AMSOUTH BANCORPORATION
Form 10-Q
August 09, 2004
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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended June 30, 2004

Commission file number 1-7476

AmSouth Bancorporation

(Exact Name of registrant as specified in its charter)

Delaware **(State or other jurisdiction of** **Incorporation or Organization)**	**63-0591257** **(I.R.S. Employer** **Identification No.)**
AmSouth Center **1900 Fifth Avenue North** **Birmingham, Alabama** **(Address of principal executive offices)**	**35203** **(Zip Code)**

(205) 320-7151

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes x No ¨

As of July 31, 2004, AmSouth Bancorporation had 353,734,000 shares of common stock outstanding.

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AMSOUTH BANCORPORATION

FORM 10-Q

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Forward-Looking Statements. Statements made in this report that are not purely historical are forward-looking statements (as defined in the Private Securities Litigation Reform Act of 1995), including any statements regarding descriptions of management s plans, objectives or goals for future operations, products or services, and forecasts of its revenues, earnings or other measures of performance. Forward-looking statements are based on current management expectations and, by their nature, are subject to risks and uncertainties. A number of factors-many of which are beyond AmSouth s control-could cause actual conditions, events or results to differ materially from those described in the forward-looking statements. Factors which could cause results to differ materially from current management expectations include, but are not limited to: the execution of AmSouth s strategic initiatives; legislation and regulation; general economic conditions, especially in the Southeast; the performance of the stock and bond markets; changes in interest rates, yield curves and interest rate spread relationships; prepayment speeds within the loan and investment security portfolios; deposit flows; the cost of funds; cost of federal deposit insurance premiums; demand for loan products; demand for financial services; competition, including a continued consolidation in the financial services industry; changes in the quality or composition of AmSouth s loan and investment portfolios including capital market inefficiencies that may affect the marketability and valuation of available-for-sale securities; changes in consumer spending and saving habits; technological changes; the growth and profitability of AmSouth s mortgage banking business, including mortgage-related income and fees, being less than expected; adverse changes in the financial performance and/or condition of AmSouth s borrowers which could impact the repayment of such borrowers outstanding loans; changes in accounting and tax principles, policies or guidelines and in tax laws; other economic, competitive, governmental and regulatory factors affecting AmSouth s operations, products, services and prices; unexpected judicial actions and developments; results of investigations, examinations and reviews of regulatory and law enforcement authorities; the outcome of litigation, which is inherently uncertain and depends on the findings of judges and juries; the impact on AmSouth s businesses, as well as on the risks set forth above, of various domestic or international military or terrorist activities or conflicts; and AmSouth s success at managing the risks involved in the foregoing. Forward-looking statements speak only as of the date they are made. AmSouth does not undertake a duty to update forward-looking statements to reflect circumstances or events that occur after the date the forward-looking statements are made.

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PART I

FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

AMSOUTH BANCORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CONDITION

(Unaudited)

	June 30 2004	December 31 2003	June 30 2003
		(Dollars in thousands)	
ASSETS			
Cash and due from banks	$ 1,055,370	$ 1,163,986	$ 1,451,537
Federal funds sold and securities purchased under agreements to resell	87,000	-0-	484,300
Trading securities	11,092	2,721	287
Available-for-sale securities	6,586,697	7,125,971	5,814,466
Held-to-maturity securities (market value of $5,905,830, $4,948,556 and $4,919,981, respectively)	6,004,032	4,928,195	4,842,826
Loans held for sale	261,968	102,292	17,655
Loans	32,037,283	30,088,814	28,876,285
Less: Allowance for loan losses	382,482	384,124	384,011
Unearned income	685,786	749,450	653,743
Net loans	30,969,015	28,955,240	27,838,531
Other interest-earning assets	11,813	40,218	48,602
Premises and equipment, net	1,020,033	964,692	907,680
Cash surrender value - bank owned life insurance	1,089,445	1,065,996	1,041,391
Accrued interest receivable and other assets	1,199,348	1,266,205	1,336,932
	$ 48,295,813	$ 45,615,516	$ 43,784,207
LIABILITIES AND SHAREHOLDERS EQUITY			
Deposits and interest-bearing liabilities:			
Deposits:			
Noninterest-bearing demand	$ 6,636,325	$ 6,273,835	$ 5,849,456
Interest-bearing checking	6,809,885	6,183,832	5,739,344
Money market and savings deposits	7,827,390	7,592,020	7,553,650
Time	5,623,470	6,278,053	6,532,948
Certificates of deposit of $100,000 or more	3,638,933	2,818,490	2,696,099
Foreign	1,603,241	1,294,123	727,329
Total deposits	32,139,244	30,440,353	29,098,826
Federal funds purchased and securities sold under agreements to repurchase	2,145,521	2,026,253	1,837,292
Other borrowed funds	1,370,893	343,202	149,333
Long-term Federal Home Loan Bank advances	5,779,709	5,737,952	5,826,839
Other long-term debt	2,084,213	2,114,482	1,517,224
Total deposits and interest-bearing liabilities	43,519,580	40,662,242	38,429,514
Accrued expenses and other liabilities	1,480,755	1,723,605	2,209,118

Total liabilities	45,000,335	42,385,847	40,638,632
Shareholders equity:			
Preferred stock no par value:			
Authorized 2,000,000 shares; Issued and outstanding none	-0-	-0-	-0-
Common stock par value $1 a share:			
Authorized 750,000,000 shares; Issued 416,768,000, 416,878,000 and 416,890,000 shares, respectively	416,768	416,878	416,890
Capital surplus	714,134	715,663	706,042
Retained earnings	3,372,672	3,228,533	3,083,424
Cost of common stock in treasury 63,353,000, 64,987,000 and 66,413,000 shares, respectively	(1,043,783)	(1,076,644)	(1,106,191)
Deferred compensation on restricted stock	(14,496)	(14,501)	(15,838)
Accumulated other comprehensive (loss)/income	(149,817)	(40,260)	61,248
Total shareholders equity	3,295,478	3,229,669	3,145,575
	$ 48,295,813	$ 45,615,516	$ 43,784,207

See notes to consolidated financial statements.

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AMSOUTH BANCORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF EARNINGS

(Unaudited)

	Six Months Ended June 30		Three Months Ended June 30	
	2004	**2003**	**2004**	**2003**
	(In thousands except per share data)			
INTEREST INCOME				
Loans	$ 752,317	$ 788,402	$ 376,602	$ 389,859
Available-for-sale securities	163,996	152,747	80,577	75,065
Held-to-maturity securities	126,527	117,064	63,934	56,199
Trading securities	97	61	25	6
Loans held for sale	5,897	478	3,270	318
Federal funds sold and securities purchased under agreements to resell	348	1,055	197	889
Other interest-earning assets	98	264	39	110
Total interest income	1,049,280	1,060,071	524,644	522,446
INTEREST EXPENSE				
Interest-bearing checking	15,986	16,164	8,640	8,129
Money market and savings deposits	19,003	27,816	9,688	13,819
Time deposits	85,372	103,409	40,565	51,116
Certificates of deposit of $100,000 or more	34,388	32,041	17,147	16,555
Foreign deposits	6,187	3,359	3,598	1,675
Federal funds purchased and securities sold under agreements to repurchase	14,830	10,474	8,185	4,555
Other borrowed funds	3,886	2,130	1,905	985
Long-term Federal Home Loan Bank advances	120,944	131,667	60,475	64,949
Other long-term debt	27,777	20,613	13,031	11,307
Total interest expense	328,373	347,673	163,234	173,090
NET INTEREST INCOME	720,907	712,398	361,410	349,356
Provision for loan losses	54,700	87,400	26,600	42,700
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	666,207	624,998	334,810	306,656
NONINTEREST REVENUES				
Service charges on deposit accounts	187,592	157,233	94,377	81,677
Trust income	58,815	51,625	29,935	25,598
Consumer investment services income	42,341	32,359	21,930	16,049
Interchange income	36,927	35,047	20,628	18,360
Bank owned life insurance policies	23,279	26,894	11,610	13,060
Bankcard income	14,365	12,892	7,509	6,691
Mortgage income	11,401	27,146	3,889	17,130
Portfolio income	17,812	21,836	8,145	15,906
Other noninterest revenues	46,150	38,571	20,229	16,247
Total noninterest revenues	438,682	403,603	218,252	210,718
NONINTEREST EXPENSES				

Salaries and employee benefits	341,217	310,788	167,511	156,723
Net occupancy expense	71,578	65,009	36,326	33,484
Equipment expense	61,512	58,540	30,968	30,572
Postage and office supplies	23,955	23,290	10,997	11,351
Marketing expense	20,995	18,331	9,249	9,173
Professional fees	18,029	16,138	9,699	7,726
Communications expense	12,452	14,607	6,040	7,044
Amortization of intangibles	2,326	2,396	1,163	1,198
Other noninterest expenses	81,980	79,129	39,817	41,351
Total noninterest expenses	634,044	588,228	311,770	298,622
INCOME BEFORE INCOME TAXES	470,845	440,373	241,292	218,752
Income taxes	143,783	130,192	74,329	63,927
NET INCOME	$ 327,062	$ 310,181	$ 166,963	$ 154,825
Average common shares outstanding	351,399	350,738	351,602	349,509
Earnings per common share	$ .93	$ .88	$ .47	$ .44
Diluted average common shares outstanding	356,611	354,304	356,314	353,354
Diluted earnings per common share	$ .92	$ .88	$ .47	$ .44

See notes to consolidated financial statements.

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AMSOUTH BANCORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY

(Unaudited)

	Common Stock	Capital Surplus	Retained Earnings	Treasury Stock	Deferred Compensation on Restricted Stock	Accumulated Other Comprehensive Income/(Loss)	Total
	(In thousands)						
BALANCE AT JANUARY 1, 2004	$ 416,878	$ 715,663	$ 3,228,533	$ (1,076,644)	$ (14,501)	$ (40,260)	$ 3,229,669
Comprehensive income:							
Net income	-0-	-0-	327,062	-0-	-0-	-0-	327,062
Other comprehensive income, net of tax:							
Changes in unrealized gains and losses on derivative instruments (net of $7,045 tax benefit)	-0-	-0-	-0-	-0-	-0-	(13,084)	(13,084)
Changes in unrealized gains and losses on available-for-sale securities, net of reclassification adjustment (net of $59,350 tax benefit)	-0-	-0-	-0-	-0-	-0-	(96,334)	(96,334)
Changes in unrealized gains and losses on minimum pension liability adjustment (net of $84 tax benefit)	-0-	-0-	-0-	-0-	-0-	(139)	(139)
Comprehensive income							217,505
Cash dividends declared	-0-	-0-	(171,500)	-0-	-0-	-0-	(171,500)
Common stock transactions:							
Purchase of common stock	-0-	-0-	-0-	(48,920)	-0-	-0-	(48,920)
Employee stock plans	(110)	(2,075)	(11,421)	75,949	5	-0-	62,348
Direct stock purchase and dividend reinvestment plan	-0-	546	(2)	5,832	-0-	-0-	6,376
BALANCE AT JUNE 30, 2004	$ 416,768	$ 714,134	$ 3,372,672	$ (1,043,783)	$ (14,496)	$ (149,817)	$ 3,295,478
Disclosure of reclassification amount:							
Changes in unrealized holding gains and losses on available-for-sale securities arising during the period						$ (86,223)	
Less: Reclassification adjustment for net securities gains realized in net income						10,111	
Net change in unrealized gains and losses on available-for-sale						$ (96,334)	

securities, net of tax	
Changes in unrealized holding gains and losses on derivatives arising during the period	$ (7,257)
Less: Reclassification adjustment for gains realized in net income (net of $3,511 tax expense)	5,827
Net change in unrealized gains and losses on derivatives, net of tax	$ (13,084)

See notes to consolidated financial statements.

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AMSOUTH BANCORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CASH FLOWS

(Unaudited)

(In thousands)	Six Months Ended June 30 2004	2003
OPERATING ACTIVITIES		
Net income	$ 327,062	$ 310,181
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	54,700	87,400
Depreciation and amortization of premises and equipment	53,663	47,744
Amortization of premiums and discounts on held-to-maturity securities and available-for-sale securities	23,531	16,947
Originations and purchases of loans held for sale	(660,488)	2,254
Proceeds from sales of loans held for sale	502,330	-0-
Net (increase) decrease in trading securities	(8,361)	47,671
Net gains on sales of available-for-sale securities	(16,203)	(19,001)
Net loss (gain) on guaranteed mortgage loan securitizations	73	(21,827)
Net gain on sales of business operations, subsidiaries and other assets	(10,451)	-0-
Net gain on sales of home equity loans	(4,884)	-0-
Net decrease (increase) in accrued interest receivable, bank-owned life insurance and other assets	6,684	(70,472)
Net (decrease) increase in accrued expenses and other liabilities	(96,708)	105,890
Provision for deferred income taxes	61,683	70,725
Amortization of intangible assets	2,326	2,396
Other operating activities, net	58,351	46,899
Net cash provided by operating activities	293,308	626,807
INVESTING ACTIVITIES		
Proceeds from maturities and prepayments of available-for-sale securities	679,152	1,373,271
Proceeds from sales of available-for-sale securities	1,211,887	839,237
Purchases of available-for-sale securities	(1,533,646)	(2,800,723)
Proceeds from maturities, prepayments and calls of held-to-maturity securities	952,974	1,324,330
Purchases of held-to-maturity securities	(2,141,754)	(1,493,401)
Net increase in federal funds sold and securities purchased under agreements to resell	(87,000)	(458,282)
Net decrease in other interest-earning assets	28,405	15,210
Net increase in loans, excluding guaranteed mortgage loan securitizations and sales of home equity loans	(2,443,327)	(2,360,281)
Proceeds from guaranteed mortgage loan securitizations	146,102	1,234,703
Proceeds from sales of business operations, subsidiaries and other assets	1,622	-0-
Proceeds from sales of home equity loans	156,552	-0-
Net purchases of premises and equipment	(109,004)	(116,518)
Net cash used by investing activities	(3,138,037)	(2,442,454)
FINANCING ACTIVITIES		
Net increase in deposits	1,699,353	1,784,652
Net increase in federal funds purchased and securities sold under agreements to repurchase	119,268	67,745
Net increase (decrease) in other borrowed funds	1,027,691	(1,685)
Issuance of long-term Federal Home Loan Bank advances and other long-term debt	300,487	2,350,000

Payments for maturing Federal Home Loan Bank advances and other long-term debt	(258,841)	(1,914,083)
Cash dividends paid	(169,483)	(160,698)
Proceeds from employee stock plans, direct stock purchase and dividend reinvestment plan	66,558	71,316
Purchase of common stock	(48,920)	(152,048)
Net cash provided by financing activities	2,736,113	2,045,199
(Decrease) Increase in cash and cash equivalents	(108,616)	229,552
Cash and cash equivalents at beginning of period	1,163,986	1,221,985
Cash and cash equivalents at end of period	$ 1,055,370	$ 1,451,537

See notes to consolidated financial statements.

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AMSOUTH BANCORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Six months ended June 30, 2004 and 2003

Basis of Presentation- The consolidated financial statements conform to accounting principles generally accepted in the United States. The accompanying interim financial statements are unaudited; however, in the opinion of management, all adjustments necessary for the fair presentation of the consolidated financial statements have been included. All such adjustments are of a normal recurring nature. Certain amounts in the prior year s financial statements have been reclassified to conform with the 2004 presentation. These reclassifications had no effect on net income. The notes included herein should be read in conjunction with the notes to consolidated financial statements included in AmSouth Bancorporation s (AmSouth) 2003 annual report on Form 10-K.

The consolidated financial statements and notes are presented in accordance with the instructions for Form 10-Q. The consolidated financial statements include the accounts of AmSouth and all of its subsidiaries, all of which are wholly- owned. All significant intercompany balances and transactions have been eliminated.

The Financial Accounting Standards Board (FASB) issued a revised version of Interpretation No. 46 Consolidation of Variable Interest Entities (Interpretation 46), in December of 2003. This accounting guidance significantly changes how companies determine whether they must consolidate an entity depending on whether the entity is a voting rights entity or a variable interest entity (VIE). The revised Interpretation 46 is effective no later than the end of the first interim or annual period ending after December 15, 2003 for entities created after January 31, 2003, and for entities created before February 1, 2003, no later than the end of the first interim or annual period ending after March 15, 2004. As required, AmSouth adopted the guidance of Interpretation 46 for all entities.

In accordance with the new guidance, AmSouth considers a voting rights entity to be a subsidiary and consolidates it if AmSouth has a controlling financial interest in the entity. VIEs are consolidated by AmSouth if it is exposed to the majority of the VIE s expected losses and/or residual returns (i.e., AmSouth is considered to be the primary beneficiary).

Unconsolidated investments in voting rights entities or VIEs in which AmSouth has significant influence over operating and financing decisions (usually defined as a voting or economic interest of 20% to 50%) are accounted for using the equity method. Unconsolidated investments in voting rights entities or VIEs in which AmSouth has a voting or economic interest of less than 20% are generally carried at cost.

Prior to the adoption of Interpretation 46, AmSouth generally determined whether consolidation of an entity was appropriate based on the nature and amount of equity contributed by third parties, the decision-making power granted to those parties and the extent of their control over the entity s operating and financial policies. Entities controlled, generally through majority ownership, were consolidated and were considered subsidiaries.

Use of Estimates The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, benefit plan obligations and expenses and the valuation of derivative instruments used in hedging transactions and the corresponding value of items being hedged.

Provision (benefit) for deferred income taxes
(546
)

(449
)
Net gain on property, plant and equipment disposals
(186
)

(3
)
Stock-based compensation expense
750

520

Write-off of deferred financing costs
—

92

Changes in operating assets and liabilities:

Receivables
(2,817
)

(4,088
)
Inventories
(7,052
)

(8,010
)
Other current assets
(1,725
)

(2,707
)
Accounts payable and accrued expenses
943

2,353

Other operating assets and liabilities
(267
)

(871
)
NET CASH USED IN OPERATING ACTIVITIES
(4,275
)

(4,515
)

CASH FLOWS FROM INVESTING ACTIVITIES

Net proceeds from sales of property, plant and equipment
186

3

Purchase of property, plant and equipment
(1,987
)

(4,194
)
NET CASH USED IN INVESTING ACTIVITIES
(1,801
)

(4,191
)

CASH FLOWS FROM FINANCING ACTIVITIES

Net payments on previous credit line
—

(30,503
)
Payments on previous term loan
—

(11,324
)
Net borrowings on current credit line
6,002

49,831

Borrowings on current mortgage note payable
—

11,063

Payments on current mortgage note payable
(553
)

—

Payments on previous mortgage note payable
—

(5,736
)
Borrowings on equipment financing
2,503

1,270

Payments on equipment financing
(1,002
)

(2,413

)
Payments on capitalized leases
(95
)

(333
)
Borrowings on notes payable
795

733

Payments on notes payable
(583
)

(474
)
Payments on subordinated indebtedness
—

(2,500
)
Change in outstanding checks in excess of cash
(923
)

308

Common stock acquired for treasury
(199
)

(127
)
Payments for debt issuance costs
(53
)

(1,212
)
NET CASH PROVIDED BY FINANCING ACTIVITIES
5,892

8,583

DECREASE IN CASH AND CASH EQUIVALENTS	(184)	(123)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	298	244
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 114	$ 121
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid	$ 2,042	$ 2,489
Income taxes paid, net of tax refunds	1,315	102
Equipment purchased under capital leases	631	—

See accompanying notes to the consolidated condensed financial statements.

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

NOTE A - BASIS OF PRESENTATION

The accompanying unaudited consolidated condensed financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial statements which do not include all the information and footnotes required by such accounting principles for annual financial statements. In the opinion of management, all adjustments (generally consisting of normal recurring accruals) considered necessary for a fair presentation have been included in the accompanying financial statements. The accompanying financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's 2011 Annual Report on Form 10-K filed with the Securities and Exchange Commission for the fiscal year ended December 31, 2011. Operating results for the three and nine month periods ended September 29, 2012 are not necessarily indicative of the results that may be expected for the entire 2012 year. The nine months ended September 29, 2012 contains 39 weeks compared with 40 weeks for the nine months ended October 1, 2011.

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

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

NOTE B - RECENT ACCOUNTING PRONOUNCEMENTS

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

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

adjustments, the Company is required to continue reporting reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect before ASU 2011-05.

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

In July 2012, the FASB issued ASU No. 2012-02, "Intangibles--Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment." This ASU states that an entity has the option first to assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that the indefinite-lived intangible asset is impaired. If, after assessing the totality of events and circumstances, an entity concludes that it is not more likely than not that the indefinite-lived intangible asset is impaired, then the entity is not required to take further action. However, if an entity concludes otherwise, then it is required to determine the fair value of the indefinite-lived intangible asset and perform the quantitative impairment test by comparing the fair value with the carrying amount in accordance with Codification Subtopic

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350-30, "Intangibles--Goodwill and Other, General Intangibles Other than Goodwill." Under the guidance in this ASU, an entity also has the option to bypass the qualitative assessment for any indefinite-lived intangible asset in any period and proceed directly to performing the quantitative impairment test. An entity will be able to resume performing the qualitative assessment in any subsequent period. The amendments in this ASU are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted, including for annual and interim impairment tests performed as of a date before July 27, 2012, if a public entity's financial statements for the most recent annual or interim period have not yet been issued or, for nonpublic entities, have not yet been made available for issuance. The Company does not expect that the adoption of this ASU will have a a material effect on the Company’s Consolidated Condensed Financial Statements.

NOTE C - STOCK COMPENSATION EXPENSE

The Company recognizes compensation expense relating to share-based payments based on the fair value of the equity instrument issued and records such expense in selling and administrative expenses in the Company's Consolidated Condensed Financial Statements. The number of shares to be issued is determined by dividing the specified dollar value of the award by the market value per share on the grant date. Pursuant to a policy adopted by the Compensation Committee of the Board of Directors applicable to awards granted for years 2009 through 2012, $5.00 per share will be used as the market value per share to calculate the number of shares to be issued if the market value per share is less than $5.00 per share on the grant date. The Company's stock compensation expense was $335 and $750 for the three and nine months ended September 29, 2012, respectively, and $147 and $520 for the three and nine months ended October 1, 2011, respectively.

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

On August 21, 2012, the Company issued 48,000 shares of restricted stock to certain key employees. The grant-date fair value of the awards was $156, or $3.255 per share, and will be recognized as stock compensation over a 4 year vesting period from the date the awards were granted. Each award is subject to a continued service condition. The fair value of each share of restricted stock awarded was equal to the market value of a share of the Company's Common Stock on the grant date.

NOTE D - RECEIVABLES, NET

Receivables are summarized as follows:

	September 29, 2012	December 31, 2011
Customers, trade	$31,192	$28,372
Other receivables	1,061	1,268
Gross receivables	32,253	29,640
Less allowance for doubtful accounts	(263)	(467)
Net receivables	$31,990	$29,173

The Company had notes receivable in the amount of $485 and $483 at September 29, 2012 and December 31, 2011, respectively. The current portions of notes receivable are included in other receivables above and the non-current portions are included in other assets in the Company's Consolidated Condensed Financial Statements.

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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:

	September 29, 2012	December 31, 2011
Raw materials	$22,058	$19,624
Work-in-process	14,276	13,116
Finished goods	48,601	45,840
Supplies, repair parts and other	463	351
LIFO reserve	(14,407)	(14,992)
Total inventories	$70,991	$63,939

NOTE F - ACCRUED EXPENSES

Accrued expenses are summarized as follows:

	September 29, 2012	December 31, 2011
Compensation and benefits	$4,342	$4,348
Provision for customer rebates, claims and allowances	4,506	4,249
Outstanding checks in excess of cash	1,805	2,728
Other	5,494	5,860
Total accrued expenses	$16,147	$17,185

NOTE G - PRODUCT WARRANTY RESERVES

The Company generally provides product warranties related to manufacturing defects and specific performance standards for its products. At the time sales are recorded, the Company records reserves for the estimated costs of defective products and failure of its products to meet applicable performance standards. The level of reserves the Company establishes is based primarily upon historical experience, including the level of sales and evaluation of pending claims. Product warranty reserves are included in accrued expenses in the Company's Consolidated Condensed Financial Statements. The following is a summary of the Company's product warranty activity.

	Three Months Ended		Nine Months Ended	
	September 29, 2012	October 1, 2011	September 29, 2012	October 1, 2011
Warranty reserve at beginning of period	$1,208	$1,248	$1,219	$1,472
Warranty liabilities accrued	803	819	2,349	2,432
Warranty liabilities settled	(740)	(733)	(2,367)	(2,314)
Changes for pre-existing warranty liabilities	(50)	(60)	20	(316)
Warranty reserve at end of period	$1,221	$1,274	$1,221	$1,274

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NOTE H - LONG-TERM DEBT AND CREDIT ARRANGEMENTS

Long-term debt consists of the following:

	September 29, 2012	December 31, 2011
Senior indebtedness	$58,808	$52,806
Mortgage note payable	10,325	10,878
Equipment notes payable	2,863	3,354
Notes payable	795	584
Capital lease obligations	2,993	464
Total long-term debt	75,784	68,086
Less: current portion of long-term debt	(3,058)	(2,729)
Total long-term debt, less current portion	$72,726	$65,357

Senior indebtedness

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

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

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

The Company can use the proceeds of the senior credit facility for general corporate purposes, including financing acquisitions and refinancing other indebtedness. As of September 29, 2012, the unused borrowing availability under the senior credit facility was $20,217.

Mortgage Note Payable

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

NOTE I - FAIR VALUE MEASUREMENTS

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

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

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

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

The Company's interest rate swaps and related instruments are measured under the fair value guidance. The following table summarizes the hierarchy level the Company used to determine fair value of its interest rate swaps and related instruments as of September 29, 2012 and December 31, 2011:

	September 29, 2012	December 31, 2011	Fair Value Hierarchy Level
Assets:			
Interest rate swaptions	$—	$197	Level 2
Liabilities:			
Interest rate swaps	$1,226	$958	Level 2

The fair value of the interest rate swaps and swaptions was obtained from external sources. The interest rate swaps and swaptions were valued using observable inputs (e.g., LIBOR yield curves, credit spreads). Valuations of interest rate swaps may fluctuate considerably from period-to-period due to volatility in underlying interest rates, which are driven by market conditions and the duration of the instrument. Credit adjustments could have a significant impact on the valuations due to changes in credit ratings of the Company or its counterparties. During the three months ended September 29, 2012, the Company terminated the swaptions and received consideration of $285.

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

	September 29, 2012		December 31, 2011	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Cash and cash equivalents	$114	$114	$298	$298
Notes receivable, including current portion	485	485	483	483
Interest rate swaptions	—	—	197	197
Financial Liabilities:				
Long-term debt and capital leases, including current portion	75,784	79,936	68,086	68,900
Interest rate swaps	1,226	1,226	958	958

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

The Company's earnings, cash flows and financial position are exposed to market risks relating to interest rates. It is the Company's policy to minimize its exposure to adverse changes in interest rates and manage interest rate risks inherent in funding the Company with debt. The Company addresses this risk by maintaining a mix of fixed and floating rate debt and entering into interest rate swaps for a portion of its variable rate debt to minimize interest rate volatility. The Company does not hold speculative financial instruments, nor does it hold or issue financial

instruments for trading purposes.

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

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The following is a summary of the Company's interest rate swaps as of September 29, 2012:

Type	Notional Amount		Effective Date	Fixed Rate	Variable Rate
Interest rate swap	$5,185	*	April 1, 2003 through April 1, 2013	4.54%	1 Month LIBOR
Interest rate swap	$25,000		July 11, 2010 through May 11, 2013	1.42%	1 Month LIBOR
Interest rate swap	$10,000		October 3, 2011 through September 1, 2016	1.33%	1 Month LIBOR
Interest rate swap	$10,000		March 1, 2013 through September 1, 2016	1.62%	1 Month LIBOR
Interest rate swap	$5,000		June 1, 2013 through September 1, 2016	1.70%	1 Month LIBOR

* Interest rate swap has an amortizing notional amount.

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

	Location on Consolidated Condensed Balance Sheets	Fair Value September 29, 2012	December 31, 2011
Asset Derivatives:			
Derivatives not designated as hedging instruments:			
Interest rate swaptions	Other Assets	$—	$197
Total Asset Derivatives		$—	$197
Liability Derivatives:			
Derivatives designated as hedging instruments:			
Interest rate swaps, current portion	Accrued Expenses	$517	$559
Interest rate swaps, long term portion	Other Long-Term Liabilities	709	399
Total Liability Derivatives		$1,226	$958

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The following tables summarize the pre-tax impact of derivative instruments on the Company's financial statements:

	Amount of Gain or (Loss) Recognized in AOCIL on the effective portion of the Derivative			
	Three Months Ended		Nine Months Ended	
	September 29, 2012	October 1, 2011	September 29, 2012	October 1, 2011
Derivatives designated as hedging instruments:				
Cash flow hedges - interest rate swaps	$(230)	$(282)	$(748)	$(495)

	Amount of Gain or (Loss) Reclassified from AOCIL on the effective portion into Income (1)(2)			
	Three Months Ended		Nine Months Ended	
	September 29, 2012	October 1, 2011	September 29, 2012	October 1, 2011
Derivatives designated as hedging instruments:				
Cash flow hedges - interest rate swaps	$(155)	$(158)	$(467)	$(436)

	Amount of Gain or (Loss) Recognized on the ineffective portion in Income on Derivative (3)			
	Three Months Ended		Nine Months Ended	
	September 29, 2012	October 1, 2011	September 29, 2012	October 1, 2011
Derivatives designated as hedging instruments:				
Cash flow hedges - interest rate swaps	$—	$21	$—	$23

	Amount of Gain or (Loss) Recognized in Income on Derivative (4)			
	Three Months Ended		Nine Months Ended	
	September 29, 2012	October 1, 2011	September 29, 2012	October 1, 2011
Derivatives not designated as hedging instruments:				
Interest rate swaptions	$5	$(3)	$87	$(3)

(1) The amount of gain (loss) reclassified from AOCIL is included in interest expense on the Company's Consolidated Condensed Statements of Operations.
(2) The amount of loss expected to be reclassified from AOCIL into earnings during the next 12 months subsequent to September 29, 2012 is $517.
(3) The amount of gain (loss) recognized in income on the ineffective portion of interest rate swaps is included in other (income) expense, net on the Company's Consolidated Condensed Statements of Operations.
(4) The amount of gain (loss) recognized in income for derivatives not designated as hedging instruments is included in other (income) expense, net on the Company's Consolidated Condensed Statements of Operations.

NOTE J - EMPLOYEE BENEFIT PLANS

Defined Contribution Plans

The Company sponsors a 401(k) defined contribution plan that covers a significant portion, or approximately 70% of the Company's associates. This plan was modified in 2012 compared with prior years to include a mandatory Company match on the first 1% of participants' contributions. The Company matches the next 2% of participants' contributions if the Company meets prescribed earnings levels. The plan also provides for additional Company contributions above the 3% level if the Company attains certain additional performance targets. The Company, at its discretion, did not match participants' contributions in 2011. Matching contribution expense for this 401(k) plan was $51 for the three months ended September 29, 2012 and was $182 for the nine months ended September 29, 2012.

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Additionally, the Company sponsors a 401(K) defined contribution plan that covers those associates at one facility who are under a collective-bargaining agreement, or approximately 30% of the Company's associates. Under this plan, the Company generally matches participants' contributions, on a sliding scale, up to a maximum of 2.75% of the participant's earnings. Matching contribution expense for the collective-bargaining 401(k) plan was $16 and $20 for the three months ended September 29, 2012 and October 1, 2011, respectively, and $61 and $68 for the nine months ended September 29, 2012 and October 1, 2011, respectively.

Non-Qualified Retirement Savings Plan

The Company sponsors a non-qualified retirement savings plan that allows eligible associates to defer a specified percentage of their compensation. The obligations owed to participants under this plan were $11,080 at September 29, 2012 and $10,927 at December 31, 2011 and are included in other long-term liabilities in the Company's Consolidated Condensed Balance Sheets. The obligations are unsecured general obligations of the Company and the participants have no right, interest or claim in the assets of the Company, except as unsecured general creditors. The Company utilizes a Rabbi Trust to hold, invest and reinvest deferrals and contributions under the plan. Amounts are invested in Company-owned life insurance in the Rabbi Trust and the cash surrender value of the policies was $11,932 at September 29, 2012 and $10,913 at December 31, 2011 and is included in other assets in the Company's Consolidated Condensed Balance Sheets.

Multi-Employer Pension Plan

The Company contributes to a multi-employer pension plan under the terms of a collective-bargaining agreement that covers its union-represented employees. Expenses related to the multi-employer pension plan were $59 and $72 for the three months ended September 29, 2012 and October 1, 2011, respectively, and $193 and $218 for the nine months ended September 29, 2012 and October 1, 2011, respectively.

Postretirement Plans

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

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

	Three Months Ended		Nine Months Ended	
	September 29, 2012	October 1, 2011	September 29, 2012	October 1, 2011
Service cost	$2	$2	$6	$6
Interest cost	6	6	18	19
Amortization of prior service credits	(22)	(22)	(66)	(67)
Recognized net actuarial gains	(10)	(7)	(29)	(21)
Net periodic benefit cost (credit)	$(24)	$(21)	$(71)	$(63)

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

NOTE K - INCOME TAXES

The Company's effective income tax provision (benefit) rates are based upon estimated annual income tax rates. The difference between the effective rates and the statutory rates for the three and nine months ended September 29, 2012 was primarily due to changes to the provision as the result of filing the income tax return as well as the utilization of certain state tax net operating loss carryforwards that resulted in the reversal of the valuation allowance related to their utilization. During the nine months ended October 1, 2011, the Company's effective income tax rate was affected by the inclusion of a $492 non-taxable settlement gain associated with a company-owned insurance policy.

The Company and its subsidiaries are subject to United States federal income taxes, as well as income taxes in a number of state jurisdictions. The tax years subsequent to 2003 remain open to examination for U.S. federal income taxes. The majority of state jurisdictions remain open for tax years subsequent to 2007. A few state jurisdictions remain open to examination for tax years subsequent to 2006.

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The Company's unrecognized tax benefits were $16 at September 29, 2012 and December 31, 2011. Due to the Company's valuation allowances, such benefits, if recognized, would not significantly affect the Company's effective tax rate. There were no significant interest or penalties accrued as of September 29, 2012 or December 31, 2011. The Company does not expect its unrecognized tax benefits to change significantly during the next twelve months. The Company recognizes interest and penalties related to uncertain tax positions, if any, in income tax expense.

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

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

	Three Months Ended		Nine Months Ended	
	September 29, 2012	October 1, 2011	September 29, 2012	October 1, 2011
Basic earnings (loss) per share:				
Income (loss) from continuing operations	$269	$22	$(240)	$1,474
Less: Allocation of earnings to participating securities	(10)	(1)	—	(35)
Income (loss) from continuing operations available to common shareholders - basic	$259	$21	$(240)	$1,439
Basic weighted-average shares outstanding (1)	12,650	12,596	12,630	12,582
Basic earnings (loss) per share - continuing operations	$0.02	$0.00	$(0.02)	$0.11
Diluted earnings (loss) per share:				
Income (loss) from continuing operations available to common shareholders - basic	$259	$21	$(240)	$1,439
Add: Undistributed earnings reallocated to unvested shareholders	—	—	—	—
Income (loss) from continuing operations available to common shareholders - basic	$259	$21	$(240)	$1,439
Basic weighted-average shares outstanding (1)	12,650	12,596	12,630	12,582
Effect of dilutive securities:				
Stock options (2)	—	—	—	1
Directors' stock performance units (2)	63	52	—	49
Diluted weighted-average shares outstanding (1)(2)	12,713	12,648	12,630	12,632
Diluted earnings (loss) per share - continuing operations	$0.02	$0.00	$(0.02)	$0.11

(1) Includes Common and Class B Common shares, less shares held in treasury, in thousands.
(2) Because their effects are anti-dilutive, shares issuable under stock option plans where the exercise price is greater than the average market price of the Company's Common Stock at the end of the relevant period, directors' stock performance units, and shares issuable on conversion of subordinated debentures into shares of Common Stock

have been excluded. Aggregate shares excluded for the three and nine months ending September 29, 2012 were 766 and 836, respectively and for the three and nine months ending October 1, 2011 were 1,087 and 1,108, respectively.

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NOTE M - OTHER COMPREHENSIVE INCOME (LOSS)

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

	Three Months Ended		Nine Months Ended	
	September 29, 2012	October 1, 2011	September 29, 2012	October 1, 2011
Other comprehensive income (loss):				
Unrealized gain (loss) on interest rate swaps:				
Before income taxes	$(230)	$(282)	$(748)	$(495)
Income taxes	(88)	(107)	(283)	(188)
Net of taxes	(142)	(175)	(465)	(307)
Reclassification of loss into earnings from interest rate swaps:				
Before income taxes	37	137	114	415
Income taxes	14	52	43	158
Net of taxes	23	85	71	257
Amortization of unrealized loss on dedesignated interest rate swaps:				
Before income taxes	118	21	353	21
Income taxes	45	8	134	8
Net of taxes	73	13	219	13
Reclassification of net actuarial gain into earnings from postretirement benefit plans:				
Before income taxes	(10)	(7)	(29)	(21)
Income taxes	(4)	(3)	(12)	(8)
Net of taxes	(6)	(4)	(17)	(13)
Reclassification of prior service credits into earnings from postretirement benefit plans:				
Before income taxes	(22)	(22)	(66)	(67)
Income taxes	(8)	(8)	(26)	(26)
Net of taxes	(14)	(14)	(40)	(41)
Other comprehensive income (loss)	$(66)	$(95)	$(232)	$(91)

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

	Interest Rate Swaps	Post-Retirement Liabilities	Total
Balance at December 31, 2011	$(565)	$ 477	$(88)
Unrealized gain (loss) on interest rate swaps, net of tax of $283	(465)	—	(465)
Reclassification of loss into earnings from interest rate swaps, net of tax of $43	71	—	71
Amortization of unrealized loss on dedesignated interest rate swaps, net of tax of $134	219	—	219
Reclassification of net actuarial gain into earnings from postretirement benefit plans, net of tax of $12	—	(17)	(17)

Reclassification of prior service credits into earnings from postretirement benefit plans, net of tax of $26	—	(40)	(40)
Balance at September 29, 2012	$(740)	$ 420	$(320)

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NOTE N - OTHER (INCOME) EXPENSE

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

	Three Months Ended		Nine Months Ended	
	September 29, 2012	October 1, 2011	September 29, 2012	October 1, 2011
Other operating (income) expense, net:				
Insurance proceeds (1)	$—	$—	$—	$(492)
Gain on property, plant and equipment disposals	—	(1)	—	(3)
Retirement expenses	28	118	164	274
Miscellaneous (income) expense	(76)	(15)	(116)	(128)
Other operating (income) expense, net	$(48)	$102	$48	$(349)

(1) The Company recognized a settlement gain of $492 from a company-owned insurance policy during the nine months ending October 1, 2011.

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

	Three Months Ended		Nine Months Ended	
	September 29, 2012	October 1, 2011	September 29, 2012	October 1, 2011
Other (income) expense, net:				
(Gain) loss on non-hedged swaptions	$(5)	$3	$(87)	$3
Gain on sale of non-operating assets	(187)	—	(187)	—
Miscellaneous (income) expense	3	(24)	(7)	(29)
Other (income) expense, net	$(189)	$(21)	$(281)	$(26)

NOTE O - FACILITY CONSOLIDATION AND SEVERANCE EXPENSES, NET

2008 Facilities Consolidation

In 2008 and 2009, in response to the difficult economic conditions, the Company consolidated certain manufacturing operations and ceased operating in a leased facility and made organizational changes to reduce staff and expenses throughout the Company ("2008 Facilities Consolidation"). Costs related to the facilities consolidation included equipment and inventory relocation, severance costs, employee relocation, asset impairments and costs associated with terminating a lease obligation. During the nine months ended October 1, 2011, the Company terminated the lease obligation and paid a termination fee of $700 resulting in a gain of $551 from the reduction of previously accrued estimates associated with this plan. Total costs to complete this restructuring plan were $7,410. There are no remaining costs to be incurred under this plan.

2009 Organization Restructuring

In 2009, the Company developed and implemented a plan to realign its organizational structure to combine its three residential carpet units into one business with three distinct brands ("2009 Organization Restructuring"). As a result,

the Company's residential business is organized much like its commercial carpet business and more like the rest of the industry. Costs related to the organization realignment included severance costs, associate relocation expenses and costs related to the migration of certain computer applications necessary to support the realignment. During the nine months ended October 1, 2011, the Company had a reduction of expenses of $12 associated with this plan. Total costs to complete this restructuring plan were $1,450. There are no remaining costs to be incurred under this plan.

NOTE P - 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 will be incurred, the amount of the loss, or an amount within the range of loss, that can be reasonably estimated will be recorded.

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

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. Should 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 Q)

NOTE Q - DISCONTINUED OPERATIONS

The Company has previously either sold or discontinued certain operations that are accounted for as "Discontinued Operations" under applicable accounting guidance. The Company has certain contingent obligations directly related to such operations, primarily related to self-insured workers' compensation and environmental liabilities. Costs related to these obligations for those businesses are classified as discontinued operations. Discontinued operations are summarized as follows:

	Three Months Ended		Nine Months Ended	
	September 29, 2012	October 1, 2011	September 29, 2012	October 1, 2011
Loss from discontinued operations:				
Workers' compensation costs	$(52)	$(67)	$(85)	$(90)
Environmental remediation costs	(158)	(43)	(283)	(119)
Loss from discontinued operations, before taxes	(210)	(110)	(368)	(209)
Income tax benefit	(43)	(45)	(96)	(82)
Loss from discontinued operations, net of tax	$(167)	$(65)	$(272)	$(127)

Workers' Compensation

Undiscounted reserves are maintained for the self-insured workers' compensation obligations. 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.

Environmental Remediation

Reserves for environmental remediation obligations are established on an undiscounted basis. The Company has ongoing obligations at five previously owned sites that were associated with its discontinued textile businesses. Each of these sites contains relatively low levels of ground or ground water contaminants. Each site has a Corrective Action Plan ("CAP") with the applicable authoritative state regulatory body responsible for oversight for environmental compliance and the Company contracts with third party qualified environmental specialists for related remediation, monitoring and reporting for each location. The CAP for four of these sites involves natural attenuation (degradation

of the contaminants through naturally occurring events) over periods currently estimated at 10 to 20 years and the CAP on the remaining site involves a pump and treat remediation process, currently estimated to remediate over a period of 25 years. Additionally, the Company has an environmental liability related to the property of a facility and related business that was sold in 2004. The CAP, involving an oxidation-based remediation plan, was approved in 2010 and is currently estimated to remediate over a 7 year period beginning in 2010. The Company has an accrual for environmental remediation obligations of $1,861 and $1,733 as of September 29, 2012 and December 31, 2011, respectively. 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.

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

NOTE R - SUBSEQUENT EVENT

On November 2, 2012, the Company completed the acquisition of a continuous dyeing facility in Calhoun, Georgia. The purchase price consisted of a $5,500 seller-financed note and provided for a five-year agreement to process certain of the seller's products on a commission basis. This acquisition will allow the Company to transition certain products from its beck dyeing operation in Atmore, Alabama and outside commission continuous dyeing operations in the North Georgia area to this facility.

Additionally, as a result of the acquisition, the Company amended its senior credit facility to provide for additional permitted debt under the facility and to modify the definitions of certain financial ratios.

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 2011 Annual Report on Form 10-K 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 2011 Annual Report on Form 10-K filed with the Securities and Exchange Commission. There have been no significant changes to those critical accounting policies subsequent to the date of that report.

OVERVIEW

Our residential sales growth rates for the third quarter and first nine months of 2012 were slightly below those of the industry. Excluding a one-time special in our mass merchant sector in the 2011 periods, our residential sales growth rates exceeded those of the industry. Our commercial business has significantly underperformed the industry during the third quarter and first nine months of 2012 and underperformed the comparable year ago sales periods, which were very strong, and we have seen a significant softening of commercial business since the middle of 2011. However, our backlog for commercial products has shown improvement more recently.

We are taking advantage of several opportunities to invest in products we believe will further differentiate us from the competition. We have access to two new yarn systems that are limited in distribution and, we believe, will provide exceptional softness and colorfastness qualities. In addition, we have developed a new “permaset process” for wool which we believe will allow our designer customers the broadest possible choice of colorations. As a result, during 2012 we have invested at an increased rate in sampling initiatives related to these product offerings as compared to the same periods in the prior year.

Beginning in the latter part of our first quarter of 2012 and continuing through the third quarter, we relocated certain of our tufting technologies from our manufacturing facility in Atmore, Alabama to our facility in Eton, Georgia to achieve a more favorable cost structure for the products and markets served from those technologies. The tufting realignment was completed during our third quarter. In addition, during the second quarter, we relocated certain carpet shearing equipment from our Eton facility to our Atmore facility to accommodate quality requirements. These actions resulted in incremental operating costs during the third quarter and first nine months of 2012.

On November 2, 2012, subsequent to the end of the third quarter, we completed the acquisition of a continuous dyeing facility in Calhoun, Georgia. The acquisition of this dyeing operation will allow us to transition certain of our products from our beck dyeing operation in South Alabama or other outside commission continuous dyeing operations located in North Georgia, which we believe will allow us to achieve significant cost reductions. The purchase price of this acquisition consisted of a $5.5 million, seller financed note and provided for a five year agreement to process certain of the seller's products on a commission basis.

We remain cautiously optimistic about conditions that affect the higher-end residential markets we serve and continue to address initiatives in our commercial offerings related to our products, manufacturing processes and distribution alternatives. Additionally, in an effort to strengthen our performance in our commercial sector, we brought in new leadership for our commercial business. Although we believe raw material prices have peaked, we experienced increases in certain of our raw material costs in the first half of 2012. We implemented sales price increases to recoup these cost increases, as has the industry.

RESULTS OF OPERATIONS

Our second and third quarters of 2012 and 2011 each contained 13 operating weeks. Our first quarter of 2012 contained 13 operating weeks compared with 14 operating weeks in the first quarter of 2011; therefore, the first nine months of 2012 contained 39 operating weeks compared with 40 operating weeks in the first nine months of 2011. Discussions below related to percentage changes in net sales during the nine month periods have been adjusted to reflect the comparable number of weeks in the reporting periods and are qualified with the term “net sales as adjusted”. We believe "net sales as adjusted" will assist our financial statement users to better understand the rate of growth in our business in the comparative periods as a result of the difference in operating weeks. (See reconciliation of net sales to net sales as adjusted below.)

Reconciliation of Net Sales to Net Sales as Adjusted

	Nine Months Ended		
	September 29, 2012	October 1, 2011	% Increase/(Decrease)
Net sales as reported	$195,238	$204,761	(4.7)%
Adjustment to net sales:			
Impact of additional operating week	—	(4,711)	
Net sales as adjusted	$195,238	$200,050	(2.4)%

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		Nine Months Ended	
	September 29, 2012	October 1, 2011	September 29, 2012	October 1, 2011
Net sales	100.0 %	100.0 %	100.0 %	100.0 %
Cost of sales	74.8 %	77.3 %	75.4 %	76.0 %
Gross profit	25.2 %	22.7 %	24.6 %	24.0 %
Selling and administrative expense	24.0 %	20.8 %	23.8 %	21.9 %
Other operating (income) expense, net	0.0 %	0.2 %	0.0 %	(0.1)%
Facility consolidation and severance expenses, net	— %	— %	— %	(0.3)%
Operating income	1.2 %	1.7 %	0.8 %	2.5 %

Net Sales. Net sales for the quarter ended September 29, 2012 were $65.8 million compared with net sales of $69.6 million for the year-earlier quarter, or a decline 5.4%. Net sales in the first nine months of 2012 were $195.2 million compared with net sales of $204.8 million in the first nine months of 2011, a decline of 4.7%, or 2.4%, on a “net sales as adjusted” basis. In the third quarter of 2012, residential carpet sales reflected a decrease of 2.9% and net sales of commercial carpet decreased 10.6% compared with the third quarter of 2011. Residential carpet sales increased 0.3%, or 2.6% on net sales as adjusted, and commercial carpet net sales decreased 17.0%, or 15.1% on net sales as adjusted in the nine months of 2012 compared with the first nine months of 2011. Our residential sales in the third quarter and first nine months of 2012, compared with the prior-year periods, included increased sales through our higher-end retail and designer channels while residential sales declined through our mass merchant channels of distribution which are less predictable and more prone to volatility as a result of merchandising specials prevalent in the mass merchant channels. Our commercial business is more heavily concentrated in specified project oriented business which, we believe, is significantly affected by general economic uncertainties. Additionally, our commercial sales comparisons in both the third quarter and first nine months of 2012 are negatively affected by extremely strong sales in the 2011 periods when we were significantly outperforming the industry in sales growth.

Cost of Sales. Cost of sales as a percentage of net sales was 74.8% in the third quarter of 2012 compared with 77.3% in the third quarter of 2011. Cost of sales was 75.4% in the first nine months of 2012 compared with 76.0% in the first nine months of 2011. The improvement in the 2012 periods was principally a result of manufacturing processing efficiencies that more than offset costs included in the 2012 periods related to the tufting machinery relocations as discussed in the overview section above as well as higher expenses due to the development of new fibers.

Gross Profit. Gross profit dollars increased $784 thousand in the third quarter of 2012 compared with the third quarter 2011 and decreased $1.1 million in the first nine months of 2012 compared with the same period in 2011. In the third quarter and first nine months of 2012, gross profit as a percentage of sales increased 2.5 percentage points and 0.6 percentage points, respectively compared with the 2011 periods. The manufacturing processing cost improvements in

the 2012 reporting periods mitigated the effects of lower sales volume, costs related to the machinery realignments and higher expenses related to the new fiber development compared with the 2011 periods.

Selling and Administrative Expenses. Selling and administrative expenses increased 3.2% as a percentage of sales in the third quarter of 2012 compared with the same period in 2011 and increased 1.9% as a percent of sales in the first nine months of 2012 compared with the first nine months of 2011. The higher selling and administrative expenses as a percentage of sales is primarily a result of the increased sampling costs in the 2012 periods related to the new product initiatives discussed in the overview section above.

Other Operating (Income) Expense, Net. Other operating (income) expense was negligible in the third quarter and first nine months of 2012. The third quarter of 2011 included $118 of retirement related expenses and the first nine months of 2011 included a gain of $492 thousand related to the settlement of a company-owned insurance policy.

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Facility Consolidation and Severance Expenses, Net. We fulfilled our lease agreement obligations associated with our California facility in the second quarter of 2011 resulting in the recognition of a $563 thousand gain as a result of the reversal of previously estimated contractual obligations under the lease agreement.

Operating Income. We reported operating income of $820 thousand in the third quarter of 2012 compared with operating income of $1.2 million in the third quarter of 2011. Operating income was $1.4 million in the first nine months of 2012 compared with operating income of $5.1 million in the first nine months of 2011. Operating results in the 2012 reporting periods were negatively affected by the lower sales volume, incremental equipment relocation expenses and increased sample costs. Operating results in 2011 were favorably affected by the gains from the facilities consolidation and settlement of the company-owned insurance policy.

Interest Expense. Interest expense decreased $123 thousand in the third quarter of 2012 and $466 thousand for the first nine months of 2012, respectively compared with the same periods in 2011. The reductions are principally a result of lower interest rates in the 2012 periods compared with the 2011 periods, including the effects of related interest rate swaps.

Other Income, Net. Other income in the third quarter and first nine months of 2012 included a gain of $187 thousand from a sale of other non-operating assets.

Income Tax Provision (Benefit). Our effective income tax provision (benefit) rates are based upon estimated annual income tax rates. The difference between the effective rates and the statutory rates for the three and nine months ended September 29, 2012 was primarily due to changes to the provision as the result of filing the income tax return as well as the utilization of certain state tax net operating loss carryforwards that resulted in the reversal of the valuation allowance related to their utilization. In the third quarter of 2011, we adjusted our federal and state income tax accrual to reflect changes to the provision as a result of filing our income tax return resulting in a tax benefit of $44 thousand. Our tax provision rate for the first nine months of 2011 was 30.5%. This provision rate differed from statutory rates primarily as a result of a non-taxable settlement gain in the first quarter of 2011 related to company-owned insurance.

Income (Loss) from Continuing Operations. We had income from continuing operations of $269 thousand, or $0.02 per diluted share in the third quarter of 2012 compared with income from continuing operations of $22 thousand, or $0.00 per diluted share in the third quarter of 2011. Continuing operations reflected a loss of $240 thousand, or $0.02 per diluted share, for the first nine months of 2012 compared with income from continuing operations of $1.5 million, or $0.11 per diluted share, in the first nine months of 2011.

Net Income (Loss). Discontinued operations reflected a loss of $167 thousand, or $0.01 per diluted share, in the third quarter of 2012 compared with a loss of $65 thousand, or $0.00 per diluted share, in the same period in 2011. Discontinued operations reflected a loss of $272 thousand, or $0.02 per diluted share, in first the first nine months of 2012 compared with a loss of $127 thousand, or $0.01 per diluted share, in the first nine months of 2011. Including discontinued operations, we had income of $102 thousand, or $0.01 per diluted share, in the third quarter of 2012 compared with a net loss of $43 thousand, or $0.00 per diluted share, in the third quarter of 2011. The first nine months of 2012 reflected a loss of $512 thousand, or $0.04 per diluted share compared with net income of $1.3 million, or $0.10 per diluted share, in the comparable nine month period in 2011.

LIQUIDITY AND CAPITAL RESOURCES

During the nine months ended September 29, 2012, debt increased $7.1 million under our senior credit line and equipment financing agreements and an additional $631 thousand related to equipment acquired under a capitalized lease for a total increase in debt of $7.7 million. These funds of $7.1 million were used to finance our operations including $4.3 million in operating activities, $2.0 million in property, plant and equipment purchases, $199 thousand to acquire our common stock for treasury, and a reduction in outstanding checks in excess of cash of $923 thousand.

Working capital increased $10.5 million in the first nine months of 2012, principally as a result of an increase of $7.1 million in inventories primarily to accommodate anticipated increased levels of business associated with the launch of our new true-soft products. Accounts receivables increased $2.8 million from seasonably low year end levels while other current assets increased $1.7 million, primarily related to expenditures for new product introductions.

During the quarter ended June 30, 2012, we renegotiated an equipment operating lease resulting in the return of a security deposit of $809 thousand from the lessor and the cancellation of a standby letter of credit of $768 thousand by the lessor that resulted in an increase in borrowing availability under our senior credit agreement.

Capital asset acquisitions for the nine months ended September 29, 2012 were $2.6 million; $2.0 million through funded debt and $631 thousand of equipment acquired under a capitalized lease, while depreciation and amortization was $7.1 million. We expect capital expenditures to be approximately $4.0 million for normal capital expenditures as well as $5.5 million for the acquisition of the Colormaster facility in fiscal 2012. Total investing activities for 2012 are estimated at $9.5 million while

depreciation and amortization is expected to be approximately $9.6 million. Planned capital expenditures in 2012 are primarily for new equipment in both infrastructure support and production enhancements.

Debt Facilities

On September 14, 2011, we entered into a five-year, secured revolving credit facility (the "senior credit facility"). The senior credit facility provides for a maximum of $90.0 million of revolving credit, subject to borrowing base availability, including limited amounts of credit in the form of letters of credit and swingline loans. The borrowing base is equal to specified percentages of our eligible accounts receivable, inventories and fixed assets less reserves established, from time to time, by the administrative agent under the senior credit facility.

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

The senior credit facility includes certain affirmative and negative covenants that impose restrictions on our financial and business operations, including limitations on debt, liens, investments, fundamental changes in our business, asset dispositions, dividends and other similar restricted payments, transactions with affiliates, payments and modifications of certain existing debt, future negative pledges, and changes in the nature of our business. We are also required to maintain a fixed charge coverage ratio of 1.1 to 1.0 during any period that borrowing availability is less than $10.0 million.

We can use the proceeds of the senior credit facility for general corporate purposes, including financing acquisitions and refinancing other indebtedness. As of September 29, 2012, the unused borrowing availability under the senior credit facility was $20.2 million.

As a result of the acquisition on November 2, 2012, we amended our senior credit facility to provide for additional permitted debt under this agreement and to modify the definition of certain financial ratios.

On September 13, 2011, the Company entered into a five-year $11.1 million mortgage loan. The mortgage loan is secured by the Company's Susan Street facility and liens secondary to the senior credit facility. The mortgage loan is scheduled to mature on September 13, 2016. The mortgage loan bears interest at a variable rate equal to one month LIBOR plus 3.00% and is payable in equal monthly installments of principal of $61 thousand, plus interest calculated on the declining balance of the mortgage loan, with a final payment of $7.4 million due on maturity.

DISCONTINUED OPERATIONS

During our third quarter of 2012, we received a directive from the authoritative state regulatory body requiring additional environmental remediation at one of our discontinued operating locations. Accordingly, we increased our environmental liability by $125 thousand representing the estimated cost of compliance related to the directive.

RECENT ACCOUNTING PRONOUNCEMENTS

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

In June 2011, the FASB issued ASU No. 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income. This ASU eliminates the option to report other comprehensive income and its components in the statement of stockholders equity and requires the presentation of comprehensive income in either (1) a continuous statement of comprehensive income or (2) two separate but consecutive statements. This ASU is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011 and should be applied retrospectively. We early adopted this ASU in the prior year and presented the components of other comprehensive income in a separate statement following the statement of operations. In December 2011, the FASB issued ASU 2011-12, Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05. ASU 2011-12 deferred the changes in ASU 2011-05 that relate to the presentation of reclassification adjustments to other comprehensive income. These amendments were delayed to allow the FASB time to

redeliberate whether to present the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income on the face of the financial statements for all periods presented. While the FASB is considering the operational concerns about the presentation requirements for reclassification adjustments and the needs of financial statement users for additional information about reclassification adjustments, we are required to continue reporting reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect before ASU 2011-05.

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

In July 2012, the FASB issued ASU No. 2012-02, "Intangibles--Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment." This ASU states that an entity has the option first to assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that the indefinite-lived intangible asset is impaired. If, after assessing the totality of events and circumstances, an entity concludes that it is not more likely than not that the indefinite-lived intangible asset is impaired, then the entity is not required to take further action. However, if an entity concludes otherwise, then it is required to determine the fair value of the indefinite-lived intangible asset and perform the quantitative impairment test by comparing the fair value with the carrying amount in accordance with Codification Subtopic 350-30, "Intangibles--Goodwill and Other, General Intangibles Other than Goodwill." Under the guidance in this ASU, an entity also has the option to bypass the qualitative assessment for any indefinite-lived intangible asset in any period and proceed directly to performing the quantitative impairment test. An entity will be able to resume performing the qualitative assessment in any subsequent period. The amendments in this ASU are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted, including for annual and interim impairment tests performed as of a date before July 27, 2012, if a public entity's financial statements for the most recent annual or interim period have not yet been issued or, for nonpublic entities, have not yet been made available for issuance. We do not expect that the adoption of this ASU will have a material effect on our Consolidated Condensed Financial Statements.

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 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.

FORWARD-LOOKING INFORMATION

This Report contains statements that may be considered forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended. These statements include the use of terms or phrases that include such terms as "expects," "estimates," "projects," "believes," "anticipates," "intends," and similar terms and phrases. Such forward looking statements relate to, among other matters, our future financial performance, business prospects, growth strategies or liquidity. The following

important factors may affect our future results and could cause those results to differ materially from our historical results; these factors include, in addition to those "Risk Factors" detailed in item 1A of this report and described elsewhere in this document, the cost and availability of capital, raw material and transportation costs related to petroleum price levels, the cost and availability of energy supplies, the loss of a significant customer or group of customers, materially adverse changes in economic conditions generally in carpet, rug and floor covering markets we serve and other risks detailed from time to time in our filings with the Securities and Exchange Commission.

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 I to the Consolidated Condensed Financial Statements).

At September 29, 2012, $28,948, or approximately 38% of our total debt, was subject to floating interest rates. A 10% fluctuation in the variable interest rates applicable to this floating rate debt would have an annual after-tax impact of approximately $29.

Item 4 - Controls and Procedures

We maintain disclosure controls and procedures to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the

Commission's rules and forms and is accumulated and communicated to management, including our principal executive officer and principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Our management, under the supervision and with the participation of our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as such terms are defined in Rules 13(a)-15(e) and 15(d)-15(e)) under the Securities Exchange Act of 1934, as amended (the "Exchange Act") as of September 29, 2012, 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
None.

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 cyclical and prolonged declines in residential or commercial construction activity or corporate remodeling and refurbishment could have a material adverse effect on our business. Factors that affect such declines may include:

- 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 have significant levels of sales in certain channels of distribution.

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

We have significant levels of indebtedness.

We have significant amounts of debt relative to our equity. If our cash flow or profitability are insufficient, the value of our assets securing our loans are insufficient or we are unable to access the debt or equity markets at competitive rates or in sufficient amounts, it could materially adversely affect our ability to generate sufficient funds to satisfy the terms of our senior loan agreements and other debt obligations.

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 that has caused a number of our existing and potential competitors to be significantly larger and have significantly 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 and polyester yarn, as well as wool yarns, 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 cost increases 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 such 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 ability to supply our customers and could be material.

Environmental, safety and health regulatory governance.

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

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

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

The following table provides information regarding our repurchases of shares of our Common Stock during the three months ended September 29, 2012:

Month Ending	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced	Maximum Number (or approximate dollar value) of Shares That

			Plans or Programs (1)	May Yet Be Purchased Under Plans or Programs
August 4, 2012	—	$—	—	
September 1, 2012	13,400	3.36	13,400	
September 29, 2012	—	—	—	
Three Months Ended September 29, 2012	13,400	$3.36	$13,400	$4,475,722

(1) On August 8, 2007, we announced a program to repurchase up to $10 million of our Common Stock.

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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.
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: November 9, 2012	By: /s/ JON A. FAULKNER Jon A. Faulkner Vice President and Chief Financial Officer
Date: November 9, 2012	By: /s/ D. EUGENE LASATER D. Eugene Lasater Controller

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