

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

- Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended **March 29, 2003**
- 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



T H E D I X I E G R O U P

THE DIXIE GROUP, INC.

(Exact name of registrant as specified in its charter)

Tennessee

*(State or other jurisdiction of
incorporation or organization)*

62-0183370

(IRS Employer Identification Number)

**345-B Nowlin Lane
Chattanooga, TN**

(Address of principal executive offices)

37421

(Zip code)

(423) 510-7010

(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 is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes 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 May 1, 2003
Common Stock, \$3 Par Value	10,972,982 shares
Class B Common Stock, \$3 Par Value	795,970 shares
Class C Common Stock, \$3 Par Value	0 shares

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

	(Unaudited) March 29, 2003	December 28, 2002
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 1,035	\$ 2,440
Accounts receivable (less allowance for doubtful accounts of \$3,510 for 2003 and \$3,290 for 2002)	46,518	40,158
Inventories	110,907	95,113
Assets held for sale	14	14
Other	12,174	8,592
TOTAL CURRENT ASSETS	170,648	146,317
PROPERTY, PLANT AND EQUIPMENT	293,782	293,006
Less accumulated amortization and depreciation	(154,281)	(149,432)
NET PROPERTY, PLANT AND EQUIPMENT	139,501	143,574
GOODWILL	100,758	100,492
INVESTMENT IN AFFILIATE	11,752	13,458
OTHER ASSETS	15,500	12,805
TOTAL ASSETS	\$ 438,159	\$ 416,646

See accompanying notes to the consolidated condensed financial statements.

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

	(Unaudited) March 29, 2003	December 28, 2002
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	\$ 54,866	\$ 37,458
Accrued expenses	24,564	27,993
Current portion of long-term debt	13,113	13,294
TOTAL CURRENT LIABILITIES	92,543	78,745
LONG-TERM DEBT		
Senior indebtedness	96,857	75,408
Senior notes	37,000	---
Subordinated notes	28,571	30,952
Convertible subordinated debentures	29,737	29,737
TOTAL LONG-TERM DEBT	192,165	136,097
ACCRUED PURCHASE CONSIDERATION	---	50,000
OTHER LIABILITIES	16,776	16,529
DEFERRED INCOME TAXES	25,478	23,923
STOCKHOLDERS' EQUITY		
Common Stock (\$3 par value per share): Authorized 80,000,000 shares, issued - 14,292,234 shares for 2003 and 2002	42,877	42,877
Class B Common Stock (\$3 par value per share): Authorized 16,000,000 shares, issued - 795,970 shares for 2003 and 2002	2,388	2,388
Common Stock subscribed - 696,899 shares for 2003 and 699,332 shares for 2002	2,091	2,098
Additional paid-in capital	132,711	132,724
Stock subscriptions receivable	(5,009)	(5,029)
Unearned stock compensation	(75)	(82)
Accumulated deficit	(7,239)	(6,903)
Accumulated other comprehensive loss	(2,862)	(3,036)
Less Common Stock in treasury at cost - 3,319,252 shares for 2003 and 2002	(53,685)	(53,685)
TOTAL STOCKHOLDERS' EQUITY	111,197	111,352
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 438,159	\$ 416,646

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	
	March 29, 2003	March 30, 2002
NET SALES	\$ 111,964	\$ 123,324
Cost of sales	86,113	95,442
GROSS PROFIT	25,851	27,882
Selling and administrative expenses	22,694	23,185
Other (income) expenses - net	(124)	(472)
INCOME BEFORE INTEREST AND INCOME TAXES	3,281	5,169
Interest Expense	3,822	4,384
INCOME (LOSS) BEFORE INCOME TAXES	(541)	785
Income tax provision (benefit)	(205)	289
NET INCOME (LOSS)	\$ (336)	\$ 496
BASIC EARNINGS (LOSS) PER SHARE:		
Net income (loss)	(0.03)	0.04
SHARES OUTSTANDING	11,749	11,685
DILUTED EARNINGS (LOSS) PER SHARE:		
Net income (loss)	(0.03)	0.04
SHARES OUTSTANDING	11,749	11,795
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 CASH FLOWS
(UNAUDITED)
(dollars in thousands, except per share data)

	Three Months Ended	
	March 29, 2003	March 30, 2002
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	\$ (336)	\$ 496
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities:		
Depreciation and amortization	5,334	6,106
Provision for deferred income taxes	1,409	367
Gain on property, plant and equipment disposals	(67)	(828)
Changes in operating assets and liabilities:		
Accounts receivable	(6,360)	(1,124)
Inventories	(15,794)	(3,827)
Accounts payable and accrued expenses	13,993	5,630
Other operating assets and liabilities	(5,953)	(2,262)
NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES	(7,774)	4,558
CASH FLOWS FROM INVESTING ACTIVITIES		
Net proceeds from sales of property, plant and equipment	54	1,131
Purchase of property, plant and equipment	(946)	(3,129)
Investment in affiliate	1,640	(157)
Additional cash paid in business combination	(50,266)	(489)
NET CASH USED IN INVESTING ACTIVITIES	(49,518)	(2,644)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net borrowings under current credit and term loan facility	21,455	---
Net borrowings under previous credit and term loan facility	---	538
Senior notes issued	37,000	---
Payments on subordinated indebtedness	(2,381)	(2,381)
Other	(187)	529
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	55,887	(1,314)
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(1,405)	600
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	2,440	1,412
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 1,035	\$ 2,012
SUPPLEMENTAL CASH FLOW INFORMATION		
Purchase of equipment with note payable	\$ ---	\$ 1,204
Interest paid	3,764	4,746
Income taxes paid, net of tax refunds (received)	1,736	(320)

See accompanying notes to the consolidated condensed financial statements.

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THE DIXIE GROUP, INC.
CONSOLIDATED CONDENSED STATEMENTS OF STOCKHOLDERS' EQUITY
(dollars in thousands, except per share data)

	Common Stock and Class B Common Stock	Common Stock Subscribed	Additional Paid-In Capital	Other	Retained Earnings (Deficit)	Accumulated Other Comprehensive Income	Common Stock in Treasury	Total Stockholders' Equity
Balance at December 28, 2002	\$ 45,265	\$ 2,098	\$ 132,724	\$ (5,111)	\$ (6,903)	\$ (3,036)	\$ (53,685)	\$ 111,352
Stock subscriptions cancelled - 2,433 shares		(7)	(13)	20				---
Amortization of restricted stock grants				7				7
Comprehensive income						174		174
Net loss for the year					(336)			(336)
Balance at March 29, 2003	\$ 45,265	\$ 2,091	\$ 132,711	\$ (5,084)	\$ (7,239)	\$ (2,862)	\$ (53,685)	\$ 111,197

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 accounting principles generally accepted in the United States of America for interim financial statements which do not include all the information and footnotes required by generally accepted accounting principles in the United States of America for complete annual financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The financial statements should be read in conjunction with the financial statements and notes thereto included in the Company's 2002 annual report filed on Form 10-K with the Securities and Exchange Commission, which includes consolidated financial statements for the fiscal year ended December 28, 2002. Operating results for the three month period ended March 29, 2003 are not necessarily indicative of the results that may be expected for the entire 2003 year.

NOTE B - RECENT ACCOUNTING PRONOUNCEMENTS

In June 2002, the Financial Accounting Standards Board (FASB) issued SFAS (Statement of Financial Accounting Standards) No. 146, "Accounting for Costs Associated With Exit or Disposal Activities." Effective December 29, 2002, the Company adopted SFAS No. 146 which addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (Including Certain Costs Incurred in a Restructuring)." This Statement requires recognition of cost associated with an exit or disposal activity, measured initially at fair value, only when the liability is incurred. Adoption of this Statement did not have a material impact on the Company's financial statements.

In January 2003, the FASB issued FIN No. 46, "Consolidation of Variable Interest Entities." FIN 46 requires that companies that control another entity through interests other than voting interests should consolidate the controlled entity. FIN 46 is effective for variable interest entities created after January 31, 2003 and to any variable interest entities in which the Company obtains an interest after that date. FIN 46 is effective for quarters beginning after June 15, 2003 for variable interest entities in which the Company held a variable interest that it acquired before February 1, 2003. The Company has evaluated the provisions of FIN 46 and does not believe adoption will have a material effect on its financial statements.

NOTE C - STOCK COMPENSATION

During 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure". SFAS No. 148 amends SFAS No. 123, "Accounting for Stock-Based Compensation", to provide alternate methods of transition for an entity that voluntarily changes to the fair value based method of accounting for stock-based employee compensation. It also amends the disclosure provisions of that statement to require prominent disclosure about the effects on the reporting of net income of an entity's accounting policy decisions with respect to stock-based employee compensation. Finally, SFAS No. 148 amends APB Opinion No. 28, "Interim Financial Reporting", to require disclosure about these effects in interim financial information.

The following pro forma summary presents the Company's net income (loss) and earnings (loss) per share which would have been reported had the Company determined stock compensation cost using the alternative fair value method of accounting set forth under SFAS No. 123, "Accounting for Stock-Based Compensation". The pro forma impact on net income (loss) shown below may not be representative of future effects.

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	March 29, 2003	March 30, 2002
Net income (loss), as reported	\$ (336)	\$ 496
Stock compensation expense under SFAS 123, net of taxes	(41)	(130)
Adjusted net income (loss)	\$ (377)	\$ 366
Basic earnings (loss) per share, as reported	\$ (0.03)	\$ 0.04
Stock compensation expense under SFAS 123, net of taxes	---	(0.01)
Adjusted basic earnings (loss) per share	\$ (0.03)	\$ 0.03
Diluted earnings (loss) per share, as reported	\$ (0.03)	\$ 0.04
Stock compensation expense under SFAS 123, net of taxes	---	(0.01)
Adjusted diluted earnings (loss) per share	\$ (0.03)	\$ 0.03

The fair value of each option grant was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions:

	March 29, 2003	March 30, 2002
Expected life	5 years	5 years
Expected volatility	54.00%	53.70%
Risk-free interest rate	3.02%	4.39%
Dividend yield	0.00%	0.00%

NOTE D - INVENTORIES

Inventories are stated at the lower of cost or market. The last in, first out (LIFO) cost method was used to determine cost for substantially all inventories at March 29, 2003 and December 28, 2002.

Inventories are summarized as follows:

	March 29, 2003	December 28, 2002
Raw Materials	\$ 32,992	\$ 25,624
Work-in-process	19,050	15,702
Finished goods	57,321	52,297
Supplies, repair parts and other	1,544	1,490
Total inventories	\$ 110,907	\$ 95,113

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NOTE E - PRODUCT WARRANTY RESERVES

The Company warrants its products against manufacturing defects and performance to specified standards. The warranty period and performance standards vary by market and uses of its products. The Company estimates the costs that may be incurred under its warranties and records a liability at the time product sales are recorded. The warranty liability is primarily based on historical claims, nature of claims and the associated cost.

	March 29, 2003
Reserve balance at December 28, 2002	\$ 1,222
Warranty liabilities accrued during 2003	1,801
Warranty liabilities settled during 2003	(1,802)
Changes for pre-existing warranty liabilities	(17)
Reserve balance at March 29, 2003	\$ 1,204

NOTE F - LONG-TERM DEBT AND CREDIT ARRANGEMENTS

Long-term debt consists of the following:

	March 29, 2003	December 28, 2002
Senior indebtedness		
Credit line borrowings	\$ 64,188	\$ 45,823
Term loans	38,333	35,243
Senior notes	37,000	---
Other	187	374
Total senior indebtedness	139,708	81,440
Subordinated notes	33,333	35,714
Convertible subordinated debentures	32,237	32,237
Total long-term debt	205,278	149,391
Less current portion	(13,113)	(13,294)
Total long-term debt (less current portion)	\$ 192,165	\$ 136,097

On March 14, 2003, the Company issued \$37,000 of senior notes and amended its senior credit facility. Interest on the senior notes is payable monthly in cash at LIBOR plus 10%, or, if LIBOR is unavailable, at a base rate plus 8%, in either event not to exceed 14% during the last fifteen months prior to the maturity of the notes, plus a 3% per annum Payment-In-Kind ("PIK") interest component which is settled quarterly by the addition of the accrued PIK interest to the notes' principal balance then outstanding. The outstanding principal and all accrued and unpaid interest is due at maturity of the notes on May 2007. The notes rank pari passu with indebtedness outstanding under the Company's senior credit facility and are secured by a second priority lien in substantially all of the Company's assets, junior to liens granted to secure borrowings under the Company's senior credit facility. The senior credit facility and the senior notes rank superior to the Company's subordinated debt.

The amendment to the senior credit facility reduced the facility's revolving credit loan commitments to \$90,000, increased amounts that can be borrowed under the facility's borrowing base formula by approximately \$10,000 and provided for the issuance of the senior notes. It also reissues a term loan for the outstanding balance of the existing term loan and included an additional \$4,551 term loan, bringing the balance of the term loan portion of the facility to \$38,333. The term loans are payable in quarterly installments of \$1,369 beginning May 1, 2003 and are due in May 2007.

Interest rates available under the amended senior facility may be selected from a number of options that effectively allow for borrowing at rates ranging from the lender's prime rate plus .25% to the lender's prime rate plus 1.25% for base rate loans, or at rates ranging from LIBOR plus 2.50% to LIBOR plus 3.75% for LIBOR loans. Commitment fees, ranging from .375% to .50% per annum, are payable on the average daily unused balance of the revolving credit facility. The Company's level of accounts receivable and inventories limits borrowing availability under the revolving credit facility. The senior credit facility is secured by a first priority lien in substantially all of the Company's assets.

The Company's credit agreements contain financial covenants relating to fixed charges, interest and debt coverage and net worth and among other things, limit future acquisitions, capital expenditures, and the payment of dividends. The unused borrowing capacity under the Company's credit facilities on May 6, 2003 was approximately \$17,825.

NOTE G - FINANCIAL INSTRUMENTS

The Company has market risk exposure for potential fluctuations in its variable rate long-term debt instruments. The Company uses derivative instruments, currently interest rate swaps, to minimize interest rate volatility. Under the interest rate swap agreement, the Company pays a fixed rate of interest times a notional principal amount, and receives in return an amount equal to a specified variable rate of interest times the same notional principal amount. The interest rate swap agreement's fair value is reflected on the balance sheet and related gains and losses are deferred in other comprehensive income.

As of March 29, 2003, the Company had an interest rate swap agreement outstanding for \$70,000, which will be in effect until March 2005. Under the terms of the Company's swap agreements, the Company paid a fixed interest rate of 6.75% through March 10, 2003 and 3.24% thereafter. The fair value of the swap agreement as of March 29, 2003 was \$2,121. Changes in the fair value of the swap agreements since December 28, 2002 resulted in an unrealized gain, net of taxes, of \$174 and, accordingly, the unrealized gain is recorded in other comprehensive income.

NOTE H - EARNINGS PER SHARE

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

	Three Months Ended	
	March 29, 2003	March 30, 2002
Net income (loss) (1)	\$ (336)	\$ 496
Denominator for calculation of basic earnings per share - weighted average shares (2)	11,749	11,685
Effect of dilutive securities:		
Stock options (3)	---	36
Stock subscriptions (3)	---	47
Restricted stock grants (3)	---	27
Denominator for calculation of diluted earnings per share - weighted average shares adjusted for potential dilution (2) (3)	11,749	11,795
Earnings (loss) per share:		
Basic	\$ (0.03)	\$ 0.04
Diluted	\$ (0.03)	\$ 0.04

(1) No adjustments needed in the numerator for diluted calculations.

(2) Includes Common and Class B Common shares in thousands.

(3) Because their effects are anti-dilutive, excludes shares under restricted stock plans and shares issuable under stock option, and stock subscription plans, whose grant price is greater than the average market price of Common Shares outstanding at the end of the relevant period, and excludes shares issuable on conversion of subordinated debentures into shares of Common Stock. Aggregate shares excluded were 3,094 in 2003 and 1,958 shares in 2002.

NOTE I - COMPREHENSIVE INCOME

Comprehensive income (loss) is as follows:

	Three Months Ended	
	March 29, 2003	March 30, 2002
Net income (loss)	\$ (336)	\$ 496
Other comprehensive income:		
Unrealized gain on interest rate swap agreements, net of taxes	174	455
Comprehensive income (loss)	\$ (162)	\$ 951

NOTE J - SEGMENT INFORMATION

The Company has two reportable segments in its continuing operations: carpet manufacturing and floorcovering base materials. Each reportable segment is organized around product similarities. The carpet manufacturing segment contains three operating businesses that manufacture and sell finished carpet and rugs. The floorcovering base materials segment manufactures and sells yarn to external customers and transfers a significant portion of its unit volumes to the Company's carpet manufacturing segment.

The profit performance measure for the Company's segments is defined as internal EBIT (earnings before interest, taxes, and other non-segment items). Assets measured in each reportable segment include long-lived assets and goodwill, inventories, and accounts receivable. The carrying amount of goodwill included in the carpet manufacturing segment was \$100,758 and \$100,492 for the periods ended March 29, 2003 and December 28, 2002, respectively. The \$266 increase in goodwill was a result of net contingent payments associated with prior business combinations. There is no goodwill included in the floorcovering base materials segment at March 29, 2003 and December 28, 2002.

Allocations of corporate, general and administrative expenses are used in the determination of segment profit performance; however, assets of the corporate departments are not used in the segment asset performance measurement.

	Three Months Ended	
	March 29, 2003	March 30, 2002
Net sales - external customers		
Carpet manufacturing	\$ 104,952	\$ 112,746
Floorcovering base materials	7,012	10,578
Segment total	\$ 111,964	\$ 123,324
Profit performance		
Carpet manufacturing	\$ 2,756	\$ 4,338
Floorcovering base materials	512	755
Segment total	3,268	5,093
Interest expense	3,822	4,384
Other non-segment (income) expense	(13)	(76)
Income (loss) before taxes	\$ (541)	\$ 785

Intersegment sales from the Company's floorcovering base materials group to the Company's carpet manufacturing group were \$39,424 for the three months ended March 29, 2003 and \$37,589 for the three months ended March 30, 2002.

	March 29, 2003		December 28, 2002
Assets used in performance measurement			
Carpet manufacturing	\$ 359,536	\$	339,882
Floorcovering base materials	40,868		38,421
Assets in performance measurement	400,404		378,303
Assets not in performance measurement			
Other operating assets	37,741		38,329
Assets held for sale	14		14
Total consolidated assets	\$ 438,159	\$	416,646

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

The following is presented to update the discussion of results of operations and financial condition included in our 2002 annual report.

CRITICAL ACCOUNTING POLICIES

Our critical accounting policies were outlined in the Management's Discussion and Analysis of Results of Operations and Financial Condition in our 2002 Annual Report to Shareholders. There have been no changes to those critical accounting policies as specified in the 2002 Annual Report.

RESULTS OF OPERATIONS

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

	Quarter Ended	
	March 29, 2003	March 30, 2002
Net sales	100.0 %	100.0 %
Cost of sales	76.9 %	77.4 %
Gross profit	23.1 %	22.6 %
Selling and administrative expenses	20.3 %	18.8 %
Other (income) expense - net	(0.1)%	(0.4)%
Operating income	2.9 %	4.2 %

Net Sales. Net sales for the quarter ended March 29, 2003 were \$112.0 million, a decline of 9.2% from \$123.3 million for the quarter ended March 30, 2002. Sales in our carpet business declined 6.9%. Carpet sales for the quarter ended March 29, 2003 were down over 20% in our manufactured housing markets due to continued weakness in the factory-built housing industry and over 16% in our home center/mass merchant markets. The decline in the home center/mass merchants markets was principally due to a decline in The Home Depot's carpet business. Sales to our high-end residential and commercial markets were stronger than the overall carpet industry, with high-end residential sales relatively flat with the prior year and commercial sales up approximately 6%. Sales in our carpet yarn business declined 33.7% principally due to the sale of our extrusion yarn facility in May 2002 and our de-emphasis of external carpet yarn sales to supply raw materials to our carpet operations. Our carpet manufacturing operations utilized approximately 86% of our carpet yarn production in the quarter ended March 29, 2003.

Cost of Sales. Cost of sales was 76.9% of sales in the quarter ended March 29, 2003 compared with 77.4% for the corresponding period in 2002. Despite the 9.2% decline in sales in 2003, cost of sales as a percentage of sales decreased due to an increase in the sales of higher-end products, continued cost containment and elimination of \$0.7 million of costs related to facility consolidation and plant shutdowns that occurred in the 2002 period. These improvements more than offset increases in raw materials and other costs. Sales in our high-end residential and commercial businesses were 41% of total sales in the first quarter 2003, compared with 36.6% in the first quarter a year ago..

Selling and Administrative Expenses. Selling and administrative expenses decreased \$0.5 million in the quarter ended March 29, 2003 compared with the same period in 2002. These costs as a percentage of sales were higher in 2003 as a result of lower sales.

Other (income) expense - net. Other (income) expense - net reflected a lower level of net gains principally due to the non-recurring net gain of \$0.7 million in the quarter ended March 30, 2002.

Interest Expense. Interest expense decreased for the quarter ended March 29, 2003 compared with the same period in 2002 principally due to lower levels of debt.

Income Tax Provision (Benefit). Our effective income tax rate was a 37.9% benefit for the quarter ended March 29, 2003 and a 36.8% provision for the quarter ended March 30, 2002. The change in the effective tax rates is principally due to the relationship of non-deductible costs to pre-tax earnings in each of these reporting periods.

Net Income (Loss). Results for the quarter ended March 29, 2003 reflected a net loss of \$0.3 million, or \$0.03 per diluted share, compared with net income of \$0.5 million, or \$0.04 per diluted share, for the quarter ended March 30, 2002.

LIQUIDITY AND CAPITAL RESOURCES

On March 14, 2003, we issued \$37.0 million of senior notes, amended our senior credit facility and settled the \$50.0 million obligation due on April 1, 2003 to the former shareholders of Fabrica International. The Fabrica obligation was settled through a cash payment of \$49.8 million, reflecting an early payment discount. The interest on the senior notes is payable monthly in cash at LIBOR plus 10%, or, if LIBOR is unavailable, at a base rate plus 8%, in either event not to exceed 14% during the last fifteen months prior to the maturity of the notes, plus a 3% per annum Payment-In-Kind ("PIK") interest component which is settled quarterly by the addition of the accrued PIK interest to the notes' principal balance then outstanding. The outstanding principal and all accrued and unpaid interest is due at maturity of the notes in May 2007. The notes rank pari passu with the indebtedness under our senior credit facility and are secured by a second priority lien in substantially all of our assets, junior to liens we granted to secure borrowings under our senior credit facility. The senior credit facility and the senior notes rank senior to our subordinated debt.

The amendment to the senior credit facility reduced the revolving credit loan commitments to \$90.0 million, increased amounts that can be borrowed under the credit facility's borrowing base formula by approximately \$10.0 million and provided for the issuance of the senior notes. The existing term loan was reissued at its outstanding balance and an additional \$4.5 million term loan was issued, bringing the aggregate balance of the term loan portion of the credit facility to \$38.3 million. The term loans are payable in quarterly installments of \$1.4 million beginning May 1, 2003 and are due in May 2007. Interest rates available under the amended senior credit facility may be selected from a number of options that effectively allow for borrowing at rates ranging from the lender's prime rate plus .25% to the lender's prime rate plus 1.25% for base rate loans, or at rates ranging from LIBOR plus 2.50% to LIBOR plus 3.75% for LIBOR loans. Commitment fees, ranging from .375% to .50% per annum, are payable on the average daily unused balance of the revolving credit facility. The level of our accounts receivable and inventories limits borrowing availability under the revolving credit facility. The senior credit facility is secured by a first priority lien in substantially all of our assets.

Our credit agreements contain financial covenants relating to fixed charges, interest, debt coverage and net worth and among other things, limit future acquisitions, sales of assets, capital expenditures, and the payment of dividends. At May 6, 2003, the unused borrowing capacity under our credit facility was \$17.8 million.

During the three-month period ended March 29, 2003, net borrowings under our senior credit facility increased \$21.5 million, we issued \$37.0 million of senior notes and received a \$1.8 million distribution from our Chroma partnership. These funds were used to satisfy the \$50.0 million obligation to the former shareholders of Fabrica International, invest \$0.9 million in capital assets, pay \$2.4 million of maturities on our subordinated indebtedness, and fund \$7.8 million of cash used in our operating activities.

Capital expenditures for the three-month period ended March 29, 2003 were \$0.9 million, while depreciation and amortization was \$5.3 million. We expect capital expenditures to be approximately \$12.0 million or less for the fiscal year 2003 while depreciation and amortization is expected to be approximately \$20.5 million.

The Fabrica asset purchase agreement provides for an additional contingent amount of up to \$2.5 million to be paid in April 2005 if Fabrica's cumulative earnings before interest and taxes for the five-year period beginning January 2000 exceed certain levels. We expect that any contingent payments that may become due under the cumulative earnings test would be treated as additional costs of the acquisition.

The acquisition of our interest in Chroma Systems Partners in 2000 is subject to a purchase price adjustment generally equal to our share of Chroma's income or loss for the three years ending June 30, 2003, less \$1.8 million. A significant portion of the amounts due by us as a result of this adjustment is paid monthly.

The 1999 acquisition of Multitex Corporation of America, Inc. ("Globaltex") provides for certain contingent obligations related to revenue growth of a specific customer through 2003. Such obligations were \$1.2 million, \$1.5 million, and \$1.6 million for fiscal years ended 2002, 2001 and 2000, respectively.

We believe our operating cash flows and credit availability under the amended senior credit facility are adequate to finance our anticipated liquidity requirements.

RECENT ACCOUNTING PRONOUNCEMENTS

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated With Exit or Disposal Activities". Effective December 29, 2002, we adopted SFAS No. 146 which addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (Including Certain Costs Incurred in a

Restructuring)". This Statement requires recognition of cost associated with an exit or disposal activity, measured initially at fair value, only when the liability is incurred. Adoption of this Statement did not have a significant impact on our financial statements.

During 2002, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 148 (SFAS 148) "Accounting for Stock-Based Compensation - Transition and Disclosure". SFAS 148 amends SFAS 123, "Accounting for Stock-Based Compensation", to provide alternate methods of transition for an entity that voluntarily changes to the fair value based method of accounting for stock-based employee compensation. It also amends the disclosure provisions of that statement to require prominent disclosure about the effects on the reporting of net income of an entity's accounting policy decisions with respect to stock-based employee compensation. Finally, SFAS 148 amends APB Opinion No. 28, "Interim Financial Reporting", to require disclosure about these effects in interim financial information. The annual disclosure requirements of SFAS 148 are effective for fiscal years ending after December 15, 2002.

In January 2003, the FASB issued FIN No. 46, "Consolidation of Variable Interest Entities." FIN 46 requires that companies that control another entity through interest other than voting interests should consolidate the controlled entity. FIN 46 is effective for variable interest entities created after January 31, 2003 and to any variable interest entities in which the Company obtains an interest after that date. FIN 46 is effective for quarters beginning after June 15, 2003 for variable interest entities in which the Company held a variable interest that it acquired before February 1, 2003. We have evaluated the provisions of FIN 46 and do not believe adoption will have a material effect on our financial statements.

CERTAIN FACTORS AFFECTING THE COMPANY'S PERFORMANCE

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

The floorcovering industry is cyclical and prolonged declines in residential or commercial construction activity, corporate remodeling and refurbishment, or in the factory-built housing industry, could have a material adverse effect on our business.

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

- consumer confidence;
- housing demand;
- financing availability;
- national and local economic conditions;
- interest rates;
- employment levels;
- changes in disposable income;
- commercial rental vacancy rates; and
- federal and state income tax policies.

We believe we are the largest producer of carpeting for the factory-built housing industry. Approximately 20% of our total net sales are made to customers in the factory-built and modular housing industries. Production in the factory-built housing industry has remained at significantly depressed levels since 1999. The U.S. construction, factory-built housing and other industries have experienced significant downturns in the past, which have adversely affected suppliers to these industries, including suppliers of floorcoverings. These industries could experience similar downturns in the future, which could have a negative impact on our business, financial condition and results of operations.

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

The floorcovering industry is highly competitive. We face competition from a number of domestic manufacturers and independent distributors of floorcovering products and, in certain product areas, foreign manufacturers. There has been a significant consolidation within the floorcovering industry during recent years which has caused a number of our existing and potential competitors to be larger and have greater resources and access to capital than we do. Maintaining our competitive position may require us to make substantial investments in our product development efforts, manufacturing facilities, distribution network and sales and marketing activities, which may be limited by restrictions set forth in our credit facilities. Competitive pressures may also result in decreased demand for our products and in the loss of market share. In addition, we face, and will continue to face, pressure on sales prices of our products from competitors. As a result of any of these factors, there could be a material adverse effect on our sales and profitability.

The loss of our business with The Home Depot, Inc. could have a material adverse effect on our sales and profitability.

Sales to The Home Depot, Inc. represented approximately 14% of the total dollar volume of our sales in the quarter ended March 29, 2003. We believe that our relationship with The Home Depot is good, but we cannot assure you that we will be able to maintain this relationship. Our reliance on The Home Depot may significantly influence our negotiations with them. We do not have long-term contracts with The Home Depot, and there can be no assurance that The Home Depot will continue to purchase our products in historical quantities or at all. The loss of, or a significant reduction in, this business could have a material adverse effect on our sales and profitability.

Raw material prices may increase.

The cost of raw materials has a significant impact on our profitability. In particular our business requires the purchase of large volumes of nylon fiber, filament, synthetic backing, polyester, polypropylene, wool fibers, latex and dyes. Increases in the cost of these raw materials could materially adversely affect our business, results of operations and financial condition if we are unable to pass these increases through to our customers. Prices of certain raw materials increased in early 2003 and additional raw material increases have been announced to become effective in the second quarter of 2003. We believe we will be successful in increasing our selling prices to pass along raw material and other cost increases; however, it could take several months to recoup these increases in the marketplace, and there can be no assurance that we will successfully recover all such cost increases.

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. The unanticipated termination or interruption of our supply arrangements could have a material adverse effect on us.

We may be responsible for environmental cleanup costs.

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

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

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

Acts of Terrorism.

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

FORWARD-LOOKING INFORMATION

This Report contains statements that may be considered forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended. These statements include the use of terms or phrases that include such terms as "expects," "estimated," "projects," "believes," "anticipates," "intends," and similar terms and phrases. Such terms or phrases relate to, among other matters, our future financial performance, business prospects, growth, strategies or liquidity. The following important factors may affect our future results of and could cause those results to differ materially from our historical results. These risks include, in addition to those detailed above under the heading "Certain Factors Affecting the Company's Performance", 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 floorcovering markets we serve and other risks detailed from time to time in our filings with the Securities and Exchange Commission.

Item 3 - Quantitative and Qualitative Disclosures About Market Risk (dollars in thousands)

The Company has market risk exposure for potential fluctuations in its variable rate long-term debt instruments. The Company uses derivative instruments, currently interest rate swaps, to minimize the impact of interest rate volatility. At March 29, 2003, the Company is party to an interest rate swap agreement through March 11, 2005, under which the Company pays a fixed rate of interest times the notional principal amount of \$70,000 and receives a variable rate of interest times the same notional principal amount. The fixed interest rate per the agreement was 6.75% through March 10, 2003 and 3.24% thereafter. The variable rate as of March 29, 2003 was 1.32%. The cumulative fair value of the agreement as of March 29, 2003 was a liability of approximately \$2,121, which was recorded in other long-term liabilities with the offset to accumulated other comprehensive loss of \$1,315 (net of taxes).

Based on the Company's \$70,000 interest rate swap agreement, a 10% fluctuation in the variable rate would result in an annual after-tax economic impact of approximately \$57.

Item 4 - Procedures and Controls

Within the 90 days prior to this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 13a-14. Based upon that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in timely alerting them to material information relating to the Company that is required to be included in our periodic SEC filings. There have been no significant changes in our internal controls or in other factors that could significantly affect these controls subsequent to the date of our evaluation.

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PART II. OTHER INFORMATION

Item 1 - Legal Proceedings

None.

Item 2 - Changes in Securities and Use of Proceeds

None.

Item 3 - Defaults Upon Senior Securities

None.

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

None.

Item 5 - Other Information

None.

Item 6 - Exhibits and Reports on Form 8-K

(a) Exhibits

(i) Exhibits Incorporated by Reference

None.

(ii) Exhibits Filed with this Report

- | | |
|--------|---|
| * 10.1 | Employment Agreement between The Dixie Group, Inc. and David E. Polley dated November 20, 2002 |
| 99.1 | CEO Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 99.2 | CFO Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

* Indicates a management contract or compensatory plan or arrangement

*

(b) Reports on Form 8-K

- (i) A Current Report on Form 8-K dated March 14, 2003 was filed to report the issuance of \$37.0 million of senior term notes, due May 2007, amendment of the senior credit facility, and settlement of the \$50.0 million obligation that was due in April 2003 to the former shareholders of Fabrica.

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SIGNATURES

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

THE DIXIE GROUP, INC.

(Registrant)

Date: May 13, 2003

By: **/s/ GARY A. HARMON**

Gary A. Harmon

Vice President and Chief Financial Officer

Date: May 13, 2003

By: **/s/ D. EUGENE LASATER**

D. Eugene Lasater

Corporate Controller

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Form of Sarbanes-Oxley Section 302(a) Certification

I, Daniel K. Frierson, Chief Executive Officer of The Dixie Group, Inc. certify that:

1. I have reviewed this quarterly report on Form 10-Q of The Dixie Group, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 13, 2003

/s/ DANIEL K. FRIERSON _____

Daniel K. Frierson
Chief Executive Officer
The Dixie Group, Inc.

Form of Sarbanes-Oxley Section 302(a) Certification

I, Gary A. Harmon, Chief Financial Officer of The Dixie Group, Inc. certify that:

1. I have reviewed this quarterly report on Form 10-Q of The Dixie Group, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 13, 2003

/s/ GARY A. HARMON

Gary A. Harmon
Chief Financial Officer
The Dixie Group, Inc.

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