

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

Form 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2018

OR

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

Commission File Number: 0-2585



THE DIXIE GROUP

THE DIXIE GROUP, INC.

(Exact name of Registrant as specified in its charter)

Tennessee

62-0183370

(State or other jurisdiction of incorporation or organization)

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

475 Reed Road, Dalton, Georgia

30720

(706) 876-5800

(Address of principal executive offices)

(zip code)

(Registrant's telephone number, including area code)

Not Applicable

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

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

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

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (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 July 26, 2018
Common Stock, \$3 Par Value	15,515,088 shares
Class B Common Stock, \$3 Par Value	936,804 shares
Class C Common Stock, \$3 Par Value	0 shares

THE DIXIE GROUP, INC.

Table of Contents

PART I. FINANCIAL INFORMATION

	<u>Page</u>
Item 1. Financial Statements	3
Consolidated Condensed Balance Sheets - June 30, 2018 (Unaudited) and December 30, 2017 (As Adjusted)	3
Consolidated Condensed Statements of Operations (Unaudited) - Three and Six Months Ended June 30, 2018 and July 1, 2017 (As Adjusted)	4
Consolidated Condensed Statements of Comprehensive Income (Loss) (Unaudited) - Three and Six Months Ended June 30, 2018 and July 1, 2017	5
Consolidated Condensed Statements of Cash Flows (Unaudited) - Six Months Ended June 30, 2018 and July 1, 2017	6
Notes to Consolidated Condensed Financial Statements (Unaudited)	7
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	22
Item 3. Quantitative and Qualitative Disclosures about Market Risk	25
Item 4. Controls and Procedures	25

PART II. OTHER INFORMATION

Item 1. Legal Proceedings	26
Item 1A. Risk Factors	26
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	30
Item 3. Defaults Upon Senior Securities	30
Item 4. Mine Safety Disclosures	30
Item 5. Other information	30
Item 6. Exhibits	30
 Signatures	 31

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

	June 30, 2018	December 30, 2017
	(Unaudited)	(As Adjusted)
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 21	\$ 19
Receivables, net	49,408	46,480
Inventories, net	122,383	113,657
Prepays and other current assets	7,155	4,669
TOTAL CURRENT ASSETS	178,967	164,825
PROPERTY, PLANT AND EQUIPMENT, NET	89,148	93,785
GOODWILL AND OTHER INTANGIBLES	5,698	5,850
OTHER ASSETS	18,089	19,447
TOTAL ASSETS	\$ 291,902	\$ 283,907
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	\$ 27,407	\$ 18,541
Accrued expenses	30,911	31,360
Current portion of long-term debt	7,982	9,811
TOTAL CURRENT LIABILITIES	66,300	59,712
LONG-TERM DEBT	130,192	123,446
OTHER LONG-TERM LIABILITIES	18,955	21,486
TOTAL LIABILITIES	215,447	204,644
COMMITMENTS AND CONTINGENCIES (See Note 18)		
STOCKHOLDERS' EQUITY		
Common Stock (\$3 par value per share): Authorized 80,000,000 shares, issued and outstanding - 15,515,088 shares for 2018 and 15,279,812 shares for 2017	46,545	45,839
Class B Common Stock (\$3 par value per share): Authorized 16,000,000 shares, issued and outstanding - 936,804 shares for 2018 and 861,499 shares for 2017	2,810	2,584
Additional paid-in capital	156,605	157,139
Accumulated deficit	(129,723)	(125,000)
Accumulated other comprehensive income (loss)	218	(1,299)
TOTAL STOCKHOLDERS' EQUITY	76,455	79,263
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 291,902	\$ 283,907

See accompanying notes to the consolidated condensed financial statements.

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

	Three Months Ended		Six Months Ended	
	June 30, 2018	July 1, 2017 (As Adjusted)	June 30, 2018	July 1, 2017 (As Adjusted)
NET SALES	\$ 106,438	\$ 107,187	\$ 205,297	\$ 204,728
Cost of sales	81,294	78,761	158,573	151,141
GROSS PROFIT	25,144	28,426	46,724	53,587
Selling and administrative expenses	23,802	25,266	46,921	49,753
Other operating (income) expense, net	1,507	(14)	1,267	39
Facility consolidation and severance expenses, net	190	—	406	—
OPERATING (LOSS) INCOME	(355)	3,174	(1,870)	3,795
Interest expense	1,642	1,357	3,176	2,719
Other expense, net	1	21	3	18
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE TAXES	(1,998)	1,796	(5,049)	1,058
Income tax provision (benefit)	(26)	570	(192)	408
INCOME (LOSS) FROM CONTINUING OPERATIONS	(1,972)	1,226	(4,857)	650
Income (loss) from discontinued operations, net of tax	157	(123)	135	(152)
NET INCOME (LOSS)	\$ (1,815)	\$ 1,103	\$ (4,722)	\$ 498
BASIC EARNINGS (LOSS) PER SHARE:				
Continuing operations	\$ (0.13)	\$ 0.08	\$ (0.31)	\$ 0.04
Discontinued operations	0.01	(0.01)	0.01	(0.01)
Net income (loss)	\$ (0.12)	\$ 0.07	\$ (0.30)	\$ 0.03
BASIC SHARES OUTSTANDING	15,763	15,707	15,739	15,690
DILUTED EARNINGS (LOSS) PER SHARE:				
Continuing operations	\$ (0.13)	\$ 0.08	\$ (0.31)	\$ 0.04
Discontinued operations	0.01	(0.01)	0.01	(0.01)
Net income (loss)	\$ (0.12)	\$ 0.07	\$ (0.30)	\$ 0.03
DILUTED SHARES OUTSTANDING	15,763	15,826	15,739	15,805
DIVIDENDS PER SHARE:				
Common Stock	\$ —	\$ —	\$ —	\$ —
Class B Common Stock	—	—	—	—

See accompanying notes to the consolidated condensed financial statements.

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

	Three Months Ended		Six Months Ended	
	June 30, 2018	July 1, 2017	June 30, 2018	July 1, 2017
NET INCOME (LOSS)	\$ (1,815)	\$ 1,103	\$ (4,722)	\$ 498
OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX:				
Unrealized gain (loss) on interest rate swaps	323	(359)	1,128	(303)
Income taxes	—	(136)	—	(115)
Unrealized gain (loss) on interest rate swaps, net	323	(223)	1,128	(188)
Reclassification of loss into earnings from interest rate swaps (1)	177	324	406	683
Income taxes	—	123	—	260
Reclassification of loss into earnings from interest rate swaps, net	177	201	406	423
Reclassification of net actuarial gain into earnings from postretirement benefit plans (2)	(7)	(8)	(15)	(16)
Income taxes	—	(3)	—	(6)
Reclassification of net actuarial gain into earnings from postretirement benefit plans, net	(7)	(5)	(15)	(10)
Reclassification of prior service credits into earnings from postretirement benefit plans (2)	(1)	(1)	(2)	(2)
Income taxes	—	—	—	(1)
Reclassification of prior service credits into earnings from postretirement benefit plans, net	(1)	(1)	(2)	(1)
TOTAL OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX	492	(28)	1,517	224
COMPREHENSIVE INCOME (LOSS)	\$ (1,323)	\$ 1,075	\$ (3,205)	\$ 722

(1) Amounts for cash flow hedges reclassified from accumulated other comprehensive income (loss) to net income (loss) were included in interest expense in the Company's Consolidated Condensed Statements of Operations.

(2) Amounts for postretirement plans reclassified from accumulated other comprehensive income (loss) to net income (loss) were included in selling and administrative expenses in the Company's Consolidated Condensed Statements of Operations.

See accompanying notes to the consolidated condensed financial statements.

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

	Six Months Ended	
	June 30, 2018	July 1, 2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Income (loss) from continuing operations	\$ (4,857)	\$ 650
Income (loss) from discontinued operations	135	(152)
Net income (loss)	(4,722)	498
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	6,307	6,406
Provision for deferred income taxes	15	390
Net loss on property, plant and equipment disposals	82	41
Stock-based compensation expense	456	488
Bad debt expense	117	17
Changes in operating assets and liabilities:		
Receivables	(3,045)	(10,024)
Inventories	(8,726)	(14,754)
Other current assets	(2,486)	104
Accounts payable and accrued expenses	6,537	8,624
Other operating assets and liabilities	314	(524)
NET CASH USED IN OPERATING ACTIVITIES	(5,151)	(8,734)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property, plant and equipment	(1,422)	(6,224)
NET CASH USED IN INVESTING ACTIVITIES	(1,422)	(6,224)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net borrowings on revolving credit facility	8,434	18,944
Payments on notes payable - buildings	(366)	(365)
Payments on notes payable related to acquisitions	(791)	(1,393)
Borrowings on notes payable - equipment and other	1,960	1,932
Payments on notes payable - equipment and other	(2,250)	(2,210)
Payments on capital leases	(2,234)	(1,931)
Change in outstanding checks in excess of cash	1,880	90
Repurchases of Common Stock	(58)	(116)
NET CASH PROVIDED BY FINANCING ACTIVITIES	6,575	14,951
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	2	(7)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	19	140
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 21	\$ 133
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid	\$ 3,054	\$ 2,660
Income taxes paid, net	73	105
Equipment purchased under capital leases	74	229
Equipment purchased under notes payable	—	59

See accompanying notes to the consolidated condensed financial statements.

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

NOTE 1 - BASIS OF PRESENTATION

The accompanying unaudited consolidated condensed financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP") for interim financial statements which do not include all the information and notes 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 2017 Annual Report on Form 10-K filed with the Securities and Exchange Commission for the fiscal year ended December 30, 2017. Operating results for the three and six month periods ended June 30, 2018 are not necessarily indicative of the results that may be expected for the entire 2018 year.

Based on applicable accounting standards, the Company has determined that it has one reportable segment, Floorcovering comprised of two operating segments, Residential and Commercial. Pursuant to applicable accounting standards, the Company has aggregated the two operating segments into one reporting segment because they have similar economic characteristics, and the operating segments are similar in all of the following areas: (a) the nature of the products and services; (b) the nature of the production processes; (c) the type or class of customer for their products and services; (d) the methods used to distribute their products or provide their services; and (e) the nature of the regulatory environment.

NOTE 2 - RECENT ACCOUNTING PRONOUNCEMENTS

Accounting Standard Adopted in Fiscal 2018

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, "Revenue from Contracts with Customers (Topic 606)". The ASU requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU and all subsequently issued clarifying ASUs replaced most existing revenue recognition guidance in U.S. GAAP. The ASU was effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. The standard permits the use of either the retrospective or cumulative effect transition method. The ASU also required expanded disclosures relating to the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Additionally, qualitative and quantitative disclosures are required for customer contracts, significant judgments and changes in judgments. The Company adopted the new standard effective December 31, 2017, the first day of the Company's fiscal year, using the full retrospective method approach and expanded its financial statement disclosures in order to comply with the ASU. (See Note 3.) The adoption of this ASU did not have a significant impact on the Company's consolidated financial statements. The majority of the Company's revenue arrangements generally consist of a single performance obligation to transfer promised goods or services. Based on the Company's evaluation process and review of its contracts with customers, the timing (point in time) and amount of revenue recognized previously is consistent with how revenue is recognized under the new standard.

Therefore, no changes were required to its reported revenues as a result of the adoption. However, the adoption resulted in the recognition of an asset related to certain product returns by increasing the returns liability for December 30, 2017 and recognizing a corresponding asset for the estimated value of the returns from customers; this gross up had no corresponding impact on the Consolidated Condensed Statement of Operations. The Consolidated Balance Sheet as of December 30, 2017 has been adjusted to reflect retrospective application of the new accounting standard as follows:

	December 30, 2017		
	As Previously Reported	Adjustments	As Adjusted
ASSETS			
Prepays and other current assets	\$ 3,600	\$ 1,069	\$ 4,669
LIABILITIES AND STOCKHOLDERS' EQUITY			
Accrued expenses	\$ 30,291	\$ 1,069	\$ 31,360

As part of the adoption of the ASU, the Company elected to use the following practical expedients (i) to exclude disclosures of transaction prices allocated to remaining performance obligations when the Company expects to recognize such revenue for all periods prior to the date of initial application of the ASU; (ii) not to adjust the promised amount of consideration for the effects of a significant financing component when the Company expects, at contract inception, that the period between the Company's transfer

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

of a promised product or service to a customer and when the customer pays for that product or service will be one year or less; (iii) to expense costs as incurred for costs to obtain a contract when the amortization period would have been one year or less; (iv) not to recast revenues for contracts that begin and end in the same fiscal year; and (v) not to assess whether promised goods or services are performance obligations if they are immaterial in the context of the contract with the customer. The Company's revenue is recognized at a point in time based on the transfer of control whereby the Company does not invest in contract costs that are recoverable. In addition, performance obligations and customer payments are within one year or less. For these reasons, there is not a significant impact as a result of electing these practical expedients.

Accounting Standards Yet to Be Adopted

In February 2016, the FASB issued ASU No. 2016-02, "*Leases (Topic 842)*," which requires lessees to recognize on the balance sheet a right-of-use asset, representing the right to use the underlying asset for the lease term, and a lease liability for all leases with terms greater than 12 months. The guidance also requires qualitative and quantitative disclosures designed to assess the amount, timing, and uncertainty of cash flows arising from leases. The standard requires the use of a modified retrospective transition approach, which includes a number of optional practical expedients that entities may elect to apply. ASU 2016-02 is effective for annual periods beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted. The Company is continuing to evaluate the impact of the adoption of this ASU on its financial statements. The Company has developed a project team relative to the process of adopting this ASU and is currently completing a detailed review of the Company's leasing arrangements, which consist primarily of building and equipment leases, to determine the impact.

In June 2016, the FASB issued ASU No. 2016-13, "*Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*," which amends the impairment model to utilize an expected loss methodology in place of the current incurred loss methodology, which will result in the more timely recognition of losses. For public entities, ASU 2016-13 is effective for annual periods beginning after December 15, 2019, including interim periods within those fiscal years. Early application will be permitted for all organizations for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Company does not believe the adoption of this ASU will have a significant impact on the financial statements due to the nature of the Company's customers and the limited amount of write-offs in past years.

In August 2017, the FASB issued ASU No. 2017-12, "*Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*." The amendments in this ASU update current guidance by more closely aligning the results of cash flow and fair value hedge accounting with risk management activities through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. ASU 2017-12 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with early adoption permitted. The Company does not believe the adoption of this ASU will have a significant impact on the financial statements.

NOTE 3 - REVENUE

Revenue Recognition Policy

The Company derives its revenues primarily from the sale of floorcovering products and processing services. Revenues are recognized when control of these products or services is transferred to its customers, in an amount that reflects the consideration the Company expects to be entitled to in exchange for those products and services. Sales, value add, and other taxes the Company collects concurrent with revenue-producing activities are excluded from revenue. Shipping and handling fees charged to customers are reported within revenue. Incidental items that are immaterial in the context of the contract are recognized as expense. The Company does not have any significant financing components as payment is received at or shortly after the point of sale. The Company determined revenue recognition through the following steps:

- Identification of the contract with a customer
- Identification of the performance obligations in the contract
- Determination of the transaction price
- Allocation of the transaction price to the performance obligations in the contract
- Recognition of revenue when, or as, the performance obligation is satisfied

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

Disaggregation of Revenue from Contracts with Customers

The following table disaggregates the Company's revenue by end-user markets for the three months and six months ended June 30, 2018 and July 1, 2017:

	Three Months Ended		Six Months Ended	
	June 30, 2018	July 1, 2017	June 30, 2018	July 1, 2017
Residential floorcovering products	\$ 75,034	\$ 72,115	\$ 142,129	\$ 134,654
Commercial floorcovering products	30,954	34,443	62,242	68,959
Other services	450	629	926	1,115
Total net sales	\$ 106,438	\$ 107,187	\$ 205,297	\$ 204,728

Residential floorcovering products. Residential floorcovering products include broadloom carpet, rugs, luxury vinyl flooring and engineered hardwood. These products are sold into the designer, retailer, mass merchant and builder markets.

Commercial floorcovering products. Commercial floorcovering products include broadloom carpet, carpet tile, rugs, and luxury vinyl flooring. These products are sold into the corporate, hospitality, healthcare, government, and education markets through the use of designers and architects.

Other services. Other services include carpet yarn processing and carpet dyeing services.

Contract Balances

Other than receivables that represent an unconditional right to consideration, which are presented separately (See Note 4), the Company does not recognize any contract assets which give conditional rights to receive consideration, as the Company does not incur costs to obtain customer contracts that are recoverable. The Company often receives cash payments from customers in advance of the Company's performance for limited production run orders resulting in contract liabilities. These contract liabilities are classified in accrued expenses in the Consolidated Condensed Balance Sheets based on the timing of when the Company expects to recognize revenue, which is typically less than a year. The net decrease or increase in the contract liabilities is primarily driven by order activity for limited runs requiring deposits offset by the recognition of revenue and application of deposit on the receivables ledger for such activity during the period. The activity in the advanced deposits for the three and six months ended June 30, 2018 and July 1, 2017 is as follows:

	Three Months Ended		Six Months Ended	
	June 30, 2018	July 1, 2017	June 30, 2018	July 1, 2017
Beginning contract liability	\$ 5,296	\$ 7,572	\$ 5,717	\$ 8,212
Revenue recognized from contract liabilities included in the beginning balance	(4,711)	(6,246)	(5,005)	(7,534)
Increases due to cash received, net of amounts recognized in revenue during the period	6,139	4,903	6,012	5,551
Ending contract liability	\$ 6,724	\$ 6,229	\$ 6,724	\$ 6,229

Performance Obligations

For performance obligations related to residential floorcovering and commercial floorcovering products, control transfers at a point in time. To indicate the transfer of control, the Company must have a present right to payment, legal title must have passed to the customer and the customer must have the significant risks and rewards of ownership. The Company's principal terms of sale are FOB Shipping Point and FOB Destination and the Company transfers control and records revenue for product sales either upon shipment or delivery to the customer, respectively. Revenue is allocated to each performance obligation based on its relative stand-alone selling prices. Stand-alone selling prices are based on observable prices at which the Company separately sells the products or services.

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

Variable Consideration

The nature of the Company's business gives rise to variable consideration, including rebates, allowances, and returns that generally decrease the transaction price which reduces revenue. These variable amounts are generally credited to the customer, based on achieving certain levels of sales activity, product returns or price concessions.

Variable consideration is estimated at the most likely amount that is expected to be earned. Estimated amounts are included in the transaction price to the extent it is probable that a significant reversal of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is resolved. Estimates of variable consideration are estimated based upon historical experience and known trends.

Warranties

The Company generally provides product warranties related to manufacturing defects and specific performance standards for its products for a period up to two years. The Company accrues for estimated future assurance warranty costs in the period in which the sale is recorded. The costs are included in Cost of Sales in the Consolidated Condensed Statements of Operations and the product warranty reserve is included in accrued expenses in the Consolidated Condensed Balance Sheets. The Company calculates its accrual using the portfolio approach based upon historical experience and known trends. (See Note 9.) The Company does not provide an additional service-type warranty.

Bill-and-Hold Arrangement

At the customer's request, the Company entered into a bill-and-hold arrangement with one customer during the three months ended March 31, 2018. The Company recognized revenue of \$630 but retained physical possession of the inventory. The Company segregated the inventory and no longer had the ability to use or direct it to another customer. The inventory was available to be physically transferred to the customer. As of June 30, 2018, approximately 62% of the order had been shipped to the customer.

NOTE 4 - RECEIVABLES, NET

Receivables are summarized as follows:

	June 30, 2018	December 30, 2017
Customers, trade	\$ 46,645	\$ 43,683
Other receivables	2,962	2,930
Gross receivables	49,607	46,613
Less: allowance for doubtful accounts	(199)	(133)
Receivables, net	\$ 49,408	\$ 46,480

Bad debt expense (credit) was \$57 and \$117 for the three and six months ended June 30, 2018, respectively, and \$(13) and \$17 for the three and six months ended July 1, 2017, respectively.

NOTE 5 - INVENTORIES, NET

Inventories are summarized as follows:

	June 30, 2018	December 30, 2017
Raw materials	\$ 42,874	\$ 39,264
Work-in-process	23,206	24,454
Finished goods	70,136	65,172
Supplies and other	138	143
LIFO reserve	(13,971)	(15,376)
Inventories, net	\$ 122,383	\$ 113,657

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

NOTE 6 - PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment consists of the following:

	June 30, 2018	December 30, 2017
Land and improvements	\$ 8,291	\$ 7,886
Buildings and improvements	63,349	62,852
Machinery and equipment	188,810	188,971
Assets under construction	1,731	2,443
	262,181	262,152
Accumulated depreciation	(173,033)	(168,367)
Property, plant and equipment, net	\$ 89,148	\$ 93,785

Depreciation of property, plant and equipment, including amounts for capital leases, totaled \$3,036 and \$6,051, respectively, in the three and six months ended June 30, 2018 and \$3,068 and \$6,150, respectively, in the three and six months ended July 1, 2017.

NOTE 7 - GOODWILL AND OTHER INTANGIBLES

The carrying amount of goodwill is \$3,389 as of June 30, 2018 and December 30, 2017. The Company has a net carrying amount of \$2,309 and \$2,461 as of June 30, 2018 and December 30, 2017, respectively, for certain intangible assets subject to amortization. Amortization expense was \$76 and \$153 for the three and six months ended June 30, 2018 and July 1, 2017, respectively.

NOTE 8 - ACCRUED EXPENSES

Accrued expenses are summarized as follows:

	June 30, 2018	December 30, 2017 (As Adjusted)
Compensation and benefits	\$ 7,493	\$ 9,276
Provision for customer rebates, claims and allowances	8,446	9,820
Advanced customer deposits	6,724	5,717
Outstanding checks in excess of cash	2,259	379
Other	5,989	6,168
Accrued expenses	\$ 30,911	\$ 31,360

NOTE 9 - PRODUCT WARRANTY RESERVES

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

	Three Months Ended		Six Months Ended	
	June 30, 2018	July 1, 2017 (As Adjusted)	June 30, 2018	July 1, 2017 (As Adjusted)
Product warranty reserve at beginning of period	\$ 1,248	\$ 1,357	\$ 1,356	\$ 1,439
Warranty liabilities accrued	623	491	1,236	895
Warranty liabilities settled	(626)	(490)	(1,318)	(906)
Changes for pre-existing warranty liabilities	(2)	59	(31)	(11)
Product warranty reserve at end of period	\$ 1,243	\$ 1,417	\$ 1,243	\$ 1,417

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

NOTE 10 - LONG-TERM DEBT AND CREDIT ARRANGEMENTS

Long-term debt consists of the following:

	June 30, 2018	December 30, 2017
Revolving credit facility	\$ 106,142	\$ 97,708
Notes payable - buildings	12,053	12,419
Acquisition note payable - Robertex	—	791
Notes payable - equipment and other	6,224	8,474
Capital lease obligations	14,330	14,530
Deferred financing costs, net	(575)	(665)
Total long-term debt	138,174	133,257
Less: current portion of long-term debt	7,982	9,811
Long-term debt	\$ 130,192	\$ 123,446

Revolving Credit Facility

The revolving credit facility provides for a maximum of \$150,000 of revolving credit, subject to borrowing base availability. The borrowing base is currently equal to specified percentages of the Company's eligible accounts receivable, inventories, fixed assets and real property less reserves established, from time to time, by the administrative agent under the facility. The revolving credit facility matures on September 23, 2021. The revolving credit facility is secured by a first priority lien on substantially all of the Company's assets.

At the Company's election, advances of the revolving credit facility bear interest at annual rates equal to either (a) LIBOR for one, two or three-month periods, as selected by the Company, plus an applicable margin ranging between 1.50% and 2.00%, or (b) the higher of the prime rate, the Federal Funds rate plus 0.5%, or a daily LIBOR rate plus 1.00%, plus an applicable margin ranging between 0.50% and 1.00%. The applicable margin is determined based on availability under the revolving credit facility with margins increasing as availability decreases. As of June 30, 2018, the applicable margin on our revolving credit facility was 1.75%. The Company pays an unused line fee on the average amount by which the aggregate commitments exceed utilization of the revolving credit facility equal to 0.375% per annum. The weighted-average interest rate on borrowings outstanding under the revolving credit facility was 4.41% at June 30, 2018 and 4.12% at December 30, 2017.

The revolving credit facility includes certain affirmative and negative covenants that impose restrictions on the Company's financial and business operations. The revolving credit facility restricts the Company's borrowing availability if its fixed charge coverage ratio is less than 1.1 to 1.0. During any period that the fixed charge coverage ratio is less than 1.1 to 1.0, the Company's borrowing availability is reduced by \$16,500. As of June 30, 2018, the unused borrowing availability under the revolving credit facility was \$26,780; however, since the Company's fixed charge coverage ratio was less than 1.1 to 1.0, the unused availability accessible by the Company was \$10,280 (the amount above \$16,500) at June 30, 2018.

Notes Payable - Buildings

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

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

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

Acquisition Note Payable - Robertex

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

Notes Payable - Equipment and Other

The Company's equipment financing notes have terms ranging from 1 to 7 years, bear interest ranging from 1.00% to 7.68% and are due in monthly installments through their maturity dates. The Company's equipment financing notes are secured by the specific equipment financed and do not contain any financial covenants.

Capital Lease Obligations

The Company's capitalized lease obligations have terms ranging from 3 to 7 years, bear interest ranging from 3.55% to 7.76% and are due in monthly or quarterly installments through their maturity dates. The Company's capital lease obligations are secured by the specific equipment leased.

NOTE 11 - FAIR VALUE MEASUREMENTS

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

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

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

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

The following table reflects the fair values of assets and liabilities measured and recognized at fair value on a recurring basis on the Company's Consolidated Condensed Balance Sheets as of June 30, 2018 and December 30, 2017:

	<u>June 30, 2018</u>		<u>December 30, 2017</u>	<u>Fair Value Hierarchy Level</u>
Assets:				
Interest rate swaps (1)	\$ 196	\$	—	Level 2
Liabilities:				
Interest rate swaps (1)	\$ 861	\$	2,229	Level 2
Contingent consideration (2)	26		25	Level 3

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

(2) As a result of the Robertex acquisition in 2013, a contingent consideration liability was recorded by the company.

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

Changes in the fair value measurements using significant unobservable inputs (Level 3) during the six months ending June 30, 2018 and July 1, 2017 were as follows:

	June 30, 2018	July 1, 2017
Beginning balance	\$ 25	\$ 200
Fair value adjustments	1	(144)
Ending balance	<u>\$ 26</u>	<u>\$ 56</u>

There were no transfers of assets or liabilities between Level 1, Level 2 and Level 3 during the three and six months ending June 30, 2018 or July 1, 2017. If any, the Company recognizes the transfers at the end of the reporting period.

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

	June 30, 2018		December 30, 2017	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Cash and cash equivalents	\$ 21	\$ 21	\$ 19	\$ 19
Notes receivable	282	282	282	282
Interest rate swaps	196	196	—	—
Financial liabilities:				
Long-term debt and capital leases, including current portion	138,174	136,277	133,257	131,203
Interest rate swaps	861	861	2,229	2,229

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

NOTE 12 - DERIVATIVES

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

The following is a summary of the Company's interest rate swaps outstanding as of June 30, 2018:

Type	Notional Amount	Effective Date	Fixed Rate	Variable Rate
Interest rate swap	\$ 25,000	September 1, 2016 through September 1, 2021	3.105%	1 Month LIBOR
Interest rate swap	\$ 25,000	September 1, 2015 through September 1, 2021	3.304%	1 Month LIBOR
Interest rate swap	\$ 6,838 (1)	November 7, 2014 through November 7, 2024	4.500%	1 Month LIBOR
Interest rate swap	\$ 5,215 (2)	January 7, 2017 through January 7, 2025	4.300%	1 Month LIBOR

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

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

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

The following table summarizes the fair values of derivative instruments included in the Company's financial statements:

	Location on Consolidated Balance Sheets	Fair Value	
		June 30, 2018	December 30, 2017
Asset Derivatives:			
Derivatives designated as hedging instruments:			
Interest rate swaps, current portion	Prepays and other current assets	\$ 2	—
Interest rate swaps, long-term portion	Other Assets	194	\$ —
Total Asset Derivatives		<u>\$ 196</u>	<u>\$ —</u>
Liability Derivatives:			
Derivatives designated as hedging instruments:			
Interest rate swaps, current portion	Accrued Expenses	\$ 449	\$ 842
Interest rate swaps, long-term portion	Other Long-Term Liabilities	412	1,387
Total Liability Derivatives		<u>\$ 861</u>	<u>\$ 2,229</u>

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, 2018	July 1, 2017	June 30, 2018	July 1, 2017
Derivatives designated as hedging instruments:				
Cash flow hedges - interest rate swaps	\$ 323	\$ (359)	\$ 1,128	\$ (303)

	Amount of Gain or (Loss) Reclassified from AOCIL on the effective portion into Income (1)(2)			
	Three Months Ended		Six Months Ended	
	June 30, 2018	July 1, 2017	June 30, 2018	July 1, 2017
Derivatives designated as hedging instruments:				
Cash flow hedges - interest rate swaps	\$ (177)	\$ (324)	\$ (406)	\$ (683)

(1) The amount of gain (loss) reclassified from AOCIL is included in interest expense on the Company's financial statements.

(2) The amount of loss expected to be reclassified from AOCIL into earnings during the next 12 months subsequent to June 30, 2018 is \$447.

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

NOTE 13 - EMPLOYEE BENEFIT PLANS

Defined Contribution Plans

The Company sponsors a 401(k) defined contribution plan that covers approximately 86% of the Company's current associates. This plan includes a mandatory Company match on the first 1% of participants' contributions. The Company matches the next 2% of participants' contributions if the Company meets prescribed earnings levels. The plan also provides for additional Company contributions above the 3% level if the Company attains certain additional performance targets. Matching contribution (credit) expense for this 401(k) plan was \$(33) and \$245 for the three months ended June 30, 2018 and July 1, 2017, respectively, and \$231 and \$478 for the six months ended June 30, 2018 and July 1, 2017, respectively. The reduction in the matching contribution expense for the three months ended June 30, 2018 was a result of revising the estimated match for the year.

Additionally, the Company sponsors a 401(k) defined contribution plan that covers approximately 14% of the Company's current associates at one facility who are under a collective-bargaining agreement. Under this plan, the Company generally matches participants' contributions, on a sliding scale, up to a maximum of 2.75% of the participant's earnings. Matching contribution expense

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

for the collective-bargaining 401(k) plan was \$38 and \$42 for the three months ended June 30, 2018 and July 1, 2017, respectively, and \$67 and \$60 for the six months ended June 30, 2018 and July 1, 2017, 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 \$15,462 at June 30, 2018 and \$17,010 at December 30, 2017 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 \$16,410 at June 30, 2018 and \$18,232 at December 30, 2017 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 \$81 and \$85 for the three months ended June 30, 2018 and July 1, 2017, respectively, and \$173 and \$151 for the six months ended June 30, 2018 and July 1, 2017, respectively.

NOTE 14 - INCOME TAXES

On December 22, 2017, the President signed the Tax Cuts and Jobs Act (the "Tax Act"). The Tax Act, among other things, lowered the U.S. corporate income tax rate from 35% to 21% effective January 1, 2018. While the Company has substantially completed its provisional analysis of the income tax effects of the Tax Act and recorded a reasonable estimate of such effects during the fourth quarter of 2017, the charge related to the Tax Act may differ, possibly materially, due to, among other things, further refinement of its calculations, changes in interpretations and assumptions that the Company has made or additional guidance that may be issued related to the Tax Act. Pursuant to Staff Accounting Bulletin No. 118, the Company will complete its analysis over a one-year measurement period from the enactment date, and any adjustments during this measurement period will be included in income from continuing operations as an adjustment to income tax expense in the reporting period when such adjustments are determined.

The benefit rate for the six months ending June 30, 2018 was 3.8% compared with an effective income tax rate of 38.6% for the six months ending July 1, 2017. During the fourth quarter of 2017, the Company recorded a full valuation allowance against the deferred tax assets resulting in only refundable credits and a small amount of state taxes being recognized in the tax benefit for the first half of 2018. The six months ended July 1, 2017 included \$164 of tax expense related to the adoption of ASU No. 2016-09 which requires a shortfall of tax benefits related to stock compensation to be recognized in income tax expense instead of additional paid-in capital. The Company is in a net deferred tax liability position of \$1,120 and \$1,105 at June 30, 2018 and December 30, 2017, respectively, which is included in other long-term liabilities in the Company's Consolidated Balance Sheets.

The Company accounts for uncertainty in income tax positions according to FASB guidance relating to uncertain tax positions. Unrecognized tax benefits were \$424 and \$414 at June 30, 2018 and December 30, 2017, respectively. Such benefits, if recognized, would affect the Company's effective tax rate. There were no significant interest or penalties accrued as of June 30, 2018 and December 30, 2017.

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 2013 remain open to examination for U.S. federal income taxes. The majority of state jurisdictions remain open for tax years subsequent to 2013. A few state jurisdictions remain open to examination for tax years subsequent to 2012.

NOTE 15 - EARNINGS (LOSS) PER SHARE

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

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

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

	Three Months Ended		Six Months Ended	
	June 30, 2018	July 1, 2017	June 30, 2018	July 1, 2017
Basic earnings (loss) per share:				
Income (loss) from continuing operations	\$ (1,972)	\$ 1,226	\$ (4,857)	\$ 650
Less: Allocation of earnings to participating securities	—	(31)	—	(31)
Income (loss) from continuing operations available to common shareholders - basic	\$ (1,972)	\$ 1,195	\$ (4,857)	\$ 619
Basic weighted-average shares outstanding (1)	15,763	15,707	15,739	15,690
Basic earnings (loss) per share - continuing operations	\$ (0.13)	\$ 0.08	\$ (0.31)	\$ 0.04
Diluted earnings (loss) per share:				
Income (loss) from continuing operations available to common shareholders - basic	\$ (1,972)	\$ 1,195	\$ (4,857)	\$ 619
Add: Undistributed earnings reallocated to unvested shareholders	—	—	—	—
Income (loss) from continuing operations available to common shareholders - basic	\$ (1,972)	\$ 1,195	\$ (4,857)	\$ 619
Basic weighted-average shares outstanding (1)	15,763	15,707	15,739	15,690
Effect of dilutive securities:				
Stock options (2)	—	—	—	—
Directors' stock performance units (2)	—	119	—	115
Diluted weighted-average shares outstanding (1)(2)	15,763	15,826	15,739	15,805
Diluted earnings (loss) per share - continuing operations	\$ (0.13)	\$ 0.08	\$ (0.31)	\$ 0.04

(1) Includes Common and Class B Common shares, excluding 675 thousand unvested participating securities.

(2) Shares issuable under stock option plans where the exercise price is greater than the average market price of the Company's Common Stock during the relevant period and directors' stock performance units have been excluded to the extent they are anti-dilutive. Aggregate shares excluded for the three and six months ended June 30, 2018 were 426 thousand and for the three and six months ended July 1, 2017 were 307 thousand.

NOTE 16 - STOCK COMPENSATION EXPENSE

The Company recognizes compensation expense relating to share-based payments based on the fair value of the equity instrument issued and records such expense in selling and administrative expenses in the Company's Consolidated Condensed Financial Statements. The number of shares to be issued is determined by dividing the specified dollar value of the award by the market value per share on the grant date. The Company's stock compensation expense was \$228 and \$455 for the three and six months ended June 30, 2018, respectively, and \$201 and \$488 for the three and six months ended July 1, 2017, respectively.

On March 12, 2018, the Company granted 297,292 shares of restricted stock to certain key employees of the Company. The grant-date fair value of the awards was \$832, or \$2.80 per share, and will be recognized as stock compensation expense over a weighted-average period of 6.1 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.

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

NOTE 17 - ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

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

	Interest Rate Swaps	Post-Retirement Liabilities	Total
Balance at December 30, 2017	(1,587)	288	(1,299)
Unrealized gain on interest rate swaps	1,128	—	1,128
Reclassification of loss into earnings from interest rate swaps	406	—	406
Reclassification of net actuarial gain into earnings from postretirement benefit plans	—	(15)	(15)
Reclassification of prior service credits into earnings from postretirement benefit plans	—	(2)	(2)
Balance at June 30, 2018	<u>\$ (53)</u>	<u>\$ 271</u>	<u>\$ 218</u>

NOTE 18 - COMMITMENTS AND CONTINGENCIES

Commitments and Contingencies

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

Environmental Remediation

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

Legal Proceedings

The Company has been sued, together with the 3M Company and approximately 30 other carpet manufacturers, by the Gadsden (Alabama) Water Works in the circuit court of Etowah County Alabama [The Water Works and Sewer Board of the City of Gadsden v. 3M Company, et al, civil action No. 31-CV-2016-900676.00] and by the Town of Centre (Alabama) Water Works in the circuit court of Cherokee County Alabama [The Water Works and Sewer Board of the Town of Centre v. 3M Company, et al, civil action No. 13-CV-2017-900049.00]. Both cases seek monetary damages and injunctive relief related to the use of certain chemical compounds in the manufacture and finishing of carpet products “in and around Dalton Georgia.” On motion of the defendants, the cases were removed to the U.S. District Court for the Northern District of Alabama (Middle Division) Case No. 4:16-CV-01755-SGC and Case No. 4:17-CV-01026-KOB. Subsequently, the Gadsden Water Works filed a motion to have the case remanded back to the state court and such motion has been granted. The lawsuits allege that perfluorinated compounds (“PFC”), perfluorinated acid (“PFOA”) and perfluorooctane sulfonate (“PFOS”) manufactured by 3M were used in certain finishing and treatment processes by the defendants and, as a consequence of such use, were subsequently either discharged into or leached into the water systems around Dalton, Georgia. The Complaints seeks damages that exceed \$10, but are otherwise unspecified in amount in addition to injunctive relief and punitive damages. The Company intends to defend the matters vigorously and is unable to estimate the potential exposure to loss, if any, at this time.

As of June 25, 2018, the Company and the Class Representative, as a result of court ordered mediation, have agreed to a Memorandum of Understanding regarding settlement of the class action litigation styled Carlos Garcia v. Fabrica International, Inc. et al Orange County Superior Court Case No. 30-2017-00949461-CU-OE-CXC. The parties have agreed during the quarter to file a motion for approval of a memorandum of understanding with the court in which the case is pending, and to finalize a definitive settlement agreement subject to court approval. The required court approval of the settlement is expected to occur within the next quarter. During the quarter ended June 30, 2018, the Company has recorded costs of approximately \$1,514 to reflect our estimate of the costs related to such issues.

The Company is one of multiple parties to a current lawsuit filed in Madison County Illinois styled Danny Atkins and Pamela Atkins, Pltfs., vs. Aurora Pump Company, et al. No. 18-L-2. The lawsuit entails a claim for damages to be determined in excess of \$50 filed on behalf of a former employee that alleges that the deceased contracted mesothelioma as a result of exposure to asbestos while employed by the Company. Discovery in the matter is ongoing. The Company has denied liability, is defending the matters

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

vigorously and is unable to estimate its potential exposure to loss, if any, at this time. In March of 2018, a similar lawsuit styled Charles Anderson, Pltf., vs. 3M Company, et al, No. 17-L-525 was dismissed. In May of 2018, the lawsuit styled Brenda Bridgeman, Individually and as Special Administrator of the Estate of Robert Bridgeman, Deceased, vs. American Honda Motor Co., Inc., f/k/a Metropolitan Life Insurance Co. et al No. 15-L-374 was placed in the category of "special closed with settlements and bankruptcy claims pending" to all remaining defendants.

On April 24th, 2018, subsequent to the end of the first quarter, a law firm claiming to represent one of the Company's shareholders owning 50 shares, sent a request for information concerning the Company's equity incentive plans, and equity awards granted under those plans to the Company's chairman and chief operating officer, alleging that the law firm is investigating "possible breaches of fiduciary duty" in approving such plans and such awards. All such equity plans were approved by shareholders, and all such awards were made in accordance with the applicable terms of the plans. The Company has responded to the request in accordance with applicable law. No claim or suit has been filed.

NOTE 19 - OTHER (INCOME) EXPENSE, NET

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

	Three Months Ended		Six Months Ended	
	June 30, 2018	July 1, 2017	June 30, 2018	July 1, 2017
Other operating (income) expense, net:				
Loss on property, plant and equipment disposals	82	41	\$ 82	\$ 41
(Gain) loss on currency exchanges	\$ 5	\$ (15)	(3)	2
Amortization of intangibles	76	76	153	153
Retirement (income) expense	(120)	54	(66)	72
Settlement of class action litigation (1)	1,514	—	1,514	—
Miscellaneous (income) expense	(50)	(170)	(413)	(229)
Other operating (income) expense, net	<u>\$ 1,507</u>	<u>\$ (14)</u>	<u>\$ 1,267</u>	<u>\$ 39</u>

(1) See "Note 18 - Commitments and Contingencies" for further explanation.

	Three Months Ended		Six Months Ended	
	June 30, 2018	July 1, 2017	June 30, 2018	July 1, 2017
Other expense, net:				
Post-retirement income	\$ (5)	\$ (5)	(9)	(11)
Miscellaneous (income) expense	6	26	12	29
Other expense, net	<u>\$ 1</u>	<u>\$ 21</u>	<u>\$ 3</u>	<u>\$ 18</u>

NOTE 20 - FACILITY CONSOLIDATION AND SEVERANCE EXPENSES, NET

2014 Warehousing, Distribution & Manufacturing Consolidation Plan

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

To complete the Warehousing, Distribution & Manufacturing Consolidation Plan, the Company moved its Saraland rug operation from an expiring leased building to an owned facility in March 2016. The Company completed this consolidation plan during 2016. As a result of eliminating its dyeing operations in Atmore, Alabama, the Company disposed of its waste water treatment plant in

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

2014. Subsequently, after extensive testing, it was determined that the Company still had some contaminants above background levels and installed a soil cap to finalize the cleanup of the site of the Company's former waste water treatment plant.

2015 Corporate Office Consolidation Plan

In April 2015, the Company's Board of Directors approved the Corporate Office Consolidation Plan, to cover the costs of consolidating three of the Company's existing leased divisional and corporate offices to a single leased facility located in Dalton, Georgia. The Company paid a fee to terminate one of the leased facilities, did not renew a second facility and vacated the third facility. Related to the vacated facility, the Company recorded the estimated costs related to the fulfillment of its contractual lease obligation and on-going facility maintenance, net of an estimate of sub-lease expectations. Accordingly, if the estimates differ, the Company would record an additional charge or benefit, as appropriate. Costs related to the consolidation included the lease termination fee, contractual lease obligations and moving costs.

2017 Profit Improvement Plan

During the fourth quarter of 2017, the Company announced a Profit Improvement Plan to improve profitability through lower cost and streamlined decision making and aligning processes to maximize efficiency. The plan includes consolidating the management of the Company's two commercial brands, Atlas Carpet Mills and Masland Contract, under one management team, sharing operations in sales, marketing, product development and manufacturing. Specific to this plan includes focusing nearly all commercial solution dyed make-to-order production in our Atmore, Alabama operations where the Company has developed such make-to-order capabilities over the last 5 years. Further, the Company is aligning its west coast production facilities, better utilizing its west coast real estate by moving production to its Porterville, California and Atmore, Alabama operations and preparing for more efficient distribution of its west coast products. Furthermore, the Company is re-configuring its east coast distribution facilities to provide more efficient distribution of its products. In addition, the Company had reductions in related support functions such as accounting and information services.

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

	Accrued Balance at December 30, 2017	2018 Expenses To Date	2018 Cash Payments	Accrued Balance at June 30, 2018	As of June 30, 2018	
					Total Costs Incurred To Date	Total Expected Costs
Warehousing, Distribution & Manufacturing Consolidation Plan	\$ —	\$ —	\$ —	\$ —	\$ 7,440	\$ 7,440
Corporate Office Consolidation Plan	171	4	40	135	811	811
Profit Improvement Plan	\$ 334	\$ 402	\$ 653	\$ 83	\$ 1,038	\$ 1,903
Total All Plans	\$ 505	\$ 406	(1) \$ 693	\$ 218	\$ 9,289	\$ 10,154

	Accrued Balance at December 31, 2016	2017 Expenses To Date	2017 Cash Payments	Accrued Balance at July 1, 2017
Corporate Office Consolidation Plan	248	—	38	210
Profit Improvement Plan	—	—	—	—
Totals	\$ 514	\$ —	(1) \$ 242	\$ 272

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

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

NOTE 21 - DISCONTINUED OPERATIONS

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

	Three Months Ended		Six Months Ended	
	June 30, 2018	July 1, 2017	June 30, 2018	July 1, 2017
Loss from discontinued operations:				
Workers' compensation (costs) credits from former textile operations	\$ 208	\$ (82)	214	(109)
Environmental remediation (costs) credits from former textile operations	(51)	(103)	(79)	(124)
Income (loss) from discontinued operations, before taxes	\$ 157	\$ (185)	135	(233)
Income tax benefit	—	(62)	—	(81)
Income (loss) from discontinued operations, net of tax	\$ 157	\$ (123)	\$ 135	\$ (152)

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

Reserves for environmental remediation obligations are established on an undiscounted basis. The Company has an accrual for environmental remediation obligations related to discontinued operations of \$1,753 as of June 30, 2018 and \$1,746 as of December 30, 2017. The liability established represents the Company's best estimate of possible loss and is the reasonable amount to which there is any meaningful degree of certainty given the periods of estimated remediation and the dollars applicable to such remediation for those periods. The actual timeline to remediate, and thus, the ultimate cost to complete such remediation through these remediation efforts, may differ significantly from our estimates. Pre-tax cost for environmental remediation obligations classified as discontinued operations were primarily a result of specific events requiring action and additional expense in each period.

NOTE 22 - RELATED PARTY TRANSACTIONS

The Company is a party to a five-year lease with the seller of Atlas Carpet Mills, Inc. to lease three manufacturing facilities as part of the acquisition in 2014. The lessor is controlled by an associate of the Company. Rent paid to the lessor during the three and six months ended June 30, 2018 was \$251 and \$501, respectively. Rent paid to the lessor during the three and six months ended July 1, 2017 was \$251 and \$477, respectively. The lease was based on current market values for similar facilities.

The Company purchases a portion of its product needs in the form of fiber, yarn and carpet from Engineered Floors, an entity substantially controlled by Robert E. Shaw, a shareholder of the Company. An affiliate of Mr. Shaw holds approximately 7.3% of the Company's Common Stock, which represents approximately 3.3% of the total vote of all classes of the Company's Common Stock. Engineered Floors is one of several suppliers of such materials to the Company. Total purchases from Engineered Floors during the three and six months ended June 30, 2018 were approximately \$2,855 and \$4,570, respectively; or approximately 3.5% and 2.9%, respectively, of the Company's cost of goods sold. Total purchases from Engineered Floors during the three and six months ended July 1, 2017 were approximately \$1,663 and \$3,658, respectively; or approximately 2.1% and 2.4%, respectively, of the Company's cost of goods sold. Purchases from Engineered Floors are based on market value negotiated prices. The Company has no contractual commitments with Mr. Shaw associated with its business relationship with Engineered Floors. Transactions with Engineered Floors are reviewed annually by the Company's board of directors.

The Company is a party to a ten-year lease with the Rothman Family Partnership to lease a facility as part of the Robertex acquisition in 2013. The lessor is controlled by an associate of the Company. Rent paid to the lessor during the three and six months ended June 30, 2018 was \$69 and \$138, respectively. Rent paid to the lessor during the three and six months ended July 1, 2017 was \$67 and \$135, respectively. The lease was based on current market values for similar facilities. In addition, the Company had a note payable to Robert P. Rothman related to the acquisition of Robertex Inc. The note matured on June 30, 2018. (See Note 10).

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

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

FORWARD-LOOKING INFORMATION

This Report contains statements that may be considered forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended. Such statements include the use of terms or phrases such as "expects," "estimates," "projects," "believes," "anticipates," "intends," and similar terms and phrases. Such forward-looking statements relate to, among other matters, our future financial performance, business prospects, growth strategies or liquidity. The following important factors may affect our future results and could cause those results to differ materially from our historical results; these factors include, in addition to those "Risk Factors" detailed in item 1A of this report, and described elsewhere in this document, the cost and availability of capital, the cost and availability of certain specialized yarns and branded products, 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, ability to attract, develop and retain qualified personnel, 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.

OVERVIEW

Our business consists principally of marketing, manufacturing and selling floorcovering products to high-end residential and commercial customers through our various sales forces and brands. We focus exclusively on the upper-end of the floorcovering market where we believe we have strong brands and competitive advantages with our style and design capabilities and customer relationships. Our Fabrica, Masland, and Dixie Home brands have a significant presence in the high-end residential floorcovering markets. Our Atlas Carpet Mills and Masland Contract brands, participate in the upper-end specified commercial marketplace. Dixie International sells all of our brands outside of the North American market.

Our business is primarily concentrated in areas of the soft floorcovering markets which include broadloom carpet, carpet tiles and rugs. However, over the past few years, there has been a significant shift in the flooring marketplace as hard surface products have grown at a rate much faster than soft surface products. We have responded to this accelerated shift to hard surface flooring by launching several initiatives in both our residential and commercial brands. Our commercial brands offer luxury vinyl flooring ("LVF") products under the Calibré brand in the commercial markets. Our residential brands, Dixie Home and Masland Residential, offer Stainmaster® PetProtect™ luxury vinyl flooring. In this upcoming third quarter of 2018, our residential brand, Fabrica, will begin offering a high-end engineered wood line.

During the second quarter of 2018, our net sales decreased 0.7% compared with the second quarter of 2017. Sales of residential products increased 4.0% during the quarter versus prior year quarter while, we estimate, the industry was up slightly. Commercial product sales decreased 10.1% during the quarter while, we believe, the industry was down slightly. During the first six months of 2018 our net sales increased 0.3% compared with the first six months of 2017. Sales of residential products increased 5.6% during the first six months versus prior year period. Commercial product sales decreased 9.7% during the first six months of 2018 compared to the first six months of 2017.

RESULTS OF OPERATIONS

Three and Six Months Ended June 30, 2018 Compared with Three and Six Months Ended July 1, 2017

	Three Months Ended		Six Months Ended	
	June 30, 2018	July 1, 2017	June 30, 2018	July 1, 2017
Net sales	100.0 %	100.0 %	100.0 %	100.0 %
Cost of sales	76.4 %	73.5 %	77.2 %	73.8 %
Gross profit	23.6 %	26.5 %	22.8 %	26.2 %
Selling and administrative expenses	22.4 %	23.6 %	22.9 %	24.3 %
Other operating (income) expense, net	1.4 %	(0.1)%	0.6 %	—%
Facility consolidation and severance expenses, net	0.2 %	—%	0.2 %	—%
Operating income (loss)	(0.4)%	3.0 %	(0.9)%	1.9%

Net Sales

Net sales for the quarter ended June 30, 2018 were \$106.4 million, a decrease of 0.7% compared with net sales of \$107.2 million for the year-earlier quarter. In the second quarter of 2018, residential floorcovering sales increased 4.0% and net sales of commercial floorcovering decreased 10.1% compared with the second quarter of 2017.

Net sales for the six months ended June 30, 2018 were \$205.3 million, an increase of 0.3% compared to the net sales of \$204.7 million in the six months ended July 1, 2017. In the first six months of 2018, net sales of residential products increased 5.6% and net sales of commercial products decreased 9.7% compared to the first six months of 2017.

Gross Profit

Gross profit as a percentage of net sales was 23.6% in the second quarter of 2018 compared with 26.5% in the second quarter of 2017, or a 2.9 percentage point decrease as a percentage of sales. During the second quarter of 2018, our sales and costs were negatively impacted by lower sales in our commercial business contributing to under absorbed costs in our manufacturing operations. To address this issue we have launched new products through our commercial brands which we believe are being well received. In the residential business, we plan to implement a price increase in August to cover rising material and production costs. Our gross margin was further impacted by higher than normal waste, purchase price variances and distribution expenses. To this regard, we have made changes in our manufacturing operations to lower costs by better aligning staffing to demand, implemented several waste reduction initiatives, and are streamlining our operations. We also were impacted by a workers' compensation claim in the amount of \$450 thousand due to an accident at a yarn processing facility.

Gross profit declined 3.4% as a percentage of sales in the first six months of 2018 compared with the first six months of 2017.

Selling and Administrative Expenses

Selling and administrative expenses were \$23.8 million in second quarter 2018 compared with \$25.3 million in the year earlier period, a decrease of 1.2 percentage points as a percentage of sales. The lower expenses in selling and administrative areas were partially related to cost savings from the actions taken in the Profit Improvement Plan during the fourth quarter of 2017.

Selling and administrative expenses were \$46.9 million in the first six months of 2018 compared with \$49.8 million in the year earlier period. This was a decrease of 1.4% as a percentage of sales.

Other Operating (Income) Expense, Net

Other operating (income) expense, net was an expense of \$1.5 million in the second quarter of 2018 compared with net income of \$14 thousand in the second quarter of 2017. For the six months ended June 30, 2018 other operating (income) expense, net was an expense of \$1.3 million compared with an expense of \$39 thousand in the first six months of 2017. As described in Legal Proceedings, in the second quarter of 2018 we agreed to a Memorandum of Understanding with regard to a proposed settlement of a class action litigation. As a result of this agreement, we recorded a \$1.5 million charge during the period to reflect our estimate of costs related to the issues raised by the litigation.

Facility Consolidation and Severance Expenses, Net

Facility consolidation and severance expenses totaled \$190 thousand in the second quarter of 2018 and \$406 thousand for the six months ended June 30, 2018. There were no expenses recorded in the year-earlier quarter or six month period. These expenses are the result of the expenses associated with the Profit Improvement Plan which began in October 2017.

Operating Income (Loss)

We reported an operating loss of \$355 thousand in the second quarter of 2018 compared with operating income of \$3.2 million in the second quarter of 2017. During the second quarter of 2018, our sales and costs were negatively impacted by lower sales in our commercial business, contributing to unabsorbed costs in our manufacturing operations. Our gross margin was further impacted by higher than normal waste, purchase price variances and distribution expenses. We also were impacted by a large workers' compensation claim due to an accident at a yarn processing facility which resulted in a charge of \$450 thousand. To address the operational issues we have launched new products through our commercial brands during the quarter and believe they are being well received. Further we have made changes in our manufacturing operations to lower costs by better aligning staffing to demand, implemented several waste reduction initiatives, and are streamlining our distribution operations. In addition, we were impacted by a \$1.5 million charge related to the settlement of a pending class action (see legal proceedings). These items were partially offset by lower general and administrative expenses.

The first six months of 2018 ended with an operating loss of \$1.9 million compared to an operating income of \$3.8 million in the first six months of 2017.

Interest Expense

Interest expense increased \$285 thousand in the second quarter of 2018 compared with the second quarter of 2017 principally a result of higher interest rates and higher levels of debt in 2018.

Interest expense increased \$457 thousand in the first six months of 2018 compared with the first six months of 2017.

Income Tax Provision (Benefit)

On December 22, 2017, the President signed the Tax Cuts and Jobs Act (the "Tax Act"). The Tax Act, among other things, lowered the U.S. corporate income tax rate from 35% to 21% effective January 1, 2018. While we have substantially completed our provisional analysis of the income tax effects of the Tax Act and recorded a reasonable estimate of such effects during the fourth quarter of 2017, the charge related to the Tax Act may differ, possibly materially, due to, among other things, further refinement of our calculations, changes in interpretations and assumptions that we have made or additional guidance that may be issued related to the Tax Act. Pursuant to Staff Accounting Bulletin No. 118, we will complete our analysis over a one-year measurement period from the enactment date, and any adjustments during this measurement period will be included in income from continuing operations as an adjustment to income tax expense in the reporting period when such adjustments are determined.

The benefit rate applied to the pretax loss for the first six months of 2018 was 3.8% compared to the tax rate of 38.6% applied to the pretax income in the first six months of 2017. During the fourth quarter of 2017, we recorded a full valuation allowance against the deferred tax assets resulting in only refundable credits and a small amount of state taxes being recognized in the tax benefit for the first six months of 2018.

Net Income (Loss)

Continuing operations reflected a loss of \$2.0 million, or \$0.13 per diluted share, in the second quarter of 2018 compared with a profit of \$1.2 million, or \$0.08 per diluted share, in the same period in 2017. Discontinued operations reflected an income of \$157 thousand, or \$0.01 per diluted share, in the second quarter of 2018 compared with a loss of \$123 thousand, or \$0.01 per diluted share, in the same period in 2017. Including discontinued operations, we had net loss of \$1.8 million, or \$0.12 per diluted share, in the second quarter of 2018 compared with a net profit of \$1.1 million, or \$0.07 per diluted share, in the second quarter of 2017.

Continuing operations for the first six months of 2018 reflected a loss of \$4.9 million, or \$0.31 per diluted share. This compares to income from continuing operations of \$650 thousand, or \$0.04 per diluted share, in the first six months of 2017. Discontinued operations reflected an income of \$135 thousand, or \$0.01 per diluted share, for the first six months of 2018 compared with a loss of \$152 thousand, or \$0.01 per diluted share, in the first six months of 2017. Including discontinued operations, the net loss for the first six months of 2018 was \$4.7 million, or \$0.30 per diluted share, compared to a net income during the first six months of 2017 in the amount of \$498 thousand, or \$0.03 per diluted share.

LIQUIDITY AND CAPITAL RESOURCES

During the six months ended June 30, 2018, cash used in operations was \$5.2 million. Accounts receivable increased \$3.0 million and inventories increased \$8.7 million which was offset by an increase in accounts payable and accrued expenses of \$6.5 million. The increase in accounts receivable was due to the second quarter 2018 sales mix being more concentrated in our residential business which generally has more favorable selling terms. We increased inventories and accounts payable to build inventories to prepare for the summer selling season.

Capital asset acquisitions for the six months ended June 30, 2018 were \$1.4 million. Depreciation and amortization for the six months ended June 30, 2018 were \$6.3 million. We expect capital expenditures to be approximately \$6.0 million in 2018 while depreciation and amortization is expected to be approximately \$13.0 million. Planned capital expenditures in 2018 are primarily for new equipment.

During the six months ended June 30, 2018, cash provided by financing activities was \$6.6 million. We had net borrowings on our revolving credit facility and notes payable of \$10.4 million. These proceeds were offset by payments on other debt obligations of \$5.6 million. The cash provided by financing was used to fund the operations during the quarter.

We believe our operating cash flows, credit availability under our revolving credit facility and other sources of financing are adequate to finance our anticipated liquidity requirements under current operating conditions. As of June 30, 2018, the unused borrowing availability under our revolving credit facility was \$26.8 million. Our revolving credit facility requires us to maintain a fixed charge coverage ratio of 1.1 to 1.0 during any period that borrowing availability is less than \$16.5 million. As of the date hereof, our fixed charge coverage ratio was less than 1.1 to 1.0, accordingly the unused availability accessible by us was \$10.3 million (the amount above \$16.5 million) at June 30, 2018. Significant additional cash expenditures above our normal liquidity requirements or significant deterioration in economic conditions could affect our business and require supplemental financing or other funding sources. There can be no assurance that such supplemental financing or other sources of funding can be obtained or will be obtained on terms favorable to us.

Contractual Obligations

The following table summarizes our future minimum payments under contractual obligations as of June 30, 2018.

	Payments Due By Period							Total
	(dollars in millions)							
	2018	2019	2020	2021	2022	Thereafter		
Debt	\$ 2.1	\$ 2.8	\$ 1.9	\$ 107.9	\$ 1.0	\$ 8.8	124.5	
Interest - debt (1)	3.9	5.1	5.0	3.8	0.4	0.7	18.9	
Capital leases	2.4	3.9	3.8	3.1	0.9	0.2	14.3	
Interest - capital leases	0.4	0.6	0.4	0.2	—	—	1.6	
Operating leases	1.9	2.9	2.4	1.9	1.5	3.5	14.1	
Purchase commitments	2.2	—	—	—	—	—	2.2	
Totals	12.9	15.3	13.5	116.9	3.8	13.2	175.6	

(1) Interest rates used for variable rate debt were those in effect at June 30, 2018.

Changes to Critical Accounting Policies

Our critical accounting policies were outlined in Management's Discussion and Analysis of Results of Operations and Financial Condition in our 2017 Annual Report on Form 10-K filed with the Securities and Exchange Commission. During the first quarter ended March 31, 2018, we adopted the provisions of ASC 606, "Revenue from Contracts with Customers". See Note 2, Recent Accounting Pronouncements and Note 3, Revenue, in the notes to the Consolidated Condensed Financial Statements, related to the impact of the adoption on our financial statements and accounting policies.

Recent Accounting Pronouncements

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

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

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

At June 30, 2018, \$56,142, or approximately 41% of our total debt, was subject to floating interest rates. A one-hundred basis point fluctuation in the variable interest rates applicable to this floating rate debt would have an annual after-tax impact of approximately \$415.

Item 4. Controls and Procedures

We maintain disclosure controls and procedures to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Commission's rules and forms and is accumulated and communicated to management, including our principal executive officer and principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Our management, under the supervision and with the participation of our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as such terms are defined in Rules 13(a)-15(e) and 15(d)-15(e)) under the Securities Exchange Act of 1934, as amended (the "Exchange Act") as of June 30, 2018, the date of the financial statements included in this Form 10-Q (the "Evaluation Date"). Based on that evaluation, our CEO and CFO concluded that our disclosure controls and procedures were effective as of the Evaluation Date.

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

Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures, as well as diverse interpretation of U. S. generally accepted accounting principles by accounting professionals. It is also possible that internal control over financial reporting can be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements

may not be prevented or detected on a timely basis by internal control over financial reporting. Furthermore, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. These inherent limitations are known features of the financial reporting process; therefore, while it is possible to design into the process safeguards to reduce such risk, it is not possible to eliminate all risk.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

We have been sued, together with the 3M Company and approximately 30 other carpet manufacturers, by the Gadsden (Alabama) Water Works in the circuit court of Etowah County Alabama [The Water Works and Sewer Board of the City of Gadsden v. 3M Company, et al, civil action No. 31-CV-2016-900676.00] and by the Town of Centre (Alabama) Water Works in the circuit court of Cherokee County Alabama [The Water Works and Sewer Board of the Town of Centre v. 3M Company, et al, civil action No. 13-CV-2017-900049.00]. Both cases seek monetary damages and injunctive relief related to the use of certain chemical compounds in the manufacture and finishing of carpet products “in and around Dalton Georgia.” On motion of the defendants, the cases were removed to the U.S. District Court for the Northern District of Alabama (Middle Division) Case No. 4:16-CV-01755-SGC and Case No. 4:17-CV-01026-KOB. Subsequently, the Gadsden Water Works filed a motion to have the case remanded back to the state court and such motion has been granted. The lawsuits allege that perfluorinated compounds (“PFC”), perfluorinated acid (“PFOA”) and perfluorooctane sulfonate (“PFOS”) manufactured by 3M were used in certain finishing and treatment processes by the defendants and, as a consequence of such use, were subsequently either discharged into or leached into the water systems around Dalton, Georgia. The Complaints seeks damages that exceed \$10,000, but are otherwise unspecified in amount in addition to injunctive relief and punitive damages. We intend to defend the matters vigorously and are unable to estimate our potential exposure to loss, if any, at this time.

As of June 25, 2018, the Company and the Class Representative, as a result of court ordered mediation, have agreed to a Memorandum of Understanding regarding settlement of the class action litigation styled Carlos Garcia v. Fabrica International, Inc. et al Orange County Superior Court Case No. 30-2017-00949461-CU-OE-CXC. The parties have agreed during the quarter to file a motion for approval of a memorandum of understanding with the court in which the case is pending, and to finalize a definitive settlement agreement subject to court approval. The required court approval of the settlement is expected to occur within the next quarter. During the quarter ended June 30, 2018, the Company has recorded costs of approximately \$1.5 million to reflect our estimate of the costs related to such issues.

We are one of multiple parties to a current lawsuit filed in Madison County Illinois styled Danny Atkins and Pamela Atkins, Pltfs., vs. Aurora Pump Company, et al. No. 18-L-2. The lawsuit entails a claim for damages to be determined in excess of \$50,000 filed on behalf of a former employee that alleges that the deceased contracted mesothelioma as a result of exposure to asbestos while employed by us. Discovery in the matter is ongoing. We have denied liability, are defending the matters vigorously and are unable to estimate our potential exposure to loss, if any, at this time. In March of 2018, a similar lawsuit styled Charles Anderson, Pltf., vs. 3M Company, et al, No. 17-L-525 was dismissed. In May of 2018, the lawsuit styled Brenda Bridgeman, Individually and as Special Administrator of the Estate of Robert Bridgeman, Deceased, vs. American Honda Motor Co., Inc., f/k/a Metropolitan Life Insurance Co. et al No. 15-L-374 was placed in the category of “special closed with settlements and bankruptcy claims pending” to all remaining defendants.

On April 24th, 2018, subsequent to the end of the first quarter, a law firm claiming to represent one of our shareholders owning 50 shares, sent a request for information concerning our equity incentive plans, and equity awards granted under those plans to our chairman and to our chief operating officer, alleging that the law firm is investigating “possible breaches of fiduciary duty” in approving such plans and such awards. All such equity plans were approved by shareholders, and all such awards were made in accordance with the applicable terms of the plans. We have responded to the request in accordance with applicable law. No claim or suit has been filed.

Item 1A. Risk Factors

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

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

The floorcovering industry, in which we participate, is highly dependent on general economic conditions, such as consumer confidence and income, corporate and government spending, interest rate levels, availability of credit and demand for housing. We derive a majority of our sales from the replacement segment of the market. Therefore, economic changes that result in a significant

or prolonged decline in spending for remodeling and replacement activities could have a material adverse effect on our business and results of operations.

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

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

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

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

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

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

The floorcovering industry is highly competitive. We face competition from a number of domestic manufacturers and independent distributors of floorcovering products and, in certain product areas, foreign manufacturers. Significant consolidation within the floorcovering industry has caused a number of our existing and potential competitors to grow significantly larger and have greater access to resources and capital than we do. Maintaining our competitive position may require us to make substantial additional investments in our product development efforts, manufacturing facilities, distribution network and sales and marketing activities. These additional investments may be limited by our access to capital, as well as restrictions set forth in our credit facilities. Competitive pressures, stylistic changes in the market, and the accelerated growth of hard surface alternatives have resulted in decreased market demand for soft floorcovering products and the industry has seen a loss of market share to hard surface products. As a result, competition from providers of other soft surfaces has intensified and may result in decreased demand for our products. In addition, we face, and will continue to face, competitive pressures on our sales price and cost of our products. As a result of any of these factors, there could be a material adverse effect on our sales and profitability.

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

A significant amount of our sales are generated through certain retail and mass merchant channels of distribution. A significant reduction of sales through such channels could adversely affect our business.

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

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

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

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

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

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

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

Our businesses rely on sophisticated systems to obtain, rapidly process, analyze and manage data. We rely on these systems to, among other things facilitate the purchase, manufacture and distribution of our products; receive, process and ship orders on a timely basis; and to maintain accurate and up-to-date operating and financial data for the compilation of management information. We rely on our computer hardware, software and network for the storage, delivery and transmission of data to our sales and distribution systems, and certain of our production processes are managed and conducted by computer. Any damage by unforeseen events or system failure which causes interruptions to the input, retrieval and transmission of data or increase in the service time, whether caused by human error, natural disasters, power loss, computer viruses, intentional acts of vandalism, various forms of cybercrimes including and not limited to hacking, intrusions and malware or otherwise, could disrupt our normal operations. There can be no assurance that we can effectively carry out our disaster recovery plan to handle the failure of our information systems, or that we will be able to restore our operational capacity within sufficient time to avoid material disruption to our business. The occurrence of any of these events could cause unanticipated disruptions in service, decreased customer service and customer satisfaction and harm to our reputation, which could result in loss of customers, increased operating expenses and financial losses. Any such events could in turn have a material adverse effect on our business, financial condition, results of operations, and prospects.

The long-term performance of our business relies on our ability to attract, develop and retain qualified personnel.

To be successful, we must attract, develop and retain qualified and talented personnel in management, sales, marketing, product design and operations. We compete with other floorcovering companies for these employees and invest resources in recruiting, developing, motivating and retaining them. The failure to attract, develop, motivate and retain key employees could negatively affect our business, financial condition and results of operations.

We are subject to various governmental actions that may interrupt our supply of materials.

We import most of our luxury vinyl flooring ("LVF"), some of our wood offering, some of our rugs and broadloom offerings. Though currently a small part of our business, the growth in LVF products is an important product offering to provide our customers a complete selection of flooring alternatives. Recently there have been trade proposals that threatened these product categories with added tariffs which would make our offerings less competitive compared to those manufactured in other countries or produced domestically. These proposals, if enacted, or if expanded, or imposed for a significant period of time, would materially interfere with our ability to successfully enter into these product categories and could have a material adverse effect upon the company's cost of goods and results of operations.

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

We are subject to various environmental, safety and health and other regulations that may subject us to costs, liabilities and other obligations which could have a material adverse effect on our business. The applicable requirements under these laws are subject to amendment, to the imposition of new or additional requirements and to changing interpretations of agencies or courts. We could

incur material expenditures to comply with new or existing regulations, including fines and penalties and increased costs of our operations. Additionally, future laws, ordinances, regulations or regulatory guidelines could give rise to additional compliance or remediation costs that could have a material adverse effect on our business, results of operations and financial condition. For example, in California producer responsibility regulations regarding end-of-life disposal have imposed additional costs and complexity to our business and could result in lower sales or decreased profitability of those products sold in that state.

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

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

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

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

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

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

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

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

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

Many of our business activities involve substantial investments in manufacturing facilities and many products are produced at a limited number of locations. These facilities could be materially damaged by natural disasters, such as floods, tornadoes, hurricanes and earthquakes, or by fire or other unexpected events such as adverse weather conditions or other disruptions to our facilities, supply chain or our customer's facilities. We could incur uninsured losses and liabilities arising from such events, including damage to our reputation, and/or suffer material losses in operational capacity, which could have a material adverse impact on our business, financial condition and results of operations.

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

Repurchases of Common Stock

The following table provides information regarding our repurchases of our Common Stock Shares during the three months ended June 30, 2018:

Fiscal Month Ending	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or approximate dollar value) of Shares That May Yet Be Purchased Under Plans or Programs
May 5, 2018	400	\$ 2.95	400	
June 2, 2018	100	2.70	100	
June 30, 2018	—	—	—	
Three Months Ended June 30, 2018	500	\$ 2.90	500	\$ 2,170,597

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not Applicable.

Item 5. Other Information

None.

Item 6. Exhibits

(a.) Exhibits

- 31.1 [CEO Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.](#)
- 31.2 [CFO Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.](#)
- 32.1 [CEO Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.](#)
- 32.2 [CFO Certification pursuant to 18 U.S. C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.](#)
- 10.1 [Memorandum of Understanding, Carlos Garcia v. Fabrica Internacional, Inc., et al. \(Filed herewith\)](#)
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema Document
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

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: August 2, 2018

By: /s/ JON A. FAULKNER

Jon A. Faulkner

Vice President and Chief Financial Officer

MEMORANDUM OF UNDERSTANDING

Carlos Garcia v. Fabrica International, Inc., et al.

Orange County Superior Court Case No. 30-2017-00949461-CU-OE-CXC

1. This Memorandum of Understanding ("MOU") is entered into by and between Plaintiff Carlos Garcia ("Plaintiff"), on behalf of himself and all other current and former hourly employees, and defendant Fabrica International, Inc. ("Defendant"), to settle the putative class and representative action currently pending in the Orange County Superior Court (the "Garcia Action"). Plaintiff will file a Second Amended Complaint to include claims the additional wage and hour claims contemplated by the settlement, including, but not limited to, claims relating to Defendant's time keeping practices.
 2. The Settlement Class shall include all current and former hourly employees employed by Defendant during the Class Period (collectively, the "Settlement Class").
 3. The "Class Period" is defined as the period from October 12, 2013 through the date the Court enters a preliminary approval order for this settlement.
 4. Within 14 days of the date on which this MOU is fully executed, Plaintiff shall file the Second Amended Complaint in conformity with the terms herein. Defendant shall not be required to file an Answer or other Responsive Pleading. Plaintiff agrees that no default shall be taken nor shall there be any other pleadings filed without mutual consent of the Parties.
 5. In consideration for the release contemplated by the settlement, Defendant shall pay a Gross Settlement Amount ("GSA") of \$1,500,000. Defendant shall make the settlement payment 180 days after the date of final approval of the settlement.
 6. The Settlement shall be an "all in," non-reversionary settlement. The Parties will agree upon an allocation formula for individual settlement payments in the long-form settlement agreement.
 - a. Defendant will not object to a request for attorneys' fees by class counsel of up to 1/3 of the GSA.
 - b. Defendant will not object to reimbursement of class counsel's out-of-pocket costs up to \$25,000 from the GSA.
 - c. Defendant will not object to a service award to Plaintiff in the amount of \$5,000 to be paid out of the GSA and to be reported on an IRS 1099 basis.
 - d. The Parties agree that reasonable settlement administration costs will also be deducted - from the GSA, and the Parties agree that a qualified settlement administrator as may be selected by the Parties to serve as the Settlement Administrator. The settlement administration fees would be bid out and paid from the GSA and the Parties agree to solicit bids from several qualified settlement administrators. These settlement administration costs are estimated to be no more than \$25,000. Prior to mailing, the
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Settlement Administrator will perform a search based on the National Change of Address Database information to update and connect for any known or identifiable address changes.

- e. The Parties agree to a PAGA allocation of \$50,000 of which 75% shall be remitted to the LWDA for its statutorily-set portion of the PAGA penalties and the remaining 25% shall be distributed to the Settlement Class as part of the Net Settlement Amount.
 - f. To the extent that Individual Settlement Payment checks are uncashed 180 days after the date listed on the check, the amount of uncashed checks will escheat to the State of California's unclaimed property program.
 - g. The Net Settlement Amount shall be allocated in the following fashion: 20% toward wages, 40% toward penalties and 40% toward interest. Defendant shall pay the employer's portion of payroll taxes on the wage allocation outside of the GSA.
7. Plaintiff and all other Settlement Class members will release and discharge Defendant, and any of its, former and present parents, subsidiaries, and affiliates, and their officers, directors, managers, owners, executives, partners, employees, shareholders, agents, attorneys, and any other successors, assigns, or legal representatives, ("Released Parties"), from the claims alleged in the Action, including any potential claims reasonably related to the claims in the Action, arising during the Class Period, including state wage and hour claims, claims for wages, fees, over time, minimum wage, on-duty meal periods, off-duty meal periods, off-duty rest periods, timely payment violations, accurate and complete wage statements violations, wages and all claims under the Private Attorneys General Act of 2004 based on the foregoing. This release includes claims alleging violations of Labor Code §§ 201, 201.3, 202, 203, 204, 210, 226, 226.3, and 226.7, et seq.; Labor Code §§ 510, 512, 558, et seq.; Labor Code §§ 1194, 1197.1, 1198, 1199, et seq., and 2698 et seq.; and Sections 11 and 12 of the applicable IWC Wage Order.
8. The Net Settlement Amount ("NSA") is the GSA minus all the deductions and subject to the terms referenced in paragraph 6. The Class Representative's service award will be in addition to his allocated portion of the NSA and shall be reported on an IRS 1099 basis. Class members will be provided with information used to calculate their individual settlement payment. Settlement Class members will be provided with notice of the Settlement, which shall summarize the terms of the Settlement and advise them of their right to opt out, object, appear at the fairness hearing, or challenge the information in Defendant's records on which their estimated settlement payment shall be based.
9. The NSA will be allocated as follows: (1) 20% to wages and reported on an IRS W-2 basis and (2) 80% to non-wage penalties and interest, to be reported on an IRS form 1099. Defendant agrees to fund the employer's portion of the payroll taxes on the portion of settlement awards allocated to W2 wages which will be computed and paid by the Settlement Administrator but funded separately and in addition to the GSA.
10. The Parties agree to use reasonable commercial efforts to finalize a long-form Settlement Agreement within 30 days of the execution of this MOU and Plaintiff will promptly file a
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motion for preliminary approval of the settlement thereafter. Plaintiff's counsel will prepare the initial drafts of the long-form Settlement Agreement, class notice, and claim form. Plaintiff's counsel will prepare the motion for preliminary approval, and supporting papers, and motion for final approval, and supporting papers, and Defendant agrees not to oppose the motion as long as Defendant is provided with an opportunity to review the papers in a reasonable time period before they are filed and provided they comport with this MOU, the long-form Settlement Agreement, and the facts of the Action.

11. The Effective Date of this settlement shall be the later of the time when: (i) the date of final affirmance of the Judgment on an appeal of the Judgment, the expiration of the time for, or the denial of, a petition to review the Judgment, or if review is granted, the date of final affirmance of the Judgment following review pursuant to that grant, (ii) the date of final dismissal of any appeal from the Judgment or the final dismissal of any proceeding to review the Judgment, provided that the Judgment is affirmed and/or not reversed in any party, (iii) the final resolution (or withdrawal) of any filed appeal in a way that affirms the Final Approval Order and Judgment in a form substantially identical to the form of the Final Approval Order entered by the Court, and the time to petition for review with respect to any appellate decision affirming the Final Approval Order has expired; or (iv) if no appeal is filed, the sixty-first (61st) day after the Court enters final approval of the settlement and the Judgment approving this Agreement. ("Effective Settlement Date").
 12. In the event that the Court fails to approve the settlement, or if the appropriate appellate court fails to approve the settlement or if the Settlement Agreement is otherwise terminated: (1) the Settlement Agreement shall have no force and effect and the Parties shall be restored to their respective positions prior to entering into it, and no Party shall be bound by any of the terms of the Settlement Agreement; (2) Defendant shall have no obligation to make any payments to the Settlement Class members, the Settlement Administrator, the LWDA, Plaintiff or Plaintiff's counsel; (3) any preliminary approval order, final approval order or judgment, shall be vacated; and (4) the Settlement Agreement and all negotiations, statements, proceedings and data relating thereto shall be deemed confidential mediation settlement communications and not subject to disclosure for any purpose in any proceeding.
 13. If either (i) 10% or more of the Settlement Class members, or, (ii) a number of Settlement Class members whose share of the Class Settlement Proceeds is 10% or more elect not to participate in the settlement or both (i) and (ii), Defendant may, at its election, rescind the settlement and all actions taken in its furtherance of it will be thereby null and void. Defendant must exercise this right of rescission, in writing, to Class Counsel, within 30 calendar days after the Settlement Administrator notifies the Parties of the total number of opt-outs. If the option to rescind is exercised, then Defendant shall be solely responsible for all costs of the claims administration accrued to that point.
 14. This is a binding and enforceable agreement. Notwithstanding anything else contained herein, this MOU shall be enforceable under California Code of Civil Procedure section 664.6 and admissible under California Evidence Code section 1123(a). Regardless of any settlement privilege or other rules of evidence, this MOU may be admitted in Court and enforceable even if a finalized settlement document cannot be agreed upon.
 15. Neither this MOU, nor final form of the Settlement Agreement, will constitute an admission by Defendant of any form of liability or the accuracy of any fact or allegation against it.
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16. Escalator Clause: Defendant represents that there are 54,000 workweeks worked by settlement class members during the Class Period. If the number of workweeks worked by settlement class members during the Class Period is more than 10% greater than this figure (i.e., if there are 59,400 or more workweeks worked by settlement class members), Defendant agrees to increase the Maximum Settlement Amount on a proportional basis (i.e., if there was a 12% increase in the number of workweeks worked by settlement class members, Defendant would agree to increase the Maximum Settlement Amount by 2%).
17. The Parties and their counsel agree that they will not issue any press releases, initiate any contact with the press, respond to any press inquiry or make any public communication about the fact, amount or terms of the settlement, except, however, that the Released Parties may make disclosures as required by law. Any communication about the settlement to Settlement Class members may not be made prior to the court-approved mailing.

Dated: June 21, 2018

Plaintiff: Defendant:

Carlos Garcia
Class Representative

Fabrica International, Inc.
By: _____

Its: _____

Approved as to form and content:

HAINES LAW GROUP, APC

CAROTHERS DiSANTE & FREUDENBERG LLP

/s/ Sean M. Blakely, Esq.

Paul K. Haines, Esq. Sean M. Blakely, Esq.

Timothy M.

Freudenberger, Esq.
Amy S. Williams, Esq.

Kimberly M. Jansen, Esq.

Counsel for Plaintiff and the Settlement Class Counsel for Defendant

15. Neither this MOU, nor final form of the Settlement Agreement, will constitute an admission by Defendant of any form of liability or the accuracy of any fact or allegation against it.
16. Escalator Clause: Defendant represents that there are 54,000 workweeks worked by settlement class members during the Class Period. If the number of workweeks worked by settlement class members during the Class Period is more than 10% greater than this figure (i.e, if there are 59,400 or more workweeks worked by settlement class members), Defendant agrees to increase the Maximum Settlement Amount on a proportional basis (i.e., if there was a 12% increase in the number of workweeks worked by settlement class members, Defendant would agree to increase the Maximum Settlement Amount by 2%). -
17. The Parties and their counsel agree that they will not issue any press releases, initiate any contact with the press, respond to any press inquiry or make any public communication about the fact, amount or terms of the settlement, except, however, that the Released Parties may make disclosures as required by law. Any communication about the settlement to Settlement Class members may not be made prior to the court-approved mailing.

Dated: June 21, 2018

Plaintiff: Defendant:

_____ /s/ W. Derek Davis

Carlos Garcia Fabrica International, Inc
Class Representative By: W. Derek Davis

Its: Vice President Human Resources
and Corporate Secretary

Approved as to form and content:

HAINES LAW GROUP, APC

CAROTHERS DiSANTE & FREUDENBERG LLP

Paul K. Haines, Esq. Sean M. Blakely, Esq.

Timothy M. Freudenberger, Esq.
Amy S. Williams, Esq.

Counsel for Plaintiff and the Settlement Class /s/ Kimberly M. Jansen, Esq. Kimberly M. Jansen, Esq.

Counsel for Defendant

EXHIBIT 31.1

Certification of Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Daniel K. Frierson, certify that:

1. I have reviewed this quarterly report on Form 10-Q of The Dixie Group, Inc.;
2. Based on my knowledge, this 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 report;
3. Based on my knowledge, the financial statements, and other financial information included in this 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 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-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, 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 report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 2, 2018

/s/ DANIEL K. FRIERSON

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

EXHIBIT 31.2

Certification of Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Jon A. Faulkner, certify that:

1. I have reviewed this quarterly report on Form 10-Q of The Dixie Group, Inc.;
2. Based on my knowledge, this 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 report;
3. Based on my knowledge, the financial statements, and other financial information included in this 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 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-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, 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 report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 2, 2018

/s/ JON A. FAULKNER

Jon A. Faulkner
Chief Financial Officer
The Dixie Group, Inc.

EXHIBIT 32.1

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of The Dixie Group, Inc. (the "Company") on Form 10-Q for the quarter ended June 30, 2018, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Daniel K. Frierson, the Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

- (1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ DANIEL K. FRIERSON

Daniel K. Frierson, Chief Executive Officer

Date: August 2, 2018

A signed original of this written statement required by Section 906 has been provided to The Dixie Group, Inc. and will be retained by The Dixie Group, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

EXHIBIT 32.2

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of The Dixie Group, Inc. (the "Company") on Form 10-Q for the quarter ended June 30, 2018, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Jon A. Faulkner, the Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

(1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ JON A. FAULKNER

Jon A. Faulkner, Chief Financial Officer

Date: August 2, 2018

A signed original of this written statement required by Section 906 has been provided to The Dixie Group, Inc. and will be retained by The Dixie Group, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

