

DIXIE GROUP INC  
Form 10-Q  
November 04, 2015

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

Form 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 26, 2015  
OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 0-2585

THE DIXIE GROUP, INC.

(Exact name of Registrant as specified in its charter)

Tennessee

62-0183370

(State or other jurisdiction of incorporation or organization)

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

104 Nowlin Lane, Suite 101, Chattanooga, TN 37421

(423) 510-7000

(Address of principal executive offices) (zip code)

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

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

Edgar Filing: DIXIE GROUP INC - Form 10-Q

The number of shares outstanding of each of the issuer's classes of Common Stock as of the latest practicable date.	
Class	Outstanding as of October 23, 2015
Common Stock, \$3 Par Value	15,145,474 shares
Class B Common Stock, \$3 Par Value	861,493 shares
Class C Common Stock, \$3 Par Value	0 shares

Table of Contents 1

---

THE DIXIE GROUP, INC.

Table of Contents

PART I. FINANCIAL INFORMATION	Page
Item 1. <u>Financial Statements</u>	<u>3</u>
<u>Consolidated Condensed Balance Sheets - September 26, 2015 (Unaudited) and December 27, 2014</u>	<u>3</u>
<u>Consolidated Condensed Statements of Operations - Three and Nine Months Ended September 26, 2015 and September 27, 2014 (Unaudited)</u>	<u>4</u>
<u>Consolidated Condensed Statements of Comprehensive Income (Loss) - Three and Nine Months Ended September 26, 2015 and September 27, 2014 (Unaudited)</u>	<u>5</u>
<u>Consolidated Condensed Statements of Cash Flows - Nine Months Ended September 26, 2015 and September 27, 2014 (Unaudited)</u>	<u>6</u>
<u>Notes to Consolidated Condensed Financial Statements (Unaudited)</u>	<u>8</u>
Item 2. <u>Management's Discussion and Analysis of Results of Operations and Financial Condition</u>	<u>22</u>
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	<u>26</u>
Item 4. <u>Controls and Procedures</u>	<u>26</u>
 PART II. OTHER INFORMATION	
Item 1. <u>Legal Proceedings</u>	<u>27</u>
Item 1A. <u>Risk Factors</u>	<u>27</u>
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>30</u>
Item 3. <u>Defaults Upon Senior Securities</u>	<u>30</u>
Item 4. <u>Mine Safety Disclosures</u>	<u>30</u>
Item 5. <u>Other information</u>	<u>30</u>
Item 6. <u>Exhibits</u>	<u>30</u>
<u>Signatures</u>	<u>31</u>

## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

## THE DIXIE GROUP, INC.

## CONSOLIDATED CONDENSED BALANCE SHEETS

(amounts in thousands, except share data)

	September 26, 2015 (Unaudited)	December 27, 2014
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 179	\$ 394
Receivables, net	53,808	50,524
Inventories	114,856	104,207
Prepaid expenses	4,762	5,970
Deferred income taxes	13,719	12,722
<b>TOTAL CURRENT ASSETS</b>	<b>187,324</b>	<b>173,817</b>
<b>PROPERTY, PLANT AND EQUIPMENT, NET</b>	<b>102,069</b>	<b>102,489</b>
<b>GOODWILL AND OTHER INTANGIBLES</b>	<b>6,537</b>	<b>6,767</b>
<b>OTHER ASSETS</b>	<b>16,457</b>	<b>17,807</b>
<b>TOTAL ASSETS</b>	<b>\$312,387</b>	<b>\$300,880</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable	\$27,658	\$22,108
Accrued expenses	34,717	29,307
Current portion of long-term debt	9,337	9,078
<b>TOTAL CURRENT LIABILITIES</b>	<b>71,712</b>	<b>60,493</b>
<b>LONG-TERM DEBT</b>	<b>121,844</b>	<b>118,210</b>
<b>DEFERRED INCOME TAXES</b>	<b>8,166</b>	<b>9,376</b>
<b>OTHER LONG-TERM LIABILITIES</b>	<b>19,933</b>	<b>19,824</b>
<b>TOTAL LIABILITIES</b>	<b>221,655</b>	<b>207,903</b>
<b>COMMITMENTS AND CONTINGENCIES</b>		
<b>STOCKHOLDERS' EQUITY</b>		
Common Stock (\$3 par value per share): Authorized 80,000,000 shares, issued and outstanding - 15,145,474 shares for 2015 and 15,007,423 shares for 2014	45,436	45,022
Class B Common Stock (\$3 par value per share): Authorized 16,000,000 shares, issued and outstanding - 861,493 shares for 2015 and 764,191 shares for 2014	2,584	2,293
Additional paid-in capital	155,377	155,127
Accumulated deficit	(109,850)	(107,952)
Accumulated other comprehensive income (loss)	(2,815)	(1,513)
<b>TOTAL STOCKHOLDERS' EQUITY</b>	<b>90,732</b>	<b>92,977</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$312,387</b>	<b>\$300,880</b>

See accompanying notes to the consolidated condensed financial statements.

Table of Contents 3

---

THE DIXIE GROUP, INC.  
CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS  
(UNAUDITED)

(amounts in thousands, except per share data)

	Three Months Ended		Nine Months Ended	
	September 26, 2015	September 27, 2014	September 26, 2015	September 27, 2014
NET SALES	\$108,908	\$109,006	\$314,721	\$302,014
Cost of sales	81,643	82,407	234,811	230,643
GROSS PROFIT	27,265	26,599	79,910	71,371
Selling and administrative expenses	25,267	23,801	76,215	68,179
Other operating expense, net	131	230	684	601
Facility consolidation expenses	614	1,632	2,264	2,654
Impairment of assets	—	104	—	759
OPERATING INCOME (LOSS)	1,253	832	747	(822 )
Interest expense	1,203	991	3,603	3,161
Other (income) expense, net	4	(23 )	45	(60 )
Gain on purchase of business	—	(173 )	—	(11,110 )
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE TAXES	46	37	(2,901 )	7,187
Income tax provision (benefit)	(38 )	45	(1,121 )	2,884
INCOME (LOSS) FROM CONTINUING OPERATIONS	84	(8 )	(1,780 )	4,303
Loss from discontinued operations, net of tax	(18 )	(177 )	(118 )	(505 )
NET INCOME (LOSS)	\$66	\$(185 )	\$(1,898 )	\$3,798
BASIC EARNINGS (LOSS) PER SHARE:				
Continuing operations	\$0.01	\$(0.00 )	\$(0.11 )	\$0.29
Discontinued operations	(0.00 )	(0.01 )	(0.01 )	(0.04 )
Net income (loss)	\$0.01	\$(0.01 )	\$(0.12 )	\$0.25
BASIC SHARES OUTSTANDING	15,573	15,394	15,518	14,040
DILUTED EARNINGS (LOSS) PER SHARE:				
Continuing operations	\$0.01	\$(0.00 )	\$(0.11 )	\$0.29
Discontinued operations	(0.00 )	(0.01 )	(0.01 )	(0.04 )
Net income (loss)	\$0.01	\$(0.01 )	\$(0.12 )	\$0.25
DILUTED SHARES OUTSTANDING	15,666	15,394	15,518	14,216
DIVIDENDS PER SHARE:				
Common Stock	\$—	\$—	\$—	\$—
Class B Common Stock	—	—	—	—

See accompanying notes to the consolidated condensed financial statements.

Table of Contents 4

---

THE DIXIE GROUP, INC.  
CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)  
(UNAUDITED)  
(amounts in thousands)

	Three Months Ended		Nine Months Ended	
	September 26, 2015	September 27, 2014	September 26, 2015	September 27, 2014
NET INCOME (LOSS)	\$66	\$(185)	\$(1,898)	\$3,798
OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX:				
Unrealized gain (loss) on interest rate swaps	(1,923)	(24)	(2,466)	(2,003)
Income taxes	(731)	(9)	(937)	(761)
Unrealized gain (loss) on interest rate swaps, net	(1,192)	(15)	(1,529)	(1,242)
Reclassification of loss into earnings from interest rate swaps (1)	187	86	453	259
Income taxes	71	32	172	99
Reclassification of loss into earnings from interest rate swaps, net	116	54	281	160
Reclassification of net actuarial gain into earnings from postretirement benefit plans (2)	(9)	(10)	(28)	(30)
Income taxes	(4)	(4)	(12)	(12)
Reclassification of net actuarial gain into earnings from postretirement benefit plans, net	(5)	(6)	(16)	(18)
Reclassification of prior service credits into earnings from postretirement benefit plans (2)	(22)	(22)	(66)	(66)
Income taxes	(9)	(8)	(28)	(25)
Reclassification of prior service credits into earnings from postretirement benefit plans, net	(13)	(14)	(38)	(41)
TOTAL OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX	(1,094)	19	(1,302)	(1,141)
COMPREHENSIVE INCOME (LOSS)	\$(1,028)	\$(166)	\$(3,200)	\$2,657

- (1) Amounts for cash flow hedges reclassified from accumulated other comprehensive income (loss) to net income (loss) were included in interest expense in the Company's Consolidated Condensed Statement of Operations.
- (2) Amounts for postretirement plans reclassified from accumulated other comprehensive income (loss) to net income (loss) were included in selling and administrative expenses in the Company's Consolidated Condensed Statement of Operations.

See accompanying notes to the consolidated condensed financial statements.



Table of Contents 5

---

THE DIXIE GROUP, INC.  
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS  
(UNAUDITED)  
(amounts in thousands)

	Nine Months Ended	
	September 26, 2015	September 27, 2014
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Income (loss) from continuing operations	\$(1,780)	\$4,303
Loss from discontinued operations	(118)	(505)
Net income (loss)	(1,898)	3,798
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities, net of acquisitions:		
Depreciation and amortization - continuing operations	10,954	9,533
Depreciation and amortization - discontinued operations	—	48
Provision (benefit) for deferred income taxes	(1,403)	2,681
Net gain on property, plant and equipment disposals	(187)	(18)
Impairment of assets	—	759
Gain on purchase of business	—	(11,110)
Stock-based compensation expense	1,071	900
Excess tax benefits from stock-based compensation	(287)	(367)
Bad debt expense	110	325
Changes in operating assets and liabilities:		
Receivables	(3,301)	(7,686)
Inventories	(10,649)	(2,974)
Other current assets	(649)	1,627
Accounts payable and accrued expenses	9,876	1,902
Other operating assets and liabilities	(863)	(495)
<b>NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES</b>	<b>2,774</b>	<b>(1,077)</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Net proceeds from sales of property, plant and equipment	66	369
Deposits on property, plant and equipment	—	(119)
Purchase of property, plant and equipment	(5,266)	(6,753)
Proceeds from sale of equity investment	—	870
Net cash paid in business acquisitions	—	(17,657)
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<b>(5,200)</b>	<b>(23,290)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net borrowings on revolving credit facility	1,182	4,331
Borrowings on notes payable - buildings	6,290	—
Payments on notes payable - buildings	(522)	—
Payments on notes payable related to acquisitions	(1,572)	(1,513)
Borrowings on notes payable - equipment and other	998	2,195
Payments on notes payable - equipment and other	(3,370)	(2,072)
Payments on capital leases	(2,050)	(966)
Change in outstanding checks in excess of cash	1,278	(1,848)

Edgar Filing: DIXIE GROUP INC - Form 10-Q

Proceeds from equity offering, net of issuance costs	—	24,559
Proceeds from exercise of stock options	274	145
Repurchases of Common Stock	(584	) (518
Excess tax benefits from stock-based compensation	287	367
Payments for debt issuance costs	—	(84
NET CASH PROVIDED BY FINANCING ACTIVITIES	2,211	24,596
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(215	) 229
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	394	255
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$179	\$484

Table of Contents 6

---

	Nine Months Ended	
	September 26, 2015	September 27, 2014
<b>SUPPLEMENTAL CASH FLOW INFORMATION:</b>		
Interest paid	\$3,246	\$2,799
Income taxes paid, net of tax refunds	104	325
Equipment purchased under capital leases	87	8,709
Equipment purchased under notes payable	2,850	—
Deposits utilized on purchased equipment, net	1,857	—
Assets acquired in acquisitions, net of cash acquired	—	36,349
Liabilities assumed in acquisitions	—	(6,397 )
Accrued consideration for working capital adjustment in acquisitions	—	(298 )
Accrued consideration for holdbacks in acquisition	—	(887 )
Deposits on property, plant & equipment financed	—	3,977
Shortfall of tax benefits from stock-based compensation	(93 )	(607 )
Note receivable on sale of equipment	93	—

See accompanying notes to the consolidated condensed financial statements.

[Table of Contents](#) 7

---

THE DIXIE GROUP, INC.  
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS  
(UNAUDITED)  
(amounts in thousands, except per share data)

NOTE 1 - BASIS OF PRESENTATION

The accompanying unaudited consolidated condensed financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("US GAAP") for interim financial statements which do not include all the information and footnotes required by such accounting principles for annual financial statements. In the opinion of management, all adjustments (generally consisting of normal recurring accruals) considered necessary for a fair presentation have been included in the accompanying financial statements. The accompanying financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's 2014 Annual Report on Form 10-K filed with the Securities and Exchange Commission for the fiscal year ended December 27, 2014. Operating results for the three and nine month periods ended September 26, 2015 are not necessarily indicative of the results that may be expected for the entire 2015 year.

The Company has one reportable segment, carpet and rug manufacturing.

NOTE 2 - RECENT ACCOUNTING PRONOUNCEMENTS

In April 2014, the Financial Accounting Standards Board ("FASB") issued ASU No. 2014-08, "Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360) - Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity". The ASU was issued to change the requirements for reporting discontinued operations and to enhance the disclosures in this area. The ASU requires a disposal of a component of an entity or a group of components of an entity to be reported in discontinued operations only if the disposal represents a strategic shift and will have a major effect on an entity's operations and financial results. The ASU is effective prospectively for interim and annual reporting periods beginning after December 15, 2014. The adoption of this ASU did not have a material effect on the Company's Consolidated Condensed Financial Statements.

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)". The ASU requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The standard permits the use of either the retrospective or cumulative effect transition method. In August 2015, the FASB issued ASU No. 2015-14, "Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date." The amendments in ASU 2015-14 defer the effective date of ASU 2014-09 for all entities by one year. Public business entities, certain not-for-profit entities, and certain employee benefit plans should apply the guidance in ASU 2014-09 to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. Management has not yet selected a transition method and is currently evaluating the impact of the pending adoption of this ASU on the Company's Consolidated Condensed Financial Statements.

In August 2014, the FASB issued ASU No. 2014-15, "Presentation of Financial Statements - Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern." The guidance requires an entity to evaluate whether there are conditions or events, in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued and to provide related footnote disclosures in certain circumstances. The guidance is effective for the annual period ending after December 15, 2016, and for annual and interim periods thereafter. Early application

is permitted. The Company does not believe the adoption of this ASU will have a significant impact on the Consolidated Condensed Financial Statements.

In April 2015, the FASB issued ASU No. 2015-03, "Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs." The amendments in ASU 2015-03 require entities to present debt issuance costs related to a recognized debt liability as a direct deduction from the carrying amount of that debt liability. The guidance in ASU 2015-03 (see paragraph 835-30-45-1A) does not address presentation or subsequent measurement of debt issuance costs related to line-of-credit arrangements. Given the absence of authoritative guidance within ASU 2015-03 for debt issuance costs related to line-of-credit arrangements, the FASB issued ASU No. 2015-15, "Interest—Imputation of Interest (Subtopic 835-30) - Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements (Amendments to SEC Paragraphs Pursuant to Staff Announcement at June 18, 2015 EITF Meeting)." The SEC staff stated that they would not object to an entity deferring and presenting debt issuance costs as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this ASU. The ASU is effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption is permitted for financial statements that have not been previously issued. The Company does not believe the adoption of these ASUs will have a significant impact on the Consolidated Condensed Financial Statements.

Table of Contents 8

---

## THE DIXIE GROUP, INC.

## NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(UNAUDITED)

(amounts in thousands, except per share data) (Continued)

In April 2015, the FASB issued ASU No. 2015-05, "Customer's Accounting for Fees Paid in a Cloud Computing Arrangement." ASU 2015-05 provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software license. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The guidance will not change GAAP for a customer's accounting for service contracts. The Company does not believe the adoption of this ASU will have a significant impact on the Consolidated Condensed Financial Statements.

In July 2015, the FASB issued ASU No. 2015-11, "Inventory (Topic 330): Simplifying the Measurement of Inventory." Topic 330, Inventory, currently requires an entity to measure inventory at the lower of cost or market. Market could be replacement cost, net realizable value, or net realizable value less an approximately normal profit margin. The amendments do not apply to inventory that is measured using last-in, first-out (LIFO) or the retail inventory method. The amendments apply to all other inventory, which includes inventory that is measured using first-in, first-out (FIFO) or average cost. An entity should measure in scope inventory at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. Subsequent measurement is unchanged for inventory measured using LIFO or the retail inventory method. The amendments are effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. The amendments should be applied prospectively with earlier application permitted as of the beginning of an interim or annual reporting period. The Company measures substantially all inventories using the LIFO method; therefore, the Company does not believe the adoption of this ASU will have a significant impact on the Consolidated Condensed Financial Statements.

In September 2015, the FASB issued ASU No. 2015-16, "Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments." The amendments in ASU 2015-16 require that an acquirer recognize adjustments to estimated amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined, rather than retrospectively adjusting amounts previously reported. The amendments require that the acquirer record, in the same period's financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the estimated amounts, calculated as if the accounting had been completed at the acquisition date. Effective for public business entities for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years. The amendments should be applied prospectively to adjustments to provisional amounts that occur after the effective date with earlier application permitted for financial statements that have not been issued. The Company does not believe the adoption of this ASU will have a significant impact on the Consolidated Condensed Financial Statements.

## NOTE 3 - RECEIVABLES, NET

Receivables are summarized as follows:

	September 26, 2015	December 27, 2014
Customers, trade	\$49,279	\$46,422
Other receivables	4,984	4,552
Gross receivables	54,263	50,974

Edgar Filing: DIXIE GROUP INC - Form 10-Q

Less allowance for doubtful accounts	(455	) (450	)
Receivables, net	\$53,808	\$50,524	

Bad debt expense was \$51 and \$110 for the three and nine months ended September 26, 2015, respectively, and \$179 and \$325 for the three and nine months ended September 27, 2014, respectively.

Table of Contents 9

---



THE DIXIE GROUP, INC.  
 NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS  
 (UNAUDITED)  
 (amounts in thousands, except per share data) (Continued)

## NOTE 4 - INVENTORIES

Inventories are summarized as follows:

	September 26, 2015	December 27, 2014
Raw materials	\$40,983	\$40,649
Work-in-process	23,346	19,976
Finished goods	61,488	57,913
Supplies and other	236	126
LIFO reserve	(11,197	) (14,457
Inventories	\$114,856	\$104,207

## NOTE 5 - PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment consists of the following:

	September 26, 2015	December 27, 2014
Land and improvements	\$7,385	\$7,327
Buildings and improvements	62,504	61,557
Machinery and equipment	175,328	171,586
	245,217	240,470
Accumulated depreciation	(143,148	) (137,981
Property, plant and equipment, net	\$102,069	\$102,489

Depreciation of property, plant and equipment, including amounts for capital leases, totaled \$3,503 and \$10,508, respectively, in the three and nine months ended September 26, 2015 and \$2,921 and \$8,604, respectively, in the three and nine months ended September 27, 2014.

## NOTE 6 - ACQUISITIONS

On March 19, 2014, the Company acquired all outstanding stock of Atlas Carpet Mills, Inc. ("Atlas") for total purchase price consideration of \$18,759. The fair value of the net assets acquired exceeded the purchase price resulting in a bargain purchase of \$10,937 for the nine months ended September 27, 2014. Net sales related to Atlas included in the Company's Consolidated Condensed Statement of Operations for the three months ended September 26, 2015 and September 27, 2014 were \$12,415 and \$12,079, respectively, and were \$32,395 and \$25,927 for the nine months ended September 26, 2015 and September 27, 2014, respectively.

On September 22, 2014, the Company acquired certain assets and assumed certain liabilities of Burtco Enterprises, Inc. ("Burtco") for total purchase price consideration of \$2,549. The fair value of the net assets acquired exceeded the purchase price resulting in a bargain purchase of \$173 for the three and nine months ended September 27, 2014.

## NOTE 7 - GOODWILL AND OTHER INTANGIBLE ASSETS

Edgar Filing: DIXIE GROUP INC - Form 10-Q

The carrying amount of goodwill is \$3,389 as of September 26, 2015 and December 27, 2014. The Company has a net carrying amount of \$3,148 and \$3,378 as of September 26, 2015 and December 27, 2014 for certain intangible assets subject to amortization. Amortization expense was \$76 and \$229 for the three and nine months ended September 26, 2015, respectively, and \$105 and \$255 for the three and nine months ended September 27, 2014, respectively.

Table of Contents 10

---

THE DIXIE GROUP, INC.  
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS  
(UNAUDITED)  
(amounts in thousands, except per share data) (Continued)

## NOTE 8 - ACCRUED EXPENSES

Accrued expenses are summarized as follows:

	September 26, 2015	December 27, 2014
Compensation and benefits	\$9,407	\$8,894
Provision for customer rebates, claims and allowances	9,196	7,960
Advanced customer deposits	5,362	3,501
Outstanding checks in excess of cash	2,468	1,190
Other	8,284	7,762
Accrued expenses	\$34,717	\$29,307

## NOTE 9 - PRODUCT WARRANTY RESERVES

The Company generally provides product warranties related to manufacturing defects and specific performance standards for its products. Product warranty reserves are included in accrued expenses in the Company's Consolidated Condensed Financial Statements. The following is a summary of the Company's product warranty activity.

	Three Months Ended		Nine Months Ended	
	September 26, 2015	September 27, 2014	September 26, 2015	September 27, 2014
Product warranty reserve at beginning of period	\$2,115	\$2,210	\$2,214	\$1,850
Warranty reserve assumed in business combination	—	—	—	209
Warranty liabilities accrued	1,430	1,180	4,707	3,372
Warranty liabilities settled	(1,880)	(1,266)	(6,682)	(3,715)
Changes for pre-existing warranty liabilities	616	204	2,042	612
Product warranty reserve at end of period	\$2,281	\$2,328	\$2,281	\$2,328

## NOTE 10 - LONG-TERM DEBT AND CREDIT ARRANGEMENTS

Long-term debt consists of the following:

	September 26, 2015	December 27, 2014
Revolving credit facility - Tranche A	\$84,080	\$82,897
Notes payable - buildings	14,063	8,295
Acquisition note payable - Obligation to Development Authority of Gordon County	2,595	3,413
Acquisition note payable - Robertex	2,308	3,062
Notes payable - equipment and other	15,101	14,623
Capital lease obligations	13,034	14,998
Total long-term debt	131,181	127,288
Less: current portion of long-term debt	(9,337)	(9,078)
Long-term debt	\$121,844	\$118,210

### Revolving Credit Facility

The revolving portion of the credit facility ("Tranche A Advance") provides for a maximum of \$150,000 of revolving credit, subject to borrowing base availability. The borrowing base is currently equal to specified percentages of the Company's eligible accounts receivable, inventories, fixed assets and real property less reserves established, from time to time, by the administrative agent under the facility. The term of the revolving credit facility matures on March 14, 2019. The revolving credit facility is secured by a first priority lien on substantially all of the Company's assets.

At the Company's election, Tranche A Advances of the revolving credit facility bear interest at annual rates equal to either (a) LIBOR for 1, 2 or 3 month periods, as selected by the Company, plus an applicable margin of either 1.50%, 1.75% or 2.00%, or

Table of Contents 11

---

THE DIXIE GROUP, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(UNAUDITED)

(amounts in thousands, except per share data) (Continued)

(b) the higher of the prime rate, the Federal Funds rate plus 0.5%, or a daily LIBOR rate plus 1.00%, plus an applicable margin of either 0.50%, 0.75% or 1.00%. The applicable margin is determined based on availability under the revolving credit facility with margins increasing as availability decreases. The Company pays an unused line fee on the average amount by which the aggregate commitments exceed utilization of the senior credit facility equal to 0.375% per annum.

The revolving credit facility includes certain affirmative and negative covenants that impose restrictions on the Company's financial and business operations. The revolving credit facility requires the Company to maintain a fixed charge coverage ratio of 1.1 to 1.0 during any period that borrowing availability is less than \$16,500. As of September 26, 2015, the unused borrowing availability under the revolving credit facility was \$36,362. As of September 26, 2015, the Company's fixed charge coverage ratio was less than 1.1 to 1.0, accordingly, the unused availability accessible by the Company is the amount above \$16,500.

Notes Payable - Buildings

On November 7, 2014, the Company entered into a ten-year \$8,330 note payable to purchase a previously leased distribution center in Adairsville, Georgia. The note payable is scheduled to mature on November 7, 2024 and is secured by the distribution center. The note payable bears interest at a variable rate equal to one month LIBOR plus 2.0% and is payable in equal monthly installments of principal of \$35, plus interest calculated on the declining balance of the note, with a final payment of \$4,165 due on maturity. In addition, the Company entered into an interest rate swap with an amortizing notional amount effective November 7, 2014 which effectively fixes the interest rate at 4.50%.

On January 23, 2015, the Company entered into a ten-year \$6,290 note payable to finance an owned facility in Saraland, Alabama. The note payable is scheduled to mature on January 7, 2025 and is secured by the facility. The note payable bears interest at a variable rate equal to one month LIBOR plus 2.0% and is payable in equal monthly installments of principal of \$26, plus interest calculated on the declining balance of the note, with a final payment of \$3,145 due on maturity. In addition, the Company entered into a forward interest rate swap with an amortizing notional amount effective January 7, 2017 which effectively fixes the interest rate at 4.30%.

Acquisition Note Payable - Obligation to Development Authority of Gordon County

On November 2, 2012, the Company signed a 6.00% seller-financed note of \$5,500 with Lineage PCR, Inc. ("Lineage") related to the acquisition of the continuous carpet dyeing facility in Calhoun, Georgia. Effective December 28, 2012, through a series of agreements between the Company, the Development Authority of Gordon County, Georgia (the "Authority") and Lineage, obligations with identical payment terms as the original note to Lineage became payment obligations to the Authority. These transactions were consummated in order to provide a tax abatement to the Company related to the real estate and equipment at this facility. The tax abatement plan provides for abatement for certain components of the real and personal property taxes for up to ten years. At any time, the Company has the option to pay off the obligation, plus a nominal amount. The debt to the Authority bears interest at 6.00% and is payable in equal monthly installments of principal and interest of \$106 over 57 months.

Acquisition Note Payable - Robertex

On July 1, 2013, the Company signed a 4.50% seller-financed note of \$4,000, which was recorded at a fair value of \$3,749, with Robert P. Rothman related to the acquisition of Robertex Associates, LLC ("Robertex") in Calhoun, Georgia. The note is payable in five annual installments of principal of \$800 plus interest. The note matures June 30, 2018.

#### Notes Payable - Equipment

The Company's equipment financing notes have terms ranging from three to seven years, bear interest ranging from 1.00% to 6.86% and are due in monthly or quarterly installments through their maturity dates. In connection with certain of the notes, the Company is required to maintain funds in a separate escrow account. At September 26, 2015 and December 27, 2014, the balances held were \$0 and \$574, respectively, and are included in other current assets on the Company's Consolidated Condensed Balance Sheets. The Company's equipment financing notes are secured by the specific equipment financed and do not contain any financial covenants.

#### Capital Lease Obligations

The Company's capital lease obligations have terms ranging from three to seven years, bear interest ranging from 2.90% to 7.37% and are due in monthly or quarterly installments through their maturity dates. The Company's capital lease obligations are secured by the specific equipment leased.

THE DIXIE GROUP, INC.  
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS  
(UNAUDITED)  
(amounts in thousands, except per share data) (Continued)

NOTE 11 - FAIR VALUE MEASUREMENTS

Fair value is defined as the exchange value of an asset or a liability in an orderly transaction between market participants. The fair value guidance outlines a valuation framework and establishes a fair value hierarchy in order to increase the consistency and comparability of fair value measurements and disclosures. The hierarchy consists of three levels as follows:

Level 1 - Quoted market prices in active markets for identical assets or liabilities as of the reported date;

Level 2 - Other than quoted market prices in active markets for identical assets or liabilities, quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, and other than quoted prices for assets or liabilities and prices that are derived principally from or corroborated by market data by correlation or other means; and

Level 3 - Measurements using management's best estimate of fair value, where the determination of fair value requires significant management judgment or estimation.

The following table reflects the fair values of assets and liabilities measured and recognized at fair value on a recurring basis on the Company's Consolidated Condensed Balance Sheets as of September 26, 2015 and December 27, 2014:

	September 26, 2015	December 27, 2014	Fair Value Hierarchy Level
Assets:			
Rabbi Trust (1)	\$14,404	\$15,316	Level 2
Interest rate swaps (2)	—	34	Level 2
Liabilities:			
Interest rate swaps (2)	\$5,072	\$3,040	Level 2
Deferred compensation plan (3)	13,412	14,331	Level 2
Contingent consideration (4)	1,093	1,855	Level 3

The Company maintains a Rabbi Trust that serves as an investment designed to offset its deferred compensation (1) plan liability. The investment assets of the trust consist of life insurance policies for which the Company recognizes income or expense based upon changes in cash surrender value.

The fair value of the interest rate swaps was obtained from external sources. The interest rate swaps were valued using observable inputs (e.g., LIBOR yield curves, credit spreads). Valuations of interest rate swaps may fluctuate (2) considerably from period-to-period due to volatility in underlying interest rates, which are driven by market conditions and the duration of the instrument. Credit adjustments could have a significant impact on the valuations due to changes in credit ratings of the Company or its counterparties.

Senior management and other highly compensated associates may defer a specified percentage of their (3) compensation into a non-qualified deferred compensation plan. Changes in the value of the deferred compensation under this plan are recognized each period based on the fair value of the underlying measurement funds.

(4) As a result of the Colormaster and Crown Rug acquisitions in 2012 and the Robertex acquisition in 2013, the Company recorded contingent consideration liabilities at fair value. These fair value measurements were based on

calculations that utilize significant inputs not observable in the market including forecasted revenues, gross margins and discount rates and thus represent Level 3 measurements. These fair value measurements are directly impacted by the Company's estimates. Accordingly, if the estimates are higher or lower than the estimates within the fair value measurement, the Company would record additional charges or benefits, respectively, as appropriate.

Table of Contents 13

---



THE DIXIE GROUP, INC.  
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS  
(UNAUDITED)  
(amounts in thousands, except per share data) (Continued)

Changes in the fair value measurements using significant unobservable inputs (Level 3) during the nine months ending September 26, 2015 and September 27, 2014 were as follows:

	September 26, 2015	September 27, 2014
Beginning balance	\$1,855	\$2,751
Fair value adjustments	(387	) (264
Settlements	(375	) (214
Ending balance	\$1,093	\$2,273

There were no transfers of assets or liabilities between Level 1, Level 2 and Level 3 during the three and nine months ending September 26, 2015 or September 27, 2014. If any, the Company recognizes the transfers in or transfers out at the end of the reporting period.

The carrying amounts and estimated fair values of the Company's financial instruments are summarized as follows:

	September 26, 2015		December 27, 2014	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
<b>Financial Assets:</b>				
Cash and cash equivalents	\$ 179	\$ 179	\$ 394	\$ 394
Notes receivable, including current portion	282	282	282	282
Interest rate swaps	—	—	34	34
<b>Financial Liabilities:</b>				
Long-term debt and capital leases, including current portion	131,181	128,304	127,288	119,776
Interest rate swaps	5,072	5,072	3,040	3,040

The fair values of the Company's long-term debt and capital leases were estimated using market rates the Company believes would be available for similar types of financial instruments and represent level 2 measurements. The fair values of cash and cash equivalents and notes receivable approximate their carrying amounts due to the short-term nature of the financial instruments.

#### NOTE 12 - DERIVATIVES

The Company's earnings, cash flows and financial position are exposed to market risks relating to interest rates. It is the Company's policy to minimize its exposure to adverse changes in interest rates and manage interest rate risks inherent in funding the Company with debt. The Company addresses this risk by maintaining a mix of fixed and floating rate debt and entering into interest rate swaps for a portion of its variable rate debt to minimize interest rate volatility.

The following is a summary of the Company's interest rate swaps as of September 26, 2015:

Type	Notional Amount	Effective Date	Fixed Rate	Variable Rate
------	--------------------	----------------	---------------	---------------

Edgar Filing: DIXIE GROUP INC - Form 10-Q

Interest rate swap	\$ 10,000	October 3, 2011 through September 1, 2016	1.330%	1 Month LIBOR
Interest rate swap	\$ 10,000	March 1, 2013 through September 1, 2016	1.620%	1 Month LIBOR
Interest rate swap	\$ 5,000	June 1, 2013 through September 1, 2016	1.700%	1 Month LIBOR
Interest rate swap	\$ 25,000	September 1, 2016 through September 1, 2021	3.105%	1 Month LIBOR
Interest rate swap	\$ 25,000	September 1, 2015 through September 1, 2021	3.304%	1 Month LIBOR
Interest rate swap	\$ 7,983	(1) November 7, 2014 through November 7, 2024	4.500%	1 Month LIBOR
Interest rate swap	\$ 5,661	(2) January 7, 2017 through January 7, 2025	4.300%	1 Month LIBOR

(1) Interest rate swap notional amount amortizes by \$35 monthly to maturity.

(2) Interest rate swap notional amount amortizes by \$26 monthly to maturity.

Table of Contents 14

---

THE DIXIE GROUP, INC.  
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS  
(UNAUDITED)  
(amounts in thousands, except per share data) (Continued)

The following table summarizes the fair values of derivative instruments included in the Company's Consolidated Condensed Balance Sheets:

	Location on Consolidated Balance Sheets	Fair Value September 26, 2015	December 27, 2014
Asset Derivatives:			
Derivatives designated as hedging instruments:			
Interest rate swaps	Other Assets	\$—	\$34
Total Asset Derivatives		\$—	\$34
Liability Derivatives:			
Derivatives designated as hedging instruments:			
Interest rate swaps, current portion	Accrued Expenses	\$1,200	\$650
Interest rate swaps, long-term portion	Other Long-Term Liabilities	3,872	2,390
Total Liability Derivatives		\$5,072	\$3,040

The following tables summarize the pre-tax impact of derivative instruments on the Company's financial statements:

	Amount of Gain or (Loss) Recognized in AOCIL on the effective portion of the Derivative			
	Three Months Ended		Nine Months Ended	
	September 26, 2015	September 27, 2014	September 26, 2015	September 27, 2014
Derivatives designated as hedging instruments:				
Cash flow hedges - interest rate swaps	\$(1,923	) \$(24	) \$(2,466	) \$(2,003
				)
	Amount of Gain or (Loss) Reclassified from AOCIL on the effective portion into Income (1)(2)(3)			
	Three Months Ended		Nine Months Ended	
	September 26, 2015	September 27, 2014	September 26, 2015	September 27, 2014
Derivatives designated as hedging instruments:				
Cash flow hedges - interest rate swaps	\$(187	) \$(86	) \$(453	) \$(259
				)

(1) The amount of gain (loss) reclassified from AOCIL is included in interest expense on the Company's Consolidated Condensed Statements of Operations.

(2) The amount of loss expected to be reclassified from AOCIL into earnings during the next 12 months subsequent to September 26, 2015 is \$1,200.

(3) The amount of gain (loss) recognized in income on any ineffective portion of interest rate swaps is included in other (income) expense, net on the Company's Consolidated Condensed Statements of Operations. There was no ineffective portion for the periods presented.

NOTE 13 - EMPLOYEE BENEFIT PLANS

Defined Contribution Plans

The Company sponsors a 401(k) defined contribution plan that covers a significant portion, or approximately 85% of the Company's associates. This plan includes a mandatory Company match on the first 1% of participants' contributions. The Company matches the next 2% of participants' contributions if the Company meets prescribed earnings levels. The plan also provides for additional Company contributions above the 3% level if the Company attains certain additional performance targets. Matching contribution expense for this 401(k) plan was \$223 and \$(95) for the three months ended September 26, 2015 and September 27, 2014, respectively, and \$683 and \$272 for the nine months ended September 26, 2015 and September 27, 2014, respectively. The reduction in the matching contribution expense for the three months ended September 27, 2014 was a result of a reduction in the Company match due to lower earnings levels.

Table of Contents 15

---

THE DIXIE GROUP, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(UNAUDITED)

(amounts in thousands, except per share data) (Continued)

Additionally, the Company sponsors a 401(k) defined contribution plan that covers those associates at one facility who are under a collective-bargaining agreement, or approximately 15% of the Company's associates. Under this plan, the Company generally matches participants' contributions, on a sliding scale, up to a maximum of 2.75% of the participant's earnings. Matching contribution expense for the collective-bargaining 401(k) plan was \$17 and \$20 for the three months ended September 26, 2015 and September 27, 2014, respectively, and \$62 and \$65 for the nine months ended September 26, 2015 and September 27, 2014, respectively.

#### Non-Qualified Retirement Savings Plan

The Company sponsors a non-qualified retirement savings plan that allows eligible associates to defer a specified percentage of their compensation. The obligations owed to participants under this plan were \$13,412 at September 26, 2015 and \$14,331 at December 27, 2014 and are included in other long-term liabilities in the Company's Consolidated Condensed Balance Sheets. The obligations are unsecured general obligations of the Company and the participants have no right, interest or claim in the assets of the Company, except as unsecured general creditors. The Company utilizes a Rabbi Trust to hold, invest and reinvest deferrals and contributions under the plan. Amounts are invested in Company-owned life insurance in the Rabbi Trust and the cash surrender value of the policies was \$14,404 at September 26, 2015 and \$15,316 at December 27, 2014 and is included in other assets in the Company's Consolidated Condensed Balance Sheets.

#### Multi-Employer Pension Plan

The Company contributes to a multi-employer pension plan under the terms of a collective-bargaining agreement that covers its union-represented employees. Expenses related to the multi-employer pension plan were \$66 and \$69 for the three months ended September 26, 2015 and September 27, 2014, respectively, and \$197 and \$210 for the nine months ended September 26, 2015 and September 27, 2014, respectively.

#### Postretirement Plans

The Company inherited a legacy postretirement benefit plan that provides life insurance to a limited number of associates as a result of a prior acquisition. The Company also sponsors a postretirement benefit plan that provides medical insurance for a limited number of associates who retired prior to January 1, 2003 and life insurance to a limited number of associates upon retirement. The net periodic benefit cost (credit) for all postretirement plans is insignificant.

#### NOTE 14 - INCOME TAXES

The Company's effective income tax rate for the period ending September 26, 2015 is based upon the projected estimated annual income tax rate. The effective income tax rate for the nine months ending September 26, 2015 was 38.6% compared with an effective income tax rate of 40.1% for the nine months ending September 27, 2014. The nine months ending September 27, 2014 included the recognition of approximately \$117 of tax expense related to certain market-based stock awards that were not earned.

The Company accounts for uncertainty in income tax positions according to FASB guidance relating to uncertain tax positions. Unrecognized tax benefits were \$339 and \$400 at September 26, 2015 and December 27, 2014, respectively. Such benefits, if recognized, would affect the Company's effective tax rate. There were no significant interest or penalties accrued as of September 26, 2015 and December 27, 2014.

The Company and its subsidiaries are subject to United States federal income taxes, as well as income taxes in a number of state jurisdictions. The tax years subsequent to 2010 remain open to examination for U.S. federal income taxes. The majority of state jurisdictions remain open for tax years subsequent to 2010. A few state jurisdictions remain open to examination for tax years subsequent to 2009.

#### NOTE 15 - EARNINGS (LOSS) PER SHARE

##### Earnings (Loss) Per Share

The Company's unvested stock awards that contain non-forfeitable rights to dividends or dividend equivalents, whether paid or unpaid, are considered participating securities and are included in the computation of earnings per share. The accounting guidance requires additional disclosure of EPS for common stock and unvested share-based payment awards, separately disclosing distributed and undistributed earnings. Undistributed earnings represent earnings that were available for distribution but were not distributed. Common stock and unvested share-based payment awards earn dividends equally. All earnings were undistributed in all periods presented.

Table of Contents 16

---

THE DIXIE GROUP, INC.  
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS  
(UNAUDITED)  
(amounts in thousands, except per share data) (Continued)

The following table sets forth the computation of basic and diluted earnings (loss) per share from continuing operations:

	Three Months Ended		Nine Months Ended	
	September 26, 2015	September 27, 2014	September 26, 2015	September 27, 2014
Basic earnings (loss) per share:				
Income (loss) from continuing operations	\$84	\$(8)	\$(1,780)	\$4,303
Less: Allocation of earnings to participating securities	(2)	—	—	(197)
Income (loss) from continuing operations available to common shareholders - basic	\$82	\$(8)	\$(1,780)	\$4,106
Basic weighted-average shares outstanding (1)	15,573	15,394	15,518	14,040
Basic earnings (loss) per share - continuing operations	\$0.01	\$(0.00)	\$(0.11)	\$0.29
Diluted earnings (loss) per share:				
Income (loss) from continuing operations available to common shareholders - basic	\$82	\$(8)	\$(1,780)	\$4,106
Add: Undistributed earnings reallocated to unvested shareholders	—	—	—	3
Income (loss) from continuing operations available to common shareholders - basic	\$82	\$(8)	\$(1,780)	\$4,109
Basic weighted-average shares outstanding (1)	15,573	15,394	15,518	14,040
Effect of dilutive securities:				
Stock options (2)	37	—	—	111
Directors' stock performance units (2)	56	—	—	65
Diluted weighted-average shares outstanding (1)(2)	15,666	15,394	15,518	14,216
Diluted earnings (loss) per share - continuing operations	\$0.01	\$(0.00)	\$(0.11)	\$0.29

(1) Includes Common and Class B Common shares, in thousands.

Because their effects are anti-dilutive, shares issuable under stock option plans where the exercise price is greater than the average market price of the Company's Common Stock during the relevant period and directors' stock

(2) performance units have been excluded. Aggregate shares excluded for the three and nine months ended September 26, 2015 were 220 and 308, respectively, and for the three and nine months ending September 27, 2014 were 552 and 432, respectively.

#### NOTE 16 - STOCK COMPENSATION EXPENSE

The Company recognizes compensation expense relating to share-based payments based on the fair value of the equity instrument issued and records such expense in selling and administrative expenses in the Company's Consolidated Condensed Financial Statements. The number of shares to be issued is determined by dividing the specified dollar

value of the award by the market value per share on the grant date. The Company's stock compensation expense was \$346 and \$1,071 for the three and nine months ended September 26, 2015, respectively, and \$289 and \$900 for the three and nine months ended September 27, 2014, respectively.

On August 1, 2015, the Company granted 10,000 shares of restricted stock to an employee. The grant-date fair value of the award was \$100, or \$9.980 per share and will be recognized as stock compensation over a 3 year vesting period from the date the award was granted. The award is subject to a continued service condition. The fair value of each share of restricted stock awarded was equal to the market value of a share of the Company's Common Stock on the grant date.

On April 29, 2015, the Company granted 100,000 shares of restricted stock to the Company's Chief Executive Officer. The grant-date fair value of the award was \$982, or \$9.815 per share and will be recognized as stock compensation expense over a 4 year vesting period from the date the award was granted. Vesting of the award is subject to both a service condition and performance condition. The fair value of each share of restricted stock awarded was equal to the market value of a share of the Company's Common Stock on the grant date.

Table of Contents 17

---



## THE DIXIE GROUP, INC.

## NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(UNAUDITED)

(amounts in thousands, except per share data) (Continued)

On March 12, 2015, the Company issued 114,625 shares of restricted stock to officers and other key employees. The grant-date fair value of the awards was \$1,021, or \$8.910 per share, and is expected to be recognized as stock compensation expense over a weighted-average period of 7.4 years from the date the awards were granted. Each award is subject to a continued service condition. The fair value of each share of restricted stock awarded was equal to the market value of a share of the Company's Common Stock on the grant date.

## NOTE 17 - ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

Components of accumulated other comprehensive income (loss), net of tax, are as follows:

	Interest Rate Swaps	Post-Retirement Liabilities	Total
Balance at December 27, 2014	(1,841 )	328	(1,513 )
Unrealized gain (loss) on interest rate swaps, net of tax of \$937	(1,529 )	—	(1,529 )
Reclassification of loss into earnings from interest rate swaps, net of tax of \$172	281	—	281
Reclassification of net actuarial gain into earnings from postretirement benefit plans, net of tax of \$12	—	(16 )	(16 )
Reclassification of prior service credits into earnings from postretirement benefit plans, net of tax of \$28	—	(38 )	(38 )
Balance at September 26, 2015	\$(3,089 )	\$ 274	\$(2,815 )

## NOTE 18 - COMMITMENTS AND CONTINGENCIES

## Commitments

On April 1, 2015, the Company entered into a 15-year lease agreement to lease office space in Dalton, Georgia. The lease began on September 11, 2015. Base annual rent is initially set at approximately \$28 per month. Total base rent payable over the lease period is approximately \$5,028.

## Contingencies

The Company assesses its exposure related to legal matters, including those pertaining to product liability, safety and health matters and other items that arise in the regular course of its business. If the Company determines that it is probable a loss has been incurred, the amount of the loss, or an amount within the range of loss, that can be reasonably estimated will be recorded.

## Environmental Remediation

The Company accrues for losses associated with environmental remediation obligations when such losses are probable and estimable. Remediation obligations are accrued based on the latest available information and are recorded at undiscounted amounts. The Company regularly monitors the progress of environmental remediation. If studies indicate that the cost of remediation has changed from the previous estimate, an adjustment to the liability would be recorded in the period in which such determination is made. (See Note 21)

Table of Contents 18

---

THE DIXIE GROUP, INC.  
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS  
(UNAUDITED)  
(amounts in thousands, except per share data) (Continued)

## NOTE 19 - OTHER (INCOME) EXPENSE

Other operating (income) expense, net is summarized as follows:

	Three Months Ended		Nine Months Ended	
	September 26, 2015	September 27, 2014	September 26, 2015	September 27, 2014
Other operating (income) expense, net:				
Gain on property, plant and equipment disposals	\$(79)	) \$(15)	) \$(187)	) \$(18)
Loss on currency exchanges	85	116	530	342
Amortization of intangibles	76	105	229	255
Retirement expenses	83	48	173	94
Miscellaneous (income) expense	(34)	) (24)	) (61)	) (72)
Other operating (income) expense, net	\$131	\$230	\$684	\$601

Other expense, net is summarized as follows:

	Three Months Ended		Nine Months Ended	
	September 26, 2015	September 27, 2014	September 26, 2015	September 27, 2014
Other (income) expense, net:				
Earnings from equity investments	\$—	) \$(24)	) \$14	) \$(67)
Miscellaneous (income) expense	4	1	31	7
Other (income) expense, net	\$4	) \$(23)	) \$45	) \$(60)

## NOTE 20 - FACILITY CONSOLIDATION EXPENSES

## 2014 Warehousing, Distribution &amp; Manufacturing Consolidation Plan

The Company developed a plan to align its warehousing, distribution and manufacturing to support its growth and manufacturing strategy resulting in better cost structure and improved distribution capabilities and customer service. The key element and first major step of this plan was the acquisition of a facility to serve as a finished goods warehouse and a cut-order and distribution center in Adairsville, Georgia. Costs related to the consolidation include moving and relocation expenses, information technology expenses and expenses relating to conversion and realignment of equipment. In addition, this plan includes the elimination of both carpet dyeing and yarn dyeing in the Company's Atmore, Alabama facility designed to more fully accommodate the distribution and manufacturing realignment. As a result, the dyeing operations in Atmore were moved to the Company's continuous dyeing facility, skein dyeing operation and other outside dyeing processors. These costs should be completed in the first half of fiscal 2016.

## 2014 Atlas Integration Plan

As a part of the March 19, 2014 acquisition of Atlas, the Company developed a plan to close the operations of the Atlas dyeing facility in Los Angeles and move the carpet dyeing of their products to the Company's dyeing operation located in Santa Ana, California. Costs related to the consolidation include equipment relocation, computer systems modifications and severance costs and should be completed in fiscal 2015.

#### 2015 Corporate Office Consolidation Plan

In April 2015, the Company's Board of Directors approved the Corporate Office Consolidation Plan, to cover the costs of consolidating three of the Company's existing divisional and corporate offices to a single facility located in Dalton, Georgia. This plan was implemented in September 2015 and should be completed in the fourth quarter of 2015 and is estimated to cost \$716. Costs related to the consolidation include lease cancellation and moving costs.

Table of Contents 19

---

THE DIXIE GROUP, INC.  
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS  
(UNAUDITED)  
(amounts in thousands, except per share data) (Continued)

Costs related to the facility consolidation plans are summarized as follows:

	Accrued Balance at December 27, 2014	2015 Expenses To Date	2015 Cash Payments	Accrued Balance at September 26, 2015	As of September 26, 2015	
					Total Costs Incurred To Date	Total Expected Costs
Warehousing, Distribution & Manufacturing Consolidation Plan	\$—	\$1,786	\$(1,786 )	\$—	\$5,832	\$6,574
Atlas Integration Plan	—	202	(202 )	—	1,670	1,670
Corporate Office Consolidation Plan	—	276	(82 )	194	276	716
Totals	\$—	\$2,264	(1) \$(2,070 )	\$194	\$7,778	(1) \$8,960
Asset impairments		\$—	(2)		\$1,133	(2) \$1,133

(1) Costs incurred under these plans are classified as "facility consolidation expenses" in the Company's Consolidated Condensed Statements of Operations.

(2) Asset impairments under these plans, when applicable, are classified as "loss on impairments" in the Company's Consolidated Condensed Statements of Operations.

#### NOTE 21 - DISCONTINUED OPERATIONS

The Company has previously either sold or discontinued certain operations that are accounted for as "Discontinued Operations" under applicable accounting guidance. Discontinued operations are summarized as follows:

	Three Months Ended		Nine Months Ended	
	September 26, 2015	September 27, 2014	September 26, 2015	September 27, 2014
Net sales - Carousel operations	\$—	\$353	\$417	\$829
Income (loss) from discontinued operations:				
Income (loss) from Carousel operations	\$(12 )	\$(304 )	\$(89 )	\$(680 )
Workers' compensation costs from former textile operations	\$(12 )	\$(8 )	\$(48 )	\$(54 )
Environmental remediation costs from former textile operations	(13 )	(25 )	(56 )	(106 )
Loss from discontinued operations, before taxes	(37 )	(337 )	(193 )	(840 )
Income tax benefit	(19 )	(160 )	(75 )	(335 )
Loss from discontinued operations, net of tax	\$(18 )	\$(177 )	\$(118 )	\$(505 )

In the fourth quarter of 2014, the Company discontinued the Carousel specialty tufting and weaving operation that was part of the 2013 Robertex, Inc. acquisition. Operating results associated with Carousel have been classified as discontinued operations for all periods presented.

Undiscounted reserves are maintained for the self-insured workers' compensation obligations related to the Company's former textile operations. These reserves are administered by a third-party workers' compensation service provider under the supervision of Company personnel. Such reserves are reassessed on a quarterly basis. Pre-tax cost incurred for workers' compensation as a component of discontinued operations primarily represents a change in estimate for each period for medical costs associated with the Company's obligations.

Reserves for environmental remediation obligations are established on an undiscounted basis for the Company's former textile operations. The Company has an accrual for environmental remediation obligations of \$1,604 and \$1,637 as of September 26, 2015 and December 27, 2014, respectively. The liability established represents the Company's best estimate of possible loss and is the reasonable amount to which there is any meaningful degree of certainty given the periods of estimated remediation

Table of Contents 20

---

THE DIXIE GROUP, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(UNAUDITED)

(amounts in thousands, except per share data) (Continued)

and the dollars applicable to such remediation for those periods. The actual timeline to remediate, and thus, the ultimate cost to complete such remediation through these remediation efforts, may differ significantly from our estimates. Pre-tax cost for environmental remediation obligations classified as discontinued operations were primarily a result of specific events requiring action and additional expense in each period.

NOTE 22 - RELATED PARTY TRANSACTIONS

The Company purchases a portion of its product needs in the form of fiber, yarn, carpet and dyeing services from Engineered Floors, an entity substantially controlled by Robert E. Shaw, a shareholder of the Company. Mr. Shaw holds approximately 8.4% of the Company's Common Stock, which represents approximately 3.9% of the total vote of all classes of the Company's Common Stock. Engineered Floors is one of several suppliers of such services to the Company. Total purchases from Engineered Floors during the three and nine months ended September 26, 2015 were approximately \$2,396 and \$6,889, respectively; or approximately 2.9% and 2.9%, respectively, of the Company's cost of goods sold. Total purchases from Engineered Floors during the three and nine months ended September 27, 2014 were approximately \$2,666 and \$8,792, respectively; or approximately 3.2% and 3.8%, respectively, of the Company's cost of goods sold. Purchases from Engineered Floors are based on market value, negotiated prices. The Company has no contractual arrangements or commitments with Mr. Shaw associated with its business relationship with Engineered Floors. Transactions with Engineered Floors were reviewed and approved by the Company's board of directors.

The Company is a party to a 5-year lease with the seller of Atlas Carpet Mills, Inc. to lease three manufacturing facilities as part of the acquisition in 2014. The lessor is controlled by an associate of the Company. Rent paid to the lessor during the three and nine months ended September 26, 2015 was \$114 and \$343, respectively. Rent paid to the lessor during the three and nine months ended September 27, 2014 was \$114 and \$229, respectively. The lease was based on current market values for similar facilities.

The Company is a party to a 10-year lease with the Rothman Family Partnership to lease a manufacturing facility as part of the Robertex acquisition in 2013. The lessor is controlled by an associate of the Company. Rent paid to the lessor during the three and nine months ended September 26, 2015 was \$66 and \$196, respectively. Rent paid to the lessor for the three and nine months ended September 27, 2014 was \$65 and \$192, respectively. The lease was based on current market values for similar facilities. In addition, the Company has a note payable to Robert P. Rothman related to the acquisition of Robertex Inc. (See Note 10).

Table of Contents 21

---

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following is presented to update the discussion of results of operations and financial condition included in our 2014 Annual Report on Form 10-K filed with the Securities and Exchange Commission.

### FORWARD-LOOKING INFORMATION

This Report contains statements that may be considered forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended. These statements include the use of terms or phrases that include such terms as "expects," "estimates," "projects," "believes," "anticipates," "intends," and similar terms and phrases. Such forward looking statements relate to, among other matters, our future financial performance, business prospects, growth strategies or liquidity. The following important factors may affect our future results and could cause those results to differ materially from our historical results; these factors include, in addition to those "Risk Factors" detailed in item 1A of this report and described elsewhere in this document, the cost and availability of capital, raw material and transportation costs related to petroleum price levels, the cost and availability of energy supplies, the loss of a significant customer or group of customers, materially adverse changes in economic conditions generally in carpet, rug and floor covering markets we serve and other risks detailed from time to time in our filings with the Securities and Exchange Commission.

### OVERVIEW

During the third quarter of 2015, our sales were 0.1% below those of the same period in 2014. Sales of residential products decreased 1.5% in 2015 versus 2014, while, we estimate, the industry had a decrease in the low single digits. We anticipate the residential remodeling market to have marginal growth for the remainder of the year.

Commercial product sales increased 4.5% during the third quarter of 2015, while, we believe, the industry reflected an increase in the low single digits. Our Atlas products had an increase of 11.8% during the quarter. We are pleased with the new products we have introduced for Atlas so far in 2015.

We have completed the bulk of our capacity expansion and consolidation initiatives. The more significant impacts in 2015 relate to training, quality and waste associated with these endeavors. We anticipate these costs to drop as the training process comes to an end and our associates become more proficient in their new duties. Further we are seeing a decline in quality related costs for production subsequent to our restructuring efforts, reflecting the results of our training and related process improvement efforts. The status of our restructuring and facilities consolidation plans are discussed below.

Our Warehousing, Distribution & Manufacturing Consolidation Plan was developed to align our warehousing, distribution and manufacturing with our growth and manufacturing strategy. The plan was designed to create a better cost structure as well as improve distribution capabilities and customer service. In June of 2014, the Board of Directors approved a modification of this plan to include the elimination of both carpet dyeing and yarn dyeing in our Atmore, Alabama facility. Elimination of dyeing at this facility was designed to more fully accommodate our distribution and manufacturing realignment. Accordingly, the dyeing operations in Atmore were moved to our Colormaster continuous dyeing facility, our Calhoun Wool skein dyeing operation and other outside dyeing processors.

Total expenses of the Warehousing, Distribution & Manufacturing Consolidation Plan are anticipated to be approximately \$6.4 million. Expenses of this plan were \$341 thousand in the third quarter of 2015 and \$5.8 million since its initiation in 2014. We estimate additional spending primarily related to the movement of our Saraland,



Alabama rug operation moving from a rented facility into a company-owned facility of approximately \$742 thousand under this plan through early 2016. These expenses of the plan primarily consist of moving and relocating inventory and equipment, facility restoration, information technology expenses and expenses relating to conversion and realignment of equipment. In addition, we incurred non-cash asset impairment charges of \$1.1 million subsequent to the first quarter of 2014 related to manufacturing changes and equipment taken out of service in our facilities.

On March 19, 2014, we acquired Atlas Carpet Mills. As a part of the Atlas acquisition, we discontinued operations at the Atlas dyeing facility in Los Angeles and moved the carpet dyeing of their products to our Susan Street dyeing operation located in Santa Ana, California. We initiated an Atlas Integration Plan to accommodate the dyeing move and address the modification of computer systems. The costs of these initiatives were \$1.7 million. This plan was completed in the second quarter of 2015.

In April 2015, our Board of Directors approved our Corporate Office Consolidation Plan, to cover the costs of consolidating three of our existing divisional and corporate offices to a single facility located in Dalton, Georgia. We began implementing this plan during the third quarter of 2015 and incurred expenses of \$276 thousand during the quarter. We estimate this plan to cost approximately \$716 thousand, primarily related to lease cancellation charges for the facilities we are vacating.

## RESULTS OF OPERATIONS

As a result of the discontinuance of the non-core Carousel brand in the fourth quarter of 2014, the operating results of Carousel have been reclassified to discontinued operations for all periods presented. Carousel was acquired as a portion of the Robertex acquisition in 2013.

The following table sets forth certain elements of our continuing operations as a percentage of net sales for the periods indicated:

	Three Months Ended		Nine Months Ended		
	September 26, 2015	September 27, 2014	September 26, 2015	September 27, 2014	
Net sales	100.0	% 100.0	% 100.0	% 100.0	%
Cost of sales	75.0	% 75.6	% 74.6	% 76.4	%
Gross profit	25.0	% 24.4	% 25.4	% 23.6	%
Selling and administrative expenses	23.2	% 21.8	% 24.2	% 22.6	%
Other operating expense, net	0.1	% 0.2	% 0.3	% 0.2	%
Facility consolidation expenses	0.5	% 1.5	% 0.7	% 0.9	%
Impairment of assets	—	% 0.1	% —	% 0.2	%
Operating income (loss)	1.2	% 0.8	% 0.2	% (0.3	)%

## Net Sales

Net sales for the quarter ended September 26, 2015 were \$108.9 million, a decrease of 0.1% compared with net sales of \$109.0 million for the year-earlier quarter. In the third quarter of 2015, residential carpet sales decreased 1.5% while net sales of commercial carpet increased 4.5% compared with the third quarter of 2014.

Net sales in the first nine months of 2015 were \$314.7 million compared with net sales of \$302.0 million in the first nine months of 2014, an increase of 4.2%. Excluding sales related to Atlas, net sales reflected an increase of 2.3% in the nine months of 2015 compared to the nine months of 2014. Residential carpet sales decreased 0.3% and commercial net sales increased 16.7% in the first nine months of 2015 compared with the first nine months of 2014.

## Cost of Sales

Cost of sales as a percentage of net sales was 75.0% in the third quarter of 2015 compared with 75.6% in the third quarter of 2014, reflecting a 0.6 percentage point improvement as a percentage of net sales. The improvement was a result of improved operations as our restructuring winds down, partially offset by continued higher than desired levels of waste and quality costs related to production made during the facility consolidation period. The third quarter of 2014 included expenses of \$196 thousand for the amortization of the step-up in inventory for the acquisition of Atlas. The third quarter of 2014 was negatively affected by operational inefficiencies in our manufacturing processes as we implemented our facility consolidation plans.

Cost of sales as a percentage of net sales was 74.6% in the first nine months of 2015 compared with 76.4% in the first nine months of 2014, reflecting a 1.8 percentage point improvement as a percentage of net sales. During the first nine months of 2015, we experienced higher costs associated with our self-insured group medical plan, certain product quality costs, training and increased waste as we continued to realign processes within our facilities. We have seen decreases in raw material costs in 2015; however, due to the volatility of raw material costs, it is difficult at this time to predict the future cost trends. The nine months of 2015 included a reduction of cost of \$459 thousand for an

adjustment to estimated acquisition-related contingent payments compared with a reduction of cost of \$391 thousand in the nine months of 2014. The nine months of 2014 included expenses of \$390 thousand for the amortization of the step-up in inventory for the acquisition of Atlas. The first nine months of 2014 were negatively affected by operational inefficiencies in our manufacturing processes as we implemented our facility consolidation plans. Additionally, the first nine months of 2014 included \$1.5 million of costs directly attributable to the adverse weather conditions in January and February of 2014 and manufacturing inefficiencies related to the replacement of the dryer at our Colormaster continuous dyeing facility.

#### Gross Profit

Gross profit as a percentage of sales improved in the third quarter of 2015 and nine months of 2015 compared with the year-earlier periods for the reasons discussed above in Cost of Sales.

Table of Contents 23

---

### Selling and Administrative Expenses

Selling and administrative expenses were 23.2% of sales during the third quarter of 2015 compared with 21.8% of sales during the third quarter of 2014. Selling and administrative expenses increased as a percentage of sales primarily as a result of higher selling expenses and higher health care costs. The third quarter of 2014 included \$151 thousand of costs related primarily to the Atlas and Burtco acquisitions.

Selling and administrative expenses were 24.2% of sales during the nine months of 2015 compared with 22.6% of sales during the nine months of 2014. Selling and administrative expenses increased as a percentage of sales primarily as a result of higher selling expenses, partially due to the acquisition of Atlas which has higher selling and administrative costs than the overall company average, and higher health care costs. In addition, we continued to spend at a higher level for product sampling during the nine months of 2015 related to a number of new and differentiated products to be introduced intended to enhance our market position and profitability. The nine months of 2014 included \$759 thousand of costs related to the Atlas and Burtco acquisitions.

### Other Operating Expense, Net

Other operating expense, net was an expense of \$131 thousand in the third quarter of 2015 compared with an expense of \$231 thousand in the third quarter of 2014. Other operating expense, net was an expense of \$684 thousand in the nine months of 2015 compared with an expense of \$601 thousand in the year-earlier period.

### Facility Consolidation Expenses & Impairment of Assets

Facility consolidation expenses were \$614 thousand in the third quarter of 2015 compared with \$1.6 million in the year-earlier period. We did not have any asset impairment charges in the third quarter of 2015 as compared to \$104 thousand of such charges in the year earlier period. Expenses in the third quarter of 2015 were lower as a result of the completion of the Atlas Integration Plan and the winding down of the Warehousing, Distribution & Manufacturing Consolidation Plan during the quarter.

Facility consolidation expenses were \$2.3 million in the first nine months of 2015 compared with \$2.7 million in the year-earlier period. We did not have any asset impairment charges in the nine month period in 2015 as compared to \$759 thousand in such charges in the year earlier period.

### Operating Income (Loss)

We reported operating income of \$1.3 million in the third quarter of 2015 compared with \$832 thousand in the third quarter of 2014. During the third quarter of 2015, our operations continued to improve as our restructuring continued to wind down partially offset by continued higher than desired levels of quality and waste costs. The third quarter of 2014 was negatively affected by operational inefficiencies in our manufacturing processes as we implemented our facility consolidation plans.

For the nine months of 2015, we reported operating income of \$747 thousand compared with an operating loss of \$822 thousand in the year-earlier period. During the first nine months of 2015, we experienced higher costs associated with our self-insured group medical plan, certain product quality costs, training and increased waste as we continued to realign processes within our facilities. Operating results in the 2014 reporting period were negatively affected by weather-related costs, manufacturing inefficiencies related to the replacement of the dryer at Colormaster and the Atlas acquisition-related expenses.

### Interest Expense

Interest expense increased \$212 thousand in the third quarter of 2015 and \$442 thousand in the nine months of 2015 compared with the year-earlier periods principally a result of higher interest rates and levels of debt in 2015.

### Other (Income) Expense, Net

Other (income) expense, net was not significant in the third quarter or nine months of 2015 or 2014.

### Income Tax Provision (Benefit)

Our effective income tax rate is based upon estimated annual income tax rates. The effective income tax rate in the nine months of 2015 was 38.6% compared with an effective income tax rate of 40.1% in the year-earlier period. The first nine months of 2014 included the recognition of approximately \$117 thousand of tax expense related to certain market-based stock awards that were not earned.

### Income (Loss) from Continuing Operations

We had income from continuing operations of \$84 thousand, or \$0.01 per diluted share in the third quarter of 2015 compared with a loss from continuing operations of \$8 thousand, or \$0.00 per diluted share in the third quarter of 2014. We had a loss from continuing operations of \$1.8 million, or \$0.11 per diluted share in the nine months of 2015 compared with income from

[Table of Contents](#) 24

---

continuing operations of \$4.3 million, or \$0.29 per diluted share in the nine months of 2014. The nine months of 2014 included a pretax gain of \$11.1 million on the purchases of Atlas and Burtco which had a positive effect on income from continuing operations of approximately \$6.6 million after-tax.

#### Net Income (Loss)

Discontinued operations reflected a loss of \$18 thousand, or \$0.00 per diluted share, in the third quarter of 2015 compared with a loss of \$177 thousand, or \$0.01 per diluted share, in the same period in 2014. Including discontinued operations, we had net income of \$66 thousand, or \$0.01 per diluted share, in the third quarter of 2015 compared with a net loss of \$185 thousand, or \$0.01 per diluted share, in the third quarter of 2014.

Discontinued operations reflected a loss of \$118 thousand, or \$0.01 per diluted share, in the nine months of 2015 compared with a loss of \$505 thousand, or \$0.04 per diluted share, in the same period in 2014. Including discontinued operations, we had a net loss of \$1.9 million, or \$0.12 per diluted share, in the nine months of 2015 compared with net income of \$3.8 million, or \$0.25 per diluted share, in the nine months of 2014.

#### LIQUIDITY AND CAPITAL RESOURCES

During the nine months ended September 26, 2015, cash provided by operations was \$2.8 million. Inventories increased \$10.6 million which was offset by an increase in accounts payable and accrued expenses of \$9.9 million. Inventories increased to seasonal levels to support anticipated higher levels of business.

Capital asset acquisitions for the nine months ended September 26, 2015 were \$10.0 million; \$5.3 million of cash used in investing activities, \$2.9 million of equipment acquired under notes and capital leases and \$1.8 million of previous deposits utilized for capital additions. Depreciation and amortization for the nine months ended September 26, 2015 were \$11.0 million. We expect capital expenditures to be approximately \$13.0 million in 2015 for normal capital expenditures while depreciation and amortization is expected to be approximately \$14.5 million. Planned capital expenditures in 2015 are primarily for new equipment.

During the nine months ended September 26, 2015, cash provided by financing activities was \$2.2 million. In January 2015, we entered into a ten-year \$6.3 million mortgage note payable to finance an owned facility in Saraland, Alabama. We had proceeds of \$1.2 million from our revolving credit facility and \$1.0 million from equipment notes payable. These proceeds are offset by payments on other notes payable and lease obligations of \$7.5 million. See Note 10 in the Notes to Consolidated Condensed Financial Statements of this Form 10-Q for a discussion of our long-term debt arrangements which is incorporated herein by reference.

We believe our operating cash flows, credit availability under our revolving credit facility and other sources of financing are adequate to finance our normal liquidity requirements. As of September 26, 2015, the unused borrowing availability under our revolving credit facility was \$36.4 million. Our revolving credit facility requires us to maintain a fixed charge coverage ratio of 1.1 to 1.0 during any period that borrowing availability is less than \$16.5 million. As of the date hereof, our fixed coverage ratio was less than 1.1 to 1.0, accordingly the unused availability accessible by us is the amount above \$16.5 million. Significant additional cash expenditures above our normal liquidity requirements or significant deterioration in economic conditions could affect our business and require supplemental financing or other funding sources. There can be no assurance that such supplemental financing or other sources of funding can be obtained or will be obtained on terms favorable to us.

#### Contractual Obligations

Our contractual obligations were described in Management's Discussion and Analysis of Results of Operations and Financial Condition in our 2014 Annual Report on Form 10-K filed with the Securities and Exchange Commission. On April 1, 2015, we entered into a 15-year lease agreement to lease office space in Dalton, Georgia. The lease began in September 2015. Base annual rent is initially set at approximately \$28 thousand per month. Total base rent payable over the lease period is \$5.0 million.

#### Critical Accounting Policies

Our critical accounting policies were outlined in Management's Discussion and Analysis of Results of Operations and Financial Condition in our 2014 Annual Report on Form 10-K filed with the Securities and Exchange Commission. There have been no significant changes to those critical accounting policies subsequent to the date of that report.

#### Recent Accounting Pronouncements

See Note 2 in the Notes to Consolidated Condensed Financial Statements of this Form 10-Q for a discussion of new accounting pronouncements which is incorporated herein by reference.

Table of Contents 25

---

### Item 3. Quantitative and Qualitative Disclosures About Market Risk (Dollars in thousands)

Our earnings, cash flows and financial position are exposed to market risks relating to interest rates, among other factors. It is our policy to minimize our exposure to adverse changes in interest rates and manage interest rate risks inherent in funding our Company with debt. We address this financial exposure through a risk management program that includes maintaining a mix of fixed and floating rate debt and the use of interest rate swap agreements (See Note 12 to the Consolidated Condensed Financial Statements).

At September 26, 2015, \$40,160, or approximately 31% of our total debt, was subject to floating interest rates. A 10% fluctuation in the variable interest rates applicable to this floating rate debt would have an annual after-tax impact of approximately \$5.

### Item 4. Controls and Procedures

We maintain disclosure controls and procedures to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Commission's rules and forms and is accumulated and communicated to management, including our principal executive officer and principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Our management, under the supervision and with the participation of our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as such terms are defined in Rules 13(a)-15(e) and 15(d)-15(e)) under the Securities Exchange Act of 1934, as amended (the "Exchange Act") as of September 26, 2015, the date of the financial statements included in this Form 10-Q (the "Evaluation Date"). Based on that evaluation, our CEO and CFO concluded that our disclosure controls and procedures were effective as of the Evaluation Date.

No changes in our internal control over financial reporting occurred during the quarter covered by this report that materially affected, or are reasonably likely to affect, our internal control over financial reporting.

On March 19, 2014 and September 22, 2014, we acquired Atlas Carpet Mills, Inc. ("Atlas") and Burtco Enterprises ("Burtco"), respectively. We excluded the operations of Atlas and Burtco from the scope of our Sarbanes-Oxley Section 404 report on internal controls over financial reporting for the year ended December 27, 2014. We are in the process of implementing our internal control structure with respect to the acquired operations. This implementation will be completed in fiscal 2015.

Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures, as well as diverse interpretation of U. S. generally accepted accounting principles by accounting professionals. It is also possible that internal control over financial reporting can be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. Furthermore, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. These inherent limitations are known features of the financial reporting process; therefore, while it is possible to design into the process safeguards to reduce such risk, it is not possible to eliminate all risk.





## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

None.

### Item 1A. Risk Factors

In addition to the other information provided in this Report, the following risk factors should be considered when evaluating the results of our operations, future prospects and an investment in shares of our Common Stock. Any of these factors could cause our actual financial results to differ materially from our historical results, and could give rise to events that might have a material adverse effect on our business, financial condition and results of operations.

The floorcovering industry is sensitive to changes in general economic conditions and a decline in residential or commercial construction activity or corporate remodeling and refurbishment could have a material adverse effect on our business.

The floorcovering industry, in which the Company participates, is highly dependent on general economic conditions, such as consumer confidence and income, corporate and government spending, interest rate levels, availability of credit and demand for housing. The Company derives a majority of its sales from the replacement segment of the market. Therefore, economic changes that result in a significant or prolonged decline in spending for remodeling and replacement activities could have a material adverse effect on the Company's business and results of operations.

The floorcovering industry is highly dependent on construction activity, including new construction, which is cyclical in nature, and recently experienced a downturn. The 2008 downturn in the U.S. and global economies, along with the residential and commercial markets in such economies, negatively impacted the floorcovering industry and the Company's business. Although the impact of a decline in new construction activity is typically accompanied by an increase in remodeling and replacement activity, these activities lagged during the downturn. Although the difficult economic conditions have improved, there may be additional downturns that could cause the industry to deteriorate in the foreseeable future. A significant or prolonged decline in residential or commercial construction activity could have a material adverse effect on the Company's business and results of operations.

We have significant levels of sales in certain channels of distribution and reduction in sales through these channels could adversely affect our business.

A significant amount of our sales are generated through certain retail and mass merchant channels of distribution. Because we depend on such certain channels of distribution, a significant reduction of sales through these channels could adversely affect our business.

We have significant levels of indebtedness that could result in negative consequences to us.

We have a significant amount of indebtedness relative to our equity. Insufficient cash flow, profitability or the value of our assets securing our loans could materially adversely affect our ability to generate sufficient funds to satisfy the terms of our senior loan agreements and other debt obligations. Additionally, the inability to access debt or equity markets at competitive rates in sufficient amounts to satisfy our obligations could adversely impact our business.

Uncertainty in the credit market or downturns in the economy and our business could affect our overall availability and cost of credit.

Uncertainty in the credit markets could affect the overall availability and cost of credit. Despite recent improvement in overall economic conditions, market conditions could impact our ability to obtain financing in the future, including any financing necessary to refinance existing indebtedness, and the cost and terms of it, remains uncertain. These and other economic factors could have a material adverse effect on demand for our products and on its financial condition and operating results.

We face intense competition in our industry, which could decrease demand for our products and could have a material adverse effect on our profitability.

The floorcovering industry is highly competitive. We face competition from a number of domestic manufacturers and independent distributors of floorcovering products and, in certain product areas, foreign manufacturers. Significant consolidation within the floorcovering industry has caused a number of our existing and potential competitors to grow significantly larger and have greater access to resources and capital than we do. Maintaining our competitive position may require us to make substantial additional investments in our product development efforts, manufacturing facilities, distribution network and sales and marketing activities. These additional investments may be limited by our access to capital, as well as restrictions set forth in our

Table of Contents 27

---

credit facilities. Competitive pressures, both from other providers of soft surfaces and the growth of hard surface alternatives, may also result in decreased demand for our products and in the loss of market share. In addition, we face, and will continue to face, competitive pressures on our sales price and cost of our products. As a result of any of these factors, there could be a material adverse effect on our sales and profitability.

If we are unable to anticipate consumer preferences and successfully develop and introduce new, innovative and updated products, we may not be able to maintain or increase our net revenues and profitability.

Our success depends on our ability to identify and originate product trends as well as to anticipate and react to changing consumer demands in a timely manner. All of our products are subject to changing consumer preferences that cannot be predicted with certainty. In addition, long lead times for certain of our products may make it hard for us to quickly respond to changes in consumer demands. Our new products may not receive consumer acceptance as consumer preferences could shift rapidly to different types of flooring products or away from these types of products altogether, and our future success depends in part on our ability to anticipate and respond to these changes. Failure to anticipate and respond in a timely manner to changing consumer preferences could lead to, among other things, lower sales and excess inventory levels, which could have a material adverse effect on our financial condition.

Raw material prices may vary and the inability to either offset or pass on such cost increases or avoid passing on decreases larger than the cost decrease to our customers could materially adversely affect our business, results of operations and financial condition.

We require substantial amounts of raw materials to produce our products, including nylon and polyester yarn, as well as wool yarns, synthetic backing, latex, and dyes. Substantially all of the raw materials we require are purchased from outside sources. The prices of raw materials and fuel-related costs vary significantly with market conditions. The fact that we source a significant amount of raw materials means that several months of raw materials and work in process are moving through our supply chain at any point in time. We are not able to predict whether commodity costs will significantly increase or decrease in the future. If commodity costs increase in the future and we are not able to reduce or eliminate the effect of the cost increases by reducing production costs or implementing price increases, our profit margins could decrease. If commodity costs were to decline, we may experience pressures from customers to reduce our selling prices. The timing of any price reductions and decreases in commodity costs may not align. As a result, our margins could be affected.

Unanticipated termination or interruption of our arrangements with third-party suppliers of nylon yarn could have a material adverse effect on us.

Nylon yarn is the principal raw material used in our floorcovering products. A significant portion of such yarn is purchased from one supplier. Our yarn supplier is one of the leading fiber suppliers within the industry and is the exclusive supplier of certain innovative branded fiber technology upon which we rely. We believe our offerings of this innovative fiber technology contribute materially to the competitiveness of our products. While we believe there are other sources of nylon yarns, an unanticipated termination or interruption of our current supply of nylon yarn could have a material adverse effect on our ability to supply our product to our customers and have a material adverse impact on our competitiveness if we are unable to replace our nylon supplier with another supplier that can offer similar innovative fiber products. An extended interruption in the supply of these or other raw materials or sourced products used in the Company's business or in the supply of suitable substitute materials or products would disrupt the Company's operations, which could have a material adverse effect on the Company's business.

We may experience certain risks associated with internal expansion, acquisitions, joint ventures and strategic investments.

We have recently embarked on several strategic and tactical initiatives, including aggressive internal expansion, acquisitions and investment in new products, to strengthen our future and to enable us to return to sustained growth and profitability. Growth through expansion and acquisition involves risks, many of which may continue to affect us after the acquisition or expansion. An acquired company, operation or internal expansion may not achieve the levels of revenue, profitability and production that we expect. The combination of an acquired company's business with ours involves risks. Further, internally generated growth that involves expansion involves risks as well. Such risks include the integration of computer systems, alignment of human resource policies and the retention of valued talent. Reported earnings may not meet expectations because of goodwill and intangible asset impairment, other asset impairments, increased interest costs and issuance of additional securities or debt as a result of these acquisitions. We may also face challenges in consolidating functions and integrating our organizations, procedures, operations and product lines in a timely and efficient manner.

The diversion of management attention and any difficulties encountered in the transition and integration process could have a material adverse effect on our revenues, level of expenses and operating results. Failure to successfully manage and integrate an acquisition with our existing operations or expansion of our existing operations could lead to the potential loss of customers of the acquired or existing business, the potential loss of employees who may be vital to the new or existing operations, the potential loss of business opportunities or other adverse consequences that could have a material adverse effect on our business, financial condition and results of operations. Even if integration occurs successfully, failure of the expansion or acquisition to achieve levels of anticipated sales growth, profitability or productivity, or otherwise perform as expected, may have a material adverse effect on our business, financial condition and results of operations.

Table of Contents 28

---

We are subject to various environmental, safety and health regulations that may subject us to costs, liabilities and other obligations, which could have a material adverse effect on our business, results of operations and financial condition.

We are subject to various environmental, safety and health and other regulations that may subject us to costs, liabilities and other obligations which could have a material adverse effect on our business. The applicable requirements under these laws are subject to amendment, to the imposition of new or additional requirements and to changing interpretations of agencies or courts. We could incur material expenditures to comply with new or existing regulations, including fines and penalties and increased costs of its operations. Additionally, future laws, ordinances or regulations could give rise to additional compliance or remediation costs that could have a material adverse effect on our business, results of operations and financial condition. For example, producer responsibility regulations regarding end-of-life disposal could impose additional cost and complexity to our business.

Various federal, state and local environmental laws govern the use of our current and former facilities. These laws govern such matters as:

- Discharge to air and water;
- Handling and disposal of solid and hazardous substances and waste, and
- Remediation of contamination from releases of hazardous substances in our facilities and off-site disposal locations.

Our operations also are governed by laws relating to workplace safety and worker health, which, among other things, establish noise standards and regulate the use of hazardous materials and chemicals in the workplace. We have taken, and will continue to take, steps to comply with these laws. If we fail to comply with present or future environmental or safety regulations, we could be subject to future liabilities. However, we cannot ensure that complying with these environmental or health and safety laws and requirements will not adversely affect our business, results of operations and financial condition.

We may be exposed to litigation, claims and other legal proceedings in the ordinary course of business relating to our products or business, which could have a material adverse effect on our business, results of operations and financial condition.

In the ordinary course of business, we are subject to a variety of work-related and product-related claims, lawsuits and legal proceedings, including those relating to product liability, product warranty, product recall, personal injury, and other matters that are inherently subject to many uncertainties regarding the possibility of a loss our business. Such matters could have a material adverse effect on our business, results of operations and financial condition if we are unable to successfully defend against or resolve these matters or if our insurance coverage is insufficient to satisfy any judgments against us or settlements relating to these matters. Although we have product liability insurance, the policies may not provide coverage for certain claims against us or may not be sufficient to cover all possible liabilities. Further, we may not be able to maintain insurance at commercially acceptable premium levels. Additionally, adverse publicity arising from claims made against us, even if the claims are not successful, could adversely affect our reputation or the reputation and sales of our products.

Our business operations could suffer significant losses from natural disasters, catastrophes, fire or other unexpected events.

Many of our business activities involve substantial investments in manufacturing facilities and many products are produced at a limited number of locations. These facilities could be materially damaged by natural disasters, such as floods, tornadoes, hurricanes and earthquakes, or by fire or other unexpected events such as adverse weather

conditions or other disruptions to our facilities, supply chain or our customer's facilities. We could incur uninsured losses and liabilities arising from such events, including damage to our reputation, and/or suffer material losses in operational capacity, which could have a material adverse impact on our business, financial condition and results of operations.

Table of Contents 29

---

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Repurchases of Common Stock

The following table provides information regarding our repurchases of shares of our Common Stock during the three months ended September 26, 2015:

Month Ending	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	Maximum Number (or approximate dollar value) of Shares That May Yet Be Purchased Under Plans or Programs
August 1, 2015	—	\$—	—	
August 29, 2015	3,876	10.98	3,876	
September 26, 2015	1,205	10.02	1,205	
Three Months Ended September 26, 2015	5,081	\$10.75	5,081	\$2,496,241

(1) During the three months ended September 26, 2015, 5,081 shares were withheld from employees in lieu of cash payments for withholding taxes due for a total amount of \$54,633.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not Applicable.

Item 5. Other Information

None.

Item 6. Exhibits

(a.) Exhibits

- 10.1 Thornton Edge LLC Lease for Reed Road Facility
- 10.2 Thornton Edge LLC First Lease Amendment for Reed Road Facility
- 10.3 Thornton Edge LLC Second Lease Amendment for Reed Road Facility
- 31.1 CEO Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 CFO Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.



Edgar Filing: DIXIE GROUP INC - Form 10-Q

32.1 CEO Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 CFO Certification pursuant to 18 U.S. C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101.INSXBRL Instance Document

101.SCHXBRL Taxonomy Extension Schema Document

101.CALXBRL Taxonomy Extension Calculation Linkbase Document

101.DEF XBRL Taxonomy Extension Definition Linkbase Document

101.LABXBRL Taxonomy Extension Label Linkbase Document

101.PREXBRL Taxonomy Extension Presentation Linkbase Document

Table of Contents 30

---

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

THE DIXIE GROUP, INC.  
(Registrant)

Date: November 4, 2015

By: /s/ JON A. FAULKNER  
Jon A. Faulkner  
Vice President and Chief Financial Officer

Table of Contents 31