIES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. As a result of significant deductibles in its insurance coverage for liability and worker's compensation claims, the Company provides amounts which management believes are sufficient to cover the associated liabilities.

COMMITMENTS

LEASES

The Company leases certain manufacturing facilities under operating leases which expire over the next seven years. The Company also leases showroom space under operating leases expiring over the next five years.

Future minimum rental payments required under operating leases that have initial or remaining non-cancelable lease terms in excess of one year as of December 31, 1998 are:

Year ending December 31,

| | |
|---|---|
| 1999 | $ 1,058,000 |
| 2000 | 968,000 |
| 2001 | 573,000 |
| 2002 | 532,000 |
| 2003 | 469,000 |

Subsequent to 2003 62,000 Total minimum lease payments $ 3,662,000 Total rental expense for all operating leases aggregated $ 1,899,000 in 1998, $ 1,955,000 in 1997, and $ 1,912,000 in 1996.

SHORT-TERM BORROWINGS
The Company has unsecured lines of credit amounting to $20,000,000 at interest rates of prime or less. At December 31, 1998, all of these lines were unused.

LONG-TERM DEBT
Long-term debt at December 31, 1998, and 1997 consisted of the following:

| | 1998 | 1997 |
|---|---|---|
| 7.8% senior notes due in quarterly installments through July 1999 | $3,000,000 | $7,000,000 |
| Less amounts due within one year | 3,000,000 | 4,000,000 |
| | $ -- | $3,000,000 |

The terms of the senior note agreement contain certain restrictions. At December 31, 1998, the Company was in compliance with all such restrictions. The final $863,000 of a capitalized lease obligation was discharged by assignment with sale of the related facility in August 1996.

COMMON STOCK INFORMATION (UNAUDITED)

The following table sets forth the high and low sales prices of the Company's common stock as reported by the New York Stock Exchange.

| Sales Prices | | High | Low |
|---|---|---|---|
| 1998 | 1st Quarter | 17 1/8 | 14 5/8 |
| | 2nd Quarter | 16 1/8 | 14 5/8 |
| | 3rd Quarter | 15 3/4 | 11 7/8 |
| | 4th Quarter | 13 1/8 | 11 7/8 |
| 1997 | 1st Quarter | 17 7/8 | 11 7/8 |
| | 2nd Quarter | 14 3/8 | 11 3/8 |
| | 3rd Quarter | 19 7/8 | 13 3/4 |
| | 4th Quarter | 20 5/8 | 14 3/4 |

At December 31, 1998, there were approximately 3,000 holders of record of the Company's common stock, including individual participants in security position listings.

The Company declared and paid cash dividends on its common stock during the last two fiscal years as follows:

| Period | Cash Dividend per Common Share 1998 | 1997 |
|---|---|---|
| 1st Quarter | $ 0.09 | $ 0.08 |
| 2nd Quarter | 0.09 | 0.08 |
| 3rd Quarter | 0.09 | 0.08 |
| 4th Quarter | 0.09 | 0.08 |
| | $ 0.36 | $ 0.32 |

QUARTERLY RESULTS (UNAUDITED)
Summarized quarterly results for the two years ended December 31, 1998 follows (dollars in thousands, except for per share amounts):

<TABLE>
<CAPTION>

| | 1998 | | | | 1997 | | | |
|---|---|---|---|---|---|---|---|---|
| | FOURTH | THIRD | SECOND | FIRST | FOURTH | THIRD | SECOND | FIRST |
| <S> | <C> | <C> | <C> | <C> | <C> | <C> | <C> | <C> |
| Net sales | $ 44,237 | $ 42,387 | $ 40,829 | $ 38,484 | $ 41,966 | $ 39,608 | $ 39,749 | $ 36,456 |
| Gross profit | 10,962 | 10,095 | 9,937 | 8,555 | 10,256 | 9,435 | 9,182 | 8,057 |
| Income from continuing operations | 3,120 | 2,727 | 2,689 | 2,078 | 2,862 | 2,532 | 2,450 | 1,833 |
| Net income (loss) | 3,120 | 2,727 | (4,476) | 2,114 | 2,985 | 2,734 | 2,707 | 2,166 |
| Income (loss) per share (basic and diluted): | | | | | | | | |
| Continuing operations | 0.35 | 0.30 | 0.29 | 0.22 | 0.31 | 0.27 | 0.26 | 0.21 |
| Net income (loss) | 0.35 | 0.30 | (0.49) | 0.23 | 0.32 | 0.29 | 0.29 | 0.25 |

</TABLE>

STOCK OPTION PLANS
Under the Company's incentive stock option plan and directors' stock option plan, options are granted to key employees and directors to purchase the Company's common stock at not less than fair market value at date of grant. At December 31, 1998 and 1997, there were 276,000 and 308,000 shares, respectively, reserved for issuance under the plans. Of options granted, 20,000 in 1997 and 16,000 in 1996 have five year terms and vest and become fully exercisable at the end of six months service. The remaining options granted in 1997 and 1996 and all of the options granted in 1998 have five year terms and vest and become exercisable in 1/3 increments after 15 months, 30 months, and 45 months, respectively, of continued employment.

The intrinsic value method is used in accounting for stock-based awards under the Company's stock option plans. Because the exercise price of the Company's stock options at least equals the market price of the under-lying stock on the date of grant, no compensation expense is recognized.

A summary of the Company's stock option activity, and related information for years ended December 31 follows:

<TABLE>
<CAPTION>

| | 1998 | | 1997 | | 1996 | |
|---|---|---|---|---|---|---|
| | Options (000) | Weighted-Average Exercise Price | Options (000) | Weighted-Average Exercise Price | Options (000) | Weighted-Average Exercise Price |
| <S> | <C> | <C> | <C> | <C> | <C> | <C> |
| Outstanding-beginning of year | 217 | $ 12.17 | 147 | $ 9.97 | 119 | $ 8.30 |
| Granted | 43 | 16.69 | 107 | 13.96 | 63 | 12.25 |
| Exercised | (28) | 10.37 | (34) | 8.61 | (35) | 8.38 |
| Forfeited | (4) | 14.00 | (3) | 8.38 | -- | -- |
| Outstanding-end of year | 228 | $ 13.21 | 217 | $ 12.17 | 147 | $ 9.97 |
| Exercisable at end of year | 111 | $ 11.62 | 88 | $ 10.89 | 79 | $ 9.14 |
| Weighted-average fair value of options granted during the year | $ 5.17 | | $ 4.05 | | $ 3.68 | |

</TABLE>

Exercise prices for options outstanding as of December 31, 1998 ranged from $7.94 to $8.73 for 33,000 options and $12.12 to $18.15 for 195,000 options, with weighted-average exercise prices of $8.03 and $14.10, respectively. The weighted-average remaining contractual life of those options is 1 year and 3 years, respectively, or 2.7 years as a whole. Exercise prices for options exercisable at December 31, 1998 ranged from $7.94 to $8.73 for 33,000 shares and $12.12 to $15.25 for 78,000 shares, with weight-average exercise prices of $8.03 and $13.15, respectively.

The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted-average assumptions for 1996, 1997 and 1998, respectively: risk-free interest rates of 6.5%, 6.2% and 5.3%; dividend yields of 2.7%, 2.6% and 2.2%; volatility factors of the expected market price of the Company's common stock of .32, .31 and .35; and a weighted-average expected life of the option of five years.

The effect of applying the fair value method to the Company's stock-based awards results in net income and earnings per share that are not materially different from amounts reported. The assumed dilutive effect of stock options, which were the only dilutive securities outstanding in 1998, 1997 and 1996, was 30,000, 52,000 and 33,000 shares, respectively.

RESTRUCTURING CHARGE

Due to increases in lumber prices and increased competition primarily from imported products, the Company made changes in its product and manufacturing strategies during December 1994, designed to make the Company more competitive in the industry. The plan was to exit certain portions of the Company's enterprise by selling an upholstery business with a related manufacturing facility and discontinuing a part of the product lines in the health care, university and office markets, resulting in closure of another plant. The Company anticipated completing the restructuring by December 31, 1995; however, the sale of the upholstery business was not completed until August 1996.

At December 31, 1995, accrued liabilities included $439,000 related to the plan. These costs were paid and charged against the liability in 1996, completing the plan. In 1996, revenues and net operating income for the upholstery business that was sold amounted to $5,858,000 and $182,000, respectively.

DISCONTINUED OPERATIONS

On July 14, 1998, the Company's Board of Directors approved management's plan to discontinue the Company's distribution operations of textile and floor covering products manufactured by outside suppliers. Of the two businesses comprising these operations, one was sold and one was liquidated. The plan was completed in December, 1998. During the second quarter 1998, the Company recorded a loss on the disposition of these operations of $9,698,000, or $7,081,000 after taxes, including a provision for losses prior to disposal, which is summarized below:

<TABLE>

| <S> | <C> |
|---|---|
| Reduction of inventory value | $4,706,000 |
| Reduction of property to net realizable value | 2,198,000 |
| Reduction of accounts receivable and prepaids value | 629,000 |
| Other liabilities | 1,445,000 |
| Losses through disposition | 720,000 |
| Total | 9,698,000 |
| Income tax benefit | 2,617,000 |
| | $7,081,000 |

</TABLE>

The operating results of the discontinued operations are summarized as follows:

<TABLE>
<CAPTION>

| Year ended December 31, | 1998 | 1997 | 1996 |
|---|---|---|---|
| <S> | <C> | <C> | <C> |
| Net sales | $ 6,981,000 | $21,849,000 | $22,950,000 |
| Income (loss) before income taxes | (77,000) | 1,474,000 | 1,052,000 |
| Income taxes (benefit) | (29,000) | 559,000 | 391,000 |
| Net income (loss) | (48,000) | 915,000 | 661,000 |
| Net income (loss) per share | (0.01) | 0.10 | 0.08 |
| Net income (loss) per share-assuming dilution | (0.01) | 0.10 | 0.07 |

</TABLE>

The net assets of the discontinued operations follows:

| As of December 31, | 1997 |
|---|---|
| Current assets | $ 9,947,000 |
| Current liabilities | 1,090,000 |
| Net assets of discontinued operations, current | $ 8,857,000 |
| Property, net | $ 2,235,000 |
| Net assets of discontinued operations, non-current | $ 2,235,000 |

The consolidated financial statements of the Company have been restated to reflect the results of operations and net assets of these operations as a discontinued operation in accordance with generally accepted accounting principles. The losses recorded on the disposition of these operations were not materially different from those incurred on the actual amounts realized in the sale and liquidation process.

RETIREMENT PLANS

The Company has several defined pension plans covering essentially all of its employees in the United States. These plans held 66,000 shares of the Company's common stock at December 31, 1998 and December 31, 1997.

Weighted-average assumptions used in the accounting were as follows:

| As of December 31, | 1998 | 1997 |
|---|---|---|
| Discounts rates | 7.0% | 8.3% |
| Rates of compensation increase | 3.5% | 3.5% |
| Expected return on plan assets | 8.5% | 8.5% |

Components of net periodic benefit cost are as follows:

| Year ended December 31, | 1998 | 1997 | 1996 |
|---|---|---|---|
| Benefit cost: | | | |
| Service cost | $ 1,062,000 | $ 964,000 | $ 966,000 |
| Interest cost | 1,496,000 | 1,354,000 | 1,151,000 |
| Expected return on plan assets | (1,654,000) | (1,350,000) | (1,143,000) |
| Amortization: | | | |
| Transition asset | (25,000) | (25,000) | (25,000) |
| Net actuarial loss | -- | 38,000 | 102,000 |
| Net benefit cost | $ 879,000 | $ 981,000 | $ 1,051,000 |

Changes in plan assets and benefit obligation, indicating the end of year funded status and prepaid pension, included in prepaid expenses of the accompanying consolidated balance sheets, were as follows:

| Year ended December 31, | 1998 | 1997 |
|---|---|---|
| Fair value of plan assets: | | |
| Beginning of year | $ 19,485,000 | $ 15,142,000 |
| Actual return on plan assets | 2,318,000 | 3,169,000 |
| Employer contribution | 1,462,000 | 1,858,000 |
| Benefits paid | (809,000) | (684,000) |
| End of year | 22,456,000 | 19,485,000 |
| Benefit obligation: | | |
| Beginning of year | 18,484,000 | 15,983,000 |
| Service cost | 1,062,000 | 964,000 |
| Interest cost | 1,496,000 | 1,354,000 |
| Actuarial loss | 3,859,000 | 867,000 |
| Benefits paid | (809,000) | (684,000) |
| End of year | 24,092,000 | 18,484,000 |
| Funded status | (1,636,000) | 1,001,000 |
| Unrecognized net asset | (137,000) | (163,000) |
| Unrecognized net loss | 4,184,000 | 989,000 |
| Unrecognized prior service cost | 60,000 | 61,000 |
| Prepaid pension at end of year | $ 2,471,000 | $ 1,888,000 |

The Company has an employee stock ownership plan covering essentially all salaried employees. The contributions were $83,000 for 1998, $69,000 for 1997, and $63,000 for 1996. The plan held 52,000 shares of the Company's common stock at December 31, 1998 and 44,000 shares at December 31, 1997.

Retirement plan expense was $962,000, $1,050,000, and $1,114,000 for 1998, 1997, and 1996 respectively.

OPERATING SEGMENTS

The Financial Accounting Standards Board has issued Statement of Financial Accounting Standards No. 131, "Disclosures about Segments of an Enterprise and Related Information". Applying the criteria from this statement, the Company has three segments. The hotel and foodservice furniture segment manufactures and distributes chairs, tables, and guest, banquet and function room furnishings, along with specialty items for banquet use, for the hospitality market. The healthcare and university furniture segment produces and markets seating products used for healthcare, university and other institutional facilities. The wallcoverings segment processes and distributes vinyl wallcoverings for the hospitality and other markets.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. Cash and cash equivalents are considered corporate assets and interest expense and interest income are unallocated. Intersegment sales are not significant. The Company evaluates performance based on income before income taxes.

The Company's segments are strategic business units that offer different products or serve different markets. They are managed separately because each requires different technology and marketing strategies, which are coordinated to the extent practical.

Segment information follows:

<TABLE>
<CAPTION>

| <S> | December 31, and year then ended <C> | Hotel and foodservice furniture <C> | Healthcare and university furniture <C> | Wallcoverings <C> | Totals <C> |
|---|---|---|---|---|---|
| Net sales: | 1998 | $ 126,726,000 | $ 23,478,000 | $ 15,733,000 | $ 165,937,000 |
| | 1997 | 117,707,000 | 24,868,000 | 15,204,000 | 157,779,000 |
| | 1996 | 113,436,000 | 22,135,000 | 13,910,000 | 149,481,000 |
| Depreciation and amortization: | 1998 | 1,564,000 | 431,000 | 483,000 | 2,478,000 |
| | 1997 | 1,396,000 | 417,000 | 485,000 | 2,298,000 |
| | 1996 | 1,501,000 | 419,000 | 537,000 | 2,457,000 |
| Segment profit: | 1998 | 13,990,000 | 1,022,000 | 1,645,000 | 16,657,000 |
| | 1997 | 11,991,000 | 1,178,000 | 1,582,000 | 14,751,000 |
| | 1996 | 10,626,000 | 504,000 | 1,297,000 | 12,427,000 |
| Capital expenditures: | 1998 | 2,390,000 | 684,000 | 845,000 | 3,919,000 |
| | 1997 | 2,737,000 | 465,000 | 355,000 | 3,557,000 |
| | 1996 | 751,000 | 115,000 | 323,000 | 1,189,000 |
| Segment assets: | 1998 | 59,685,000 | 15,797,000 | 7,796,000 | 83,278,000 |
| | 1997 | 52,387,000 | 15,346,000 | 7,189,000 | 74,922,000 |

</TABLE>

Reconciliation of segment profits to consolidated income from continuing operations before income taxes, follows:

<TABLE>
<CAPTION>

| Year Ended December 31, <S> | 1998 <C> | 1997 <C> | 1996 <C> |
|---|---|---|---|
| Total profit for segments | $ 16,657,000 | $ 14,751,000 | $ 12,427,000 |
| Unallocated: | | | |
| Interest expense | (391,000) | (622,000) | (969,000) |
| Interest income | 539,000 | 614,000 | 18,000 |
| Income from continuing operations before income taxes | $ 16,805,000 | $ 14,743,000 | $ 11,476,000 |

</TABLE>

Reconciliation of segment assets to consolidated assets, follows:

| As of December 31, | 1998 | 1997 |
|---|---|---|
| Total assets for segments | $83,278,000 | $74,922,000 |
| Net assets of discontinued operations | -- | 11,192,000 |
| Cash and cash equivalents | 6,355,000 | 11,124,000 |
| Consolidated assets | $89,633,000 | $97,238,000 |

Geographic information for net sales follows:

| Year ended December 31, | 1998 | 1997 | 1996 |
|---|---|---|---|
| Net sales: | | | |
| United States | $151,727,000 | $140,834,000 | $135,025,000 |
| Foreign (exports) | 14,210,000 | 16,945,000 | 14,456,000 |
| Total | $165,937,000 | $157,779,000 | $149,481,000 |

Geographic information for long-lived assets follows:

| As of December 31, | 1998 | 1997 |
|---|---|---|
| Long-lived assets: | | |
| United States | $23,070,000 | $21,527,000 |
| Mexico | 3,066,000 | 3,244,000 |
| Total | $26,136,000 | $24,771,000 |

Income Taxes

Deferred income tax liabilities (assets) for differences in tax bases and amounts in the financial statements were as follows:

| As of December 31, | 1998 | 1997 |
|---|---|---|
| Current: | | |
| Allocated costs of acquisition inventories | $ 796,000 | $1,005,000 |
| Prepaid pension | 850,000 | 763,000 |
| Other-net | (1,641,000) | (368,000) |
| Total included in current income taxes | 5,000 | 1,400,000 |
| Noncurrent: | | |
| Property, plant and equipment | 1,991,000 | 2,031,000 |
| Net deferred tax liabilities | $ 1,996,000 | $3,431,000 |

The components of income tax expense are as follows:

| Year ended December 31, | 1998 | 1997 | 1996 |
|---|---|---|---|
| Current: | | | |
| Federal | $ 6,806,000 | $4,414,000 | $2,790,000 |
| State | 820,000 | 512,000 | 457,000 |
| | 7,626,000 | 4,926,000 | 3,247,000 |
| Deferred: | | | |
| Federal | (1,435,000) | 140,000 | 473,000 |
| | $6,191,000 | $5,066,000 | $3,720,000 |

Income tax expense differs from amounts computed by applying the Federal statutory tax rate to income before income taxes as follows:

| Year ended December 31, | 1998 | 1997 | 1996 |
|---|---|---|---|
| Statutory rate | $ 5,714,000 | $ 5,013,000 | $ 3,902,000 |
| State income taxes, net of Federal tax benefit | 541,000 | 337,000 | 302,000 |
| Other | (64,000) | (284,000) | (484,000) |
| | $ 6,191,000 | $ 5,066,000 | $ 3,720,000 |
| Effective rate | 36.8% | 34.4% | 32.4% |

Report of Independent Auditors

ERNST & YOUNG LLP

The Board of Directors and Stockholders
Shelby Williams Industries, Inc.

We have audited the accompanying consolidated balance sheets of Shelby Williams Industries, Inc., as of December 31, 1998 and 1997, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Shelby Williams Industries, Inc., as of December 31, 1998 and 1997, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 1998 in conformity with generally accepted accounting principles.

ERNST & YOUNG LLP

January 29, 1999
Atlanta, Georgia

MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND RESULTS OF
OPERATIONS

LIQUIDITY AND CAPITAL RESOURCES
The Company's short-term cash needs are primarily for working capital to support its accounts receivable and inventory requirements. The Company has historically financed its short-term liquidity needs with internally generated funds and short-term bank borrowings. At December 31, 1998, the Company had $ 39.2 million of working capital and $ 20.0 million of unused short-term bank credit lines.

At December 31, 1998, total debt of $ 3.0 million amounted to only 4% of total capitalization. The indebtedness consisted of a note payable to an institutional investor bearing interest at an annual rate of 7.8%. Amortization of $ 1.0 million per quarter continues through July 1999. Pursuant to the terms of the note, a prepayment option is available only at a substantial penalty.

Net cash provided by operating activities was $ 12.1 million in 1998.

Net cash used by investing activities was $ 2.3 million in 1998, which included capital expenditures of $ 3.9 million consisting of $ 0.3 million to finish the installation begun in 1997 of a modern powder coating system completed in March 1998 at a total cost of $ 2.0 million, approximately $ 0.8 million for facilities expansion and improvements which increased wallcovering production capacity by about 25%, and the balance primarily for automated machinery. The Company plans to expend approximately $ 6 million in 1999 for additional automated machinery and facilities expansion including a state- of-the-art aluminum production facility and a new wood-finishing system. On July 14, 1998, the Company's Board of Directors approved management's plan to discontinue the Company's distribution operations of textile and floor covering products manufactured by outside suppliers. Of the two businesses comprising these operations, one was liquidated and one was sold. Cash proceeds from the sale amounted to $ 1.5 million. The plan was completed in December 1998. Proceeds from other disposals amounted to $ 0.1 million.

Net cash used by financing activities in 1998 was $ 14.6 million which principally reflects the repayment of $ 4.0 million of total indebtedness, the payment of $ 3.3 million in dividends and the repurchase of $ 7.6 million of treasury stock. The Company received $ 0.3 million for common stock issued under stock option plans.

The Company's stockholders' equity at December 31, 1998, was $ 64.7 million, or $ 7.31 per share. The Company purchased 525,000 shares of its common stock in 1998 for $ 7.6 million at an average repurchase price of $ 14.40 per share. These repurchases were made to be used for proper corporate purposes as authorized and unissued shares. The Company's Board of Directors has authorized the repurchase of an additional 420,000 shares of common stock. The Company may purchase these shares from time to time, depending on market conditions, in the open market or privately negotiated transactions. Inventories, excluding those of the discontinued operations, increased during the year 1998 by 26.9% to $ 22.5 million. This was mainly due to a 7.5% increase in backlog of unshipped orders during the same period and the timing of receipt of raw material as reflected by the $ 2.3 million increase in accounts payable.

The Company operates a frame and component manufacturing plant in Mexico. The year-end carrying value of property, plant and equipment at this facility was $ 3.1 million for 1998, $ 3.2 million for 1997, and $ 3.5 million for 1996. All items produced at the plant are shipped to facilities of the Company in the United States for further processing. The value of these transfers amounted to $ 2.1 million in 1998, $ 2.3 million in 1997, and $ 2.1 million in 1996.

The Company believes that cash on hand, internally generated cash flows, and available credit lines will be adequate to support currently planned business operations both on a near-term and long-term basis.

IMPACT OF YEAR 2000

The Company does not have a significant amount of date- dependent software programs in its centralized information systems. Other systems, such as computer controlled machinery and even telephones may have Year 2000 problems with their computer chips. The Company's manufacturing operations are not significantly dependent on computer controlled machinery. The Company has inventoried all computer controlled equipment and assessed the exposure of each system to ensure all computer controlled equipment is Year 2000 compliant. Based upon this review, the Company believes that all critical equipment is compliant.

The Company has completed an assessment of its centralized information system and has modified or replaced portions of its software so that its computer systems will function properly with respect to dates in the year 2000 and thereafter. The project, according to plan, has been completed. The Year 2000 project cost was approximately $ 163,000 of which approximately $ 118,000 was capitalized and the remainder expensed.

The Company believes that with modifications to existing software which have been completed and conversions to new software which have been made, the Year 2000 Issue will not pose significant operational problems

for its computer systems. However, actual results could differ from those anticipated and have a material impact on the operations of the Company. In addition, disruptions in the general economy resulting from Year 2000 issues could also materially adversely affect the Company. The amount of potential lost revenue and additional cost cannot be reasonably estimated at this time. The Company has contingency plans for certain critical applications. These contingency plans involve, among other actions, manual workarounds and adjusting staffing strategies.

The Company's centralized information systems do not interface with third party systems. The Company has queried its significant suppliers, all of whose products are available from alternative sources. To date, the Company is not aware of any supplier with a Year 2000 issue that would materially impact the Company's results of operations, liquidity, or capital resources. However, the Company has no means of ensuring that its suppliers will be Year 2000 ready. The inability of suppliers to complete their Year 2000 resolution process in a timely fashion could materially impact the Company, the effect of which is not determinable.

This is a Year 2000 readiness disclosure entitled to protection as provided in the Year 2000 Information and Readiness Disclosure Act.

1998 COMPARED TO 1997

Net sales increased 5.2% to $ 165.9 million in 1998 from $ 157.8 million for 1997. This increase was due almost entirely to volume increases. Volume growth was primarily attributable to continued robust activity in the hospitality and foodservice markets. The Company's products sold in these markets include virtually all of its hotel and foodservice furniture, which amounted to $ 126.7 million in 1998, or a 7.7% increase from the prior year, and most of its wallcoverings, which increased 3.5% to $ 15.7 million. Reflecting consolidation within the healthcare industry in 1998, sales of healthcare and university furniture declined 5.6% to $ 23.5 million.

Notwithstanding ongoing economic difficulties in the export markets served by the Company, its overall business remains strong. In 1998, export sales decreased $ 2.7 million, or 16.1%, from 1997. The Company's position as market leader abroad leaves management confident that it will garner a significant share of export business as the international situation normalizes, although there can be no assurance in this regard. The Company's backlog of unshipped orders at December 31, 1998 increased 7.5%, to a year-end record of $ 34.2 million, compared to $ 31.8 million a year earlier.

Gross profit increased 7.1% to $ 39.5 million in 1998 from $ 36.9 million in 1997. The gross profit margin increased to 23.8% in 1998, compared to 23.4% in 1997, reflecting higher factory utilization rates and improved productivity resulting from recent investments in automated machinery.

Selling, general and administrative expenses increased 3.3% to $ 23.0 million in 1998 from $ 22.3 million in 1997. As a percentage of net sales, selling, general and administrative expenses decreased to 13.9% in 1998 from 14.1% in 1997, principally due to function of volume.

As a result of the factors described above, operating profit increased 12.9% to $ 16.6 million in 1998 from $ 14.7 million in 1997. The operating margin improved to 10.0% in 1998 compared to 9.3% in 1997.

Net interest income of $ 0.1 million in 1998, contrasted to net interest expense of almost nil in 1997, which reflects the reduction in outstanding indebtedness to $ 3.0 million at December 31, 1998 from $ 7.0 million at December 31, 1997.

The effective tax rate increased to 36.8% in 1998 from 34.4% in 1997 primarily due to increased state income taxes resulting, in part, from the effect of reduced export sales and loss of federal income tax benefits also related to export sales.

As a result of the foregoing, income from continuing operations increased 9.7% to $ 10.6 million in 1998, or $ 1.17 per share, compared to $ 9.7 million, or $ 1.05 per share in 1997.

During the second quarter 1998, the Company recorded a loss on the disposition of the discontinued operations, indicated under Liquidity and Capital Resources above, of $ 9.7 million, or $ 7.1 million after taxes. These operations did not make a contribution to profits in 1998, and management believed they offered limited upside potential. The losses recorded on the disposition of these operations were not materially different from those incurred on the actual amounts realized in the sale and liquidation process. See Note to Consolidated Financial Statements captioned "Discontinued Operations." 1997 Compared to 1996 This comparison reflects restatement for operations discontinued in 1998.

Net sales increased 5.6% to $ 157.8 million in 1997 from $ 149.5 million in 1996. The Company divested its contemporary upholstered seating product line, Preview, and a related manufacturing facility in August 1996. See Note to Consolidated Financial Statements captioned "Restructuring Charge." Excluding Preview, net sales increased 9.9% to $ 157.8 million in 1997 from $ 143.6 million in 1996. Approximately 2% of this increase was due to increased pricing and favorable product mix with the remainder attributable to volume increases. Efforts to strengthen foreign marketing capability resulted in increased export sales for 1997 to $ 16.9 million, compared to $ 14.5 million in 1996. The demand for hotel rooms across the U.S. remained strong in 1997. As a result, lodging companies continued to build new hotels and refurbish older ones in order to remain competitive. New construction and refurbishing of hotels provide a market for the Company's products, allowing it to benefit from this major industry expansion. Sales of these products increased from 1996 to 1997 by 3.8%, or 9.4% excluding Preview, to $ 117.7 million for hotel and foodservice furniture, and 9.3% to $ 15.2 million for wallcoverings. Sales of healthcare and university furniture also increased from 1996, amounting to $ 24.9 million for 1997, or an increase of 12.3%. At December 31, 1997, the Company's backlog of unshipped orders was approximately $ 31.8 million, compared to $ 30.7 million at December 31, 1996.

Gross profit increased 7.1% to $ 36.9 million in 1997 from $ 34.5 million in 1996. The gross profit margin increased to 23.4% in 1997, compared to 23.1% in 1996, reflecting higher capacity utilization and favorable product mix.

Selling, general and administrative expenses were $ 22.3 million in 1997 and $ 22.1 million in 1996. As a percentage of net sales, selling, general and administrative expenses decreased to 14.1% in 1997 from 14.8% in 1996. This decrease as a percentage of net sales was a function of volume and reflects the high selling, general and administrative expenses of Preview.

As a result of the factors described above, operating profit increased 18.4% to

$ 14.7 million in 1997 from $ 12.4 million in 1996. The operating margin improved to 9.3% in 1997 compared to 8.3% in 1996. Excluding Preview, operating profits in 1997 and 1996 were $ 14.7 million and $ 12.2 million, respectively, and as a percentage of sales, were 9.3% and 8.5%, respectively.

Net interest expense in 1996 of $ 1.0 million was reduced to almost nil in 1997 as a result of reduced debt and increased cash equivalents.

The effective tax rate increased to 34.4% in 1997 from 32.4% in 1996 due to the absence of tax credits which were no longer available.

As a result of the foregoing, income from continuing operations for 1997 was $ 9.7 million, a 24.8% increase over $ 7.8 million for 1996. Income per share from continuing operations increased 19.3% to $ 1.05 from $ .88 on 4.5% more average shares outstanding.

Exhibit 23.1

CONSENT OF INDEPENDENT AUDITORS

We consent to the incorporation by reference in this Annual Report (Form 10-K) of Shelby Williams Industries, Inc. of our report dated January 29, 1999, included in the 1998 Annual Report to Shareholders of Shelby Williams Industries, Inc.

Ernst & Young LLP

Atlanta, Georgia
January 29, 1999

Exhibit 23.2

CONSENT OF INDEPENDENT AUDITORS

We consent to the incorporation by reference in the Registration Statement (Form S-8, No. 33-48370) pertaining to the Shelby Williams Industries, Inc. 1992 Key Employees' Incentive Stock Option Plan and the related Prospectus and Registration Statement (Form S-8, No. 33-59705) pertaining to the Shelby Williams Industries, Inc. Directors' Stock Option Plan and the related Prospectus of our report dated January 29, 1998, with respect to the consolidated financial statements of Shelby Williams Industries, Inc. incorporated by reference in the Annual Report (Form 10-K) for the year ended December 31, 1998.

Ernst & Young LLP

Atlanta, Georgia
March 24, 1999

Exhibit 24.1

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that each of the undersigned directors and officers of SHELBY WILLIAMS INDUSTRIES, INC., a Delaware corporation (the "Company"), does hereby constitute and appoint Paul N. Steinfeld, Manfred Steinfeld, Robert P. Coulter and Walter Roth, and each of them severally, the true and lawful attorneys and agents of the undersigned, each with full power to act without any other and with full power of substitution and resubstitution, to do any and all acts and things and to execute any and all instruments which said attorneys and agents may deem necessary or desirable to enable the Company to comply with the Securities Exchange Act of 1934, as amended (the "Act"), and any rules, regulations and requirements of the Securities and Exchange Commission thereunder in connection with the filing under the Act of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1998 and all related matters, including specifically, but without limiting the generality of the foregoing, power and authority to sign the names of the undersigned directors and officers in the capacities indicated below to said Form 10-K to be filed with the Securities and Exchange Commission, to any and all amendments to said Form 10-K, and to any and all instruments or documents filed as part of or in connection with any of the foregoing and any and all amendments thereto; and each of the undersigned hereby ratifies and confirms all that said attorneys and agents, or any of them, shall do or cause to be done by virtue hereof.

IN WITNESS WHEREOF, each of the undersigned has subscribed these presents this 23rd day of March, 1999.

| Capacities | Signatures |
| --- | --- |
| Chairman of the Board and Director (Principal Executive Officer) | s/ Paul N. Steinfeld<br>------------------------------<br>Paul N. Steinfeld |
| Chairman of the Executive Committee and Director | s/ Manfred Steinfeld<br>------------------------------<br>Manfred Steinfeld |
| President and Director | s/ Robert P. Coulter<br>------------------------------<br>Robert P. Coulter |

| | |
|---|---|
| Vice-President Finance, Treasurer and Assistant Secretary (Principal Financial and Accounting Officer) | s/ Sam Ferrell<br>------------------------------<br>Sam Ferrell |
| Director | s/ William B. Kaplan<br>------------------------------<br>William B. Kaplan |
| Director | s/ Robert E. Lowe<br>------------------------------<br>Robert E. Lowe |
| Director | s/ Douglas Parker<br>------------------------------<br>Douglas Parker |
| Director | s/ Trisha Wilson<br>------------------------------<br>Trisha Wilson |

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