

DIXIE GROUP INC
Form 10-Q
November 03, 2016

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 24, 2016
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.)

475 Reed Road, Dalton, Georgia

30720

(706) 876-5800

(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 28, 2016
Common Stock, \$3 Par Value	15,248,538 shares
Class B Common Stock, \$3 Par Value	870,714 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 Consolidated Condensed Balance Sheets - September 24, 2016 (Unaudited) and December 26, 2015 Consolidated Condensed Statements of Operations - Three and Nine Months Ended September 24, 2016 and September 26, 2015 (Unaudited) Consolidated Condensed Statements of Comprehensive Income (Loss) - Three and Nine Months Ended September 24, 2016 and September 26, 2015 (Unaudited) Consolidated Condensed Statements of Cash Flows - Nine Months Ended September 24, 2016 and September 26,</u>	<u>3</u>
		<u>4</u>
		<u>5</u>
		<u>6</u>
		<u>7</u>

	<u>2015</u>	
	<u>(Unaudited)</u>	
	<u>Notes to</u>	
	<u>Consolidated</u>	
	<u>Condensed</u>	8
	<u>Financial</u>	
	<u>Statements</u>	
	<u>(Unaudited)</u>	
	<u>Management's</u>	
	<u>Discussion and</u>	
	<u>Analysis of</u>	
Item 2.	<u>Results of</u>	21
	<u>Operations and</u>	
	<u>Financial</u>	
	<u>Condition</u>	
	<u>Quantitative</u>	
	<u>and Qualitative</u>	
Item 3.	<u>Disclosures</u>	25
	<u>about Market</u>	
	<u>Risk</u>	
Item 4.	<u>Controls and</u>	25
	<u>Procedures</u>	

PART II. OTHER
INFORMATION

Item 1.	<u>Legal</u>	25
	<u>Proceedings</u>	
Item 1A.	<u>Risk Factors</u>	26
	<u>Unregistered</u>	
Item 2.	<u>Sales of Equity</u>	29
	<u>Securities and</u>	
	<u>Use of Proceeds</u>	
	<u>Defaults Upon</u>	
Item 3.	<u>Senior</u>	29
	<u>Securities</u>	
Item 4.	<u>Mine Safety</u>	29
	<u>Disclosures</u>	
Item 5.	<u>Other</u>	29
	<u>information</u>	
Item 6.	<u>Exhibits</u>	29
	<u>Signatures</u>	30

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Table of Contents 3

THE DIXIE GROUP, INC.
CONSOLIDATED CONDENSED BALANCE SHEETS
(amounts in thousands, except share data)

	September 24, 2016	December 26, 2015
	(Unaudited)	
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 88	\$ 281
Receivables, net	47,568	50,806
Inventories, net	107,965	115,146
Prepaid expenses	4,820	3,362
TOTAL CURRENT ASSETS	160,441	169,595
PROPERTY, PLANT AND EQUIPMENT, NET	94,690	101,146
GOODWILL AND OTHER INTANGIBLES	6,232	6,461
OTHER ASSETS	23,935	21,016
TOTAL ASSETS	\$ 285,298	\$ 298,218
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	\$ 23,805	\$ 26,483
Accrued expenses	35,848	34,338
Current portion of long-term debt	9,230	10,142
TOTAL CURRENT LIABILITIES	68,883	70,963
LONG-TERM DEBT	106,395	115,907
OTHER LONG-TERM LIABILITIES	22,173	20,544
TOTAL LIABILITIES	197,451	207,414
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY		
Common Stock (\$3 par value per share): Authorized 80,000,000 shares, issued and outstanding - 15,253,086 shares for 2016 and 15,155,274 shares for 2015	45,759	45,466
Class B Common Stock (\$3 par value per share): Authorized 16,000,000 shares, issued and outstanding - 871,714 shares for 2016 and 851,693 shares for 2015	2,615	2,555
Additional paid-in capital	156,090	155,734
Accumulated deficit	(112,934)	(110,378)
Accumulated other comprehensive income (loss)	(3,683)	(2,573)
TOTAL STOCKHOLDERS' EQUITY	87,847	90,804
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 285,298	\$ 298,218

See accompanying notes to the consolidated condensed financial statements.

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, 2016	September 26, 2015	September 26, 2016	September 26, 2015
NET SALES	\$100,297	\$ 108,908	\$294,847	\$ 314,721
Cost of sales	74,466	81,643	221,268	234,811
GROSS PROFIT	25,831	27,265	73,579	79,910
Selling and administrative expenses	23,774	25,267	71,760	76,215
Other operating expense, net	141	131	525	684
Facility consolidation expenses	—	614	1,816	2,264
OPERATING INCOME (LOSS)	1,916	1,253	(522)	747)
Interest expense	1,312	1,203	3,969	3,603
Other expense, net	4	4	15	45
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE TAXES	600	46	(4,506)	(2,901)
Income tax provision (benefit)	27	(38)	(1,937)	(1,121)
INCOME (LOSS) FROM CONTINUING OPERATIONS	573	84	(2,569)	(1,780)
Income (loss) from discontinued operations, net of tax	(39)	(18)	13	(118)
NET INCOME (LOSS)	\$534	\$ 66	\$(2,556)	\$(1,898)
BASIC EARNINGS (LOSS) PER SHARE:				
Continuing operations	\$0.04	\$ 0.01	\$(0.16)	\$(0.11)
Discontinued operations	(0.00)	(0.00)	(0.00)	(0.01)
Net income (loss)	\$0.04	\$ 0.01	\$(0.16)	\$(0.12)
BASIC SHARES OUTSTANDING	15,648	15,573	15,631	15,518
DILUTED EARNINGS (LOSS) PER SHARE:				
Continuing operations	\$0.04	\$ 0.01	\$(0.16)	\$(0.11)
Discontinued operations	(0.00)	(0.00)	(0.00)	(0.01)
Net income (loss)	\$0.04	\$ 0.01	\$(0.16)	\$(0.12)
DILUTED SHARES OUTSTANDING	15,744	15,666	15,631	15,518
DIVIDENDS PER SHARE:				
Common Stock	\$—	\$—	\$—	\$—
Class B Common Stock	—	—	—	—

See accompanying notes to the consolidated condensed financial statements.

[Table of Contents](#) 5

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

	Three Months Ended		Nine Months Ended	
	September 2016	September 2015	September 2016	September 2015
NET INCOME (LOSS)	\$534	\$ 66	\$(2,556)	\$(1,898)
OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX:				
Unrealized gain (loss) on interest rate swaps	24	(1,923)	(2,648)	(2,466)
Income taxes	9	(731)	(1,006)	(937)
Unrealized gain (loss) on interest rate swaps, net	15	(1,192)	(1,642)	(1,529)
Reclassification of loss into earnings from interest rate swaps (1)	308	187	891	453
Income taxes	117	71	339	172
Reclassification of loss into earnings from interest rate swaps, net	191	116	552	281
Reclassification of net actuarial gain into earnings from postretirement benefit plans (2)	(10)	(9)	(30)	(28)
Income taxes	(4)	(4)	(12)	(12)
Reclassification of net actuarial gain into earnings from postretirement benefit plans, net	(6)	(5)	(18)	(16)
Reclassification of prior service credits into earnings from postretirement benefit plans (2)	(1)	(22)	(3)	(66)
Income taxes	—	(9)	(1)	(28)
Reclassification of prior service credits into earnings from postretirement benefit plans, net	(1)	(13)	(2)	(38)
TOTAL OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX	199	(1,094)	(1,110)	(1,302)
COMPREHENSIVE INCOME (LOSS)	\$733	\$(1,028)	\$(3,666)	\$(3,200)

(1) Amounts for cash flow hedges reclassified from accumulated other comprehensive income (loss) to net 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 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](#) 6

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

	Nine Months Ended	
	September 26,	September 26,
	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES		
Loss from continuing operations	\$(2,569)	\$ (1,780)
Income (loss) from discontinued operations	13	(118)
Net loss	(2,556)	(1,898)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	10,234	10,954
Benefit for deferred taxes	(1,623)	(1,403)
Net (gain) loss on property, plant and equipment disposals	259	(187)
Stock-based compensation expense	1,021	1,071
Excess tax benefits from stock-based compensation	(3)	(287)
Bad debt expense (credit)	(70)	110
Changes in operating assets and liabilities:		
Receivables	3,308	(3,301)
Inventories	7,181	(10,649)
Other current assets	(1,458)	(649)
Accounts payable and accrued expenses	510	9,876
Other operating assets and liabilities	(799)	(863)
NET CASH PROVIDED BY OPERATING ACTIVITIES	16,004	2,774
CASH FLOWS FROM INVESTING ACTIVITIES		
Net proceeds from sales of property, plant and equipment	1	66
Purchase of property, plant and equipment	(3,426)	(5,266)
NET CASH USED IN INVESTING ACTIVITIES	(3,425)	(5,200)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net (payments) borrowings on revolving credit facility	(3,878)	1,182
Borrowings on notes payable - buildings	—	6,290
Payments on notes payable - buildings	(548)	(522)
Payments on notes payable related to acquisitions	(1,634)	(1,572)
Borrowings on notes payable - equipment and other	—	998
Payments on notes payable - equipment and other	(3,510)	(3,370)
Borrowings on equipment purchased under capital leases	1,396	—
Payments on capital leases	(2,325)	(2,050)
Change in outstanding checks in excess of cash	(1,854)	1,278
Proceeds from exercise of stock options	—	274
Repurchases of Common Stock	(135)	(584)
Excess tax benefits from stock-based compensation	3	287
Payments for debt issuance costs	(287)	—
NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES	(12,772)	2,211

Edgar Filing: DIXIE GROUP INC - Form 10-Q

DECREASE IN CASH AND CASH EQUIVALENTS	(193)	(215)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	281		394	
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$88		\$ 179	

SUPPLEMENTAL CASH FLOW INFORMATION:

Interest paid	\$3,720		\$ 3,246	
Income taxes paid (received), net	(93)	104	
Equipment purchased under capital leases	169		87	
Equipment purchased under notes payable	—		2,850	
Deposits utilized on purchased equipment, net	—		1,857	
Shortfall of tax benefits from stock-based compensation	(179)	(93)
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 ("U.S. 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 2015 Annual Report on Form 10-K filed with the Securities and Exchange Commission for the fiscal year ended December 26, 2015. Operating results for the three and nine month periods ended September 24, 2016 are not necessarily indicative of the results that may be expected for the entire 2016 year.

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

NOTE 2 - RECENT ACCOUNTING PRONOUNCEMENTS

In May 2014, the Financial Accounting Standards Board ("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 and all subsequently issued clarifying ASUs 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 July 2015, the FASB issued ASU No. 2015-11, "Inventory (Topic 330): Simplifying the Measurement of Inventory." Topic 330 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. This ASU does not apply to inventory that is measured using last-in, first-out (LIFO) or the retail inventory method. This ASU is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. 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 January 2016, the FASB issued ASU 2016-01, "Financial Instruments Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities," which addresses the recognition, measurement, presentation and disclosure of financial assets and liabilities. The ASU primarily affects the accounting for equity investments, financial liabilities under the fair value option and the presentation and disclosure requirements for financial instruments. In addition, the ASU clarifies the valuation allowance assessment when recognizing deferred tax assets resulting from unrealized losses on available-for-sale debt securities. The ASU is effective for public companies for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company does not believe the adoption of this ASU will have a significant impact on the Consolidated Condensed Financial Statements.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)," which requires lessees to recognize on the balance sheet a right-of use asset, representing its right to use the underlying asset for the lease term, and a lease liability for all leases with terms greater than 12 months. The guidance also requires qualitative and quantitative disclosures designed to assess the amount, timing, and uncertainty of cash flows arising from leases. The standard requires the use of a modified retrospective transition approach, which includes a number of optional practical expedients that entities may elect to apply. ASU 2016-02 is effective for annual periods beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted. The Company is currently evaluating the impact of the adoption of this ASU 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 March 2016, the FASB issued ASU 2016-09, "Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting," which is intended to simplify several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. For public entities, ASU 2016-09 is effective for annual periods beginning after December 15, 2016, including interim periods within those fiscal years. Early application is permitted. The Company is currently evaluating the impact of the adoption of this ASU on the Consolidated Condensed Financial Statements.

In June 2016, the FASB issued ASU 2016-13, "Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments," which amends the impairment model to utilize an expected loss methodology in place of the currently used incurred loss methodology, which will result in the more timely recognition of losses. For public entities, ASU 2016-13 is effective for annual periods beginning after December 15, 2019, including interim periods within those fiscal years. Early application will be permitted for all organizations for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Company is currently evaluating the impact of the adoption of this ASU on the Consolidated Condensed Financial Statements.

In August 2016, the FASB issued ASU 2016-15, "Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments," which provides clarification guidance on certain cash flow presentation issues that have developed due to diversity in practice. These issues include certain cash receipts and payments for debt prepayment or extinguishment costs, the maturing of a zero coupon bond, the settlement of contingent liabilities arising from a business combination, proceeds from insurance settlements, distributions from certain equity method investees and beneficial interests obtained in a financial asset securitization. ASU 2016-15 clarifies that when cash receipts and cash payments have aspects of more than one class of cash flows and cannot be separated, classification will depend on the predominant source or use. For public entities, ASU 2016-15 is effective for annual periods beginning after December 15, 2017, including interim periods within those fiscal years, with early adoption permitted. The Company is currently evaluating the impact of the adoption of this ASU on the Consolidated Condensed Financial Statements.

NOTE 3 - RECEIVABLES, NET

Receivables are summarized as follows:

	September 24, 2016	December 26, 2015
Customers, trade	\$ 45,060	\$ 46,110
Other receivables	2,710	5,166
Gross receivables	47,770	51,276
Less: allowance for doubtful accounts	(202)	(470)
Receivables, net	\$ 47,568	\$ 50,806

Bad debt expense (credit) was \$25 and \$(70) for the three and nine months ended September 24, 2016, respectively, and \$51 and \$110 for the three and nine months ended September 26, 2015, respectively.

NOTE 4 - INVENTORIES, NET

Inventories are summarized as follows:

	September 24, 2016	December 26, 2015
Raw materials	\$ 37,790	\$ 46,164
Work-in-process	19,878	21,306
Finished goods	58,667	58,037
Supplies and other	119	192
LIFO reserve	(8,489)	(10,553)
Inventories, net	\$ 107,965	\$ 115,146

Table of Contents 9

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

NOTE 5 - PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment consists of the following:

	September 24, 2016	December 26, 2015
Land and improvements	\$ 7,781	\$ 7,610
Buildings and improvements	62,032	61,396
Machinery and equipment	176,416	174,636
Assets under construction	2,493	2,819
	248,722	246,461
Accumulated depreciation	(154,032)	(145,315)
Property, plant and equipment, net	\$ 94,690	\$ 101,146

Depreciation of property, plant and equipment, including amounts for capital leases, totaled \$3,264 and \$9,791, respectively, in the three and nine months ended September 24, 2016 and \$3,503 and \$10,508, respectively, in the three and nine months ended September 26, 2015.

NOTE 6 - GOODWILL AND OTHER INTANGIBLES

The carrying amount of goodwill is \$3,389 as of September 24, 2016 and December 26, 2015. The Company has a net carrying amount of \$2,843 and \$3,072 as of September 24, 2016 and December 26, 2015, respectively, for certain intangible assets subject to amortization. Amortization expense was \$76 for the three months ended September 24, 2016 and September 26, 2015, respectively. Amortization expense was \$229 for the nine months ended September 24, 2016 and September 26, 2015, respectively.

NOTE 7 - ACCRUED EXPENSES

Accrued expenses are summarized as follows:

	September 24, 2016	December 26, 2015
Compensation and benefits	\$ 8,328	\$ 9,173
Provision for customer rebates, claims and allowances	9,231	8,995
Advanced customer deposits	8,321	6,674
Outstanding checks in excess of cash	1,152	3,006
Other	8,816	6,490
Accrued expenses	\$ 35,848	\$ 34,338

NOTE 8 - 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

Edgar Filing: DIXIE GROUP INC - Form 10-Q

	September 26, 2016	September 26, 2015	September 26, 2016	September 26, 2015
Product warranty reserve at beginning of period	\$2,214	\$ 2,115	\$2,159	\$ 2,214
Warranty liabilities accrued	1,537	1,430	4,574	4,707
Warranty liabilities settled	(1,583)	(1,880)	(5,128)	(6,682)
Changes for pre-existing warranty liabilities	(45)	616	518	2,042
Product warranty reserve at end of period	\$2,123	\$ 2,281	\$2,123	\$ 2,281

[Table of Contents](#) 10

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

NOTE 9 - LONG-TERM DEBT AND CREDIT ARRANGEMENTS

Long-term debt consists of the following:

	September 24, 2016	December 26, 2015
Revolving credit facility	\$ 76,692	\$ 80,569
Notes payable - buildings	13,332	13,881
Acquisition note payable - Development Authority of Gordon County	1,446	2,314
Acquisition note payable - Robertex	1,555	2,321
Notes payable - equipment and other	11,497	15,008
Capital lease obligations	11,992	12,751
Deferred financing costs, net	(889) (795)
Total long-term debt	115,625	126,049
Less: current portion of long-term debt	9,230	10,142
Long-term debt	\$ 106,395	\$ 115,907

Revolving Credit Facility

On September 23, 2016, the Company amended its revolving credit facility to revise certain definitions and extend the maturity date from March 2019 to September 2021. The revolving credit facility 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 revolving credit facility is secured by a first priority lien on substantially all of the Company's assets.

At the Company's election, 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 ranging between 1.50% and 2.00%, or (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 ranging between 0.50% and 1.00%. The applicable margin is determined based on availability under the revolving credit facility with margins increasing as availability decreases, with the exception that the applicable margin cannot go below 1.75% until after March 31, 2017. As of September 24, 2016, the applicable margin on our revolving credit facility was 1.75%. The Company pays an unused line fee on the average amount by which the aggregate commitments exceed utilization of the revolving credit facility equal to 0.375% per annum. The weighted-average interest rate on borrowings outstanding under the revolving credit facility was 4.09% at September 24, 2016 and 3.12% at December 26, 2015.

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 was less than \$16,500. As of September 24, 2016, the unused borrowing availability under the revolving credit facility was \$41,806; however, since the Company's fixed charge coverage ratio was less than 1.1 to 1.0, the unused availability accessible by the Company was \$25,306 (the amount above \$16,500) at September 24, 2016.

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 will effectively fix the interest rate at 4.30%.

Table of Contents 11

THE DIXIE GROUP, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(UNAUDITED)

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

Acquisition Note Payable - 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 a 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 and Other

The Company's equipment financing notes have terms ranging from 3 to 7 years, bear interest ranging from 1.00% to 6.86% and are due in monthly or quarterly installments through their maturity dates. 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 capitalized lease obligations have terms ranging from 3 to 7 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.

NOTE 10 - 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 24, 2016 and December 26, 2015:

	September 24, 2016	December 26, 2015	Fair Value Hierarchy Level
Liabilities:			
Interest rate swaps (1)	\$ 6,456	\$ 4,689	Level 2
Contingent consideration (2)	280	584	Level 3

The Company uses certain external sources in deriving the fair value of the interest rate swaps. The interest rate swaps were valued using observable inputs (e.g., LIBOR yield curves, credit spreads). Valuations of interest rate swaps may fluctuate 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.

As a result of the Colormaster acquisition 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 within the fair value measurement are higher or lower, the Company would record additional charges or benefits, respectively, as appropriate.

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 24, 2016 and September 26, 2015 were as follows:

	September 24, 2016		September 26, 2015	
Beginning balance	\$	584	\$	1,855
Fair value adjustments	(168)	(387)
Settlements	(136)	(375)
Ending balance	\$	280	\$	1,093

There were no transfers of assets or liabilities between Level 1, Level 2 and Level 3 during the three and nine months ending September 24, 2016 or September 26, 2015. 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 24, 2016		December 26, 2015	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial Assets:				
Cash and cash equivalents	\$ 88	\$ 88	\$ 281	\$ 281
Notes receivable, including current portion	308	308	282	282
Financial Liabilities:				
Long-term debt and capital leases, including current portion	115,625	115,934	126,049	123,318
Interest rate swaps	6,456	6,456	4,689	4,689

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 11 - 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 24, 2016:

Type	Notional Amount	Effective Date	Fixed Rate	Variable Rate
Interest rate swap	\$25,000	September 1, 2016 through September 1, 2021	3.105%	1 Month LIBOR

Edgar Filing: DIXIE GROUP INC - Form 10-Q

Interest rate swap \$25,000	September 1, 2015 through September 1, 2021	3.304%	1 Month LIBOR
Interest rate swap \$7,566	(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 13

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 24, 2016	December 26, 2015
Liability Derivatives:			
Derivatives designated as hedging instruments:			
Interest rate swaps, current portion	Accrued Expenses	\$1,477	\$ 1,159
Interest rate swaps, long-term portion	Other Long-Term Liabilities	4,979	3,530
Total Liability Derivatives		\$6,456	\$ 4,689

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 24, 2016	September 26, 2015	September 24, 2016	September 26, 2015
Derivatives designated as hedging instruments:				
Cash flow hedges - interest rate swaps	\$24	\$ (1,923)	\$ (2,648)	\$ (2,466)

	Amount of Gain or (Loss) Reclassified from AOCIL on the effective portion into Income (1)(2)			
	Three Months Ended		Nine Months Ended	
	September 24, 2016	September 26, 2015	September 24, 2016	September 26, 2015
Derivatives designated as hedging instruments:				
Cash flow hedges - interest rate swaps	\$(308)	\$(187)	\$(891)	\$(453)

(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 24, 2016 is \$1,477.

The amount of gain (loss) recognized in income on the ineffective portion of interest rate swaps, if any, 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 12 - EMPLOYEE BENEFIT PLANS

Defined Contribution Plans

The Company sponsors a 401(k) defined contribution plan that covers approximately 86% of the Company's current 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 \$(132) and \$223 for the three months ended September 24, 2016 and September 26, 2015, respectively, and \$333 and \$683 for the nine months ended September 24, 2016 and September 26, 2015, respectively. The reduction in the matching contribution expense for the three months ended September 24, 2016 was a result of revising the estimated match for the year.

Additionally, the Company sponsors a 401(k) defined contribution plan that covers approximately 14% of the Company's current associates at one facility who are under a collective-bargaining agreement. 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 \$18 and \$17 for the three months ended September 24, 2016 and September 26, 2015, respectively, and \$53 and \$62 for the nine months ended September 24, 2016 and September 26, 2015, respectively.

Table of Contents 14

THE DIXIE GROUP, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(UNAUDITED)

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

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 \$14,659 at September 24, 2016 and \$14,155 at December 26, 2015 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 \$15,555 at September 24, 2016 and \$14,981 at December 26, 2015 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 \$68 and \$66 for the three months ended September 24, 2016 and September 26, 2015, respectively, and \$202 and \$197 for the nine months ended September 24, 2016 and September 26, 2015, respectively.

NOTE 13 - INCOME TAXES

The benefit rate applied to the pretax loss for the nine months ending September 24, 2016 was 43.0% compared with a benefit rate of 38.6% for the nine months ending September 26, 2015. The nine months ended September 24, 2016 included certain tax credits of approximately \$542 that increased the tax benefit recognized during the period. The Company is in a net deferred tax asset position of \$7,029 and \$4,726 at September 24, 2016 and December 26, 2015, respectively. The increase in the net deferred tax asset was primarily attributable to an increase in the federal tax credit carry carryforwards and the federal net operating loss carryforwards.

The Company accounts for uncertainty in income tax positions according to FASB guidance relating to uncertain tax positions. Unrecognized tax benefits were \$377 and \$375 at September 24, 2016 and December 26, 2015, respectively. Such benefits, if recognized, would affect the Company's effective tax rate. There were no significant interest or penalties accrued as of September 24, 2016 and December 26, 2015.

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 2011 remain open to examination for U.S. federal income taxes. The majority of state jurisdictions remain open for tax years subsequent to 2011. A few state jurisdictions remain open to examination for tax years subsequent to 2010.

NOTE 14 - 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 15

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 24, 2016	September 26, 2015	September 24, 2016	September 26, 2015
Basic earnings (loss) per share:				
Income (loss) from continuing operations	\$573	\$ 84	\$(2,569)	\$(1,780)
Less: Allocation of earnings to participating securities	(17)	(2)	—	—
Income (loss) from continuing operations available to common shareholders - basic	\$556	\$ 82	\$(2,569)	\$(1,780)
Basic weighted-average shares outstanding (1)	15,648	15,573	15,631	15,518
Basic earnings (loss) per share - continuing operations	\$0.04	\$ 0.01	\$(0.16)	\$(0.11)
Diluted earnings (loss) per share:				
Income (loss) from continuing operations available to common shareholders - basic	\$556	\$ 82	\$(2,569)	\$(1,780)
Add: Undistributed earnings reallocated to unvested shareholders	—	—	—	—
Income (loss) from continuing operations available to common shareholders - basic	\$556	\$ 82	\$(2,569)	\$(1,780)
Basic weighted-average shares outstanding (1)	15,648	15,573	15,631	15,518
Effect of dilutive securities:				
Stock options (2)	—	37	—	—
Directors' stock performance units (2)	96	56	—	—
Diluted weighted-average shares outstanding (1)(2)	15,744	15,666	15,631	15,518
Diluted earnings (loss) per share - continuing operations	\$0.04	\$ 0.01	\$(0.16)	\$(0.11)

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

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 performance units have been excluded to (2) the extent they are anti-dilutive. Aggregate shares excluded for the three and nine months ended September 24, 2016 were 104 and 220, respectively, and for the three and nine months ended September 26, 2015 were 220 and 308, respectively.

NOTE 15 - 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 \$269 and \$1,021 for the three and nine months ended September 24, 2016, respectively, and \$346 and \$1,071 for the three and nine months ended September 26, 2015, respectively.

On March 11, 2016, the Company issued 149,215 shares of restricted stock to officers and other key employees. The grant-date fair value of the awards was \$651, or \$4.360 per share, and is expected to be recognized as stock

compensation expense over a weighted-average period of 8.7 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.

2016 Incentive Compensation Plan

On May 3, 2016, the Company's shareholders' approved and adopted the Company's 2016 Incentive Compensation Plan (the "2016 Incentive Compensation Plan") which provides for the issuance of a maximum of 800,000 shares of Common Stock and/or Class B Common Stock for the grant of options, and/or other stock-based or stock-denominated awards to employees, officers, directors, and agents of the Company and its participating subsidiaries. The 2016 Incentive Compensation Plan and the allocation of shares thereunder superseded and replaced The Dixie Group, Inc. Stock Awards Plan, as amended (the "2006 Plan") and the allocation of shares thereunder. The 2006 Plan was terminated with respect to new awards. Awards previously granted under the 2006 Plan continue to be governed by the terms of that plan and are not affected by its termination.

[Table of Contents](#) 16

THE DIXIE GROUP, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(UNAUDITED)

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

NOTE 16 - 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 26, 2015	(2,853)	280	(2,573)
Unrealized loss on interest rate swaps, net of tax of \$1,006	(1,642)	—	(1,642)
Reclassification of loss into earnings from interest rate swaps, net of tax of \$339	552	—	552
Reclassification of net actuarial gain into earnings from postretirement benefit plans, net of tax of \$12	—	(18)	(18)
Reclassification of prior service credits into earnings from postretirement benefit plans, net of tax of \$1	—	(2)	(2)
Balance at September 24, 2016	\$(3,943)	\$ 260	\$(3,683)

NOTE 17 - 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 Notes 19 & 20)

Legal Proceedings

The Company has been sued, together with the 3M Company and approximately 30 other carpet manufacturers, by the Gadsden (Alabama) Water Works in the circuit court of Etowah County Alabama [The Water Works and Sewer Board of the City of Gadsden v. 3M Company, et al, civil action No. 31-CV-2016-900676.00], in a case seeking monetary damages and injunctive relief related to the use of certain chemical compounds in the manufacture and finishing of carpet products “in and around Dalton Georgia.” On motion of the defendants, the case was removed to the U.S. District Court for the Northern District of Alabama (Middle Division) Case No. 4:16-CV-01755-SGC. As alleged in the lawsuit, the chemicals are perflourinated compounds (“PFC”) perflourinated acid (“PFOA”) and perfluorooctane sulfonate (“PFOS”) manufactured by 3M and used in certain finishing and treatment processes by the defendants and, as a consequence of such use, either discharged into or leached into the water systems around Dalton, Georgia. The Complaint seeks damages “in excess of \$10”, but otherwise unspecified in amount in addition to injunctive relief. The Company has not yet answered the complaint; however it has reviewed the allegations of the complaint, engaged

counsel, and intends to defend the matter vigorously and is unable to estimate its potential exposure to loss, if any, at this time.

The Company is one of multiple parties to two lawsuits, both filed in Madison County Illinois, styled Sandra D. Watts, Individually and as Special Administrator of the Estate of Dianne Averett, Deceased vs. 4520 Corp., Inc. f/k/a Benjamin F. Shaw Company, et al No. 12-L-2032 and styled Brenda Bridgeman, Individually and as Special Administrator of the Estate of Robert Bridgeman, Deceased, vs. American Honda Motor Co., Inc., f/k/a Metropolitan Life Insurance Co., et al No. 15-L-374. Each lawsuit entails a claim for damages to be determined in excess of \$50 filed on behalf of the estate of an individual which alleges that the deceased contracted mesothelioma as a result of exposure to asbestos while employed by the Company. Discovery in both matters is ongoing, and tentative trial dates of February 2017 and January 2018 have been set. The Company has denied liability, is defending the matters vigorously and is unable to estimate its potential exposure to loss, if any, at this time.

Table of Contents 17

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

NOTE 18 - OTHER OPERATING EXPENSE, NET

Other operating expense, net is summarized as follows:

	Three Months Ended		Nine Months Ended	
	September 2016	September 2015	September 2016	September 2015
Other operating expense, net:				
(Gain) loss on property, plant and equipment disposals	\$—	\$ (79)	\$259	\$ (187)
(Gain) loss on currency exchanges	88	85	85	530
Amortization of intangibles	76	76	229	229
Retirement expenses	27	83	102	173
Miscellaneous (income) expense	(50)	(34)	(150)	(61)
Other operating expense, net	\$141	\$ 131	\$525	\$ 684

NOTE 19 - FACILITY CONSOLIDATION EXPENSES

2014 Warehousing, Distribution & 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 included moving and relocation expenses, information technology expenses and expenses relating to conversion and realignment of equipment. In addition, this plan included 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.

To complete the Warehousing, Distribution & Manufacturing Consolidation Plan, the Company moved its Saraland rug operation from an expiring leased building to an owned facility in March. The Company incurred some minor costs in the second quarter of 2016 as it completed the consolidation plan. As a result of eliminating its dyeing operations in Atmore, Alabama, the Company disposed of its waste water treatment plant in 2014. Subsequently, after extensive testing, it was determined that the Company still had some contaminants above background levels and that it would need to install a soil cap. During the first quarter of 2016, the Company accrued \$690 to finalize the cleanup of the site of the Company's former waste water treatment plant. Accordingly, if the actual costs are higher or lower, the Company would record an additional charge or benefit, respectively, as appropriate.

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 included equipment relocation, computer systems modifications and severance costs. These costs were 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 leased divisional and corporate offices to a single leased facility located in Dalton, Georgia. The Company paid a fee to terminate one of the leased facilities, did not renew a second facility and vacated the third facility. Related to the vacated facility, the Company recorded the estimated costs related to the fulfillment of its contractual lease obligation and on-going facility maintenance, net of an estimate of sub-lease expectations. Accordingly, if the estimates differ, the Company would record an additional charge or benefit, as appropriate. Costs related to the consolidation included the lease termination fee, contractual lease obligations and moving costs.

Table of Contents 18

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 26, 2015	2016 Expenses To Date	2016 Cash Payments	Accrued Balance at September 24, 2016	As of September 24, 2016	
					Total Costs Incurred To Date	Total Expected Costs
Warehousing, Distribution & Manufacturing Consolidation Plan	\$ —	\$ 1,740	\$ 1,065	\$ 675	\$7,806	\$7,806
Atlas Integration Plan	—	—	—	—	1,669	1,669
Corporate Office Consolidation Plan	341	76	148	269	804	804
Totals	\$ 341	\$ 1,816	(1)\$ 1,213	\$ 944	\$10,279	\$ 10,279

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

NOTE 20 - DISCONTINUED OPERATIONS

The Company has 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, 2016	September 26, 2015	September 26, 2016	September 26, 2015
Net sales - Carousel operations	\$—	\$ —	\$—	\$ 417
Income (loss) from discontinued operations:				
Income (loss) from Carousel operations	\$—	\$ (12)	\$—	\$ (89)
Workers' compensation costs from former textile operations	5	(12)	21	(48)
Environmental remediation costs from former textile operations	(65)	(13)	(101)	(56)
Income on disposal of discontinued operations	—	—	100	—
Income (loss) from discontinued operations, before taxes	(60)	(37)	20	(193)
Income tax provision (benefit)	(21)	(19)	7	(75)
Income (loss) from discontinued operations, net of tax	\$(39)	\$ (18)	\$ 13	\$ (118)

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 from unanticipated medical costs associated with the Company's obligations.

Reserves for environmental remediation obligations are established on an undiscounted basis. The Company has an accrual for environmental remediation obligations related to discontinued operations of \$1,619 as of September 24, 2016 and \$1,591 as of December 26, 2015. 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 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.

Table of Contents 19

THE DIXIE GROUP, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(UNAUDITED)

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

NOTE 21 - RELATED PARTY TRANSACTIONS

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 24, 2016 was \$226 and \$567, respectively. Rent paid to the lessor during the three and nine months ended September 26, 2015 was \$114 and \$343, respectively. The lease was based on current market values for similar facilities.

The Company purchases a portion of its product needs in the form of fiber, yarn and carpet from Engineered Floors, an entity substantially controlled by Robert E. Shaw, a shareholder of the Company. An affiliate of 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 materials to the Company. Total purchases from Engineered Floors during the three and nine months ended September 24, 2016 were approximately \$1,844 and \$5,478, respectively; or approximately 2.5%, respectively, of the Company's cost of goods sold. 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%, 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 commitments with Mr. Shaw associated with its business relationship with Engineered Floors. Transactions with Engineered Floors are reviewed annually by the Company's board of directors.

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 24, 2016 was \$67 and \$200, respectively. Rent paid to the lessor during the three and nine months ended September 26, 2015 was \$66 and \$196, 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 9).

Table of Contents 20

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

The following discussion and analysis should be read in conjunction with our consolidated financial statements and related notes appearing elsewhere in this report.

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

Our business consists principally of marketing, manufacturing and selling floorcovering products to high-end residential and commercial customers through our various sales forces and brands. We focus exclusively on the upper-end of the floorcovering market where we believe we have strong brands and competitive advantages with our style and design capabilities and customer relationships. Our Fabrica, Masland, and Dixie Home brands have a significant presence in the high-end residential soft floorcovering markets. Our Atlas Carpet Mills, Masland Contract and Masland Hospitality brands participate in the upper end specified commercial marketplace. Dixie International sells all of our brands outside of the North American market. During the fourth quarter of 2016, we will begin offering luxury vinyl tile ("LVT") products under the Calibre brand which will be our first hard surface offering in the commercial markets. These new LVT products will be sold under our existing Masland Contract sales force. We are entering this market in response to the high rate of growth for hard surface products. The growth rate, measured as market sales volume in square feet, has been substantially higher for hard surface products than soft surface products over the last 4 years.

Net sales for the third quarter were weak compared to the prior year as overall sales were down 7.9% from the third quarter of 2015. Total carpet sales for the quarter were down 6.0% on a comparative year over year basis. In particular, our commercial product sales were 13.0% below the prior year. We believe the commercial market was down slightly on a year over year basis. Residential product sales were 2.0% below the prior year period. Though our residential business was down as compared to the prior year's quarter, we believe that we outperformed the residential market which we believe was down mid to high single digits. We have seen modest decline in residential replacement housing activity during the summer months. We believe that the entire floorcovering market has been impacted by a drop in consumer expectations and political uncertainty this year.

Despite the drop in sales compared to the year ago period, our gross profit percentage for the third quarter of 2016 improved slightly to 25.8%. We have lowered our quality-related costs by having more strict and consistent quality standards throughout our manufacturing operations. We have reduced medical expenses as a result of implementing a new plan design at the beginning of 2016. However, these cost savings have been substantially offset by the unabsorbed fixed cost due to the lower sales volume. We continue to reduce expenses as we respond to the lower sales

volumes.

Table of Contents 21

RESULTS OF OPERATIONS

Three and Nine Months Ended September 24, 2016 Compared with Three and Nine Months Ended September 26, 2015

	Three Months Ended		Nine Months Ended			
	September 24, 2016	September 26, 2015	September 24, 2016	September 26, 2015		
Net sales	100.0%	100.0%	%	100.0%	100.0%	%
Cost of sales	74.2%	75.0%	%	75.0%	74.6%	%
Gross profit	25.8%	25.0%	%	25.0%	25.4%	%
Selling and administrative expenses	23.7%	23.2%	%	24.3%	24.2%	%
Other operating expense, net	0.2%	0.1%	%	0.3%	0.3%	%
Facility consolidation expenses	—	0.5%	%	0.6%	0.7%	%
Operating income (loss)	1.9%	1.2%	%	(0.2)%	0.2%	%

Net Sales

Net sales for the quarter ended September 24, 2016 was \$100.3 million, a decrease of 7.9% compared with net sales of \$108.9 million for the year-earlier quarter. In the third quarter of 2016, residential carpet sales decreased 2.0% and net sales of commercial carpet decreased 13.0% compared with the third quarter of 2015. Sales continued to be weaker in the third quarter of 2016 compared with the same period in 2015 particularly with our commercial products.

Net sales for the nine months ended September 24, 2016 was \$294.8 million, a decrease of 6.3% compared with net sales of \$314.7 million for the nine months of 2015. Residential carpet sales decreased 2.9% and net sales of commercial carpet decreased 9.9% in the first nine months of 2016 compared with the first nine months of 2015. Sales were substantially weaker in the first nine months of 2016 compared with the same period in 2015.

Cost of Sales

Cost of sales as a percentage of net sales was 74.2% in the third quarter of 2016 compared with 75.0% in the third quarter of 2015, or a 0.8 percentage point improvement as a percentage of sales. During the third quarter of 2016, we lowered costs through improved quality, tighter cost controls and reduced associate medical expenses.

Cost of sales as a percentage of net sales was 75.0% in the first nine months of 2016 compared with 74.6% in the first nine months of 2015, or a 0.4 percentage point increase as a percentage of sales. During the first nine months of 2016, our improved quality-related costs, tighter cost controls and reduced medical expenses were substantially offset by unabsorbed fixed cost due to the lower sales volumes.

Gross Profit

Gross profit as a percentage of sales improved 0.8 percentage points in the third quarter of 2016 compared with the year-earlier period. Gross profit was \$25.8 million in the third quarter of 2016 compared with \$27.3 million in the third quarter of 2015. Despite lower sales, our gross profit was positively affected in the third quarter of 2016 by the factors as discussed above in Cost of Sales.

Gross profit as a percentage of sales declined 0.4 percentage points in the first nine months of 2016 compared with the year-earlier period. Gross profit was \$73.6 million in the first nine months of 2016 compared with \$79.9 million in the first nine months of 2015. Our gross profit was affected in the first nine months of 2016 by the factors as discussed above in Cost of Sales.

Selling and Administrative Expenses

Selling and administrative expenses were \$23.8 million in third quarter of 2016 compared with \$25.3 million in the year earlier period, an increase of 0.5 percentage points as a percentage of sales. Selling and administrative expenses increased as a percentage of sales primarily as a result of the lower sales volumes in the third quarter of 2016 compared with the year earlier period.

Selling and administrative expenses were \$71.8 million in first nine months of 2016 compared with \$76.2 million in the year earlier period, an increase of 0.1 percentage points as a percentage of sales. Selling and administrative expenses increased as a percentage of sales primarily as a result of the lower sales volumes in the first nine months of 2016 compared with the year earlier period.

Table of Contents 22

Other Operating Expense, Net

Other operating expense, net was an expense of \$141 thousand in the third quarter of 2016 compared with an expense of \$131 thousand in the third quarter of 2015. There is not a significant difference in other operating expense, net for the third quarter of 2016 compared with the third quarter of 2015.

Other operating expense, net was an expense of \$525 thousand in the first nine months of 2016 compared with an expense of \$684 thousand in the first nine months of 2015. The decrease in other operating expense, net was primarily the result of lower Canadian currency exchange losses in the first nine months of 2016 offset in part by losses on the impairment of certain machinery taken out of service in the first nine months of 2016.

Facility Consolidation Expenses

Facility consolidation expenses decreased \$614 thousand in the third quarter of 2016 compared with the year-earlier period as we completed our facility consolidation plans during the second quarter of 2016.

For the first nine months of 2016, we incurred \$1.8 million of facility consolidation expenses compared with \$2.3 million in the first nine months of 2015. Facility consolidation expenses decreased compared with the year-earlier period as we completed our facility consolidation plans during the second quarter of 2016. During the first quarter of 2016, we accrued \$690 thousand to finalize the cleanup of the site of our former waste water treatment plant that was disposed of in 2014. Accordingly, if the actual costs are higher or lower, we would record an additional charge or benefit, respectively, as appropriate.

Operating Income (Loss)

We reported operating income of \$1.9 million in the third quarter of 2016 compared with operating income of \$1.3 million in the third quarter of 2015. During the third quarter of 2016, we lowered costs through improved quality, tighter cost controls and reduced associate medical expenses.

We reported an operating loss of \$522 thousand in the first nine months of 2016 compared with operating income of \$747 thousand in the first nine months of 2015. During the first nine months of 2016, our improved quality-related costs, tighter cost controls and reduced medical expenses were substantially offset by unabsorbed fixed cost due to the lower sales volumes.

Interest Expense

Interest expense increased \$109 thousand in the third quarter of 2016 compared with the third quarter of 2015. Interest costs were up as a result of long-term fixed interest rate swap contracts that are at slightly higher rates than a year ago offset by lower levels of debt during 2016.

Interest expense increased \$366 thousand in the first nine months of 2016 compared with the first nine months of 2015. Interest costs were up as a result of long-term fixed interest rate swap contracts that are at slightly higher rates than a year ago offset by lower levels of debt during 2016.

Other Expense, Net

Other expense, net was not significant in the third quarter or the first nine months of 2016 or 2015.

Income Tax Provision (Benefit)

The benefit rate applied to the pretax loss for the first nine months of 2016 was 43.0% compared with a benefit rate of 38.6% in the year-earlier period. The first nine months of 2016 included certain tax credits of approximately \$542 thousand that increased the benefit rate during the period.

Income (Loss) from Continuing Operations

We had income from continuing operations of \$573 thousand, or \$0.04 per diluted share in the third quarter of 2016 compared with income from continuing operations of \$84 thousand, or \$0.01 per diluted share in the third quarter of 2015. The income was a result of the factors discussed above.

We had a loss from continuing operations of \$2.6 million, or \$0.16 per diluted share in the first nine months of 2016 compared with a loss from continuing operations of \$1.8 million, or \$0.11 per diluted share in the first nine months of 2015. The losses were a result of the factors discussed above.

Table of Contents 23

Net Income (Loss)

Discontinued operations reflected a loss of \$39 thousand, or \$0.00 per diluted share, in the third quarter of 2016 compared with a loss from discontinued operations of \$18 thousand, or \$0.00 per diluted share, in the same period in 2015. Including discontinued operations, we had net income of \$534 thousand, or \$0.04 per diluted share, in the third quarter of 2016 compared with net income of \$66 thousand, or \$0.01 per diluted share, in the third quarter of 2015.

Discontinued operations reflected income of \$13 thousand, or \$0.00 per diluted share, in the first nine months of 2016 compared with a loss from discontinued operations of \$118 thousand, or \$0.01 per diluted share, in the same period in 2015. Including discontinued operations, we had a net loss of \$2.6 million, or \$0.16 per diluted share, in the first nine months of 2016 compared with a net loss of \$1.9 million, or \$0.12 per diluted share, in the first nine months of 2015.

LIQUIDITY AND CAPITAL RESOURCES

During the nine months ended September 24, 2016, cash provided by operations was \$16.0 million. Accounts receivable decreased \$3.3 million and inventories decreased \$7.2 million which was offset by an increase in other current assets of \$1.5 million. The decrease in accounts receivable was due to the lower sales volumes during the first nine months of 2016. We reduced inventories that were increased at the end of the fiscal year to build inventories from a supplier that was going through a year-end software conversion. Other current assets increased as a result of higher prepaid expenses associated with sampling expenses.

Capital asset acquisitions for the nine months ended September 24, 2016 were \$3.6 million; \$3.4 million of cash used in investing activities and \$169 thousand of equipment acquired under capital leases. Depreciation and amortization for the nine months ended September 24, 2016 were \$10.2 million. We expect capital expenditures to be approximately \$6.0 million in 2016 for capital expenditures while depreciation and amortization is expected to be approximately \$13.5 million. Planned capital expenditures in 2016 are primarily for new equipment.

During the nine months ended September 24, 2016, cash used in financing activities was \$12.8 million. We had net payments on our revolving credit facility of \$3.9 million and payments on other debt obligations of \$8.0 million.

On September 23, 2016, we amended our revolving credit facility (“amended revolving credit facility”) which provides for a maximum of \$150.0 million of revolving credit, subject to borrowing base availability. The amendment revised certain definitions and extended the maturity date to September 23, 2021 (See Note 9 to the Consolidated Condensed Financial Statements).

We believe our operating cash flows, credit availability under our revolving credit facility and other sources of financing are adequate to finance our anticipated liquidity requirements under our current operating conditions. As of September 24, 2016, the unused borrowing availability under our amended revolving credit facility was \$41.8 million. Our amended 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 was \$25.3 million (the amount above \$16.5 million) at September 24, 2016. 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

The following table summarizes our future minimum payments under contractual obligations as of September 24, 2016.

	Payments Due By Period						Total
	(dollars in millions)						
	2016	2017	2018	2019	2020	Thereafter	
Debt	\$1.4	\$5.7	\$4.6	\$2.7	\$1.9	\$ 88.2	104.5
Interest - debt (1)	1.1	4.5	4.2	4.1	3.9	4.0	21.8
Capital leases	0.9	3.3	3.1	1.9	1.7	1.1	12.0
Interest - capital leases	0.2	0.5	0.3	0.2	0.1	—	1.3
Operating leases	0.8	3.1	2.7	1.9	1.4	5.3	15.2
Purchase commitments	3.4	1.8	0.4	—	—	—	5.6
Totals	7.8	18.9	15.3	10.8	9.0	98.6	160.4

(1) Interest rates used for variable rate debt were those in effect at September 24, 2016.

Critical Accounting Policies

Our critical accounting policies were outlined in Management's Discussion and Analysis of Results of Operations and Financial Condition in our 2015 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

Recent accounting pronouncements are disclosed in Note 2 to the Consolidated Condensed Financial Statements.

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 11 to the Consolidated Condensed Financial Statements).

At September 24, 2016, \$32,458, or approximately 28% of our total debt, was subject to floating interest rates. A twenty-five basis point fluctuation in the variable interest rates applicable to this floating rate debt would have an annual after-tax impact of approximately \$46.

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 24, 2016, 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 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

The Company has been sued, together with the 3M Company and approximately 30 other carpet manufacturers, by the Gadsden (Alabama) Water Works in the circuit court of Etowah County Alabama [The Water Works and Sewer Board of the City of Gadsden v. 3M Company, et al, civil action No. 31-CV-2016-900676.00], in a case seeking monetary damages and injunctive relief related to the use of certain chemical compounds in the manufacture and finishing of carpet products “in and around Dalton Georgia.” On motion of the defendants, the case was removed to the U.S. District Court for the Northern District of Alabama (Middle Division) Case No. 4:16-CV-01755-SGC. As alleged in the lawsuit, the chemicals are perflourinated compounds (“PFC”) perflourinated acid (“PFOA”) and perfluorooctane sulfonate (“PFOS”) manufactured by 3M and used in certain finishing and treatment processes by the defendants and, as a consequence of such use, either discharged into or leached into the water systems around Dalton, Georgia. The Complaint seeks damages “in excess of \$10 thousand dollars”, but otherwise unspecified in amount in addition to injunctive relief. The Company has not yet answered the complaint; however it has reviewed the allegations of the complaint, engaged counsel, and intends to defend the matter vigorously and is unable to estimate its potential exposure to loss, if any, at this time. See Note 17 - Contingencies in the notes to the Consolidated Condensed Financial Statements.

Table of Contents 25

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. The U.S. and global economies, along with the residential and commercial markets in such economies, can negatively impact 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 typically lag during a cyclical downturn. Although the difficult economic conditions have improved since the last cyclical downturn in 2008, 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. A significant reduction of sales through such 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 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. The cost and terms of such financing is 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 credit facilities. Competitive pressures and the accelerated growth of hard surface alternatives, have resulted in decreased demand for our soft floorcovering products and in the loss of market share to hard surface products. As a result, competition from providers of other soft surfaces has intensified and may result in decreased demand for our products. 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.

Table of Contents 26

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 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 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 rely on information systems in managing our operations and any system failure or deficiencies of such systems may have an adverse effect on our business.

Our businesses rely on sophisticated systems to obtain, rapidly process, analyze and manage data. We rely on these systems to, among other things facilitate the purchase, manufacture and distribution of our products; receive, process and ship orders on a timely basis; and to maintain accurate and up-to-date operating and financial data for the compilation of management information. We rely on our computer hardware, software and network for the storage,

delivery and transmission of data to our sales and distribution systems, and certain of our production processes are managed and conducted by computer. Any damage by unforeseen events or system failure which causes interruptions to the input, retrieval and transmission of data or increase in the service time, whether caused by human error, natural disasters, power loss, computer viruses, intentional acts of vandalism, various forms of cybercrimes including and not limited to hacking, intrusions and malware or otherwise, could disrupt our normal operations. There can be no assurance that we can effectively carry out our disaster recovery plan to handle the failure of our information systems, or that we will be able to restore our operational capacity within sufficient time to avoid material disruption to our business. The occurrence of any of these events could cause unanticipated disruptions in service, decreased customer service and customer satisfaction and harm to our reputation, which could result in loss of customers, increased operating expenses and financial losses. Any such events could in turn have a material adverse effect on our business, financial condition, results of operations, and prospects.

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

Table of Contents 27

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.

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, regulations or regulatory guidelines 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 to 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 28

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 24, 2016:

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 Be Purchased Under Plans or Programs
July 30, 2016	—	\$ —	—	
August 27, 2016	4,045	3.82	4,045	
September 24, 2016	—	—	—	
Three Months Ended September 24, 2016	4,045	\$ 3.82	4,045	\$ 2,361,604

(1) During the three months ended September 24, 2016, 4,045 shares were withheld from employees in lieu of cash payments for withholding taxes due for a total amount of \$15,452.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not Applicable.

Item 5. Other Information

None.

Item 6. Exhibits

(a.) Exhibits

Tenth Amendment to Credit Agreement, First Amendment to Security Agreement and First Amendment to Guaranty, and Third Amendment to Deed to Secure Debt, each dated as of September 23, 2016, by and among 10.1 The Dixie Group, Inc. certain of its subsidiaries and Wells Fargo Capital Finance, LLC. as Agent and the persons identified as Lenders therein, Incorporated by reference to Exhibit 10.1 to Current Report on Form 8-K dated September 26, 2016.

31.1 CEO Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

Edgar Filing: DIXIE GROUP INC - Form 10-Q

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.

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.LAB XBRL Taxonomy Extension Label Linkbase Document

101.PREXBRL Taxonomy Extension Presentation Linkbase Document

Table of Contents 29

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 3, 2016

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

Table of Contents 30