DIXIE GROUP INC
Form 10-Q
August 08, 2007

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

Form 10-Q

(Mark One)

S

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

For the quarterly period ended: **June 30, 2007**

or

o

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

For the transition period from _____ to _____

Commission File Number: 0-2585

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

Tennessee		**62-0183370**
(State or other jurisdiction of incorporation or organization)		(I.R.S. Employer Identification No.)
104 Nowlin Lane, Suite 101, Chattanooga, TN	**37421**	**(423) 510-7000**

(Address of principal executive offices)	(zip code)	(Registrant's telephone number, including area code)

Not Applicable

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

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

S Yes o No

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

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

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

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

Class	Outstanding as of July 27, 2007
Common Stock, $3 Par Value	12,238,876 shares
Class B Common Stock, $3 Par Value	877,539 shares
Class C Common Stock, $3 Par Value	0 shares

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

THE DIXIE GROUP, INC.

CONSOLIDATED CONDENSED BALANCE SHEETS

(dollars in thousands)

	(Unaudited) June 30, 2007	December 30, 2006
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	**$ 150**	$ 538
Accounts receivable (less allowance for doubtful accounts of $602 for 2007 and $651 for 2006)	**38,686**	30,922
Inventories	**77,405**	69,600
Other current assets	**10,739**	7,652
TOTAL CURRENT ASSETS	**126,980**	108,712
PROPERTY, PLANT AND EQUIPMENT		
Land and improvements	**6,075**	6,047
Buildings and improvements	**45,642**	45,407
Machinery and equipment	**121,192**	113,673
	172,909	165,127
Less accumulated depreciation and amortization	**(73,328)**	(66,729)
NET PROPERTY, PLANT AND EQUIPMENT	**99,581**	98,398
OTHER ASSETS		
Goodwill	**56,852**	56,960
Other long-term assets	**14,787**	13,604
TOTAL OTHER ASSETS	**71,639**	70,564
TOTAL ASSETS	**$ 298,200**	$ 277,674
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	**$ 14,196**	$ 8,382
Accrued expenses	**22,117**	19,541

	Current portion of long-term debt		**8,231**	7,663
	TOTAL CURRENT LIABILITIES		**44,544**	35,586
LONG-TERM DEBT				
	Senior indebtedness		**67,353**	57,780
	Capital lease obligations		**3,254**	3,937
	Convertible subordinated debentures		**17,162**	19,662
	TOTAL LONG-TERM DEBT		**87,769**	81,379
DEFERRED INCOME TAXES			**11,902**	11,697
OTHER LONG-TERM LIABILITIES			**14,546**	13,334
COMMITMENTS AND CONTINGENCIES			**---**	---
STOCKHOLDERS' EQUITY				
	Common Stock ($3 par value per share): Authorized 80,000,000 shares, issued - 15,637,721 shares for 2007 and 15,506,664 shares for 2006		**46,913**	46,520
	Class B Common Stock ($3 par value per share): Authorized 16,000,000 shares, issued - 877,539 for 2007 and 829,825 shares for 2006		**2,633**	2,489
	Additional paid-in capital		**134,899**	134,469
	Retained earnings		**8,906**	6,297
	Accumulated other comprehensive income (loss)		**177**	(8)
			193,528	189,767
	Less Common Stock in treasury at cost - 3,398,845 shares for 2007 and 2006		**(54,089)**	(54,089)
	TOTAL STOCKHOLDERS' EQUITY		**139,439**	135,678
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY		**$**	**298,200**	$ 277,674

See accompanying notes to the consolidated condensed financial statements.

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THE DIXIE GROUP, INC.

CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS

(UNAUDITED)

(dollars in thousands, except per share data)

	Three Months Ended		Six Months Ended	
	June 30, 2007	July 1, 2006	**June 30, 2007**	July 1, 2006
Net sales	**$ 84,403**	$ 88,046	**$ 158,893**	$ 167,219
Cost of sales	**58,140**	63,296	**110,811**	120,271
Gross profit	**26,263**	24,750	**48,082**	46,948
Selling and administrative expenses	**20,543**	18,795	**40,321**	38,011
Other operating income	**(82)**	(228)	**(110)**	(570)
Other operating expense	**144**	130	**269**	286
Defined benefit pension plan termination expenses	**---**	3,249	**---**	3,249
Operating income	**5,658**	2,804	**7,602**	5,972
Interest expense	**1,669**	1,944	**3,226**	3,711
Other income	**(22)**	(95)	**(37)**	(108)
Other expense	**13**	50	**31**	54
Income from continuing operations before taxes	**3,998**	905	**4,382**	2,315
Income tax provision (benefit)	**1,442**	(123)	**1,589**	362
Income from continuing operations	**2,556**	1,028	**2,793**	1,953
Loss from discontinued operations, net of tax	**(118)**	(84)	**(184)**	(174)
Net income	**$ 2,438**	$ 944	**$ 2,609**	$ 1,779
BASIC EARNINGS (LOSS) PER SHARE:				

Continuing operations	**$ 0.20**	$ 0.08	**$ 0.22**	$ 0.15
Discontinued operations	**(0.01)**	(0.01)	**(0.02)**	(0.01)
Net income	**$ 0.19**	$ 0.07	**$ 0.20**	$ 0.14
SHARES OUTSTANDING	**12,828**	12,689	**12,799**	12,660
DILUTED EARNINGS (LOSS) PER SHARE:				
Continuing operations	**$ 0.20**	$ 0.08	**$ 0.21**	$ 0.15
Discontinued operations	**(0.01)**	(0.01)	**(0.01)**	(0.01)
Net income	**$ 0.19**	$ 0.07	**$ 0.20**	$ 0.14
SHARES OUTSTANDING	**13,010**	12,943	**12,993**	12,939
DIVIDENDS PER SHARE:				
Common Stock	**---**	**---**	**---**	**---**
Class B Common Stock	**---**	**---**	**---**	**---**

See accompanying notes to the consolidated condensed financial statements.

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THE DIXIE GROUP, INC.

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

(dollars in thousands)

	Six Months Ended	
	June 30, 2007	July 1, 2006
CASH FLOWS FROM OPERATING ACTIVITIES		
Income from continuing operations	**$ 2,793**	$ 1,953
Loss from discontinued operations	**(184)**	(174)
Net income	**2,609**	1,779
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	**6,761**	5,731
Change in deferred income taxes	**(565)**	546
Tax benefit from exercise of stock options	**(134)**	(191)
Net loss (gain) on property, plant and equipment disposals	**2**	(24)
Stock-based compensation expense	**627**	311
Changes in operating assets and liabilities:		
Accounts receivable	**(7,764)**	(6,663)
Inventories	**(7,805)**	(659)
Accounts payable and accrued expenses	**8,390**	1,200
Other operating assets and liabilities	**(2,068)**	(2,305)
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	**53**	(275)
CASH FLOWS FROM INVESTING ACTIVITIES		
Net proceeds from sales of property, plant and equipment	**---**	26
Purchases of property, plant and equipment	**(7,799)**	(10,753)
NET CASH USED IN INVESTING ACTIVITIES	**(7,799)**	(10,727)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net borrowings on credit line	**8,665**	8,987
Payments on term loan	**(855)**	(997)
Borrowings from equipment financing	**3,419**	6,456

Payments on equipment financing		**(1,021)**		(579)
Payments on capitalized leases		**(637)**		(552)
Payments on mortgage note payable		**(113)**		(106)
Payments on subordinated indebtedness		**(2,500)**		(2,500)
Common stock issued under stock option plans		**266**		699
Common stock acquired for treasury		**---**		(45)
Tax benefits from exercise of stock options		**134**		191
NET CASH PROVIDED BY FINANCING ACTIVITIES		**7,358**		11,554
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS		**(388)**		552
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD		**538**		**---**
CASH AND CASH EQUIVALENTS AT END OF PERIOD	**$**	**150**	$	552
Supplemental Cash Flow Information:				
Interest paid	**$**	**3,283**	$	3,701
Income taxes paid, net of tax refunds		**206**		380

See accompanying notes to the consolidated condensed financial statements.

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THE DIXIE GROUP, INC.

CONSOLIDATED CONDENSED STATEMENT OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME

(dollars in thousands)

.	Common Stock and Class B Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Common Stock in Treasury	Total Stockholders' Equity
Balance at December 30, 2006	**$ 49,009**	**$ 134,469**	**$ 6,297**	**$ (8)**	**$ (54,089)**	**$ 135,678**
Common Stock and Class B issued under stock option plan - 64,782 net shares	226	40	---	---	---	266
Restricted stock grants issued - 108,720 shares	326	(326)	---	---	---	---
Restricted stock grants forfeited - 5,249 shares	(15)	15	---	---	---	---
Tax benefit from exercise of stock options	---	134	---	---	---	134
Stock-based compensation expense	---	567	---	---	---	567

Comprehensive Income:						
Net income	---	---	2,609	---	---	2,609
Unrealized gain on interest rate swap agreements, net of tax of $113	---	---	---	185	---	185
Total Comprehensive Income	---	---	2,609	185	---	2,794
Balance at June 30, 2007	**$ 49,546**	**$ 134,899**	**$ 8,906**	**$ 177**	**$ (54,089)**	**$ 139,439**

See accompanying notes to the consolidated condensed financial statements.

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THE DIXIE GROUP, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(UNAUDITED)

(dollars in thousands, except per share data)

NOTE A - BASIS OF PRESENTATION

The accompanying unaudited consolidated condensed financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial statements which do not include all the information and footnotes required by such accounting principles for annual financial statements. In the opinion of management, all adjustments (generally consisting of normal recurring accruals) considered necessary for a fair presentation have been included in the accompanying financial statements. The financial statements should be read in conjunction with the financial statements and notes thereto included in the Company's 2006 Annual Report on Form 10-K/A filed with the Securities and Exchange Commission, which includes consolidated financial statements for the fiscal year ended December 30, 2006. Operating results for the three month and six month periods ended June 30, 2007 are not necessarily indicative of the results that may be expected for the entire 2007 year.

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

NOTE B - RECENT ACCOUNTING PRONOUNCEMENTS

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

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

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

The Statement permits all entities to choose the fair value measurement option at specified election dates, after which the entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings, at each subsequent reporting date. The fair value option may be applied instrument by instrument; however, the election is irrevocable and may apply only to entire instruments and not to portions of instruments. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating its options under this statement.

NOTE C - SHARE-BASED PAYMENTS

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

On March 2, 2007, the Company granted 108,720 shares of restricted stock to officers of the Company. The grant-date fair value of the awards was $1,425, or $13.11 per share. The shares will vest over terms ranging from 2 to 20 years. Each award is subject to a continued service condition. The fair value of each share of restricted stock awarded was equal to the market value of a share of the Company's Common Stock on the grant date.

The Company's stock compensation expense was $399 and $627 for the three and six months ended June 30, 2007 and $193 and $311 for the three and six months ended July 1, 2006, respectively.

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THE DIXIE GROUP, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(UNAUDITED)

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

NOTE D - ACCOUNTS RECEIVABLE

Receivables are summarized as follows:

	June 30, 2007	December 30, 2006
Customers, trade	**$ 37,035**	$ 28,278
Other	**2,253**	3,295
Gross receivables	**39,288**	31,573
Less allowance for doubtful accounts	**(602)**	(651)
Net receivables	**$ 38,686**	$ 30,922

The Company also had notes receivable in the amount of $501 and $589 at June 30, 2007 and December 30, 2006, respectively. The current portion of the notes receivable is included in accounts receivable and the long-term portion is included in other long-term assets in the Company's consolidated condensed balance sheets.

NOTE E - INVENTORIES

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

	June 30, 2007	December 30, 2006
Raw materials	**$ 26,388**	$ 21,678
Work-in-process	**16,997**	15,210
Finished goods	**44,467**	41,107
Supplies, repair parts and other	**440**	410
LIFO	**(10,887)**	(8,805)
Total inventories	**$ 77,405**	$ 69,600

NOTE F - DISCONTINUED OPERATIONS

Following is a summary of the Company's discontinued operations:

	Three Months Ended		Six Months Ended	
	June 30, 2007	July 1, 2006	**June 30, 2007**	July 1, 2006
Loss from discontinued operations:				
Before income taxes	**$ (184)**	$ (138)	**$ (287)**	$ (276)
Income tax benefit	**(66)**	(54)	**(103)**	(102)
Loss from discontinued operations, net of tax	**$ (118)**	$ (84)	**$ (184)**	$ (174)

The losses from discontinued operations in 2007 and 2006 principally related to the settlement of contingencies that had been retained by the Company in connection with the sales of the Company's factory-built housing carpet, needlebond and carpet recycling businesses sold in 2003 and 2004 and the Company's textile operations in 1999 and prior years.

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THE DIXIE GROUP, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(UNAUDITED)

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

NOTE G - ACCRUED EXPENSES

Accrued expenses are summarized as follows:

	June 30, 2007	December 30, 2006
Compensation and benefits	**$ 5,645**	$ 5,768
Provision for customer rebates, claims and allowances	**5,410**	4,968
Outstanding checks in excess of cash	**4,289**	4,193
Other	**6,773**	4,612
Total accrued expenses	**$ 22,117**	$ 19,541

NOTE H - PRODUCT WARRANTY RESERVES

The Company warrants its products against manufacturing defects and failure to meet specific performance standards. The Company records reserves for the estimated costs of defective products and failure of its products to meet applicable performance standards at the time sales are recorded. The levels of reserves are established based primarily upon historical experience and evaluation of known claims. Following is a summary of the Company's warranty activity:

	Three Months Ended		Six Months Ended	
	June 30, 2007	July 1, 2006	**June 30, 2007**	July 1, 2006
Warranty reserve beginning of period	**$ 1,354**	$ 1,091	**$ 1,276**	$ 1,109
Warranty liabilities accrued	**1,165**	1,476	**2,044**	2,778
Warranty liabilities settled	**(1,033)**	(1,593)	**(1,965)**	(3,041)
Changes for pre-existing warranty liabilities	**10**	240	**141**	368
Warranty reserve end of period	**$ 1,496**	$ 1,214	**$ 1,496**	$ 1,214

NOTE I - LONG-TERM DEBT AND CREDIT ARRANGEMENTS

Long-term debt consists of the following:

		June 30, 2007		December 30, 2006
Senior indebtedness				
Credit line borrowings	**$**	**36,486**	$	27,821
Term loans		**16,866**		17,721
Equipment financing		**11,734**		9,336
Capital lease obligations		**4,595**		5,232
Mortgage note payable		**6,657**		6,770
Total senior indebtedness		**76,338**		66,880
Convertible subordinated debentures		**19,662**		22,162
Total long-term debt		**96,000**		89,042
Less current portion of long-term debt		**(6,890)**		(6,368)
Less current portion of capital lease obligations		**(1,341)**		(1,295)
Total long-term debt, less current portions	**$**	**87,769**	$	81,379

During the six months ended June 30, 2007, the Company borrowed $3,419 under equipment financing notes. The notes are secured by the equipment financed, bear interest at fixed rates ranging from 6.83% to 6.85% and are due in monthly installments over the five to seven year terms of the notes.

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THE DIXIE GROUP, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(UNAUDITED)

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

The Company's senior loan and security agreement, which matures on May 11, 2010, provides $76,866 of credit, consisting of $60,000 of revolving credit and a $16,866 term loan. The Company's credit facilities do not contain ongoing financial covenants; however, these facilities contain covenants that generally limit dividends and repurchases of the Company's Common Stock to an aggregate of $3,000 annually and could limit future acquisitions. The unused borrowing capacity under the senior loan and security agreement on June 30, 2007 was approximately $21,099.

On July 16, 2007, the Company amended its senior loan and security agreement to increase the level of "permitted purchase money debt" as defined in the loan agreement from $10,000 to $20,000. The other provisions in the loan agreement remain unchanged.

NOTE J - DERIVATIVE FINANCIAL INSTRUMENTS

The Company is a party to an interest rate swap agreement with a notional amount of $30,000 through May 11, 2010. Under the interest rate swap agreement, the Company pays a fixed rate of interest of 4.79% times the notional amount and receives in return a specified variable rate of interest times the same notional amount. The interest rate swap is linked to the Company's variable rate debt and is considered a highly effective hedge. The fair value of the interest rate swap agreement is reflected on the Company's consolidated condensed balance sheets and related gains and losses are deferred in Accumulated Other Comprehensive Loss ("AOCL"). Net unrealized gains included in AOCL were $228 at June 30, 2007.

The Company is also a party to an interest rate swap agreement through March 2013, which is linked to a mortgage note payable and considered a highly effective hedge. Under the interest rate swap agreement, the Company pays a fixed rate of interest times a notional amount equal to the outstanding balance of the mortgage note, and receives in return an amount equal to a specified variable rate of interest times the same notional amount. The fair value of the interest rate swap agreement is reflected on the Company's consolidated condensed balance sheets and related gains and losses are deferred in AOCL. As of June 30, 2007, the notional amount of the interest swap agreement was $6,657. Under the terms of the swap agreement, the Company pays a fixed interest rate of 4.54% through March 2013, which effectively fixes interest on the mortgage note payable at 6.54%. Net unrealized gains included in AOCL were $150 at June 30, 2007.

NOTE K - EMPLOYEE BENEFIT PLANS

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

The Company sponsors a non-qualified retirement savings plan that allows eligible associates to defer a specified percentage of their compensation. The obligations owed to participants under this plan were $12,630 at June 30, 2007 and $11,704 at December 30, 2006 and are included in other liabilities in the Company's consolidated condensed balance sheets. The obligations are unsecured general obligations of the Company and the participants do not have a right, interest or claim in the assets, except as unsecured general creditors. The Company has established a Rabbi Trust to hold, invest and reinvest deferrals and contributions under the plan. Assets invested in cash and company-owned life insurance in the Rabbi Trust were $12,804 at June 30, 2007 and $11,673 at December 30, 2006 and is included in cash and cash equivalents and other long-term assets in the Company's consolidated condensed balance sheets.

The Company also sponsors a defined benefit retirement plan that covers a limited number of the Company's active associates.

During June 2006, the Company completed the termination and distribution of assets of a defined benefit plan that had been frozen since 1993 as to new benefits. The majority of associates covered by this plan were previously employed by operations that were sold or discontinued. Settlement expenses for the plan termination recognized in the quarter ended July 1, 2006 were $3,249, or $2,057 net of tax. The funds required to terminate the plan were $2,595.

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THE DIXIE GROUP, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(UNAUDITED)

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

Costs charged to continuing operations for all retirement plans are summarized as follows:

	Three Months Ended					
	June 30, 2007			July 1, 2006		
	Terminated Plan	Ongoing Plan	Total 2007	Terminated Plan	Ongoing Plan	Total 2006
Components of net periodic benefit costs:						
Defined benefit plans						
Service cost	$ ---	$ 51	$ 51	$ ---	$ 30	$ 30
Interest cost	---	43	43	117	25	142
Expected return on plan assets	---	(51)	(51)	(121)	(27)	(148)
Amortization of prior service cost	---	2	2	---	1	1
Recognized net actuarial loss	---	25	25	106	13	119
Settlement loss	---	---	---	3,249	---	3,249
Net periodic benefit cost - defined benefit plans	---	70	70	3,351	42	3,393
Net periodic benefit cost - defined contribution plans	---	240	240	---	266	266
Net periodic benefit cost - total	$ ---	$ 310	$ 310	$ 3,351	$ 308	$ 3,659

	Six Months Ended					
	June 30, 2007			July 1, 2006		
	Terminated Plan	Ongoing Plan	Total 2007	Terminated Plan	Ongoing Plan	Total 2006
Components of net periodic benefit costs:						

Defined benefit plans						
Service cost	$ ---	$ 101	$ 101	$ ---	$ 59	$ 59
Interest cost	---	86	86	117	49	166
Expected return on plan assets	---	(102)	(102)	(121)	(53)	(174)
Amortization of prior service cost	---	3	3	---	2	2
Recognized net actuarial loss	---	50	50	106	26	132
Settlement loss	---	---	---	3,249	---	3,249
Net periodic benefit cost - defined benefit plans	---	138	138	3,351	83	3,434
Net periodic benefit cost - defined contribution plans	---	507	507	---	534	534
Net periodic benefit cost - total	$ ---	$ 645	$ 645	$ 3,351	$ 617	$ 3,968

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

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

	Three Months Ended		Six Months Ended	
	June 30, 2007	July 1, 2006	June 30, 2007	July 1, 2006
Components of net periodic benefit costs:				
Defined benefit plans				
Service cost	$ 5	$ ---	$ 11	$ ---
Interest cost	21	---	42	---
Amortization of prior service costs	(16)	---	(32)	---
Recognized net actuarial loss	(10)	---	(21)	---
Net periodic benefit cost	$ ---	$ ---	$ ---	$ ---

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THE DIXIE GROUP, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(UNAUDITED)

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

Amounts contributed or expected to be contributed by the Company during the current fiscal year to its pension and postretirement plans are not anticipated to be significantly different from amounts disclosed in the Company's 2006 Annual Report filed on Form 10-K/A.

NOTE L - INCOME TAXES

The Company adopted the provisions of Financial Accounting Standards Board Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109" ("FIN 48") on the first day of the Company's fiscal year 2007. The Company's reserves for uncertain tax positions at December 30, 2006 were $319 and did not change as a result of the implementation of FIN 48. Unrecognized tax benefits were $343 at June 30, 2007, all of which, if recognized, would favorably affect the Company's effective tax rate. The Company does not expect its unrecognized tax benefits to change significantly during the next twelve months.

The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. As of June 30, 2007, accrued interest related to uncertain tax positions was $50.

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 Company's tax years 2003 through 2006 remain open to examination for U.S. federal income taxes and most state jurisdictions. A few state jurisdictions remain open to examination for tax years 2002 through 2006.

During the three months ended July 1, 2006, the Company settled a Federal income tax audit for the fiscal year 2003; although the 2003 tax year remains open to examination through September 2007. As a result of the settlement of the audit, the Company reduced its tax contingency reserve and its income tax provision by $460 to reflect the settlement of certain items previously included in the Company's tax contingency reserve. The effect on the Company's consolidated condensed statements of operations was to reduce the effective tax rate to 13.6% and 15.6%, respectively for the three and six month periods ended July 1, 2006.

NOTE M - COMMON STOCK AND EARNINGS PER SHARE

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

	Three Months Ended		Six Months Ended	
	June 30, 2007	July 1, 2006	**June 30, 2007**	July 1, 2006
Income from continuing operations (1)	**$ 2,556**	$ 1,028	**$ 2,793**	$ 1,953
Denominator for calculation of basic earnings per share - weighted-average shares (2)	**12,828**	12,689	**12,799**	12,660
Effect of dilutive securities:				
Stock options (3)	**140**	224	**156**	251
Restricted stock grants (3)	**8**	1	**5**	1
Directors' stock performance units (3)	**34**	29	**33**	27
Denominator for calculation of diluted earnings per share - weighted-average shares adjusted for potential dilution (2)(3)	**13,010**	12,943	**12,993**	12,939
Earnings per share:				
Basic	**$ 0.20**	$ 0.08	**$ 0.22**	$ 0.15
Diluted	**0.20**	0.08	**0.21**	0.15

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

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

(3) Because their effects are anti-dilutive, shares issuable under stock option plans where the exercise price is greater than the average market price of Common Shares outstanding at the end of the relevant period and shares issuable on conversion of subordinated debentures into shares of Common Stock have been excluded. Aggregate shares excluded were 1,283 and 1,320 during the three and six months of 2007 and 893 and 929 during the three and six months of 2006.

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THE DIXIE GROUP, INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(UNAUDITED)

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

NOTE N - COMPREHENSIVE INCOME

Comprehensive income is as follows:

	Three Months Ended		Six Months Ended	
	June 30, 2007	July 1, 2006	**June 30, 2007**	July 1, 2006
Net income	**$ 2,438**	$ 944	**$ 2,609**	$ 1,779
Other comprehensive income:				
Unrealized gains on interest rate swap agreements:				
Before income taxes	**471**	418	**298**	1,198
Income taxes	**179**	159	**113**	455
Net of taxes	**292**	259	**185**	743
Change in minimum pension liability:				
Before income taxes	**---**	2,503	**---**	2,503
Income taxes	**---**	951	**---**	951
Net of taxes	**---**	1,552	**---**	1,552
Comprehensive income	**$ 2,730**	$ 2,755	**$ 2,794**	$ 4,074

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

	Interest Rate Swaps	Pension and Post Retirement Liability	Total
Balance at December 30, 2006	$ 193	$ (201)	$ (8)
Unrealized gains on interest rate swap agreements, net of tax of $113	185	---	185
Balance at June 30, 2007	**$ 378**	**$ (201)**	**$ 177**

NOTE O - OTHER (INCOME) EXPENSE

Other (income) expense is summarized as follows:

	Three Months Ended		Six Months Ended	
	June 30, 2007	July 1, 2006	**June 30, 2007**	July 1, 2006
Other operating income:				
Insurance settlements and refunds	**$ ---**	$ (121)	**$ ---**	$ (353)
Miscellaneous income	**(82)**	(107)	**(110)**	(217)
Other operating income	**$ (82)**	$ (228)	**$ (110)**	$ (570)
Other operating expense:				
Retirement expenses	**$ 108**	$ 100	**$ 163**	$ 245
Miscellaneous expense	**36**	30	**106**	41
Other operating expense	**$ 144**	$ 130	**$ 269**	$ 286
Other income:				
Interest income	**$ (4)**	$ (88)	**$ (10)**	$ (101)
Miscellaneous income	**(18)**	(7)	**(27)**	(7)
Other income	**$ (22)**	$ (95)	**$ (37)**	$ (108)
Other expense:				
Miscellaneous expense	**$ 13**	$ 50	**$ 31**	$ 54
Other expense	**$ 13**	$ 50	**$ 31**	$ 54

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ITEM 2.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

The following is presented to update the discussion of results of operations and financial condition included in our 2006 Annual Report on Form 10-K/A filed with the Securities and Exchange Commission.

CRITICAL ACCOUNTING POLICIES

Our critical accounting policies were outlined in Management's Discussion and Analysis of Results of Operations and Financial Condition in our 2006 Annual Report on Form 10-K/A filed with the Securities and Exchange Commission. There have been no changes to those critical accounting policies subsequent to the date of that report.

RESULTS OF OPERATIONS

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

	Three Months Ended		Six Months Ended	
	June 30, 2007	**July 1, 2006**	**June 30, 2007**	**July 1, 2006**
Net sales	**100.0 %**	100.0 %	**100.0 %**	100.0 %
Cost of sales	**68.9 %**	71.9 %	**69.7 %**	71.9 %
Gross profit	**31.1 %**	28.1 %	**30.3 %**	28.1 %
Selling and administrative expenses	**24.3 %**	21.3 %	**25.4 %**	22.7 %
Other operating income	**(0.1)%**	(0.3)%	**(0.1)%**	(0.3)%
Other operating expense	**0.2 %**	0.2 %	**0.2 %**	0.2 %
Defined benefit pension plan termination expenses	**0.0 %**	3.7 %	**0.0 %**	1.9 %
Operating income	**6.7 %**	3.2 %	**4.8 %**	3.6 %

Net Sales. Net sales for the quarter ended June 30, 2007 were $84.4 million, down 4.1% from net sales of $88.0 million in the year-earlier quarter. Net sales for the first six months of 2007 were $158.9 million, down 5.0% from net sales of $167.2 million in the prior year period. The decline in net sales is principally attributable to significant weakness in residential carpet markets that began to be experienced in the third quarter of 2006 and has continued through the second quarter of 2007.

Our net sales of residential carpet products declined 10.3% in the second quarter of 2007 and 9.8% for the first six months of 2007, compared with the same periods in 2006. In addition to the general industry weakness, our residential carpet business has been negatively affected by a significant decline in sales to one large customer. Net sales to our other residential customers declined 4.2% in both the second quarter and first six months of 2007. We continued to experience good demand in our commercial carpet business. Year-over-year sales of our commercial carpet products reflected net sales growth of 7.3% and 3.6%, respectively for the second quarter and first six months of 2007. Despite weakness in the residential portion of our business, our sales continue to outperform the carpet industry, where sales of carpet products reflected a year-over-year decline of 7.7% in the second quarter and 8.7% for the first six months of 2007. The industry s net sales of residential products declined 12.7% and 13.8%, respectively for the second quarter and first six months of 2007. During this same period, the industry s net sales of commercial products grew 2.0% in the second quarter and 1.5% for the first six months of 2007.

Although our residential carpet markets remain weak, we have continued to develop new and differentiated products, many of which should reach the market later this year. The outlook for our commercial business continues to be favorable. Sales of commercial products grew significantly in the second quarter of this year and our order entry and sales comparisons in July indicate this business is strengthening. The recent improvement we have seen in sales and order entry for our commercial products and the anticipated effect of our new residential and commercial products make us optimistic that our sales will continue to outpace the sales of the carpet industry.

Cost of Sales. Cost of sales, as a percentage of net sales, decreased 3.0 percentage points and 2.2 percentage points, respectively in the second quarter and first six months of 2007, compared with the same periods in 2006. The decreases were primarily a result of a better product mix and improvements in materials utilization, manufacturing and distribution efficiencies and production quality.

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Raw material costs increased in June of this year and we raised our selling prices to recoup this higher cost. The effect of these higher selling prices should be felt during the third and fourth quarters of this year.

Gross Profit. Despite lower net sales, gross profit increased $1.5 million in the second quarter and $1.1 million for the first six months of 2007 compared with the same periods in 2006. The increase in gross profit reflects the effect of the factors described above that decreased cost of sales as a percentage of net sales.

Selling and Administrative Expenses. Selling and administrative expenses increased $1.7 million in the second quarter and $2.3 million for the first six months of 2007, compared with the same periods in 2006. The cost increases are principally a result of investments in our sales and marketing infrastructure and new products, information systems and normal inflationary cost increases.

Other Operating Income/Other Operating Expense. Other operating income and other operating expense were not significant in the second quarter or first six months of either 2007 or 2006.

Defined Benefit Pension Plan Termination Expenses. Expenses to terminate our legacy defined benefit pension plan were $3.2 million in the second quarter of 2006. Approximately $2.9 million of these expenses related to the settlement of pension benefits for employees of our discontinued textile business segment that had been terminated in 1999 and prior years. The remaining expenses related to the settlement of pension benefits for employees of our ongoing floorcovering business segment.

Operating Income. Operating income was $5.7 million, or 6.7% of sales, in the quarter ended June 30, 2007 and $7.6 million, or 4.8% of sales, for the first six months of 2007 compared with $2.8 million, or 3.2% of sales, in the quarter ended July 1, 2006 and $6.0 million, or 3.6% of sales, for the first six months of 2006. Defined benefit pension plan termination expenses negatively affected operating income by 3.7 percentage points and 1.9 percentage points, respectively for the quarter and six months ended July 1, 2006.

Interest Expense. Interest expense decreased in the second quarter and first six months of 2007 compared with the same periods in 2006 principally due to lower levels of debt in 2007.

Other Income/Other Expense. Other income and other expense were not significant in the second quarter or first six months of either 2007 or 2006.

Income Tax Provision. Our effective income tax rate was 36.1% and 36.3%, respectively for the three and six months ended June 30, 2007. Our income tax provision (benefit) included a $460 thousand reduction in our tax contingency reserve for the three and six months ended July 1, 2006, principally as a result of a federal income tax examination concluded during the second quarter of 2006. Excluding the contingency reserve adjustment in 2006, the effective income tax rate was 37.2% and 35.5%, respectively for the three and six months ended July 1, 2006.

Income From Continuing Operations. Income from continuing operations was $2.5 million, or $0.20 per diluted share, for the quarter ended June 30, 2007 compared with $1.0 million, or $0.08 per diluted share, for the quarter ended July 1, 2006. Income from continuing operations was $2.8 million, or $0.21 per diluted share, for the first six months of 2007 compared with $2.0 million, or $0.15 per diluted share, for the first six months of 2006. Income from continuing operations in the second quarter and first six months of 2006 was reduced by $2.1 million, net of tax, or $0.16 per diluted share as a result of settlement expenses to terminate the defined benefit pension plan in the second quarter of 2006.

Net Income. The loss from discontinued operations was $118 thousand, or $0.01 per diluted share, in the second quarter of 2007, compared with a loss of $84 thousand, or $0.01 per diluted share for the second quarter of 2006. For the first six months of 2006, the loss from discontinued operations was $184 thousand, or $0.01 per diluted share, compared with a loss of $174 thousand, or $0.01 per diluted share in the year earlier period.

Including discontinued operations, net income was $2.4 million, or $0.19 per diluted share, for the second quarter of 2007, compared with net income of $944 thousand, or $0.07 per diluted share, for the second quarter of 2006. For the first six months of 2007, net income was $2.6 million, or $0.20 per diluted share, compared with $1.8 million, or $0.14 per diluted share, in the 2006 period.

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LIQUIDITY AND CAPITAL RESOURCES

During the six-months ended June 30, 2007, we increased debt by $7.0 million, generated $400 thousand of funds from the issuance of common stock under stock option plans and utilized $400 thousand of cash on our balance sheet to fund our operations and purchase $7.8 million of capital assets. $3.4 million of the increase in debt related to equipment financing notes, which bears interest at fixed rates of interest ranging from 6.83% to 6.85%.

Working capital increased $9.3 million for the first six months of 2007 principally due to seasonable increases in accounts receivable, inventories and accounts payable and accrued expenses. Capital expenditures for the six month period ended June 30, 2007 were $7.8 million while depreciation and amortization was $6.8 million. We expect capital expenditures to be approximately $16.0 million for fiscal 2007 while depreciation and amortization is expected to be approximately $13.0 million. Planned capital expenditures in 2007 primarily relate to new manufacturing technology and information systems.

On July 16, 2007, we amended our senior loan and security agreement to increase the level of "permitted purchase money debt" as defined in the loan agreement from $10.0 million to $20.0 million. The other provisions in the loan agreement remain unchanged.

The unused borrowing capacity under the senior loan and security agreement was approximately $21.1 million at June 30, 2007.

We believe our operating cash flows and existing credit facilities are adequate to finance our anticipated liquidity requirements.

RECENT ACCOUNTING PRONOUNCEMENTS

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

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities", including an amendment of SFAS No. 115, "Accounting for Certain Investments in Debt and Equity

Securities". SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective of SFAS No. 159 is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. Eligible items for the measurement option include all recognized financial assets and liabilities except: investments in subsidiaries, interests in variable interest entities, obligations for pension benefits, assets and liabilities recognized under leases, deposit liabilities and financial instruments that are a component of shareholder's equity. Also included are firm commitments that involve only financial instruments, nonfinancial insurance contracts and warranties and host financial instruments.

The Statement permits all entities to choose the fair value measurement option at specified election dates, after which the entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings, at each subsequent reporting date. The fair value option may be applied instrument by instrument; however, the election is irrevocable and may apply only to entire instruments and not to portions of instruments. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. We are currently evaluating our options under this statement.

CERTAIN FACTORS AFFECTING THE COMPANY'S PERFORMANCE

In addition to the other information provided in this Report, the risk factors included in Item 1A should be considered when evaluating results of our operations, future prospects and an investment in shares of our Common Stock. Any of these factors could cause our actual financial results to differ materially from our historical results, and could give rise to events that might have a material adverse effect on our business, financial condition and results of operations.

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FORWARD-LOOKING INFORMATION

This Report contains statements that may be considered forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended. These statements include the use of terms or phrases that include such terms as "expects," "estimated," "projects," "believes," "anticipates," "intends," and similar terms and phrases. Such terms or phrases relate to, among other matters, our future financial performance, business prospects, growth strategies or liquidity. The following important factors may affect our future results and could cause those results to differ materially from our historical results. These factors include, in addition to those detailed above under the heading "Certain Factors Affecting the Company's Performance", the cost and availability of capital and raw materials, transportation costs related to petroleum price levels, the cost and availability of energy supplies, the loss of a significant customer or group of customers, materially adverse changes in economic conditions generally in carpet, rug and floorcovering markets we serve and other risks detailed from time to time in our filings with the Securities and Exchange Commission.

ITEM 3 - Quantitative and Qualitative Disclosures about Market Risk (Dollars in thousands)

The Company's earnings, cash flows and financial position are exposed to market risks relating to interest rates. The Company minimizes its exposure to adverse changes in interest rates and manages interest rate risks inherent in funding the Company with debt through a risk management program that includes maintaining a mix of fixed and floating rate debt and the use of derivative financial instruments.

At June 30, 2007, the Company had an interest rate swap agreement applicable to its mortgage note payable. The agreement has a notional amount equal to the outstanding balance of the mortgage note ($6,657 at June 30, 2007) which expires in March of 2013. Under the agreement, the Company pays a fixed rate of 4.54% of interest times the notional amount and receives in return an amount equal to a specified variable rate of interest times the same notional amount. The swap agreement effectively fixes the interest rate on the mortgage note payable at 6.54%.

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

At June 30, 2007, $23,352, or approximately 24% of the Company's total debt, was subject to floating interest rates. A 10% fluctuation in the variable interest rates applicable to this floating rate debt would have had an annual after-tax impact of approximately $106.

ITEM 4 - Controls and Procedures

Restatement - We amended and restated our Annual Report of on Form 10-K/A for the year ended December 30, 2006 and our Quarterly Reports on Form 10-Q/A for the quarterly periods ending July 1, 2006 and September 30, 2006 in response to comments from the Securities and Exchange Commission regarding our Annual Report on Form 10K for the fiscal year ended December 30, 2006. See Note Q Restatement of Consolidated Financial Statements , of Notes to Consolidated Financial Statements in our Annual Report on Form 10-K/A for the fiscal year ended December 30, 2006, which fully describes the restatement of our previously issued financial statements to change the presentation of pension costs relating to our discontinued textile business in our Consolidated Statements of Operations and Consolidated Statements of Cash Flows for the years ended December 31, 2006 and December 31, 2005 and of income tax payments related to the sale of a business in our Consolidated Statement of Cash Flows for the year ended December 25, 2004. These changes in presentation had no impact on previously reported Net Income, Net Income per share, total cash flow, our Balance Sheets or stockholder s equity. These changes in presentation also did not affect compliance with our loan covenants or financial rewards granted to our associates and officers.

Evaluation of Disclosure 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 Chief Executive Officer (CEO) and Chief Financial Officer (CFO) have evaluated the effectiveness 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, 2007, the date of the financial statements included in this Form 10-Q (the Evaluation Date).

Public Company Accounting Oversight Board Auditing Standard No. 2 (AS-2) defines a material weakness over financial reporting as a significant deficiency or a combination of significant deficiencies that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. AS-2 identifies certain circumstances that are to be regarded as a significant deficiency and as a strong indicator that a material weakness in internal control over financial reporting exists. The restatement of previously issued financial statements to reflect the correction of an error is such an indicator, under AS-2.

In conducting our evaluation, we considered the provisions of AS-2, which identifies a restatement as a strong indicator of a material weakness in internal control over financial reporting. We also considered the following additional factors: the facts underlying our original classification of the pension costs that were the subject of our restatement were disclosed in our consolidated financial statements and notes thereto, and our original classification of such pension costs and income tax payments were reviewed with and concurred in by Ernst & Young LLP, our independent registered public accounting firm. Based on our evaluation on July 12, 2007, our CEO and CFO concluded that as AS-2 is currently interpreted, our restatement of previously issued financial statements must be considered, a material weakness in our internal control over financial reporting and our disclosure controls and procedures were not effective as of June 30, 2007.

Remediation of Material Weakness in Internal Control and Changes in Internal Control Over Financial Reporting

Subsequent to June 30, 2007, we remediated the material weakness described above by restating our financial statements as described above. We continue to monitor new and emerging accounting guidance and industry interpretations to assist in our application of U. S. Generally Accepted Accounting Principles, and we will seek additional guidance regarding the accounting treatment of matters that, in our judgment, require such additional review. Accordingly, we have remediated the material weakness in our internal control and our CEO and CFO have concluded that, as of date hereof, our disclosure controls and procedures and internal controls over financial reporting are effective.

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

Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures, as well as diverse interpretation of U. S. Generally Accepted Accounting Principals by accounting professionals.. Internal control over financial reporting also 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. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the

policies or procedures may deteriorate. These inherent limitations are known features of the financial reporting process; therefore, it is not possible to design into the process safeguards to eliminate all risk.

PART II. OTHER INFORMATION

Item 1 - Legal Proceedings

None.

Item 1A - Risk Factors

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

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

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

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

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

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

The floorcovering industry is highly competitive. We face competition from a number of domestic manufacturers and independent distributors of floorcovering products and, in certain product areas, foreign manufacturers. There has been significant consolidation within the floorcovering industry during recent years that has caused a number of our existing and potential competitors to be larger and have greater resources and access to capital than we do.

Maintaining our competitive position may require us to make substantial additional investments in our product development efforts, manufacturing facilities, distribution network and sales and marketing activities, which may be limited by our access to capital, as well as restrictions set forth in our credit facilities. Competitive pressures may also result in decreased demand for our products and in the loss of market share. In addition, we face, and will continue to face, pressure on sales prices of our products from competitors. As a result of any of these factors, there could be a material adverse effect on our sales and profitability.

Raw material prices may increase.

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

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 nylon yarn is purchased from one supplier. We believe there are other sources of nylon yarns; however, an unanticipated termination or interruption of our supply arrangements could adversely affect our supply arrangements and could be material.

We may be responsible for environmental cleanup costs.

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

- Discharges to air and water;
- Handling and disposal of solid and hazardous substances and waste; and
-

Remediation of contamination from releases of hazardous substances in our facilities and off-site disposal locations.

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

Acts of Terrorism.

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

Unanticipated Business Interruptions.

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

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

None.

Item 3 - Defaults Upon Senior Securities

None.

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

(a) The annual meeting of shareholders was held on May 2, 2007.

(b) The meeting was held to consider and vote upon the following proposals: (1) to elect Directors for the following year. All Directors were elected and with the results of the vote summarized as follows:

	FOR	AGAINST	ABSTAIN	TOTAL
J. Don Brock	27,864,913	612,619	92,503	28,570,035
Daniel K. Frierson	26,967,433	1,510,099	92,503	28,570,035
Paul K. Frierson	26,991,575	1,485,957	92,503	28,570,035
Walter W. Hubbard	28,390,081	87,451	92,503	28,570,035
Lowry F. Kline	28,421,228	56,304	92,503	28,570,035
John W. Murrey, III	27,996,010	481,522	92,503	28,570,035

Item 5 - Other Information

None.

Item 6 - Exhibits

(a) Exhibits

(i) Exhibits Incorporated by Reference

None

(ii) Exhibits Filed with this Report

31.1	CEO Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	CFO Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	CEO Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	CFO Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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SIGNATURES

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

THE DIXIE GROUP, INC.
(Registrant)

Date: August 8, 2007

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

Date: August 8, 2007

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

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