

DIXIE GROUP INC
Form 10-Q
May 02, 2008

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

Form 10-Q

(Mark One)

S

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

For the quarterly period ended: **March 29, 2008**

or

o

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

For the transition period from _____ to _____

Commission File Number: 0-2585

THE DIXIE GROUP, INC.

(Exact name of Registrant as specified in its charter)

Tennessee

(State or other jurisdiction of incorporation
or organization)

62-0183370

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

**104 Nowlin Lane, Suite 101,
Chattanooga, TN**

37421

(423) 510-7000

Edgar Filing: DIXIE GROUP INC - Form 10-Q

(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.

S Yes o No

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

Large accelerated filer o Accelerated filer S Non-accelerated filer o

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

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 April 17, 2008 |
|-------------------------------------|----------------------------------|
| Common Stock, \$3 Par Value | 12,113,877 shares |
| Class B Common Stock, \$3 Par Value | 869,909 shares |
| Class C Common Stock, \$3 Par Value | 0 shares |

[Return to Table of Contents](#)

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

THE DIXIE GROUP, INC.
CONSOLIDATED CONDENSED BALANCE SHEETS
(dollars in thousands)

| | (Unaudited) March 29, 2008 | December 29, 2007 |
|---|----------------------------------|----------------------|
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash and cash equivalents | \$ 284 | \$ 427 |
| Accounts receivable (less allowance for doubtful accounts of \$772 for 2008 and \$676 for 2007) | 32,457 | 32,868 |
| Inventories | 82,331 | 75,928 |
| Other current assets | 9,965 | 7,742 |
| TOTAL CURRENT ASSETS | 125,037 | 116,965 |
| PROPERTY, PLANT AND EQUIPMENT | | |
| Land and improvements | 6,075 | 6,075 |
| Buildings and improvements | 46,142 | 45,890 |
| Machinery and equipment | 131,188 | 128,968 |
| | 183,405 | 180,933 |
| Less accumulated depreciation and amortization | (81,630) | (78,555) |
| NET PROPERTY, PLANT AND EQUIPMENT | 101,775 | 102,378 |
| OTHER ASSETS | | |
| Goodwill | 56,689 | 56,743 |
| Other long-term assets | 14,261 | 14,152 |
| TOTAL OTHER ASSETS | 70,950 | 70,895 |
| TOTAL ASSETS | \$ 297,762 | \$ 290,238 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| CURRENT LIABILITIES | | |
| Accounts payable | \$ 13,681 | \$ 11,492 |
| Accrued expenses | 22,392 | 21,242 |
| Current portion of long-term debt | 8,894 | 8,817 |
| TOTAL CURRENT LIABILITIES | 44,967 | 41,551 |
| LONG-TERM DEBT | | |

Edgar Filing: DIXIE GROUP INC - Form 10-Q

| | | |
|---|-------------------|------------|
| Senior indebtedness | 66,098 | 60,119 |
| Capital lease obligations | 2,185 | 2,547 |
| Convertible subordinated debentures | 17,162 | 17,162 |
| TOTAL LONG-TERM DEBT | 85,445 | 79,828 |
| | | |
| DEFERRED INCOME TAXES | 11,520 | 11,726 |
| OTHER LONG-TERM LIABILITIES | 14,804 | 15,019 |
| COMMITMENTS AND CONTINGENCIES | --- | --- |
| STOCKHOLDERS' EQUITY | | |
| Common Stock (\$3 par value per share): Authorized 80,000,000 shares, issued - 15,828,380 shares for 2008 and 15,673,714 shares for 2007 | 47,485 | 47,021 |
| Class B Common Stock (\$3 par value per share): Authorized 16,000,000 shares, issued - 869,909 shares for 2008 and 835,908 shares for 2007 | 2,610 | 2,508 |
| Additional paid-in capital | 135,026 | 135,449 |
| Retained earnings | 12,576 | 12,563 |
| Accumulated other comprehensive income | 132 | 230 |
| | 197,829 | 197,771 |
| Less Common Stock in treasury at cost - 3,694,227 shares for 2008 and 3,556,252 shares for 2007 | (56,803) | (55,657) |
| TOTAL STOCKHOLDERS' EQUITY | 141,026 | 142,114 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$ 297,762 | \$ 290,238 |

See accompanying notes to the consolidated condensed financial statements.

THE DIXIE GROUP, INC.
CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS
(UNAUDITED)
(dollars in thousands, except per share data)

| | Three Months Ended | |
|--|--------------------|-------------------|
| | March 29, 2008 | March 31, 2007 |
| Net sales | \$ 70,722 | \$ 74,490 |
| Cost of sales | 50,165 | 52,671 |
| Gross profit | 20,557 | 21,819 |
| Selling and administrative expenses | 18,943 | 19,778 |
| Other operating income | (148) | (28) |
| Other operating expense | 187 | 125 |
| Operating income | 1,575 | 1,944 |
| Interest expense | 1,476 | 1,557 |
| Other income | (61) | (14) |
| Other expense | 8 | 17 |
| Income from continuing operations before taxes | 152 | 384 |
| Income tax provision | 70 | 147 |
| Income from continuing operations | 82 | 237 |
| Loss from discontinued operations, net of tax | (69) | (66) |
| Net income | \$ 13 | \$ 171 |
| BASIC EARNINGS (LOSS) PER SHARE: | | |
| Continuing operations | \$ 0.01 | \$ 0.02 |
| Discontinued operations | (0.01) | (0.01) |
| Net income | \$ 0.00 | \$ 0.01 |
| SHARES OUTSTANDING | 12,649 | 12,771 |
| DILUTED EARNINGS (LOSS) PER SHARE: | | |
| Continuing operations | \$ 0.01 | \$ 0.02 |

Edgar Filing: DIXIE GROUP INC - Form 10-Q

| | | | | |
|-------------------------|----|---------------|----|--------|
| Discontinued operations | | (0.01) | | (0.01) |
| Net income | \$ | 0.00 | \$ | 0.01 |
| SHARES OUTSTANDING | | 12,768 | | 12,976 |
| DIVIDENDS PER SHARE: | | | | |
| Common Stock | | --- | | --- |
| Class B Common Stock | | --- | | --- |

See accompanying notes to the consolidated condensed financial statements.

[Return to Table of Contents](#)

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

| | Three Months Ended | |
|--|-------------------------------|-------------------|
| | March 29, 2008 | March 31, 2007 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Income from continuing operations | \$ 82 | \$ 237 |
| Loss from discontinued operations | (69) | (66) |
| Net income | 13 | 171 |
| Adjustments to reconcile net income to net cash (used in) provided by operating activities: | | |
| Depreciation and amortization | 3,480 | 3,373 |
| Change in deferred income taxes | (19) | (99) |
| Tax provision (benefit) from exercise of stock options | 124 | (85) |
| Net (gain) loss on property, plant and equipment disposals | (113) | 2 |
| Stock-based compensation expense | 261 | 228 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 411 | (1,838) |
| Inventories | (6,403) | (5,351) |
| Other current assets | (2,410) | --- |
| Accounts payable and accrued expenses | 735 | 6,680 |
| Other operating assets and liabilities | (443) | (2,249) |
| NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES | (4,364) | 832 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Net proceeds from sales of property, plant and equipment | 241 | --- |
| Purchase of property, plant and equipment | (2,929) | (3,041) |
| NET CASH USED IN INVESTING ACTIVITIES | (2,688) | (3,041) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Net borrowings on credit line | 7,243 | 2,039 |
| Payments on term loan | (427) | (428) |

Edgar Filing: DIXIE GROUP INC - Form 10-Q

| | | |
|--|--------------|--------------|
| Borrowings from equipment financing | --- | 908 |
| Payments on equipment financing | (724) | (508) |
| Payments on capitalized leases | (338) | (316) |
| Payments on mortgage note payable | (60) | (55) |
| Change in outstanding checks in excess of cash | 2,480 | 481 |
| Common stock issued under stock option plans | 5 | 92 |
| Common stock acquired for treasury | (1,146) | --- |
| Tax provision (benefit) from exercise of stock options | (124) | 85 |
| NET CASH PROVIDED BY FINANCING ACTIVITIES | 6,909 | 2,298 |
| | | |
| (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS | (143) | 89 |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 427 | 538 |
| | | |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | \$ 284 | \$ 627 |
| | | |
| SUPPLEMENTAL CASH FLOW INFORMATION: | | |
| Interest paid | \$ 1,192 | \$ 1,208 |
| Income taxes paid, net of tax refunds (received) | 449 | (3) |

See accompanying notes to the consolidated condensed financial statements.

[Return to Table of Contents](#)

THE DIXIE GROUP, INC.
CONSOLIDATED CONDENSED STATEMENTS OF STOCKHOLDERS' EQUITY AND
COMPREHENSIVE INCOME (LOSS)
(UNAUDITED)
(dollars in thousands)

| | Common Stock and Class B Common Stock | Additional Paid-In Capital | Retained Earnings | Accumulated Other Comprehensive Income | Common Stock in Treasury | Total Stockholders' Equity |
|---|---|----------------------------------|----------------------|---|--------------------------------|----------------------------------|
| Balance at December 29, 2007 | \$ 49,529 | \$ 135,449 | \$ 12,563 | \$ 230 | \$ (55,657) | \$ 142,114 |
| Common Stock acquired for treasury - 137,975 shares | --- | --- | --- | --- | (1,146) | (1,146) |
| Common Stock and Class B issued under stock option plan - 1,250 shares | 4 | 2 | --- | --- | --- | 6 |
| Restricted stock grants issued - 187,417 shares | 562 | (562) | --- | --- | --- | --- |
| Tax expense from exercise of stock options | --- | (124) | --- | --- | --- | (124) |
| Stock-based compensation expense | --- | 261 | --- | --- | --- | 261 |
| Comprehensive Income (Loss): | | | | | | |
| Net income | --- | --- | 13 | --- | --- | 13 |
| Unrealized loss on interest rate swap agreements, net of tax of \$379 | --- | --- | --- | (618) | --- | (618) |
| Unrealized gain on | --- | --- | --- | 538 | --- | 538 |

| | | | | | | | | |
|--|------------------|-------------------|------------------|-----------|------------|--------------------|-----------|----------------|
| available-for-sale securities, net of tax of \$330 | | | | | | | | |
| Pension and postretirement benefit plans: | | | | | | | | |
| Recognition of net actuarial gain, net of tax of \$4 | --- | --- | --- | | (7) | --- | | (7) |
| Amortization of prior service credits, net of tax of \$6 | --- | --- | --- | | (11) | --- | | (11) |
| Total Comprehensive Income (Loss) | --- | --- | 13 | | (98) | --- | | (85) |
| Balance at March 29, 2008 | \$ 50,095 | \$ 135,026 | \$ 12,576 | \$ | 132 | \$ (56,803) | \$ | 141,026 |

See accompanying notes to the consolidated condensed financial statements.

[Return to Table of Contents](#)

THE DIXIE GROUP, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(UNAUDITED)

(dollars in thousands, except per share data)

NOTE A - BASIS OF PRESENTATION

The accompanying unaudited consolidated condensed financial statements have been prepared in accordance with U.S. generally accepted accounting principles 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 financial statements should be read in conjunction with the financial statements and notes thereto included in the Company's 2007 Annual Report on Form 10-K filed with the Securities and Exchange Commission, which includes consolidated financial statements for the fiscal year ended December 29, 2007. Operating results for the three month period ended March 29, 2008 are not necessarily indicative of the results that may be expected for the entire 2008 year.

The Company is in one line of business, carpet manufacturing.

NOTE B - RECENT ACCOUNTING PRONOUNCEMENTS

In September 2006, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" ("SFAS No. 157"). SFAS No. 157 defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The adoption of this statement did not have a material effect on the Company's financial position or results of operations (See Note J).

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities", including an amendment of SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities" ("SFAS No. 159"). SFAS No. 159 permits entities to choose to measure many financial instruments and

certain other items at fair value. The objective of SFAS No. 159 is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions to such assets and liabilities.

Eligible items for the measurement option include all recognized financial assets and liabilities except: investments in subsidiaries, interests in variable interest entities, obligations for pension benefits, assets and liabilities recognized under leases, deposit liabilities and financial instruments that are a component of shareholders' equity. Also, included are firm commitments that involve only financial instruments, nonfinancial insurance contracts and warranties and host financial instruments.

The Statement permits all entities to choose the fair value measurement option at specified election dates, after which the entity must report unrealized gains and losses on items for which the fair value option has been elected in earnings, at each subsequent reporting date. The fair value option may be applied instrument by instrument; however, the election is irrevocable and may apply only to entire instruments and not to portions of instruments. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. This statement did not have a material effect on the Company's financial position or results of operations.

In December 2007, the FASB issued SFAS No. 141R, "Business Combinations" ("SFAS No. 141R"). SFAS No. 141R replaces SFAS No. 141 and establishes principles and requirements for how identifiable assets, liabilities assumed, any non-controlling interest in an acquiree, and goodwill is recognized and measured in an acquirer's financial statements. SFAS No. 141R also establishes disclosure requirements to assist users in evaluating the nature and financial effects of business combinations. This statement is effective for fiscal years beginning after December 15, 2008. The Company does not expect the adoption of this statement to have a material effect on its financial position or results of operations.

[Return to Table of Contents](#)

THE DIXIE GROUP, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(UNAUDITED)

(dollars in thousands, except per share data) - Cont'd.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements" ("SFAS No. 160"). SFAS No. 160 establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than their parent, the amount of consolidated net income attributable to their parent and to the holder of a noncontrolling interest, changes in a parent's ownership interest and the valuation of retained noncontrolling equity investments when a subsidiary is no longer consolidated. SFAS No. 160 also establishes reporting requirements to clearly identify, distinguish and disclose the interests of the parent and the interests of the noncontrolling owners. This statement is effective for fiscal years beginning after December 15, 2008. The Company does not expect the adoption of this statement to have a material effect on its financial position or results of operations.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133" ("SFAS No. 161"). SFAS No. 161 establishes, among other things, the disclosure requirements for derivative instruments and for hedging activities. SFAS No. 161 is effective for fiscal years and interim periods beginning after November 15, 2008. The Company does not expect the adoption of this statement to have a material effect on its financial position or results of operations.

NOTE C - SHARE-BASED PAYMENTS

The Company recognizes compensation expense relating to share-based payments based on the fair value of the equity or liability instrument issued.

On February 28, 2008, the Company granted 187,417 shares of restricted stock to officers of the Company. The grant-date fair value of the awards was \$1,643, or \$8.765 per share. The shares will vest over terms ranging from 2 to 19 years. 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.

The Company's stock compensation expense was \$261 and \$228 for the three months ended March 29, 2008 and March 31, 2007, respectively.

NOTE D - ACCOUNTS RECEIVABLE

Accounts receivable are summarized as follows:

| | March 29, 2008 | December 29, 2007 |
|--------------------------------------|---------------------------|----------------------|
| Customers, trade | \$ 30,295 | \$ 29,929 |
| Other | 2,934 | 3,615 |
| Gross receivables | 33,229 | 33,544 |
| Less allowance for doubtful accounts | (772) | (676) |
| Net receivables | \$ 32,457 | \$ 32,868 |

The Company also had notes receivable in the amount of \$498 and \$542 at March 29, 2008 and December 29, 2007, respectively. The notes receivable are included in accounts receivable and other long-term assets in the Company's consolidated condensed balance sheets.

[Return to Table of Contents](#)

THE DIXIE GROUP, INC.**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS****(UNAUDITED)****(dollars in thousands, except per share data) - Cont'd.****NOTE E - INVENTORIES**

Inventories are stated at the lower of cost or market. Cost is determined using the last-in, first-out (LIFO) method, which generally matches current costs of inventory sold with current revenues, for substantially all inventories.

Inventories are summarized as follows:

| | March 29, 2008 | December 29, 2007 |
|----------------------------------|---------------------------|----------------------|
| Raw materials | \$ 29,927 | \$ 26,148 |
| Work-in-process | 16,849 | 15,999 |
| Finished goods | 45,876 | 44,359 |
| Supplies, repair parts and other | 399 | 430 |
| LIFO reserve | (10,720) | (11,008) |
| Total inventories | \$ 82,331 | \$ 75,928 |

NOTE F - DISCONTINUED OPERATIONS

Results associated with operations that have been sold or discontinued are generally classified as discontinued operations for all periods presented. Discontinued operations are summarized as follows:

| | Three Months Ended | |
|---|---------------------------|-------------------|
| | March 29, 2008 | March 31, 2007 |
| Loss from discontinued operations: | | |
| Before income taxes | \$ (108) | \$ (103) |
| Income tax benefit | (39) | (37) |
| Loss from discontinued operations, net of tax | \$ (69) | \$ (66) |

Discontinued operating losses in 2008 and 2007 primarily consisted of expenses for workers' compensation related to businesses sold in 2003 and 2004.

NOTE G - ACCRUED EXPENSES

Accrued expenses are summarized as follows:

| | March 29, 2008 | December 29, 2007 |
|---|---------------------------|----------------------|
| Compensation and benefits | \$ 6,349 | \$ 7,859 |
| Provision for customer rebates, claims and allowances | 4,893 | 5,470 |
| Outstanding checks in excess of cash | 5,018 | 2,538 |
| Other | 6,132 | 5,375 |
| Total accrued expenses | \$ 22,392 | \$ 21,242 |

[Return to Table of Contents](#)

THE DIXIE GROUP, INC.**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS****(UNAUDITED)****(dollars in thousands, except per share data) - Cont'd.****NOTE H - PRODUCT WARRANTY RESERVES**

The Company provides product warranties related to manufacturing defects and specific performance standards for its products. The Company records reserves for the estimated costs of defective products and failure of its products to meet applicable performance standards at the time sales are recorded. The level of reserves is established based primarily upon historical experience and evaluation of pending claims. Product warranty reserves are included in accrued expenses in the Company's consolidated condensed balance sheets. Following is a summary of the Company's warranty activity.

| | Three Months Ended | |
|---|---------------------------|-------------------|
| | March 29, 2008 | March 31, 2007 |
| Warranty reserve beginning of period | \$ 1,515 | \$ 1,276 |
| Warranty liabilities accrued | 765 | 879 |
| Warranty liabilities settled | (780) | (932) |
| Changes for pre-existing warranty liabilities | (37) | 131 |
| Warranty reserve end of period | \$ 1,463 | \$ 1,354 |

NOTE I - LONG-TERM DEBT AND CREDIT ARRANGEMENTS

Long-term debt consists of the following:

| | March 29, 2008 | December 29, 2007 |
|------------------------|---------------------------|----------------------|
| Senior indebtedness | | |
| Credit line borrowings | \$ 36,696 | \$ 29,453 |
| Term loans | 15,584 | 16,011 |

| | | |
|---|------------------|-----------|
| Equipment financing | 12,321 | 13,045 |
| Capital lease obligations | 3,598 | 3,936 |
| Mortgage note payable | 6,478 | 6,538 |
| Total senior indebtedness | 74,677 | 68,983 |
| Convertible subordinated debentures | 19,662 | 19,662 |
| Total long-term debt | 94,339 | 88,645 |
| Less current portion of long-term debt | (7,481) | (7,428) |
| Less current portion of capital lease obligations | (1,413) | (1,389) |
| Total long-term debt, less current portion | \$ 85,445 | \$ 79,828 |

The Company's senior loan and security agreement, which matures on May 11, 2010, provides \$85,584 of credit, consisting of \$70,000 of revolving credit and a \$15,584 term loan. The Company's credit facilities do not contain ongoing financial covenants and permit payment of dividends and repurchases of the Company's Common Stock in an aggregate annual amount of up to \$3,000 and distributions in excess of \$3,000 annually under conditions specified in the agreement. The agreement also contains flexible provisions that may permit payment of an additional \$10,000 of dividends or repurchases of the Company's Common Stock prior to December 31, 2008. The agreement also contains covenants that could limit future acquisitions. The unused borrowing capacity under the senior loan and security agreement on March 29, 2008 was \$20,204.

[Return to Table of Contents](#)

THE DIXIE GROUP, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(UNAUDITED)

(dollars in thousands, except per share data) - Cont'd.

NOTE J - FAIR VALUE MEASUREMENTS

The Company adopted SFAS No. 157 on the first day of fiscal year 2008. SFAS No. 157 defines fair value as the exchange value of an asset or a liability in an orderly transaction between market participants. The standard outlines a valuation framework and creates a fair value hierarchy in order to increase the consistency and comparability of fair value measurements and the related disclosures. The three broad fair value hierarchy levels are defined 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.

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

The Company's available-for-sale securities and interest rate swaps must be measured under the fair value standard. The following table summarizes the hierarchy level the Company used to determine fair value of its financial assets and liabilities as of March 29, 2008:

| | Balance at March 29, 2008 | Fair Value Hierarchy Level | | |
|----------------------------------|---------------------------------|----------------------------|---------|---------|
| | | Level 1 | Level 2 | Level 3 |
| Assets: | | | | |
| Available-for-sale securities | \$ 868 | \$ 868 | \$ --- | \$ --- |

Liabilities:

| | | | | | | | | |
|---------------------|----|-------|----|-----|----|-------|----|-----|
| Interest rate swaps | \$ | 1,894 | \$ | --- | \$ | 1,894 | \$ | --- |
|---------------------|----|-------|----|-----|----|-------|----|-----|

The fair value of available-for-sale securities was determined based on quoted market prices and the fair value of the interest rate swaps' was obtained from external sources and was determined through the use of models that consider various assumptions and relevant economic factors.

Available-for-sale securities are reflected on the Company's consolidated condensed balance sheet in other long-term assets and related gains and losses are deferred in Accumulated Other Comprehensive Income ("AOCI"). Net unrealized gains included in AOCI were \$538 at March 29, 2008.

The Company is a party to an interest rate swap agreement with a notional amount of \$30,000 through May 11, 2010. Under the interest rate swap agreement, the Company pays a fixed rate of interest of 4.79% times the notional amount and receives in return a specified variable rate of interest times the same notional amount. The interest rate swap is linked to the Company's variable rate debt and is considered a highly effective hedge. The fair value of the interest rate swap agreement is reflected on the Company's consolidated condensed balance sheet in other long-term liabilities and related gains and losses are deferred in AOCI. Net unrealized losses included in AOCI were \$942 at March 29, 2008.

The Company is also a party to an interest rate swap agreement through March 2013, which is linked to a mortgage and considered a highly effective hedge. Under the interest rate swap agreement, the Company pays a fixed rate of interest times a notional amount equal to the outstanding balance of the mortgage, and receives in return an amount equal to a specified variable rate of interest times the same notional amount. The fair value of the interest rate swap agreement is reflected on the Company's consolidated condensed balance sheet in other long-term liabilities and related gains and losses are deferred in AOCI. At March 29, 2008, the notional amount of the interest rate swap agreement was \$6,478. Under the terms of the interest rate swap agreement, the Company pays a fixed interest rate of 4.54% through March 2013, which effectively fixes the interest rate on the mortgage at 6.54%. Net unrealized losses included in AOCI were \$231 at March 29, 2008.

[Return to Table of Contents](#)

THE DIXIE GROUP, INC.**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS****(UNAUDITED)****(dollars in thousands, except per share data) - Cont'd.****NOTE K - EMPLOYEE BENEFIT PLANS**

The Company sponsors a 401(k) defined contribution plan covering substantially all associates. The Company matches participants' contributions, on a sliding scale, up to a maximum of 5% of the participant's earnings. The Company may make additional contributions to the plan if the Company achieves certain performance targets.

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 \$11,482 at March 29, 2008 and \$12,709 at December 29, 2007 and are included in other 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 invested in company-owned life insurance in the Rabbi Trust were \$12,100 at March 29, 2008 and \$12,777 at December 29, 2007 and are included in other long-term assets in the Company's consolidated condensed balance sheets.

On December 29, 2007, the Company merged its only remaining defined benefit pension plan into a multi-employer pension plan. As a result of the merger, the Company ceased to be a plan sponsor and became a contributing employer in the multi-employer pension plan. The Company contributed \$205 in January 2008 to complete its funding obligation for the defined benefit pension plan. The Company's expense and cash contribution related to the multi-employer pension plan was \$68 during the three months ended March 29, 2008.

Components of net periodic benefit costs for all retirement plans are summarized as follows:

| | Three Months Ended | |
|-------------------------------------|---------------------------|-------------------|
| | March 29, 2008 | March 31, 2007 |
| Defined benefit plan: | | |
| Service cost | \$ --- | \$ 50 |
| Interest cost | --- | 42 |
| Expected return on plan assets | --- | (50) |
| Amortization of prior service costs | --- | 2 |

Edgar Filing: DIXIE GROUP INC - Form 10-Q

| | | |
|-------------------------------|---------------|---------------|
| Recognized net actuarial loss | --- | 24 |
| Total - Defined benefit plan | --- | 68 |
| Defined contribution plan | 306 | 267 |
| Net periodic benefit cost | \$ 306 | \$ 335 |

The Company sponsors 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 and life insurance for a limited number of associates who retired prior to January 1, 2003. Components of net periodic benefit costs for all postretirement plans are summarized as follows:

| | Three Months Ended | |
|---------------------------------------|--------------------|-------------------|
| | March 29, 2008 | March 31, 2007 |
| Defined benefit plans: | | |
| Service cost | \$ --- | \$ 5 |
| Interest cost | --- | 21 |
| Amortization of prior service credits | (17) | (16) |
| Recognized net actuarial gains | (11) | (10) |
| Net periodic benefit credit | \$ (28) | \$ --- |

Amounts contributed or expected to be contributed by the Company during the current fiscal year to its postretirement plans are not anticipated to be significantly different from amounts disclosed in the Company's 2007 Annual Report filed on Form 10-K.

[Return to Table of Contents](#)

THE DIXIE GROUP, INC.**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS****(UNAUDITED)****(dollars in thousands, except per share data) - Cont'd.****NOTE L - INCOME TAXES**

The Company adopted the provisions of Financial Accounting Standards Board Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109" ("FIN 48") on the first day of the Company's 2007 fiscal year. Unrecognized tax benefits were \$500, including \$82 of accrued interest, at March 29, 2008, all of which, if recognized, would favorably affect the Company's effective tax rate. The Company does not expect its unrecognized tax benefits to change significantly during the next twelve months. The Company recognizes interest and penalties related to uncertain tax positions in income tax expense.

Following is a summary of the change in the Company's unrecognized tax benefits excluding accrued interest during the three months ended March 29, 2008:

| | | |
|--|----|------|
| Balance at December 29, 2007 | \$ | 419 |
| Additions based on tax positions taken during a prior period | | 14 |
| Reductions related to settlement of tax matters | | (15) |
| Reductions related to a lapse of applicable statute of limitations | | --- |
| Balance at March 29, 2008 | \$ | 418 |

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 2004 through 2007 remain open to examination for U.S. federal income taxes and most state jurisdictions. A few state jurisdictions remain open to examination for tax years 2003 through 2007.

NOTE M - COMMON STOCK AND EARNINGS PER SHARE

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

Three Months Ended

Edgar Filing: DIXIE GROUP INC - Form 10-Q

| | March 29, 2008 | March 31, 2007 |
|---|---------------------------|-------------------|
| Income from continuing operations (1) | \$ 82 | \$ 237 |
| Denominator for calculation of basic earnings per share - weighted-average shares (2) | 12,649 | 12,771 |
| Effect of dilutive securities: | | |
| Stock options (3) | 77 | 173 |
| Restricted stock grants (3) | --- | 1 |
| Directors' stock performance units | 42 | 31 |
| Denominator for calculation of diluted earnings per share - weighted-average shares adjusted for potential dilution (2)(3) | 12,768 | 12,976 |
| Earnings per share: | | |
| Basic | \$ 0.01 | \$ 0.02 |
| Diluted | 0.01 | 0.02 |

(1)

No adjustments needed in the numerator for diluted calculations.

(2)

Includes Common and Class B Common shares in thousands.

(3)

Because their effects are anti-dilutive, shares issuable under stock option plans where the exercise price is greater than the average market price of Common Shares outstanding at the end of the relevant period, restricted stock grants where market conditions have not been met, and shares issuable on conversion of subordinated debentures into shares of Common Stock have been excluded. Aggregate shares excluded were 1,499 shares in 2008 and 1,358 shares in 2007.

[Return to Table of Contents](#)

THE DIXIE GROUP, INC.**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS****(UNAUDITED)****(dollars in thousands, except per share data) - Cont'd.****NOTE N - COMPREHENSIVE INCOME (LOSS)**

Comprehensive income (loss) is as follows:

| | Three Months Ended | |
|--|---------------------------|-------------------|
| | March 29, 2008 | March 31, 2007 |
| Net income | \$ 13 | \$ 171 |
| Other comprehensive income (loss): | | |
| Unrealized loss on interest rate swap agreements: | | |
| Before income taxes | (997) | (172) |
| Income taxes | (379) | (65) |
| Net of taxes | (618) | (107) |
| Unrealized gain on available-for-sale securities: | | |
| Before income taxes | 868 | --- |
| Income taxes | 330 | --- |
| Net of taxes | 538 | --- |
| Recognition of net actuarial (gain) loss of pension and postretirement benefit plans: | | |
| Before income taxes | (11) | 14 |
| Income taxes | (4) | 5 |
| Net of taxes | (7) | 9 |
| Amortization of prior service credits of postretirement benefit plans: | | |
| Before income taxes | (17) | (14) |
| Income taxes | (6) | (5) |
| Net of taxes | (11) | (9) |

| | | | | |
|-----------------------------|----|------|----|----|
| Comprehensive income (loss) | \$ | (85) | \$ | 64 |
|-----------------------------|----|------|----|----|

[Return to Table of Contents](#)

THE DIXIE GROUP, INC.**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS****(UNAUDITED)****(dollars in thousands, except per share data) - Cont'd.**

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

| | Interest Rate Swaps | Available- For-Sale Securities | Pension and Post- Retirement Liabilities | Total |
|---|---------------------------|--------------------------------------|---|---------------|
| Balance at December 29, 2007 | \$ (555) | \$ --- | \$ 785 | \$ 230 |
| Unrealized loss on interest rate swap agreements, net of tax of \$379 | (618) | --- | --- | (618) |
| Unrealized gains on available-for-sale securities, net of tax of \$330 | --- | 538 | --- | 538 |
| Recognition of net actuarial (gain) loss of pension and postretirement benefit plans, net of tax of \$4 | --- | --- | (7) | (7) |
| Amortization of prior service credits of pension and postretirement benefit plans, net of tax of \$6 | --- | --- | (11) | (11) |
| Balance at March 29, 2008 | \$ (1,173) | \$ 538 | \$ 767 | \$ 132 |

In March 2008, the Company recorded certain available-for-sale securities believed to be acquired through a prior acquisition. Such securities were not reflected in the financial statements of any prior acquisition. The effect of this transaction increased other non-current assets by \$868, increased accumulated other comprehensive income by \$538 and increased deferred tax liabilities by \$330. The effect of this transaction was not material to the Company's historical consolidated financial statements or to the consolidated condensed financial statements for the period ended March 29, 2008.

NOTE O - OTHER (INCOME) EXPENSE

Other (income) expense is summarized as follows:

| | Three Months Ended | |
|----------------------------------|--------------------|-------------------|
| | March 29, 2008 | March 31, 2007 |
| Other operating income: | | |
| Gain on sale of operating assets | \$ (113) | \$ --- |
| Miscellaneous income | (35) | (28) |
| Other operating income | \$ (148) | \$ (28) |
| Other operating expense: | | |
| Retirement expenses | \$ 143 | \$ 56 |
| Miscellaneous expense | 44 | 69 |
| Other operating expense | \$ 187 | \$ 125 |
| Other income: | | |
| Interest income | \$ (6) | \$ (6) |
| Miscellaneous income | (55) | (8) |
| Other income | \$ (61) | \$ (14) |
| Other expense: | | |
| Miscellaneous expense | \$ 8 | \$ 17 |
| Other expense | \$ 8 | \$ 17 |

[Return to Table of Contents](#)

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

The following is presented to update the discussion of results of operations and financial condition included in our 2007 annual report.

CRITICAL ACCOUNTING POLICIES

Our critical accounting policies were outlined in Management's Discussion and Analysis of Results of Operations and Financial Condition in our 2007 Annual Report on Form 10-K filed with the Securities and Exchange Commission. There have been no changes to those critical accounting policies subsequent to the date of that report.

RESULTS OF OPERATIONS

The carpet industry continued to be negatively impacted by declining sales of new and existing housing units, difficult credit conditions and contracting consumer confidence. Industry sales declined 7% in the first quarter of 2008, compared with the same period a year ago. During this period, the industry's sales of residential carpeting declined 11.8% and sales of commercial carpeting grew only 1.3%. As discussed below, our sales and operating results were also affected by the negative conditions in the industry.

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

| | Three Months Ended | |
|-------------------------------------|---------------------------|---------------------------|
| | March 29, 2008 | March 31, 2007 |
| Net sales | 100.0 % | 100.0 % |
| Cost of sales | 70.9 % | 70.7 % |
| Gross profit | 29.1 % | 29.3 % |
| Selling and administrative expenses | 26.8 % | 26.6 % |

| | | |
|-------------------------|--------|--------|
| Other operating income | (0.2)% | (0.1)% |
| Other operating expense | 0.3 % | 0.2 % |
| Operating income | 2.2 % | 2.6 % |

Net Sales. Net sales for the quarter ended March 29, 2008 were \$70.7 million, a decrease of 5.1%, compared with sales of \$74.5 million for the year earlier quarter.

Our 2008 year-over-year revenue comparison reflects a 3.1% decline in the dollar volume of carpet sales. Sales of our residential carpet products were down 10.6%, slightly less than the industry's residential carpet decline, but sales of our commercial carpet products grew 10.4%, well ahead of the industry's commercial carpet growth.

Our emphasis on development of new and differentiated products has been an important factor in our efforts to grow our share of the markets we serve. We introduced residential wool carpet collections late last year at Masland and early this year at Fabrica. Dixie Home's introductions, including the new Lifestyles collection, were well received at Surfaces, and samples already have been shipped to customers. Our commercial growth reflects the success of our new modular carpet tile and our Dixie Home and Office collection of Stainmaster® commercial products.

Although the severe weakness in the housing industry and tough credit conditions will likely persist throughout this year, the normal seasonality of the carpet industry is expected to improve sales volumes in the second quarter. We believe that conditions in the residential portion of our industry will improve somewhat in the last half of this year, but the rate of growth of the commercial carpet is expected to slow. We expect our sales to continue to outpace those of the carpet industry, as a whole, due to the performance of our commercial business and the anticipated effect of our new residential products.

Cost of Sales. Despite a 5.1% decline in sales volume, cost of sales as a percentage of sales increased only 0.2 percentage points in the first quarter of 2008 compared with the first quarter of 2007. The negative effect of lower volume on fixed cost absorption was substantially offset by improved operational performance.

[Return to Table of Contents](#)

Gross Profit. Gross profit dollars decreased \$1.3 million in the first quarter of 2008 compared with the same period in 2007 principally due to lower sales volume.

Selling and Administrative Expenses. Selling and administrative expenses decreased \$835 thousand in the first quarter of 2008, compared with the first quarter of 2007. As a percentage of net sales, these expenses slightly increased due to the lower sales volume.

Other Operating Income. Other operating income increased \$120 thousand in the first quarter of 2008, compared with the first quarter of 2007, primarily as the result of a gain on the sale of an operating asset in 2008.

Other operating expense. Other operating expense increased \$62 thousand in the first quarter of 2008, compared with the first quarter of 2007, primarily as a result of changes in the mix of investments in our non-qualified retirement plan.

Operating Income. Operating income was \$1.6 million, or 2.2% of net sales, in the first quarter of 2008 compared with \$1.9 million, or 2.6% of net sales, in the first quarter of the prior year. The decline in operating income was principally the result of lower sales volume.

Interest Expense. Interest expense decreased \$81 thousand in the first quarter of 2008, compared with the first quarter of 2007 principally as a result of lower interest rates.

Other Income/Other Expense. Other income and other expense were not significant in the first quarter of 2008 or the first quarter of 2007.

Income Tax Provision. Our effective income tax rate was 46.1% in the first quarter of 2008 compared with 38.3% for the first quarter of the prior year. The increase in the effective income tax rate was principally due to adjustments in our tax contingency reserve during the periods presented.

Income from Continuing Operations. Income from continuing operations was \$82 thousand, or \$0.01 per diluted share in the first quarter of 2008 compared with \$237 thousand, or \$0.02 per diluted share, for same period in the previous year.

Net Income. Discontinued operations reflected a loss of \$69 thousand, \$0.01 per diluted share, in the first quarter of 2008 compared with a loss of \$66 thousand, or \$0.01 per diluted share, in the same period of 2007. Including discontinued operations, net income was \$13 thousand, or \$0.00 per diluted share, in the first quarter of 2008, compared with \$171 thousand, or \$0.01 per diluted share, for the same period of 2007.

LIQUIDITY AND CAPITAL RESOURCES

During the three months ended March 29, 2008, our debt increased \$5.7 million and outstanding checks in excess of cash increased by \$2.5 million. These funds were used primarily to invest in capital assets, fund our operations, including seasonal increases in working capital, and acquire \$1.1 million of the Company's Common Stock.

Working capital increased \$4.7 million during the three month period ended March 29, 2008, principally as a result of an increase in raw material inventories to support new product offerings.

Capital expenditures for the three-months ended March 29, 2008 were \$2.9 million while depreciation and amortization was \$3.5 million. We expect capital expenditures to be approximately \$12.0 million to \$14.0 million in fiscal 2008, while depreciation and amortization is expected to be approximately \$13.9 million. The anticipated 2008 capital expenditures will primarily be for newer manufacturing technology and to a lesser extent new operating information systems.

We believe that cash generated from our operations and our existing credit facilities are adequate to fund our planned liquidity needs. Unused borrowing capacity under our revolving credit facility was \$20.2 million at March 29, 2008.

RECENT ACCOUNTING PRONOUNCEMENTS

In September 2006, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" ("SFAS No. 157"). SFAS No. 157 defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The adoption of this statement did not have a material effect on our financial position or results of operations.

[Return to Table of Contents](#)

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities", including an amendment of SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities" ("SFAS No. 159"). SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective of SFAS No. 159 is to improve financial reporting by providing entities with the opportunity to mitigate the volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions to such assets and liabilities.

Eligible items for the measurement option include all recognized financial assets and liabilities except: investments in subsidiaries, interests in variable interest entities, obligations for pension benefits, assets and liabilities recognized under leases, deposit liabilities and financial instruments that are a component of shareholders' equity. Also, included are firm commitments that involve only financial instruments, nonfinancial insurance contracts and warranties and host financial instruments.

The Statement permits all entities to choose the fair value measurement option at specified election dates, after which the entity must report unrealized gains and losses on items for which the fair value option has been elected in earnings, at each subsequent reporting date. The fair value option may be applied instrument by instrument; however, the election is irrevocable and may apply only to entire instruments and not to portions of instruments. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. This statement did not have a material effect on our financial position or results of operations.

In December 2007, the FASB issued SFAS No. 141R, "Business Combinations" ("SFAS No. 141R"). SFAS No. 141R replaces SFAS No. 141 and establishes principles and requirements for how identifiable assets, liabilities assumed, non-controlling interest in an acquiree, and goodwill is recognized and measured in an acquirer's financial statements. SFAS No. 141R also establishes disclosure requirements to assist users in evaluating the nature and financial effects of business combinations. This standard is effective for fiscal years beginning after December 15, 2008. We do not expect the adoption of this statement to have a material effect on our financial position or results of operations.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements" ("SFAS No. 160"). SFAS No. 160 establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than their parent, the amount of consolidated net income attributable to their parent and to the holder of a noncontrolling interest, changes in a parent's ownership interest and the valuation of retained noncontrolling equity investments when a subsidiary is no longer consolidated. SFAS No. 160 also establishes reporting requirements to clearly identify, distinguish and disclose the interests of the parent and the interests of the noncontrolling owners. This standard is effective for fiscal years beginning after December 15, 2008. We do not expect the adoption of this statement to have a material effect on our financial position or results of operations.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133" ("SFAS No. 161"). SFAS No. 161 establishes, among other things, the disclosure requirements for derivative instruments and for hedging activities. SFAS No. 161 is effective for fiscal years and interim periods beginning after November 15, 2008. We do not expect the adoption of this statement to have a material effect on our financial position or results of operations.

CERTAIN FACTORS AFFECTING THE COMPANY'S PERFORMANCE

In addition to the other information provided in this Report, the risk factors included in Item 1A should be considered when evaluating 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.

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," "estimated," "projects," "believes," "anticipates," "intends," and similar terms and phrases. Such terms or phrases 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 detailed above under the heading "Certain Factors Affecting the Company's Performance", the cost and availability of capital and raw materials, 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.

[Return to Table of Contents](#)

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK (Dollars in thousands)

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 financial exposure through a risk management program that includes maintaining a mix of fixed and floating rate debt and the use of derivative financial instruments.

At March 29, 2008, the Company was a party to an interest rate swap agreement on its mortgage note payable with a notional amount equal to the outstanding balance of the mortgage note (\$6,478 at March 29, 2008) which expires in March of 2013. Under the interest rate swap agreement, the Company pays a fixed rate of interest of 4.54% times the notional amount and receives in return an amount equal to a specified variable rate of interest times the same notional amount. The interest rate swap agreement effectively fixes the interest rate on the mortgage note payable at 6.54%.

On October 11, 2005, the Company entered into an interest rate swap agreement with a notional amount of \$30,000 through May 11, 2010. Under this agreement, the Company pays a fixed rate of interest of 4.79% times the notional amount and receives in return a specified variable rate of interest times the same notional amount. The interest rate swap agreement is linked to the Company's variable rate debt and is considered a highly effective hedge.

At March 29, 2008, \$22,280, or approximately 24% of the Company's 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 \$63.

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 March 29, 2008, 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.

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 Principals by accounting professionals. It is also possible that internal control over financial reporting could 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, it is possible to design into the process safeguards to reduce, through not eliminate all risk.

[Return to Table of Contents](#)

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 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 cyclical and prolonged declines in residential or commercial construction activity or corporate remodeling and refurbishment could have a material adverse effect on our business.

The U.S. floorcovering industry is cyclical and is influenced by a number of general economic factors. In general, the industry is dependent on residential and commercial construction activity, including new construction as well as remodeling. New construction is cyclical in nature. To a somewhat lesser degree, this also is true with residential and commercial remodeling. A prolonged decline in new construction or remodeling activity could have a material adverse effect on our business, financial condition and results of operations. The level of activity in these industries is significantly affected by numerous factors, all of which are beyond our control, including among others:

.

consumer confidence;

.

housing demand;

.

financing availability;

.

national and local economic conditions;

.

interest rates;

.

employment levels;

.

changes in disposable income;

.

commercial rental vacancy rates; and

.

federal and state income tax policies.

Our product concentration in the higher-end of the residential and commercial markets could significantly affect the impact of these factors on our business.

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. There has been significant consolidation within the floorcovering industry during recent years that has caused a number of our existing and potential competitors to be significantly larger and have significantly greater resources and access to 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, which may be limited by our access to capital, as well as restrictions set forth in our credit facilities. Competitive pressures 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, pressure on sales prices of our products from competitors. As a result of any of these factors, there could be a material adverse effect on our sales and profitability.

Raw material prices may increase.

The cost of raw materials has a significant impact on our profitability. In particular, our business requires the purchase of large volumes of nylon yarn, synthetic backing, latex, and dyes. Increases in the cost of these raw materials could materially adversely affect our business, results of operations and financial condition if we are unable to pass these increases through to our customers. We believe we have been generally successful in passing along raw material and other cost increases as they may occur; however, there can be no assurance that we will successfully recover such increases in cost, as they may occur in the future.

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

[Return to Table of Contents](#)

Page 20

Nylon yarn is the principal raw material used in our floorcovering products. A significant portion of such yarn is purchased from one supplier. We believe there are other sources of nylon yarns; however, an unanticipated termination or interruption of our supply arrangements could adversely affect our supply arrangements and could be material.

We may be responsible for environmental cleanup costs.

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

.

Discharges 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. 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.

Acts of Terrorism.

Our business could be materially adversely affected as a result of international conflicts or acts of terrorism. Terrorist acts or acts of war may cause damage or disruption to our facilities, employees, customers, suppliers, and distributors, which could have a material adverse effect on our business, results of operations or financial condition. Such conflicts also may cause damage or disruption to transportation and communication systems and to our ability to manage logistics in such an environment, including receipt of supplies and distribution of products.

Unanticipated Business Interruptions.

Our business could be adversely affected if a significant portion of our plant, equipment or operations were damaged or interrupted by a casualty, condemnation, utility service, work stoppage or other event beyond our control. Such an event could have a material adverse effect on our business, results of operations and financial condition.

Item 2 - Unregistered Sales Of Equity Securities And Use Of Proceeds

The following table provides information regarding our repurchases of shares of our Common Stock during the three fiscal months ended March 29, 2008:

| Fiscal Month Ending | Total Number of Shares Purchased | Average Price Paid Per Share | Maximum Number (or approximate dollar value) of Shares That May Yet Be Purchased Under Plans or Programs | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1) |
|---|---|---------------------------------------|--|---|
| February 2, 2008 | 49,943 | \$ 8.01 | \$ | 49,943 |
| March 1, 2008 | 42,198 | 8.57 | | 42,198 |
| March 29, 2008 | 45,834 | 8.26 | | 45,834 |
| Three Fiscal Months Ended March 29, 2008 | 137,975 | \$ 8.26 | \$ 7,286,304 | 137,975 |

(1) On August 8, 2007, we announced a program to repurchase up to \$10 million of our Common Stock.

[Return to Table of Contents](#)

Item 3 - Defaults Upon Senior Securities

None.

Item 4 - Submission of Matters to a Vote of Security Holders

None.

Item 5 - Other Information

None.

Item 6 - Exhibits

(a) Exhibits

(i) Exhibits Incorporated by Reference

| | |
|------|--|
| 10.1 | 2008 Incentive Compensation Plan/Range of Incentives as effective on February 15, 2008. (Incorporated by reference to the Current Report on Form 8-K dated February 15, 2008) |
|------|--|

(ii) Exhibits Filed with this Report

| | |
|------|---|
| 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. |
| 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. |

[Return to Table of Contents](#)

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: May 2, 2008

By: /s/ GARY A. HARMON
Gary A. Harmon
Vice President and Chief Financial Officer

Date: May 2, 2008

By: /s/ D. EUGENE LASATER
D. Eugene Lasater
Controller

[Return to Table of Contents](#)