

Mossberg's Investor Digest

Best Idea Profile:

The Dixie Group, Inc. (NASDAQ:DXYN)

DESCRIPTION:

Begun in 1920, The Dixie Group transitioned from textiles to floorcoverings in the 1990s. Its focus now is on carpet and rug brands in the upper-end market, including both commercial and residential floorcoverings. It also provides carpet yarn processing, dyeing and finishing services to other manufacturers. It has a diversified customer base with the top 20 carpet customers making up 18% of sales. Some of its brands include Fabrica, Masland, Atlas, and Dixie. Dixie is based in Chattanooga, Tennessee, and has 1,423 employees.

KEY INVESTMENT CONSIDERATIONS:

Restructured for Growth – Like much of the industry during 2008 to 2010, Dixie concentrated on cost reduction. But because of the lack of investment in the industry, during the next two years Dixie had the opportunity to invest in new fibers, new technology and new products that would enable it to grow faster than the industry, particularly in the high-end markets. Looking back at the post-recession period since 2009, Dixie has seen sales increase by 85%, while the industry has grown by less than 15%. The market is recovering in fits and starts, but it is believed that there is considerable pent-up demand in the refurbishment and replacement business in both housing and commercial markets.

Expenses Will Decline – The internal and acquisition growth Dixie achieved means it had to restructure its manufacturing and distribution operations faster than expected; a considerable cost to profitability in the short-term, but surely the right thing to do for shareholders. The restructuring of the operations has been costly to short-term profitability. These expenses have been more front-end loaded than management expected. However, much of this is behind Dixie now. Capital expenditures in 2014 will be almost \$31 million, but capital expenditures in 2015 will be less than half of that. Head count has grown 45% since the beginning of 2012, but this too will be absorbed as the sales grow.

Tough Comparisons – Dixie recorded an unusual fourth quarter in 2013, 35% growth, which means the comparisons for the upcoming 2014 quarter will be less than stellar. However, there should be some solid sales and profitability reported. Management indicated in the last quarter call that it expects gross margins could approach pre-recession levels, north of 25%, by the middle of 2015.

Attractive Acquisitions – The acquisition of Atlas Carpet Mills in early 2014 brought volume and profitability, as well as strength in the high-end commercial business. It was one of the last privately owned carpet manufacturers remaining, and the addition of this niche market broadens Dixie's product offerings in the commercial arena. Then in September of this year, Dixie acquired the assets of Burtco, LLC, which added immediate capability, technology, and quality reputation for a carpet product line serving the hospitality marketplace. This is a product category in which Dixie has not previously participated. It gives its sales people a "more complete bag of tricks" to call on hospitality businesses.

Expectations – Management expects sales will grow between 30% and 50%, once the restructuring is complete. And margins should increase: "there is no reason not to expect that they can be in at high 20s."

VALUATION:

The stock is selling fairly near its low for the year. Fourth quarter will be another tough comparison because of the extraordinary sales in the second half of 2013. That provides investors an opportunity to step in and participate in the benefits that the restructuring and improving market conditions will provide.

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Investment Data (as of 12/19/14)

Recent Price	\$8.74
52-Week Range	\$6.00 - \$18.41
Fiscal Year End	Dec 28
Dividend	NA
Yield	NA
Shares Outstanding	15.4 M
Average Trading Volume (3 mos)	123k
Market Capitalization	\$134.5 M
Cash	\$0.5 M
Long-term Debt	\$124.5 M
Enterprise Value (EV)	\$256.0 M
Book Value	\$6.38
TTM Revenue	\$398.6 M
P/ Revenue	0.3x
TTM EPS	\$0.35
P/ EPS	24.7x
TTM EBITDA	\$21.8 M
EV/ EBITDA	11.7x

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