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DXYN - Full Year 2019 Dixie Group Inc Earnings Call

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CORPORATE PARTICIPANTS

Allen L. Danzey *The Dixie Group, Inc. - CAO & CFO*

Daniel K. Frierson *The Dixie Group, Inc. - Chairman & CEO*

CONFERENCE CALL PARTICIPANTS

Barry Blank

PRESENTATION

Operator

Good day, and welcome to The Dixie Group, Inc. 2019 Earnings Conference Call. (Operator Instructions)

As a reminder, today's call is being recorded. At this time, for opening remarks and introductions, I would like to turn the call over to the Chairman and Chief Executive Officer, Dan Frierson. Please go ahead.

Daniel K. Frierson - *The Dixie Group, Inc. - Chairman & CEO*

Thank you, Daryl, and welcome, everyone, to our fourth quarter conference call. I have with me Allen Danzey, our Chief Financial Officer; and John Faulkner, our Vice President of Strategic Initiatives. Our safe harbor statement is included by reference both to our website and press release. For 2019, the company had net sales of $374 million as compared to $405 million in 2018. The profit from continuing operations for 2019 was $15,619,000 or $0.95 per diluted share as compared to a loss from continuing operations of $21,479,000 in 2018. Net income for the year of 2019 was $15,271,000. For the quarter, the profit from continuing operations was $26 million or $1.60 per diluted share. On a non-GAAP basis, as shown on the attached schedule to our press release the results from continuing operations for the fourth quarter was a profit of $1,182,000 or $0.07 per diluted share. In the fourth quarter of 2019, we sold our Susan Street facility and signed the lease with options for a period of up to 20 years. The gain on the sale was approximately $25 million or $1.50 per share. Our senior credit facility was paid down by $36 million as a result of the sale. Our debt reduction from the third quarter of 2018 through the end of 2019 has been over $50 million. Our total stockholders' equity increased 50% as a result of the transaction.

2019 was a year of change for both Dixie and the industry. The residential soft surface business was impacted by the weakness in soft floorcovering for the industry. The residential soft surface market was down high single digits in

2019 relative to the prior year. We also saw substantial changes in the mass merchant channel, as these retailers shifted more floor space to hard surface products. This emphasis by our mass merchant customer impacted our sales in the second half of the year. Despite the decline in our mass merchant sales, we outpaced the market in the specialty retail segment, where our soft surface sales declined low to mid-single digits and our hard surface sales grew by approximately 50%. Our commercial soft surface sales for the year were down over 12%, while the commercial soft floorcovering market we believe, was down marginally.

Despite the drop in business, we feel we've positioned Atlas | Masland Contract for growth with one of the most extensive product lines in the commercial business. At this time, I'll turn it over to Allen Danzey to give our financial results after which I will have more comments.

Allen L. Danzey - *The Dixie Group, Inc. - CAO & CFO*

Thank you, Dan. Our net sales for the fourth quarter were $90.1 million, an 8.2% decrease over sales of $98.2 million in the fourth quarter of 2018. All the year, the net sales for 2019 were $374.6 million. This was a 7.5% decrease from the 2018 net sales of $405 million. Gross profit for the quarter was 25.2% of net sales as compared to 18.7% in 2018. For the year, gross profit was 23% of net sales as compared to 21.5% in 2018. In 2018, our cost of sales was negatively impacted by inventories written down as part of our profit improvement plan. In 2019, our cost of sales showed improvement as a result of changes made as part of our profit improvement plan.

Selling and administrative expenses as a percent of net sales were 22.2% in the fourth quarter of 2019 compared to 22.9% in the same quarter of 2018. And for the year, our selling and administrative costs were 22.4% of net sales as compared to 22.8% in 2018. This favorable comparison, despite the reduction in sales was the result of cost reductions as part of the profit improvement plan, which is now complete.

As Dan stated previously, in the fourth quarter of 2019, we sold our Susan Street facility in Santa Ana, California and signed a lease with options for a period of up to 20 years. The gain on the sale was approximately $25 million or over $1.50 per share. Our senior credit facility was paid down by $36 million as a result of the sale. Our total debt reduction was over $50 million from the third quarter of 2018 through the end of 2019. As a result of this reduction in debt, interest expense in the fourth quarter of 2019 was down 17.7%, as compared to the fourth quarter of 2018. For the year, interest expense was $6.4 million in 2019 compared to $6.5 million in 2018. Our stockholders' equity increased 50% over the third quarter of 2019.

During 2019, we incurred $5 million in facility consolidation and severance expenses. This completed our profit improvement plan, which we began in the fourth quarter of 2017. Total cost reductions as a result of our plan are expected to be in excess of $18 million on an annual basis as compared to the 2017 cost structure. We had an operating profit of $26.7 million for the fourth quarter of 2019 as compared to an operating loss of $12.8 million in the same period in 2018. On a non-GAAP basis, excluding the gain on sale of our Susan Street facility and expenses related to restructuring. The results from continuing operations in the fourth quarter was a profit of $1.2 million or $0.07 per diluted share. For the year 2019, our operating profit was $21.3 million as compared to an operating loss of $15.8 million in 2018. Diluted profit per share from continuing operations was $1.60 for the fourth quarter and $0.95 for the entire year of 2019.

Turning to our balance sheet. At the end of 2019, receivables were down $5.4 million as a result of the lower sales volume. Inventory decreased $9.7 million during 2019. Capital equipment acquisitions, including those funded by cash and financing was $4.3 million in 2019. Depreciation and amortization in 2019 was $11.4 million. We anticipate capital expenditures for 2020 to be approximately $5 million and depreciation and amortization of approximately $10.9 million. Outside of our operating lease liabilities, the total of our long-term debt, including the short-term portion decreased $39.7 million during the quarter due to the sale of Susan Street and decreases in our working capital.

Under our previously announced stock buyback plan we purchased in the fourth quarter of 2019, 500,000 shares of stock at an average price of $1.63 per share. Our investor presentation, including our non-GAAP information is on our website at www.thedixiegroup.com. Dan?

Daniel K. Frierson - *The Dixie Group, Inc. - Chairman & CEO*

Thank you, Alan. We completed our profit improvement plan in 2019. Since the beginning of 2017, this plan cost over $18 million to implement and generated over $18 million in annual savings relative to our 2017 cost structure. As part of this plan, we have shut down our realigned 5 plants. With the implementation of this plan, our cost of quality has been reduced by over 25%. Our headcount has been reduced by 20% since the beginning of 2018. The combination of the sale of our Susan Street facility and reduction in our working capital has reduced our debt by over $50 million. The reduction in working capital has come about from a focused just-in-time planning scheduling system. In addition to the profit improvement plan in 2020, we anticipate cost reductions, including changes in our medical plans, raw material reductions and savings in processing of over $5 million this year as we continue to work to restore our margins to acceptable levels.

As we enter 2020, we're excited to celebrate a 100 years of business. Over our 100 year history, the company has transformed itself again and again from cotton yarns to textile synthetic yarns than to carpet yarns. Then from a yarn supplier to carpet manufacturer. And today, we continue the transformation to a full service, floorcovering provider with a growing hard surface program. We're proud of our history and heritage, and we're excited about starting the next 100 years as a company.

We have merged our 2 commercial business into Atlas | Masland Contract. We're positioned with an extensive product line, including our broadloom carpet, modular carpet tile, luxury vinyl flooring and commercial rugs to service our customers with excellent service and cutting-edge design from our focused operational facilities dedicated to the commercial marketplace. As part of the broad product line, we have introduced one of the most unique innovations. The crafted collection with Sustaina backing. This environmentally conscious and installer friendly product line comes in a beautiful set of patterns. The Sustaina modular tile backing system is a PVC and polyurethane-free cushion modular carpet tile, with very high recycled content. The product is breathable and able to be installed in environments up to 99% relative humidity and up to a pH of 12 when utilizing our custom formulated Sustaina 99 adhesive. Crafted Collection, along with Sustaina backing has an 81.5% and total recycled content, the highest available in the market today. This product innovation differentiates us in the market to our environmentally conscious designers and commercial customers.

Residentially, we introduced 50 new styles in soft surface, including Stainmaster, EnVision 6,6 and Strongwool. We continue to be a leading manufacturer in Stainmaster carpet and are proud to launch some of the most unique and beautiful Stainmaster products in the marketplace. We are also taking steps to diversify our offering with our new EnVision 6,6 program, which we initially launched in late 2018 and saw a significant traction and growth in 2019. In 2020, we have 17 new styles in EnVision 6,6 across all of our divisions. At Masland, we have our Masland Energy line. We are adding new products in broadloom and tile, addressing some of the key opportunities in that program. We are also featuring a patent-pending yarn innovation, color play and a new PetProtect product named Grace in our Masland product line. This color play innovation gives us a unique color story for solution dyed nylon with natural striations across 16 different colors.

We're very excited about a new testing technology TECHnique, which is being showcased in our Masland and Fabrica lines. TECHnique delivers a woven visual with a crisp, clean finish and products that are more of art than floorcovering. We have continued to focus on growing our luxury vinyl tile business. With the successful launch of TRUCOR and TRUCOR Prime, we are poised to continue the substantial growth we achieved in 2019. We're growing the number of items in our TRUCOR family of products by over 40%. We are building out TRUCOR SBC program with exciting visuals and new sizes in our 5, 7 and 9-inch wide plank and tile programs. We are featuring a new innovation in tile, Integrated Grout Technology, where the locking system is engineered to simulate a real grout line. We're launching this integrated grout program with 12 beautiful visuals in multiple sizes, including a 24 by 24 Carrara marble designs. We're launching our new TRUCOR Prime WPC program, including 18 oversized planks and contemporary clean visuals. The feature product in the offering is our XXL plank, 10 inches wide and 84 inches long, inspired by high-end French Oak visuals. This is the longest and widest rigid core plank product on the market. We're expanding our Fabrica wood program with 9 new products, including European White Oak and American Hickory. These enhancements will give us color finishes and price points to continue growing this new offering in our Fabrica division.

To accelerate this growth, we're adding dedicated sales representatives in our residential sales team to focus exclusively on our hard surface products under the Fabrica, Masland and Dixie Home brands. In summary, in 2019 and early '20, we have consolidated our 2 commercial brands into 1, the Atlas | Masland Contract. We launched Sustaina with 95% post-consumer recycled material, PVC and polyurethane-free backing. We launched TRUCOR and TRUCOR Prime. We're growing the number of items in TRUCOR by 40% this year. Since the third quarter of 2018, we've paid down over $50 million in debt. In 2019, we increased our equity by over 50%, and we launched around 50 new styles in our self surface offering. And in the fourth quarter, we returned to operating profitability. As Allen mentioned earlier, in the fourth quarter, we purchased 500,000 shares of stock yesterday, the Board authorized an extension of the stock buyback plan authorizing the buyback of up to $5 million of stock over the next year. As we -- as the year began, business activity was slow and behind the levels of last year. Sales and orders in February have improved significantly and are above the level of last year. We have experienced improvement in both the residential retail and commercial business. However, our mass merchant sales continued to underperform. For the quarter-to-date, excluding our mass merchant sales, our sales are slightly behind the same period of 2019. However, for the month of February, both orders and sales for the company were above year ago levels. With sales for both the residential and commercial businesses, up from a year ago and substantially above our weekly sales rate in January.

Certainly, all of us are concerned about the coronavirus. It is too early to tell what impact that will have on our business. To date, the impact has been to slightly delay some shipments of luxury vinyl tile from China. In terms of our sales and orders, it does not seem to have had an impact at this time.

And at this time we will open the meeting to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first questions come from the line of Barry Blank of J.H. Darbie.

Barry Blank

Dan, it was a great job, great quarter and a great year and congratulations.

Daniel K. Frierson - *The Dixie Group, Inc. - Chairman & CEO*

Thank you, Barry.

Barry Blank

I've got a couple of questions. In the flooring industry, I'm seeing consolidation, seeing a lot of smaller companies combined. What is the philosophy of the company and either, a, making acquisitions or possibly being acquired with this trend going on?

Daniel K. Frierson - *The Dixie Group, Inc. - Chairman & CEO*

Well, Barry, the trend has been going on for many, many years. For instance, around Dalton many years ago, there used 200 and 300 carpet mills and California around 50. So the trend is certainly -- then going on, it has not been as active in the last few years, candidly, because there are fewer players. But that is something our board continues to examine, and we will continue to do that going forward.

But at this point, obviously, our focus has been on improving operations and our financial results.

Barry Blank

One more question I have regarding the trend or hard flooring away from the soft flooring. Could you maybe give a little color on what the company is doing to increase that percentage of the business into hard flooring compared to the soft flooring?

Daniel K. Frierson - *The Dixie Group, Inc. - Chairman & CEO*

Barry, the comments I made about TRUCOR in the presentation, we have invested heavily in hard surface. We were late getting there, but we have invested heavily. We have hired people to help us with that. And for the first time, beginning in early 2020, we are hiring salespeople to sell exclusively hard surface. We think that will, again, help jump-start what is already we -- as I mentioned, we were up 50% last year in hard surface and our plans are to be up that much or more this year.

Operator

(Operator Instructions) With no further questions in the queue. I will turn the call back to Dan Frierson for any additional or closing remarks.

Daniel K. Frierson - *The Dixie Group, Inc. - Chairman & CEO*

Daryl, thank you very much. We appreciate all of you being with us for this fourth quarter conference call. Certainly, 2019 was a very active year for us. The good news in 2020 is we have no facility changes that we have planned at this time. So our emphasis is focused on improving results and improving internal operations and growing our -- both our soft and hard surface businesses. Thank you again, and we'll visit with you again at the end of next quarter.

Operator

Ladies and gentlemen that will conclude today's conference. Thank you again for your participation.
