DIXIE GROUP INC
Form 10-Q
August 08, 2012

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

Form 10-Q

(Mark One)
R QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2012
OR

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

Commission File Number: 0-2585

THE DIXIE GROUP, INC.
(Exact name of Registrant as specified in its charter)

Tennessee		62-0183370
(State or other jurisdiction of incorporation or organization)		(I.R.S. Employer Identification No.)
104 Nowlin Lane, Suite 101, Chattanooga, TN	37421	(423) 510-7000
(Address of principal executive offices)	(zip code)	(Registrant's telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

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

o Large accelerated filer	o Accelerated filer
o Non-accelerated filer (Do not check if a smaller reporting company)	R Smaller reporting company

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

The number of shares outstanding of each of the issuer's classes of Common Stock as of the latest practicable date.

Class	Outstanding as of July 23, 2012
Common Stock, $3 Par Value	12,156,590 shares
Class B Common Stock, $3 Par Value	952,784 shares
Class C Common Stock, $3 Par Value	0 shares

THE DIXIE GROUP, INC.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements
THE DIXIE GROUP, INC.
CONSOLIDATED CONDENSED BALANCE SHEETS
(dollars in thousands, except share data)

	June 30, 2012 (Unaudited)	December 31, 2011
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$240	$298
Receivables, net	30,850	29,173
Inventories	72,940	63,939
Deferred income taxes	5,291	5,860
Other current assets	2,074	1,729
TOTAL CURRENT ASSETS	111,395	100,999
PROPERTY, PLANT AND EQUIPMENT	185,536	183,816
Less accumulated depreciation and amortization	(120,926)	(116,275)
NET PROPERTY, PLANT AND EQUIPMENT	64,610	67,541
OTHER ASSETS	14,139	14,403
TOTAL ASSETS	$190,144	$182,943
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	$16,575	$14,668
Accrued expenses	16,495	17,185
Current portion of long-term debt	2,227	2,729
TOTAL CURRENT LIABILITIES	35,297	34,582
LONG-TERM DEBT		
Senior indebtedness	60,732	52,806
Mortgage note payable	9,772	10,141
Equipment notes payable	2,034	2,061
Capital lease obligations	800	349
TOTAL LONG-TERM DEBT	73,338	65,357
DEFERRED INCOME TAXES	3,687	4,804
OTHER LONG-TERM LIABILITIES	13,941	13,815
TOTAL LIABILITIES	126,263	118,558
COMMITMENTS AND CONTINGENCIES	—	—
STOCKHOLDERS' EQUITY		
Common Stock ($3 par value per share): Authorized 80,000,000 shares, issued - 16,170,030 shares for 2012 and 15,998,937 shares for 2011	48,510	47,997
Class B Common Stock ($3 par value per share): Authorized 16,000,000 shares, issued - 952,784 shares for 2012 and 882,644 shares for 2011	2,858	2,648
Additional paid-in capital	137,825	138,118

Accumulated deficit	(66,378)	(65,764)
Accumulated other comprehensive loss	(254)	(88)
	122,561	122,911
Less Common Stock in treasury at cost - 4,013,440 shares for 2012 and 3,976,396 shares for 2011	(58,680)	(58,526)
TOTAL STOCKHOLDERS' EQUITY	63,881	64,385
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$190,144	$182,943

See accompanying notes to the consolidated condensed financial statements.

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

	Three Months Ended		Six Months Ended	
	June 30, 2012	July 2, 2011	June 30, 2012	July 2, 2011
NET SALES	$66,566	$69,200	$129,416	$135,154
Cost of sales	50,847	52,477	97,995	101,861
GROSS PROFIT	15,719	16,723	31,421	33,293
Selling and administrative expenses	15,683	14,944	30,745	30,337
Other operating (income) expense, net	76	42	96	(450)
Facility consolidation and severance expenses, net	—	(563)	—	(563)
OPERATING INCOME (LOSS)	(40)	2,300	580	3,969
Interest expense	762	900	1,488	1,832
Other (income) expense, net	(95)	10	(92)	(6)
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE TAXES	(707)	1,390	(816)	2,143
Income tax provision (benefit)	(303)	582	(308)	691
INCOME (LOSS) FROM CONTINUING OPERATIONS	(404)	808	(508)	1,452
Loss from discontinued operations, net of tax	(29)	(42)	(106)	(62)
NET INCOME (LOSS)	$(433)	$766	$(614)	$1,390
BASIC EARNINGS (LOSS) PER SHARE:				
Continuing operations	$(0.03)	$0.06	$(0.04)	$0.11
Discontinued operations	—	—	(0.01)	—
Net income (loss)	$(0.03)	$0.06	$(0.05)	$0.11
BASIC SHARES OUTSTANDING	12,633	12,596	12,619	12,574
DILUTED EARNINGS (LOSS) PER SHARE:				
Continuing operations	$(0.03)	$0.06	$(0.04)	$0.11
Discontinued operations	—	—	(0.01)	—
Net income (loss)	$(0.03)	$0.06	$(0.05)	$0.11
DILUTED SHARES OUTSTANDING	12,633	12,648	12,619	12,624
DIVIDENDS PER SHARE:				
Common Stock	—	—	—	—
Class B Common Stock	—	—	—	—

See accompanying notes to the consolidated condensed financial statements.

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

	Three Months Ended		Six Months Ended	
	June 30, 2012	July 2, 2011	June 30, 2012	July 2, 2011
NET INCOME (LOSS)	$(433)	$766	$(614)	$1,390
OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX:				
Unrealized loss on interest rate swaps	(241)	(161)	(321)	(132)
Reclassification of loss into earnings from interest rate swaps	24	85	48	172
Amortization of unrealized loss on dedesignated interest rate swaps	73	—	147	—
Reclassification of net actuarial gain into earnings from postretirement benefit plans	(6)	(4)	(12)	(9)
Reclassification of prior service credits into earnings from postretirement benefit plans	(14)	(14)	(28)	(28)
TOTAL OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX	(164)	(94)	(166)	3
COMPREHENSIVE INCOME (LOSS)	$(597)	$672	$(780)	$1,393

See accompanying notes to the consolidated condensed financial statements.

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

	Six Months Ended	
	June 30, 2012	July 2, 2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Income (loss) from continuing operations	$(508)	$1,452
Loss from discontinued operations	(106)	(62)
Net income (loss)	(614)	1,390
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	4,782	4,879
Change in deferred income taxes	(446)	530
Net gain on property, plant and equipment disposals	—	(2)
Stock-based compensation expense	415	373
Excess tax benefits from stock-based compensation	(16)	—
Changes in operating assets and liabilities:		
Receivables	(1,677)	(1,995)
Inventories	(9,001)	(10,464)
Other current assets	(345)	(2,263)
Accounts payable and accrued expenses	1,326	3,043
Other operating assets and liabilities	12	(1,181)
NET CASH USED IN OPERATING ACTIVITIES	(5,564)	(5,690)
CASH FLOWS FROM INVESTING ACTIVITIES		
Net proceeds from sales of property, plant and equipment	—	2
Purchase of property, plant and equipment	(1,058)	(2,140)
NET CASH USED IN INVESTING ACTIVITIES	(1,058)	(2,138)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net borrowings on previous credit line	—	12,509
Payments on previous term loan	—	(879)
Net borrowings on current credit line	7,926	—
Payments on current mortgage note payable	(369)	—
Payments on previous mortgage note payable	—	(176)
Borrowings on equipment financing	469	—
Payments on equipment financing	(668)	(1,315)
Payments on capitalized leases	(56)	(204)
Payments on notes payable	(454)	(374)
Payments on subordinated indebtedness	—	(2,500)
Change in outstanding checks in excess of cash	(93)	801
Common stock acquired for treasury	(154)	(127)
Excess tax benefits from stock-based compensation	16	—
Payments for debt issuance costs	(53)	—
NET CASH PROVIDED BY FINANCING ACTIVITIES	6,564	7,735
DECREASE IN CASH AND CASH EQUIVALENTS	(58)	(93)

CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	298	244
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$240	$151
Supplemental Cash Flow Information:		
Interest paid	$1,326	$1,887
Income taxes paid, net of tax refunds	1,229	91
Equipment purchased under capital leases	631	—

See accompanying notes to the consolidated condensed financial statements.

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

NOTE A - BASIS OF PRESENTATION

The accompanying unaudited consolidated condensed financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial statements which do not include all the information and footnotes required by such accounting principles for annual financial statements. In the opinion of management, all adjustments (generally consisting of normal recurring accruals) considered necessary for a fair presentation have been included in the accompanying financial statements. The accompanying financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's 2011 Annual Report on Form 10-K filed with the Securities and Exchange Commission for the fiscal year ended December 31, 2011. Operating results for the three and six month periods ended June 30, 2012 are not necessarily indicative of the results that may be expected for the entire 2012 year. The six months ended June 30, 2012 contains 26 weeks compared with 27 weeks for the six months ended July 2, 2011.

The Company evaluated subsequent events through the date the financial statements were issued.

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

NOTE B - RECENT ACCOUNTING PRONOUNCEMENTS

In May 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS. This ASU represents the converged guidance of the FASB and the International Accounting Standards Board ("the Boards") on fair value measurement. The collective efforts of the Boards and their staffs have resulted in common requirements, including a consistent meaning of the term "fair value." The Boards have concluded the common requirements will result in greater comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with U.S. GAAP and IFRS. The ASU was effective during the first quarter of 2012 and its adoption did not have a material effect on the Company's Consolidated Condensed Financial Statements.

In June 2011, the FASB issued ASU No. 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income. This ASU eliminates the option to report other comprehensive income and its components in the statement of stockholders equity and requires the presentation of comprehensive income in either (1) a continuous statement of comprehensive income or (2) two separate but consecutive statements. This ASU is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011 and should be applied retrospectively. The Company early adopted this ASU in the prior year and presented the components of other comprehensive income in a separate statement following the statement of operations. In December 2011, the FASB issued ASU 2011-12, Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05 . ASU 2011-12 deferred the changes in ASU 2011-05 that relate to the presentation of reclassification adjustments to other comprehensive income. These amendments were delayed to allow the FASB time to redeliberate whether to present the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income on the face of the financial statements for all periods presented. While the FASB is considering the operational concerns about the presentation requirements for reclassification adjustments and the needs of financial statement users for additional information about reclassification adjustments, the Company is required to continue reporting reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect before ASU 2011-05.

In December 2011, the FASB issued ASU No. 2011-11, “Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities.” The amendments in this ASU require an entity to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. An entity is required to apply the amendments for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the disclosures required by those amendments retrospectively for all comparative periods presented. The Company does not expect that the adoption of this ASU will have a a material effect on the Company’s Consolidated Condensed Financial Statements.

NOTE C - 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. Pursuant to a policy adopted by the Compensation Committee of the Board of Directors applicable to awards granted for years 2009 through 2012, $5.00 per share will be used as the market value per share

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

to calculate the number of shares to be issued if the market value per share is less than $5.00 per share on the grant date. The Company's stock compensation expense was $256 and $415 for the three and six months ended June 30, 2012, respectively, and $200 and $373 for the three and six months ended July 2, 2011, respectively.

On March 12, 2012, the Company issued 241,233 shares of restricted stock to officers and other key employees. The grant-date fair value of the awards was $998, or $4.135 per share, and will be recognized as stock compensation expense over the vesting periods which range from 2 to 15 years from the date the awards were granted. Each award is subject to a continued service condition. The fair value of each share of restricted stock awarded was equal to the market value of a share of the Company's Common Stock on the grant date.

NOTE D - RECEIVABLES, NET

Receivables are summarized as follows:

	June 30, 2012	December 31, 2011
Customers, trade	$30,390	$28,372
Other receivables	1,038	1,268
Gross receivables	31,428	29,640
Less allowance for doubtful accounts	(578)	(467)
Net receivables	$30,850	$29,173

The Company had notes receivable in the amount of $476 and $483 at June 30, 2012 and December 31, 2011, respectively. The current portions of notes receivable are included in other receivables above and the non-current portions are included in other assets in the Company's Consolidated Condensed Financial Statements.

NOTE E - INVENTORIES

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

	June 30, 2012	December 31, 2011
Raw materials	$24,252	$19,624
Work-in-process	14,295	13,116
Finished goods	49,236	45,840
Supplies, repair parts and other	453	351
LIFO reserve	(15,296)	(14,992)
Total inventories	$72,940	$63,939

NOTE F - ACCRUED EXPENSES

Accrued expenses are summarized as follows:

	June 30, 2012	December 31, 2011

Compensation and benefits	$3,897	$4,348
Provision for customer rebates, claims and allowances	4,364	4,249
Outstanding checks in excess of cash	2,635	2,728
Other	5,599	5,860
Total accrued expenses	$16,495	$17,185

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

NOTE G - PRODUCT WARRANTY RESERVES

The Company generally provides product warranties related to manufacturing defects and specific performance standards for its products. At the time sales are recorded, the Company records reserves for the estimated costs of defective products and failure of its products to meet applicable performance standards. The level of reserves the Company establishes is based primarily upon historical experience, including the level of sales and evaluation of pending claims. 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		Six Months Ended	
	June 30, 2012	July 2, 2011	June 30, 2012	July 2, 2011
Warranty reserve at beginning of period	$1,106	$1,449	$1,219	$1,472
Warranty liabilities accrued	804	828	1,546	1,613
Warranty liabilities settled	(760)	(813)	(1,627)	(1,581)
Changes for pre-existing warranty liabilities	58	(216)	70	(256)
Warranty reserve at end of period	$1,208	$1,248	$1,208	$1,248

NOTE H - LONG-TERM DEBT AND CREDIT ARRANGEMENTS

Long-term debt consists of the following:

	June 30, 2012	December 31, 2011
Senior indebtedness	$60,732	$52,806
Mortgage note payable	10,509	10,878
Equipment notes payable	3,156	3,354
Notes payable	129	584
Capital lease obligations	1,039	464
Total long-term debt	75,565	68,086
Less: current portion of long-term debt	(2,227)	(2,729)
Total long-term debt, less current portion	$73,338	$65,357

Senior indebtedness

On September 14, 2011, the Company entered into a five-year, secured revolving credit facility (the "senior credit facility"). The senior credit facility provides for a maximum of $90,000 of revolving credit, subject to borrowing base availability, including limited amounts of credit in the form of letters of credit and swingline loans. The borrowing base is equal to specified percentages of the Company's eligible accounts receivable, inventories and fixed assets less reserves established, from time to time, by the administrative agent under the senior credit facility.

At the Company's election, revolving loans under the senior credit facility bear interest at annual rates equal to either (a) LIBOR for 1, 2 or 3 month periods, as selected by the Company, plus an applicable margin of either 2.00% or 2.25%, or (b) the higher of the prime rate, the Federal Funds rate plus 0.5%, or a daily LIBOR rate, plus an applicable margin of either 1.00% or 1.50%. The applicable margin is determined based on availability under the senior credit facility with margins increasing as availability decreases. The Company also pays an unused line fee on the average amount by which the aggregate commitments exceed utilization of the senior credit facility equal to 0.375% per annum.

The senior credit facility includes certain affirmative and negative covenants that impose restrictions on the Company's financial and business operations, including limitations on debt, liens, investments, fundamental changes in the Company's business, asset dispositions, dividends and other similar restricted payments, transactions with affiliates, payments and modifications of certain existing debt, future negative pledges, and changes in the nature of the Company's business. The Company is also required to maintain a fixed charge coverage ratio of 1.1 to 1.0 during any period that borrowing availability is less than $10,000.

The Company can use the proceeds of the senior credit facility for general corporate purposes, including financing acquisitions and refinancing other indebtedness. As of June 30, 2012, the unused borrowing availability under the senior credit facility was $19,320.

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

Mortgage Note Payable

On September 13, 2011, the Company entered into a five-year $11,063 mortgage loan. The mortgage loan is secured by the Company's Susan Street facility and liens secondary to the senior credit facility. The mortgage loan is scheduled to mature on September 13, 2016. The mortgage loan bears interest at a variable rate equal to one month LIBOR plus 3.00% and is payable in equal monthly installments of principal of $61, plus interest calculated on the declining balance of the mortgage loan, with a final payment of $7,436 due on maturity.

NOTE I - 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 Company's interest rate swaps and related instruments are measured under the fair value guidance. The following table summarizes the hierarchy level the Company used to determine fair value of its interest rate swaps and related instruments as of June 30, 2012 and December 31, 2011:

	June 30, 2012	December 31, 2011	Fair Value Hierarchy Level
Assets:			
Interest rate swaptions	$279	$197	Level 2
Liabilities:			
Interest rate swaps	$1,159	$958	Level 2

The fair value of the interest rate swaps and swaptions was obtained from external sources. The interest rate swaps and swaptions 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.

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

	June 30, 2012		December 31, 2011	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Cash and cash equivalents	$240	$240	$298	$298
Notes receivable, including current portion	476	476	483	483
Interest rate swaptions	279	279	197	197
Financial Liabilities:				
Long-term debt and capital leases, including current portion	75,565	78,164	68,086	68,900
Interest rate swaps	1,159	1,159	958	958

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

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.

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 Company does not hold speculative financial instruments, nor does it hold or issue financial instruments for trading purposes.

Derivatives designated as cash flow hedges relate to specific liabilities on the Company's Consolidated Condensed Balance Sheets. The Company assesses, both at inception and on an ongoing basis, whether the derivatives that are used in the hedging transactions are highly effective in offsetting changes in cash flows of the hedged items. When it is determined that a derivative is not highly effective or the derivative expires, is sold, terminated or exercised, the Company discontinues hedge accounting for that specific instrument. Changes in the fair value of effective cash flow hedges are deferred in accumulated other comprehensive income (loss) ("AOCIL") and reclassified into earnings in the same periods during which the hedged transaction affects earnings. Changes in the fair value of derivatives that are not effective hedges or that are not designated as hedges are recognized in income.

The following is a summary of the Company's interest rate swaps and swaptions as of June 30, 2012:

Type	Notional Amount		Effective Date	Fixed Rate	Variable Rate
Interest rate swap	$5,270	*	April 1, 2003 through April 1, 2013	4.54%	1 Month LIBOR
Interest rate swap	$25,000		July 11, 2010 through May 11, 2013	1.42%	1 Month LIBOR
Interest rate swap	$10,000		October 3, 2011 through September 1, 2016	1.33%	1 Month LIBOR
Interest rate swap	$10,000		March 1, 2013 through September 1, 2016	1.62%	1 Month LIBOR
Swaption	$10,000		March 1, 2013 through September 1, 2016, exercisable on September 2, 2014	2.00%	1 Month LIBOR
Interest rate swap	$5,000		June 1, 2013 through September 1, 2016	1.70%	1 Month LIBOR
Swaption	$5,000		June 1, 2013 through September 1, 2016, exercisable on September 1, 2015	1.88%	1 Month LIBOR

* Interest rate swap has an amortizing notional amount.

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

	Location on Consolidated Condensed Balance Sheets	Fair Value June 30, 2012	December 31, 2011
Asset Derivatives:			

Derivatives not designated as hedging instruments:			
Interest rate swaptions	Other Assets	$279	$197
Total Asset Derivatives		279	197
Liability Derivatives:			
Derivatives designated as hedging instruments:			
Interest rate swaps, current portion	Accrued Expenses	$563	$559
Interest rate swaps, long term portion	Other Long-Term Liabilities	596	399
Total Liability Derivatives		1,159	958

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

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		Six Months Ended	
	June 30, 2012	July 2, 2011	June 30, 2012	July 2, 2011
Derivatives designated as hedging instruments:				
Cash flow hedges - interest rate swaps	$(388)	$(259)	$(518)	$(213)

	Amount of Gain or (Loss) Reclassified from AOCIL on the effective portion into Income (1)(2)			
	Three Months Ended		Six Months Ended	
	June 30, 2012	July 2, 2011	June 30, 2012	July 2, 2011
Derivatives designated as hedging instruments:				
Cash flow hedges - interest rate swaps	$(156)	$(137)	$(312)	$(277)

	Amount of Gain or (Loss) Recognized on the ineffective portion in Income on Derivative (3)			
	Three Months Ended		Six Months Ended	
	June 30, 2012	July 2, 2011	June 30, 2012	July 2, 2011
Derivatives designated as hedging instruments:				
Cash flow hedges - interest rate swaps	$—	$(1)	$—	$1

	Amount of Gain or (Loss) Recognized in Income on Derivative (4)			
	Three Months Ended		Six Months Ended	
	June 30, 2012	July 2, 2011	June 30, 2012	July 2, 2011
Derivatives not designated as hedging instruments:				
Interest rate swaptions	$96	$—	$82	$—

(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 June 30, 2012 is $563.

(3) The amount of gain (loss) recognized in income on the ineffective portion of interest rate swaps is included in other (income) expense, net on the Company's Consolidated Condensed Statements of Operations.

(4) The amount of gain (loss) recognized in income for derivatives not designated as hedging instruments is included in other (income) expense, net on the Company's Consolidated Condensed Statements of Operations.

NOTE J - EMPLOYEE BENEFIT PLANS

Defined Contribution Plans

The Company sponsors a 401(k) defined contribution plan that covers a significant portion, or approximately 70% of the Company's associates. This plan was modified in 2012 compared with prior years to include 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. The Company, at its discretion, did not match participants' contributions

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in 2011. Matching contribution expense for this 401(k) plan was $0 for the three months ended June 30, 2012 and was $131 for the six months ended June 30, 2012.

Additionally, the Company sponsors a smaller 401(K) defined contribution plan that covers those associates at one facility who are under a collective-bargaining agreement, or approximately 30% of the Company's associates. Under this plan, the Company generally matches participants' contributions, on a sliding scale, up to a maximum of 2.75% of the participant's earnings. Matching contribution expense for the collective-bargaining 401(k) plan was $24 and $25 for the three months ended June 30, 2012 and July 2, 2011, respectively, and $45 and $48 for the six months ended June 30, 2012 and July 2, 2011, respectively.

Non-Qualified Retirement Savings Plan

The Company sponsors a non-qualified retirement savings plan that allows eligible associates to defer a specified percentage of their compensation. The obligations owed to participants under this plan were $10,846 at June 30, 2012 and $10,927 at December 31, 2011 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 $11,510 at June 30, 2012 and $10,913 at December 31, 2011 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 $63 and $74 for the three months ended June 30, 2012 and July 2, 2011, respectively, and $134 and $146 for the six months ended June 30, 2012 and July 2, 2011, respectively.

Postretirement Plans

The Company sponsors a legacy postretirement benefit plan that provides life insurance to a limited number of associates as a result of a prior acquisition. The Company also sponsors a postretirement benefit plan that provides medical insurance for a limited number of associates who retired prior to January 1, 2003 and life insurance to a limited number of associates upon retirement.

Components of net periodic benefit cost (credit) for all postretirement plans are summarized as follows:

	Three Months Ended		Six Months Ended	
	June 30, 2012	July 2, 2011	June 30, 2012	July 2, 2011
Service cost	$2	$2	$4	$4
Interest cost	6	6	12	13
Amortization of prior service credits	(22)	(22)	(44)	(45)
Recognized net actuarial gains	(9)	(7)	(19)	(15)

Net periodic benefit cost (credit)	$(23)	$(21)	$(47)	$(43)

Amounts contributed or expected to be contributed by the Company during the current fiscal year to its postretirement plans are not anticipated to be significantly different from amounts disclosed in the Company's 2011 Annual Report filed on Form 10-K.

NOTE K - INCOME TAXES

The Company's effective income tax provision (benefit) rate, based upon estimated annual income tax rates, was (42.9)% for the three months ended June 30, 2012, 41.9% for the three months ended July 2, 2011, (37.7)% for the six months ended June 30, 2012 and 32.2% for the six months ended July 2, 2011. The difference between the effective rate and the statutory rates for the three and six months ended June 30, 2012 and the three months ended July 2, 2011 was primarily due to the effect of the domestic manufacturing deduction, change in state valuation allowances, and a benefit recognized due to a adjustment of deferred taxes. The three and six months ended June 30, 2012 included interest charges related to an IRS audit for tax years 2004 through 2009. The difference for the six months ended July 2, 2011 was primarily due to the inclusion of a $492 non-taxable settlement gain associated with a company-owned insurance policy.

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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 2003 remain open to examination for U.S. federal income taxes. The majority of state jurisdictions remain open for tax years subsequent to 2007. A few state jurisdictions remain open to examination for tax years subsequent to 2006.

The Company's unrecognized tax benefits were $16 at June 30, 2012 and December 31, 2011. Due to the Company's valuation allowances, such benefits, if recognized, would not significantly affect the Company's effective tax rate. There were no significant interest or penalties accrued as of June 30, 2012 or December 31, 2011. The Company does not expect its unrecognized tax benefits to change significantly during the next twelve months. The Company recognizes interest and penalties related to uncertain tax positions, if any, in income tax expense.

NOTE L - COMMON STOCK AND EARNINGS (LOSS) PER SHARE

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

	Three Months Ended		Six Months Ended	
	June 30, 2012	July 2, 2011	June 30, 2012	July 2, 2011
Basic earnings (loss) per share:				
Income (loss) from continuing operations	$(404)	$808	$(508)	$1,452
Less: Allocation of earnings to participating securities	—	(19)	—	(35)
Income (loss) from continuing operations available to common shareholders - basic	$(404)	$789	$(508)	$1,417
Basic weighted-average shares outstanding (1)	12,633	12,596	12,619	12,574
Basic earnings (loss) per share - continuing operations	(0.03)	0.06	(0.04)	0.11
Diluted earnings (loss) per share:				
Income (loss) from continuing operations available to common shareholders - basic	$(404)	$789	$(508)	$1,417
Add: Undistributed earnings reallocated to unvested shareholders	—	19	—	35
Income (loss) from continuing operations available to common shareholders - basic	$(404)	$808	$(508)	$1,452
Basic weighted-average shares outstanding (1)	12,633	12,596	12,619	12,574
Effect of dilutive securities:				
Stock options (2)	—	2	—	2
Directors' stock performance units (2)	—	50	—	48
Diluted weighted-average shares outstanding (1)(2)	12,633	12,648	12,619	12,624
	(0.03)	0.06	(0.04)	0.11

Diluted earnings (loss) per share - continuing operations

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

(2) Because their effects are anti-dilutive, shares issuable under stock option plans where the exercise price is greater than the average market price of the Company's Common Stock at the end of the relevant period, unvested restricted stock deemed to be participating securities, directors' stock performance units, and shares issuable on conversion of subordinated debentures into shares of Common Stock have been excluded. Aggregate shares excluded for the three and six months ending June 30, 2012 were 879 and 870, respectively and for the three and six months ending July 2, 2011 were 1,080 and 1,119, respectively.

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NOTE M - OTHER COMPREHENSIVE INCOME (LOSS)

Components of other comprehensive income (loss) are as follows:

	Three Months Ended		Six Months Ended	
	June 30, 2012	July 2, 2011	June 30, 2012	July 2, 2011
Other comprehensive income (loss):				
Unrealized gain (loss) on interest rate swaps:				
Before income taxes	$(388)	$(259)	$(518)	$(213)
Income taxes	(147)	(98)	(197)	(81)
Net of taxes	(241)	(161)	(321)	(132)
Reclassification of loss into earnings from interest rate swaps:				
Before income taxes	39	137	77	277
Income taxes	15	52	29	105
Net of taxes	24	85	48	172
Amortization of unrealized loss on dedesignated interest rate swaps:				
Before income taxes	117	—	236	—
Income taxes	44	—	89	—
Net of taxes	73	—		