

CULP INC
Form 10-Q
March 13, 2015

UNITED STATES

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 February 1, 2015
Commission File No. 1-12597

CULP, INC.

(Exact name of registrant as specified in its charter)

NORTH CAROLINA
(State or other jurisdiction of
incorporation or other organization)

56-1001967
(I.R.S. Employer Identification No.)

1823 Eastchester Drive
High Point, North Carolina
(Address of principal executive offices)

27265-1402
(zip code)

(336) 889-5161

(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 the filing requirements for at least the past 90 days. YES NO

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller Reporting Company

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

Edgar Filing: CULP INC - Form 10-Q

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

Common shares outstanding at February 1, 2015: 12,219,121
Par Value: \$0.05 per share

INDEX TO FORM 10-Q
For the period ended February 1, 2015

	Page
<u>Part I - Financial Statements</u>	
<u>Item 1. Financial Statements: (Unaudited)</u>	
<u>Consolidated Statements of Net Income -- Three and Nine Months Ended February 1, 2015 and January 26, 2014</u>	I-1
<u>Consolidated Statements of Comprehensive Income - Three and Nine Months Ended February 1, 2015 and January 26, 2014</u>	I-2
<u>Consolidated Balance Sheets -- February 1, 2015, January 26, 2014, and April 27, 2014</u>	I-3
<u>Consolidated Statements of Cash Flows -- Nine Months Ended February 1, 2015 and January 26, 2014</u>	I-4
<u>Consolidated Statements of Shareholders' Equity</u>	I-5
<u>Notes to Consolidated Financial Statements</u>	I-6
<u>Cautionary Statement Concerning Forward-Looking Information</u>	I-27
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	I-28
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	I-47
<u>Item 4. Controls and Procedures</u>	I-47
<u>Part II - Other Information</u>	
<u>Item 1. Legal Proceedings</u>	II-1
<u>Item 1A. Risk Factors</u>	II-1
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	II-1
<u>Item 6. Exhibits</u>	II-2
<u>Signatures</u>	II-3

Item 1: Financial Statements

CULP, INC.
CONSOLIDATED STATEMENTS OF NET INCOME
FOR THE THREE AND NINE MONTHS ENDED FEBRUARY 1, 2015, AND JANUARY 26, 2014
UNAUDITED
(Amounts in Thousands, Except for Per Share Data)

		THREE MONTHS ENDED	
		February 1, 2015	January 26, 2014
Net sales	\$	81,269	72,389
Cost of sales		66,867	60,552
Gross profit		14,402	11,837
Selling, general and administrative expenses		8,375	7,041
Income from operations		6,027	4,796
Interest expense		-	91
Interest income		(202)	(148)
Other expense		307	279
Income before income taxes		5,922	4,574
Income taxes		2,110	(3,807)
Net income	\$	3,812	8,381
Net income per share, basic	\$	0.31	0.69
Net income per share, diluted		0.31	0.68
Average shares outstanding, basic		12,219	12,188
Average shares outstanding, diluted		12,417	12,405

		NINE MONTHS ENDED	
		February 1, 2015	January 26, 2014
Net sales	\$	231,320	213,119
Cost of sales		191,925	175,974
Gross profit		39,395	37,145
Selling, general and administrative expenses		23,173	21,340

Edgar Filing: CULP INC - Form 10-Q

	Income from operations	16,222	15,805
Interest expense		50	330
Interest income		(478)	(343)
Other expense		380	895
	Income before income taxes	16,270	14,923
Income taxes		6,113	216
	Net income	\$ 10,157	14,707
	Net income per share, basic	\$ 0.83	1.21
	Net income per share, diluted	0.82	1.19
	Average shares outstanding, basic	12,216	12,173
	Average shares outstanding, diluted	12,410	12,405

See accompanying notes to consolidated financial statements.

CULP, INC.
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
 FOR THE THREE AND NINE MONTHS ENDED FEBRUARY 1, 2015, AND JANUARY 26, 2014
 (UNAUDITED)

	THREE MONTHS ENDED	
	February 1, 2015	January 26, 2014
Net income	\$3,812	\$8,381
Other comprehensive gain (loss)		
Unrealized gains (losses) on investments	22	(14)
Total other comprehensive gain (loss)	22	(14)
Comprehensive income	\$3,834	\$8,367
	NINE MONTHS ENDED	
	February 1, 2015	January 26, 2014
Net income	\$10,157	\$14,707
Other comprehensive loss		
Unrealized losses on investments	(6)	(128)
Total other comprehensive loss	(6)	(128)
Comprehensive income	\$10,151	\$14,579

See accompanying notes to consolidated financial statements.

CULP, INC.
CONSOLIDATED BALANCE SHEETS
FEBRUARY 1, 2015, JANUARY 26, 2014, AND APRIL 27, 2014
UNAUDITED
(Amounts in Thousands)

	February 1, 2015	January 26, 2014	* April 27, 2014
Current assets:			
Cash and cash equivalents	\$28,772	23,293	29,303
Short-term investments	8,384	7,077	6,294
Accounts receivable, net	30,774	26,392	27,409
Inventories	38,013	43,687	40,674
Deferred income taxes	6,995	7,503	6,230
Income taxes receivable	104	-	121
Other current assets	2,992	2,999	2,344
Total current assets	116,034	110,951	112,375
Property, plant and equipment, net			
Goodwill	35,269	30,115	31,376
Deferred income taxes	11,462	11,462	11,462
Long-term investments	482	1,227	2,040
Other assets	2,063	-	765
	2,505	2,923	2,917
Total assets	\$167,815	156,678	160,935
Current liabilities:			
Current maturities of long-term debt	\$2,200	2,200	2,200
Accounts payable-trade	28,644	25,187	26,686
Accounts payable - capital expenditures	772	235	277
Accrued expenses	9,954	11,812	9,181
Income taxes payable - current	325	130	442
Total current liabilities	41,895	39,564	38,786
Income taxes payable - long-term	3,630	3,953	3,962
Deferred income taxes	3,384	945	1,013
Line of credit	-	573	586
Deferred compensation	3,934	-	2,644
Long-term debt, less current maturities	-	2,200	2,200
Total liabilities	52,843	47,235	49,191

Commitments and Contingencies (Note 16)

Edgar Filing: CULP INC - Form 10-Q

Shareholders' equity			
Preferred stock, \$0.05 par value, authorized 10,000,000	-	-	-
Common stock, \$0.05 par value, authorized 40,000,000 shares, issued and outstanding 12,219,121 at February 1, 2015; 12,250,030 at January 26, 2014; and 12,250,030 at April 27, 2014	611	612	612
Capital contributed in excess of par value	42,856	42,773	42,932
Accumulated earnings	71,571	66,132	68,260
Accumulated other comprehensive loss	(66)	(74)	(60)
Total shareholders' equity	114,972	109,443	111,744
 Total liabilities and shareholders' equity	 \$ 167,815	 156,678	 160,935

* Derived from audited financial statements.

See accompanying notes to consolidated financial statements.

I-3

CULP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED FEBRUARY 1, 2015, AND JANUARY 26, 2014
UNAUDITED
(Amounts in Thousands)

	NINE MONTHS ENDED	
	February 1, 2015	January 26, 2014
Cash flows from operating activities:		
Net income	\$ 10,157	14,707
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	4,244	3,964
Amortization of other assets	140	123
Stock-based compensation	482	551
Excess tax benefit related to stock-based compensation	(110)	(143)
Deferred income taxes	3,274	(2,255)
Gain on sale of equipment	(74)	(108)
Foreign currency exchange (gains) losses	(6)	353
Changes in assets and liabilities, net of effects of acquisition of assets:		
Accounts receivable	(3,455)	(2,844)
Inventories	2,536	(5,081)
Other current assets	(739)	(882)
Other assets	(30)	(53)
Accounts payable - trade	2,267	2,487
Accrued expenses and deferred compensation	2,121	13
Income taxes	(108)	162
Net cash provided by operating activities	20,699	10,994
Cash flows from investing activities:		
Capital expenditures	(8,185)	(2,656)
Net cash paid for acquisition of assets	-	(2,640)
Proceeds from the sale of equipment	625	188
Proceeds from life insurance policies	320	-
Payments on life insurance policies	(18)	(30)
Proceeds from the sale of short-term investments	1,628	-
Purchase of short-term investments	(3,719)	(1,916)
Purchase of long-term investments	(1,298)	-
Net cash used in investing activities	(10,647)	(7,054)
Cash flows from financing activities:		
Payments on lines of credit	(538)	-
Payments on long-term debt	(2,200)	(2,200)
Proceeds from common stock issued	94	194

Edgar Filing: CULP INC - Form 10-Q

Common stock shares repurchased	(745)	-
Dividends paid	(6,846)	(1,592)
Debt issuance costs	-		(62)
Excess tax benefit related to stock-based compensation	110		143
Net cash used in financing activities	(10,125)	(3,517)
Effect of exchange rate changes on cash and cash equivalents	(458)	(660)
Decrease in cash and cash equivalents	(531)	(237)
Cash and cash equivalents at beginning of period	29,303		23,530
Cash and cash equivalents at end of period	\$28,772		23,293

See accompanying notes to consolidated financial statements.

I-4

CULP, INC.
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
UNAUDITED
(Dollars in thousands, except share data)

	Common Stock		Capital Contributed	Accumulated	Accumulated	Total
	Shares	Amount	in Excess of Par Value	Earnings	Other Comprehensive Income (Loss)	Shareholders' Equity
Balance, April 28, 2013	12,224,894	\$611	41,901	53,017	54	\$95,583
Net income	-	-	-	17,447	-	17,447
Stock-based compensation	-	-	710	-	-	710
Unrealized loss on investments	-	-	-	-	(114)	(114)
Excess tax benefit related to stock based compensation	-	-	143	-	-	143
Fully vested common stock award	3,000	-	-	-	-	-
Common stock issued in connection with exercise of stock options	23,125	1	193	-	-	194
Common stock surrendered for withholding taxes payable	(989)	-	(15)	-	-	(15)
Dividends paid	-	-	-	(2,204)	-	(2,204)
Balance, April 27, 2014 *	12,250,030	612	42,932	68,260	(60)	111,744
Net income	-	-	-	10,157	-	10,157
Stock-based compensation	-	-	482	-	-	482
Unrealized loss on investments	-	-	-	-	(6)	(6)
Excess tax benefit related to stock based compensation	-	-	110	-	-	110
Common stock repurchased	(43,014)	(2)	(743)	-	-	(745)
Fully vested common stock award	3,000	-	-	-	-	-
Common stock issued in connection with exercise of stock options	10,100	1	93	-	-	94
Common stock surrendered for withholding taxes payable	(995)	-	(18)	-	-	(18)
Dividends paid	-	-	-	(6,846)	-	(6,846)
Balance, February 1, 2015	12,219,121	\$611	42,856	71,571	(66)	\$114,972

* Derived from audited financial statements.

See accompanying notes to consolidated financial statements.

I-5

Culp, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements of Culp, Inc. and subsidiaries (the “company”) include all adjustments, which are, in the opinion of management, necessary for fair presentation of the results of operations and financial position. All of these adjustments are of a normal recurring nature. Results of operations for interim periods may not be indicative of future results. The unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements, which are included in the company’s annual report on Form 10-K filed with the Securities and Exchange Commission on July 11, 2014 for the fiscal year ended April 27, 2014.

The company’s nine months ended February 1, 2015 and January 26, 2014, represent 40 and 39 week periods, respectively.

2. Significant Accounting Policies

As of February 1, 2015, there were no changes in the nature of our significant accounting policies or the application of those policies from those reported in our annual report on Form 10-K for the year then ended April 27, 2014.

Recently Adopted Accounting Pronouncements

None

Recently Issued Accounting Pronouncements

In June 2014, the Financial Accounting Standards Board (“FASB”) amended its authoritative guidance on accounting for certain share-based payment awards. The amended guidance requires that share-based compensation awards with terms of a performance target that affects vesting, and that could be achieved after the requisite service period, be treated as a performance condition. As such, the performance target should not be reflected in estimating the grant-date fair value of the award and compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved. The guidance will be effective in our fiscal 2017 first quarter. The guidance will permit an entity to apply the amendments in the update either (a) prospectively to all awards granted or modified after the effective date or (b) retrospectively to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented in the consolidated financial statements and to all new or modified awards thereafter. Currently, we do not have any share-based payment awards with terms of a performance target that affects vesting and could be achieved after the requisite service period. We will apply this new guidance when it becomes effective, and we will evaluate the impact of adoption on our consolidated financial statements.

In May 2014, the FASB issued accounting guidance on revenue recognition. The amended guidance will enhance the comparability of revenue recognition practices and will be applied to all contracts with customers. Improved disclosures related to the nature, amount, timing, and uncertainty of revenue that is recognized are requirements under the amended guidance. This guidance will be effective in our fiscal 2018 first quarter and will be required to be applied retrospectively. We are currently assessing the impact that this guidance will have on our consolidated financial statements at this time.

I-6

Culp, Inc.
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 (Unaudited)

3. Business Combinations – Mattress Fabric Segment

On May 8, 2013, we entered into an asset purchase and consulting agreement with Bodet & Horst GMBH & Co. KG and certain affiliates (“Bodet & Horst”) that provided for, among other things, the purchase of equipment and certain other assets from Bodet & Horst and the restructuring of prior consulting and non-compete agreements pursuant to an earlier asset purchase and consulting agreement with Bodet & Horst dated August 11, 2008. This agreement was accounted for as a business combination in accordance with ASC Topic 805, Business Combinations. We agreed with Bodet & Horst to replace the prior non-compete agreement that prevented us from selling certain mattress fabrics and products to a leading manufacturer, which now allows us to make such sales. In addition, the prior consulting and non-compete agreement, under which Bodet & Horst agreed not to sell most mattress fabrics in North America, was replaced, expanded, and extended pursuant to the new asset purchase and consulting agreement.

The purchase price for the equipment and the other certain assets noted below was \$2.6 million in cash.

Direct acquisition costs related to this business combination totaled \$83,000.

The following table presents the allocation of the acquisition cost to the assets acquired based on their fair values:

(dollars in thousands)	Fair Value
Equipment (Note 10)	\$ 890
Non-compete agreement (Notes 7 and 10)	882
Customer relationships (Notes 7 and 10)	868
	\$ 2,640

The company recorded its non-compete at its fair value based on a discounted cash flow valuation model. The company recorded its customer relationships at its fair value based on a multi-period excess earnings valuation model. This non-compete agreement will be amortized on a straight line basis over the fifteen year life of the agreement. The customer relationships will be amortized on a straight line basis over their useful life of seventeen years. The equipment will be amortized on a straight line basis over its useful life of seven years.

4. Stock-Based Compensation

Incentive Stock Option Awards

We did not grant any incentive stock option awards through the third quarter of fiscal 2015.

At February 1, 2015, options to purchase 140,100 shares of common stock were outstanding and exercisable, had a weighted average exercise price of \$6.49 per share, and a weighted average contractual term of 3.0 years. At February 1, 2015, the aggregate intrinsic value for options outstanding and exercisable was \$1.9 million.

The aggregate intrinsic value for options exercised for the nine months ending February 1, 2015 and January 26, 2014, was \$87,000 and \$224,000, respectively.

Culp, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

At February 1, 2015, there were no unvested incentive stock option awards. Therefore, there was no unrecognized compensation cost related to incentive stock option awards at February 1, 2015.

No compensation expense was recorded on incentive stock options for the nine months ended February 1, 2015. We recorded \$10,000 of compensation expense on incentive stock option grants within selling, general, and administrative expense for the nine months ended January 26, 2014.

Common Stock Awards

On October 1, 2014, we granted a total of 3,000 shares of common stock to our outside directors. These shares of common stock vested immediately and were measured at \$17.95 per share, which represents the closing price of the company's common stock at the date of grant.

On October 1, 2013, we granted a total of 3,000 shares of common stock to our outside directors. These shares of common stock vested immediately and were measured at \$18.84 per share, which represents the closing price of the company's common stock at the date of grant.

We recorded \$54,000 and \$57,000 of compensation expense within selling, general, and administrative expense for these common stock awards for the nine month periods ending February 1, 2015, and January 26, 2014, respectively.

Time Vested Restricted Stock Awards

We did not grant any time vested restricted stock awards through the third quarter of fiscal 2015.

We recorded \$4,000 and \$52,000 of compensation expense within selling, general, and administrative expense for time vested restricted stock awards for the nine month periods ending February 1, 2015, and January 26, 2014, respectively.

At February 1, 2015, there were no outstanding and unvested shares of time vested restricted stock. Therefore, there was no unrecognized compensation cost related to time vested restricted stock awards at February 1, 2015.

During the nine month period ended February 1, 2015, 61,667 shares of time vested restricted stock vested and had a weighted average fair value of \$257,000 or \$4.17 per share. During the nine month period ended January 26, 2014, 61,667 shares of time vested restricted stock vested and had a weighted average fair value of \$249,000 or \$4.04 per share.

Performance Based Restricted Stock Units

Fiscal 2015 Grant

On June 24, 2014, certain key members of management were granted performance based restricted common stock units which could earn up to 102,845 shares of common stock if certain performance targets are met as defined in the related restricted stock unit agreements. These awards were valued based on the fair market value on the date of grant. The fair value of these awards was \$17.70 per share, which represents the closing price of our common stock on the

date of grant. The vesting of these awards is over the requisite service period of three years.

I-8

Culp, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Fiscal 2014 Grant

On June 25, 2013, certain key members of management were granted performance based restricted common stock units which could earn up to 72,380 shares of common stock if certain performance targets are met as defined in the related restricted stock unit agreements. These awards were valued based on the fair market value on the date of grant. The fair value of these awards was \$17.12 per share, which represents the closing price of our common stock on the date of grant. The vesting of these awards is over the requisite service period of three years.

Fiscal 2013 Grant

On July 11, 2012, certain key members of management were granted performance based restricted common stock units which could earn up to 120,000 shares of common stock if certain performance targets are met as defined in the related restricted stock unit agreements. These awards were valued based on the fair market value on the date of grant. The fair value of these awards was \$10.21 per share, which represents the closing price of our common stock on the date of grant. The vesting of these awards is over the requisite service period of three years.

Overall

The company recorded compensation expense of \$424,000 and \$432,000 within selling, general, and administrative expense for performance based restricted stock units for the nine month periods ending February 1, 2015 and January 26, 2014, respectively. Compensation cost is recorded based on an assessment each reporting period of the probability if certain performance goals will be met during the vesting period. If performance goals are not probable of occurrence, no compensation cost will be recognized and any recognized compensation cost would be reversed.

As of February 1, 2015, the remaining unrecognized compensation cost related to the performance based restricted stock units was \$946,000, which is expected to be recognized over a weighted average vesting period of 1.9 years.

5. Accounts Receivable

A summary of accounts receivable follows:

(dollars in thousands)	February 1, 2015	January 26, 2014	April 27, 2014
Customers	\$31,952	\$27,424	\$28,461
Allowance for doubtful accounts	(449)	(484)	(573)
Reserve for returns and allowances and discounts	(729)	(548)	(479)
	\$30,774	\$26,392	\$27,409

Culp, Inc.
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 (Unaudited)

A summary of the activity in the allowance for doubtful accounts follows:

(dollars in thousands)	Nine months ended	
	February 1, 2015	January 26, 2014
Beginning balance	\$(573)	\$(780)
Provision for bad debts	(20)	235
Net write-offs, net of recoveries	144	61
Ending balance	\$(449)	\$(484)

A summary of the activity in the allowance for returns and allowances and discounts accounts follows:

(dollars in thousands)	Nine months ended	
	February 1, 2015	January 26, 2014
Beginning balance	\$ (479)	\$ (543)
Provision for returns, allowances and discounts	(2,065)	(1,579)
Credits issued	1,815	1,574
Ending balance	\$ (729)	\$ (548)

6. Inventories

Inventories are carried at the lower of cost or market. Cost is determined using the FIFO (first-in, first-out) method.

A summary of inventories follows:

(dollars in thousands)	February 1, 2015	January 26, 2014	April 27, 2014
Raw materials	\$5,787	\$6,177	\$6,707
Work-in-process	2,227	2,177	2,263
Finished goods	29,999	35,333	31,704
	\$38,013	\$43,687	\$40,674

7. Other Assets

A summary of other assets follows:

(dollars in thousands)	February 1, 2015	January 26, 2014	April 27, 2014
Cash surrender value - life insurance	\$338	\$647	\$644
Non-compete agreement	998	1,047	1,041
Customer relationships	779	830	817
Other	390	399	415
	\$2,505	\$2,923	\$2,917

Non-Compete Agreement

In connection with the asset purchase and consulting agreement with Bodet & Horst on May 8, 2013 (see Note 3), we restructured our prior non-compete agreement pursuant to our asset purchase and consulting agreement dated August 11, 2008. We have agreed with Bodet & Horst to replace the prior non-compete agreement that prevented us from selling certain mattress fabrics and products to a leading manufacturer, that will now allow us to make such sales. In addition, the prior consulting and non-compete agreement, under which Bodet & Horst agreed not to sell mattress fabrics in North America, was replaced, expanded, and extended pursuant to the new asset purchase consulting agreement. We recorded this non-compete agreement at its fair value based on a discounted cash flow valuation model. This non-compete agreement is amortized on a straight-line basis over the fifteen year life of the agreement.

I-10

Culp, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

The gross carrying amount of this non-compete agreement was \$2.0 million at February 1, 2015, January 26, 2014 and April 27, 2014, respectively. At February 1, 2015, January 26, 2014, and April 27, 2014, accumulated amortization for the non-compete agreement was \$1.0 million.

Of the \$1.0 million non-compete agreement carrying amount at February 1, 2015, \$219,000 pertains to the non-compete agreement that was in place as part of the asset purchase agreement dated August 11, 2008, and \$779,000 pertains to the non-compete agreement pursuant to the asset purchase agreement dated May 8, 2013 that was restructured to expand the non-compete agreement in place effective August 11, 2008.

Amortization expense for the non-compete agreement was \$56,000 for the nine month periods ended February 1, 2015 and January 26, 2014. The remaining amortization expense for the next five fiscal years and thereafter follows: FY 2015 - \$19,000; FY 2016 - \$75,000; FY 2017 - \$75,000; FY 2018 - \$75,000; FY 2019 - \$75,000; and Thereafter - \$679,000.

The weighted average amortization period for the non-compete agreement is 13.3 years as of February 1, 2015.

Customer Relationships

In connection with the asset purchase and consulting agreement with Bodet & Horst noted above, we purchased certain customer relationships. We recorded the customer relationships at its fair value based on a multi-period excess earnings valuation model. The customer relationships are amortized on a straight-line basis over its seventeen year useful life.

The gross carrying amount of these customer relationships was \$868,000 at February 1, 2015, January 26, 2014, and April 27, 2014, respectively. Accumulated amortization for these customer relationships was \$89,000, \$38,000, and \$51,000 at February 1, 2015, January 26, 2014, and April 27, 2014, respectively.

Amortization expense for the customer relationships was \$38,000 for the nine months ending February 1, 2015 and January 26, 2014. The remaining amortization expense for the next five fiscal years and thereafter follows: FY 2015 - \$13,000; FY 2016 - \$51,000; FY 2017 - \$51,000; FY 2018 - \$51,000; FY 2019 - \$51,000; and Thereafter - \$562,000.

The weighted average amortization period for the non-compete agreement is 15.3 years as of February 1, 2015.

Cash Surrender Value – Life Insurance

On May 16, 2014, we entered into an agreement with a former employee and his irrevocable trust (the “Trust”) dated September 7, 1995. As a result of this agreement, a previous split dollar life insurance agreement in which we purchased a policy on the life of this former employee and his spouse, in which we retained ownership of the policy, paid premiums to support the policy, had the right to receive cash surrender value of the policy upon the second to die of the former employee and his spouse, with the Trust receiving the remainder of the policy’s death benefit (\$2.5 million), was terminated. In connection with the termination of the previous split dollar life insurance agreement, we transferred the life insurance policy to the Trust and received cash proceeds in the amount of the cash surrender value policy totaling \$320,000 during the second quarter of fiscal 2015.

Culp, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

At February 1, 2015, we had one life insurance contract with a death benefit of \$1.4 million. At January 26, 2014 and April 27, 2014, we had two life insurance contracts with death benefits to the respective insured totaling \$3.9 million. Our cash surrender value – life insurance balances totaling \$338,000, \$647,000 and \$644,000 at February 1, 2015, January 26, 2014, and April 27, 2014, respectively, are collectible upon death of the respective insured.

8. Accrued Expenses

A summary of accrued expenses follows:

(dollars in thousands)	February 1, 2015	January 26, 2014	April 27, 2014
Compensation, commissions and related benefits	\$6,399	\$8,747	\$7,388
Interest	81	158	71
Other accrued expenses	3,474	2,907	1,722
	\$9,954	\$11,812	\$9,181

9. Long-Term Debt and Lines of Credit

A summary of long-term debt follows:

(dollars in thousands)	February 1, 2015	January 26, 2014	April 27, 2014
Unsecured senior term notes	\$2,200	\$4,400	\$4,400
Current maturities of long-term debt	(2,200)	(2,200)	(2,200)
Long-term debt, less current maturities of long-term debt	\$-	\$2,200	\$2,200

Unsecured Senior Term Notes

We entered into a note agreement dated August 11, 2008 that provided for the issuance of \$11.0 million of unsecured senior term notes with a fixed interest rate of 8.01% and a term of seven years. Principal payments of \$2.2 million per year are due on the notes beginning August 11, 2011. The remaining principal payments are payable over an average term of 0.5 years through August 11, 2015. Any principal pre-payments would be assessed a penalty as defined in the agreement. The agreement contains customary financial and other covenants as defined in the agreement.

As of February 1, 2015, we have one remaining annual payment of \$2.2 million due on August 11, 2015.

Revolving Credit Agreement – United States

We have an unsecured credit agreement with Wells Fargo Bank, N.A. (“Wells Fargo”) that provides for an unsecured revolving loan commitment of \$10.0 million to be used to finance working capital and general corporate purposes. The amount of borrowings that were outstanding under the credit agreement with Culp Europe at January 26, 2014 and April 27, 2014, noted below decreased the \$10.0 million available. Interest is charged at a rate (applicable interest rate of 1.77%, 1.76%, and 1.75% at February 1, 2015, January 26, 2014, and April 27, 2014, respectively) equal to the one-month LIBOR rate plus a spread based on our ratio of debt to EBITDA as defined in the agreement. The credit agreement contains customary financial and other covenants as defined in the agreement and expires on August 31,

2015.

I-12

Culp, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

At February 1, 2015, there was a \$250,000 outstanding letter of credit (all of which related to workers compensation). At January 26, 2014, and April 27, 2014, there was a \$195,000 outstanding letter of credit (all of which related to workers compensation). At February 1, 2015, January 26, 2014, and April 27, 2014, there were no borrowings outstanding under the credit agreement.

Our credit agreement with Wells Fargo contains a financial covenant that limits our capital expenditures to \$10 million in any fiscal year. In the fourth quarter of fiscal 2015, we expect our capital expenditures to exceed \$10 million for fiscal 2015 as a result of the capital expansion project associated with our mattress fabrics segment. As a result, effective March 3, 2015, Wells Fargo increased our capital expenditure limit from \$10 million to \$12 million for fiscal 2015.

Revolving Credit Agreement – China

We have an unsecured credit agreement associated with our operations in China that provides for a line of credit of up to 40 million RMB (approximately \$6.4 million USD at February 1, 2015), expiring on May 9, 2015. This agreement has an interest rate determined by the Chinese government. There were no borrowings outstanding under the agreement as of February 1, 2015, January 26, 2014, and April 27, 2014.

Revolving Credit Agreement – Europe

At January 26, 2014 and April 27, 2014, we had an unsecured credit agreement with Wells Fargo that incurred interest at WIBOR (Warsaw Interbank Offered Rate) plus 2% (applicable interest rate of 4.5% and 4.38% at January 26, 2014 and April 27, 2014, respectively). There was \$573,000 and \$586,000 (1.8 million Polish Zloty) in borrowings outstanding under the agreement at January 26, 2014 and April 27, 2014, respectively.

Effective May 2, 2014, we converted our 1.8 million Polish Zloty denominated borrowings under the credit agreement to EURO denominated borrowings totaling €424,000 (\$569,000 USD). In addition, the applicable interest rate was converted to EURO LIBOR plus 2%.

At February 1, 2015, no borrowings were outstanding under this agreement, as the outstanding balance was paid in full during the second quarter of fiscal 2015.

Overall

Our loan agreements require, among other things, that we maintain compliance with certain financial covenants. At February 1, 2015, the company was in compliance with these financial covenants.

The fair value of the company's long-term debt is estimated by discounting the future cash flows at rates currently offered to the company for similar debt instruments of comparable maturities. At February 1, 2015, the carrying value of our long-term debt was \$2.2 million and the fair value was \$2.3 million. At January 26, 2014, the carrying value of the company's long-term debt was \$4.4 million and the fair value was \$4.7 million. At April 27, 2014, the carrying value of the company's long-term debt was \$4.4 million and the fair value was \$4.6 million.

Culp, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

10. Fair Value of Financial Instruments

ASC Topic 820 establishes a fair value hierarchy that distinguishes between assumptions based on market data (observable inputs) and the company's assumptions (unobservable inputs). Determining where an asset or liability falls within that hierarchy depends on the lowest level input that is significant to the fair value measurement as a whole. An adjustment to the pricing method used within either level 1 or level 2 inputs could generate a fair value measurement that effectively falls in a lower level in the hierarchy. The hierarchy consists of three broad levels as follows:

Level 1 – Quoted market prices in active markets for identical assets or liabilities;

Level 2 – Inputs other than level 1 inputs that are either directly or indirectly observable, and

Level 3 – Unobservable inputs developed using the company's estimates and assumptions, which reflect those that market participants would use.

Recurring Basis

The following table presents information about assets and liabilities measured at fair value on a recurring basis:

Fair value measurements at February 1, 2015 using:

	Quoted prices in active markets for identical assets	Significant other observable inputs	Significant unobservable inputs	
(amounts in thousands)	Level 1	Level 2	Level 3	Total
Assets:				
Limited Term Bond Fund	\$ 3,112	N/A	N/A	\$ 3,112
Intermediate Term Bond Fund	2,188	N/A	N/A	2,188
Low Duration Bond Fund	2,084	N/A	N/A	2,084
Premier Money Market Fund	1,951	N/A	N/A	1,951
Strategic Income Fund	1,000	N/A	N/A	1,000
Growth Allocation Fund	63	N/A	N/A	63
Other	49	N/A	N/A	49

Fair value measurements at January 26, 2014 using:

	Quoted prices in active markets for identical assets	Significant other observable inputs	Significant unobservable inputs
--	---	--	---------------------------------------

Edgar Filing: CULP INC - Form 10-Q

(amounts in thousands)	Level 1	Level 2	Level 3	Total
Assets:				
Limited Term Bond Fund	\$ 2,570	N/A	N/A	\$ 2,570
Low Duration Bond Fund	2,069	N/A	N/A	2,069
Intermediate Term Bond Fund	1,612	N/A	N/A	1,612

I-14

Culp, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Fair value measurements at April 27, 2014 using:

(amounts in thousands)	Quoted prices in active markets for identical assets	Significant other observable inputs	Significant unobservable inputs	Total
	Level 1	Level 2	Level 3	
Assets:				
Limited Term Bond Fund	\$ 2,576	N/A	N/A	\$ 2,576
Low Duration Bond Fund	2,077	N/A	N/A	2,077
Intermediate Term Bond Fund	1,641	N/A	N/A	1,641
Premier Money Market Fund	755	N/A	N/A	755
Other	10	N/A	N/A	10

The determination of where an asset or liability falls in the hierarchy requires significant judgment. We evaluate our hierarchy disclosures each quarter based on various factors and it is possible that an asset or liability may be classified differently from quarter to quarter. However, we expect that changes in classifications between different levels will be rare.

Our short-term investments include short-term bond funds, are classified as available-for-sale, and their unrealized gains or losses are included in other comprehensive income (loss). Our short-term bond funds were recorded at their fair value of \$8.4 million, \$6.3 million and \$6.3 million at February 1, 2015, January 26, 2014, and April 27, 2014, respectively. Our short-term bond funds had an accumulated unrealized loss totaling \$66,000, \$74,000, and \$60,000 at February 1, 2015, January 26, 2014, and April 27, 2014, respectively. At February 1, 2015, January 26, 2014, and April 27, 2014, the fair value of our short-term bond funds approximated its cost basis.

Effective, January 1, 2014, we established a Rabbi Trust to set aside funds for participants of our deferred compensation plan (the "Plan") and enable the participants to credit their contributions to various investment options of the Plan. The investments associated with the Rabbi Trust consist of investments in a money market fund and various mutual funds that are classified as available for sale. Our long-term investments are recorded at its fair value of \$2.0 million and \$765,000 at February 1, 2015 and April 27, 2014, respectively. The fair value of our long-term investments approximates its cost basis.

The carrying amount of cash and cash equivalents, accounts receivable, other current assets, accounts payable, accrued expenses, and line of credit approximates fair value because of the short maturity of these financial instruments.

Culp, Inc.
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 (Unaudited)

Nonrecurring Basis

During the nine months ended February 1, 2015, we did not have any financial assets that were required to be measured at fair value on a nonrecurring basis.

During fiscal 2014, we did not have any financial assets that were required to be measured at fair value on a nonrecurring basis other than the assets acquired from Bodet & Horst (see note 3) that were acquired at fair value.

Fair value measurements at April 27, 2014 and January 26, 2014 using:

(amounts in thousands)	Quoted prices in active markets for identical assets	Significant other observable inputs	Significant unobservable inputs	Total
	Level 1	Level 2	Level 3	
Assets:				
Equipment	\$ -	\$ 890	\$ -	\$ 890
Non-compete Agreement	-	-	882	882
Customer Relationships	-	-	868	868

The equipment was classified as level 2 as the fair value was determined using quoted market prices from a third party. The non-compete was recorded at its fair value using a discounted cash flow valuation model that used significant unobservable inputs and was classified as level 3. The customer relationships were recorded at a fair value using a multi-period excess earnings valuation model that used significant unobservable inputs and was classified as level 3.

11. Cash Flow Information

Payments for interest and income taxes follows:

(dollars in thousands)	Nine months ended	
	February 1, 2015	January 26, 2014
Interest	\$ 180	\$ 283
Net income tax payments	3,005	2,312

Interest costs of \$141,000 for the construction of qualifying fixed assets were capitalized and are being amortized over the related assets' useful lives for the nine months ended February 1, 2015. No interest costs were capitalized for the nine months ended January 26, 2014.

During the nine months ended February 1, 2015, 995 shares of common stock were surrendered to satisfy withholding tax liabilities totaling \$18,000 in connection with the vesting of 3,334 shares of time vested restricted common stock. During the nine months ended January 26, 2014, 989 shares of common stock were surrendered to satisfy withholding tax liabilities totaling \$15,000 in connection with the vesting of 3,333 shares of time vested restricted common stock.

I-16

Culp, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

12. Net Income Per Share

Basic net income per share is computed using the weighted-average number of shares outstanding during the period. Diluted net income per share uses the weighted-average number of shares outstanding during the period plus the dilutive effect of stock-based compensation calculated using the treasury stock method. Weighted average shares used in the computation of basic and diluted net income per share follows:

(amounts in thousands)	Three months ended	
	February 1, 2015	January 26, 2014
Weighted average common shares outstanding, basic	12,219	12,188
Dilutive effect of stock-based compensation	198	217
Weighted average common shares outstanding, diluted	12,417	12,405

All options to purchase shares of common stock were included in the computation of diluted net income for the three months ended February 1, 2015 and January 26, 2014, as the exercise price of the options was less than the average market price of the common shares.

The computation of basic net income per share did not include 61,667 shares of time vested restricted common stock as these shares were unvested for the three months ending January 26, 2014. At February 1, 2015, there were no outstanding and unvested shares of time vested restricted common stock and therefore, the computation of basic net income per share was not affected.

(amounts in thousands)	Nine months ended	
	February 1, 2015	January 26, 2014
Weighted average common shares outstanding, basic	12,216	12,173
Dilutive effect of stock-based compensation	194	232
Weighted average common shares outstanding, diluted	12,410	12,405

All options to purchase shares of common stock were included in the computation of diluted net income for the nine months ended February 1, 2015 and January 26, 2014, as the exercise price of the options was less than the average market price of the common shares.

The computation of basic net income per share did not include 61,667 shares of time vested restricted common stock as these shares were unvested for the nine months ending January 26, 2014. At February 1, 2015, there were no outstanding and unvested shares of time vested restricted common stock and therefore, the computation of basic net income per share was not affected.

Culp, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

13. Segment Information

Our operations are classified into two business segments: mattress fabrics and upholstery fabrics. The mattress fabrics segment manufactures, sources, and sells fabrics and mattress covers to bedding manufacturers. The upholstery fabrics segment manufactures, sources, and sells fabrics primarily to residential furniture manufacturers.

We evaluate the operating performance of our segments based upon income from operations before certain unallocated corporate expenses and other non-recurring items. Cost of sales in both segments include costs to manufacture or source our products, including costs such as raw material and finished goods purchases, direct and indirect labor, overhead and incoming freight charges. Unallocated corporate expenses primarily represent compensation and benefits for certain executive officers and all costs related to being a public company. Segment assets include assets used in the operations of each segment and primarily consist of accounts receivable, inventories, and property, plant and equipment. The mattress fabrics segment also includes in segment assets, goodwill, a non-compete agreement, and customer relationships associated with an acquisition.

Financial information for the company's operating segments follows:

(dollars in thousands)	Three months ended	
	February 1, 2015	January 26, 2014
Net sales:		
Mattress Fabrics	\$45,683	\$38,541
Upholstery Fabrics	35,586	33,848
	\$81,269	\$72,389
Gross profit:		
Mattress Fabrics	\$ 8,076	\$ 5,599
Upholstery Fabrics	6,326	6,238
	\$14,402	\$11,837
Selling, general, and administrative expenses:		
Mattress Fabrics	\$2,853	\$2,286
Upholstery Fabrics	3,781	3,572
Total segment selling, general, and administrative expenses	6,634	5,858
Unallocated corporate expenses	1,741	1,183
	\$8,375	\$7,041
Income from operations:		
Mattress Fabrics	\$5,223	\$3,313
Upholstery Fabrics	2,545	2,666
Total segment income from operations	7,768	5,979
Unallocated corporate expenses	(1,741)	(1,183)
Total income from operations	6,027	4,796

Edgar Filing: CULP INC - Form 10-Q

Interest expense	-	(91)	
Interest income	202	148		
Other expense	(307)	(279)
Income before income taxes	\$5,922		\$4,574	

I-18

Culp, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(dollars in thousands)	Nine months ended	
	February 1, 2015	January 26, 2014
Net sales:		
Mattress Fabrics	\$131,543	\$117,035
Upholstery Fabrics	99,777	96,084
	\$231,320	\$213,119
Gross profit:		
Mattress Fabrics	\$22,603	\$20,312
Upholstery Fabrics	16,792	16,833
	\$39,395	\$37,145
Selling, general, and administrative expenses:		
Mattress Fabrics	\$8,019	\$7,280
Upholstery Fabrics	10,518	10,007
Total segment selling, general, and administrative expenses	18,537	17,287
Unallocated corporate expenses	4,636	4,053
	\$23,173	\$21,340
Income from operations:		
Mattress Fabrics	\$14,584	\$13,033
Upholstery Fabrics	6,274	6,825
Total segment income from operations	20,858	19,858
Unallocated corporate expenses	(4,636)	(4,053)
Total income from operations	16,222	15,805
Interest expense	(50)	(330)
Interest income	478	343
Other expense	(380)	(895)
Income before income taxes	\$16,270	\$14,923

Culp, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Balance sheet information for the company's operating segments follow:

(dollars in thousands)	February 1, 2015	January 26, 2014	April 27, 2014
Segment assets:			
Mattress Fabrics			
Current assets (1)	\$36,658	\$36,818	\$36,229
Non-compete agreement	998	1,047	1,041
Customer relationships	779	830	817
Goodwill	11,462	11,462	11,462
Property, plant and equipment (2)	33,046	27,822	29,040
Total mattress fabrics assets	82,943	77,979	78,589
Upholstery Fabrics			
Current assets (1)	32,129	33,261	31,854
Property, plant and equipment (3)	1,522	1,649	1,573
Total upholstery fabrics assets	33,651	34,910	33,427
Total segment assets	116,594	112,889	112,016
Non-segment assets:			
Cash and cash equivalents	28,772	23,293	29,303
Short-term investments	8,384	7,077	6,294
Deferred income taxes	7,477	8,730	8,270
Income taxes receivable	104	-	121
Other current assets	2,992	2,999	2,344
Property, plant and equipment (4)	701	644	763
Long-term investments	2,063	-	765
Other assets	728	1,046	1,059
Total assets	\$167,815	\$156,678	\$160,935

(dollars in thousands)	Nine months ended	
	February 1, 2015	January 26, 2014
Capital expenditures (5):		
Mattress Fabrics	\$8,232	\$1,936
Upholstery Fabrics	390	694
Unallocated Corporate	62	37
Total capital expenditures	\$8,684	\$2,667
Depreciation expense:		
Mattress Fabrics	\$3,692	\$3,510
Upholstery Fabrics	552	454
Total depreciation expense	\$4,244	\$3,964

(1) Current assets represent accounts receivable and inventory for the respective segment.

- (2) The \$33.0 million at February 1, 2015, represents property, plant, and equipment of \$23.5 million and \$9.5 million located in the U.S. and Canada, respectively. The \$27.8 million at January 26, 2014, represents property, plant, and equipment of \$20.1 million and \$7.7 million located in the U.S. and Canada, respectively. The \$29.0 million at April 27, 2014, represents property, plant, and equipment of \$20.6 million and \$8.4 million located in the U.S. and Canada, respectively.
- (3) The \$1.5 million at February 1, 2015, represents property, plant, and equipment of \$877 and \$645 located in the U.S. and China, respectively. The \$1.6 million at January 26, 2014, represents property, plant, and equipment located in the U.S. of \$1.0 million, located in China of \$561, and located in Poland of \$47. The \$1.6 million at April 27, 2014, represents property, plant, and equipment located in the U.S. of \$957, located in China of \$572, and located in Poland of \$44.
- (4) The \$701, \$644, and \$763 at February 1, 2015, January 26, 2014 and April 27, 2014, respectively, represent property, plant, and equipment associated with unallocated corporate departments and corporate departments shared by both the mattress and upholstery fabric segments. Property, plant, and equipment associated with corporate are located in the U.S.
- (5) Capital expenditure amounts are stated on the accrual basis. See Consolidated Statements of Cash Flows for capital expenditure amounts on a cash basis.

Culp, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

14. Income Taxes

Effective Income Tax Rate

We recorded income tax expense of \$6.1 million, or 37.6% of income before income tax expense, for the nine month period ended February 1, 2015, compared to income tax expense of \$216,000 or 1.4% of income before income tax expense, for the nine month period ended January 26, 2014. Our effective income tax rates for the nine month periods ended February 1, 2015 and January 26, 2014, were based upon the estimated effective income tax rate applicable for the full year after giving effect to any significant items related specifically to interim periods. The effective income tax rate can be affected over the fiscal year by the mix and timing of actual earnings from our U.S. operations and foreign sources versus annual projections and changes in foreign currencies in relation to the U.S. dollar.

The income tax expense for the nine month period ended February 1, 2015 is different from the amount obtained by applying our statutory rate of 34% to income before income taxes for the following reasons:

The income tax rate decreased by 6% for taxable income subject to lower statutory income tax rates in foreign jurisdictions (Canada and China) compared with the statutory income tax rate of 34% for the United States.

The income tax rate increased by 4% to record the income tax effects of the undistributed earnings from our foreign subsidiaries located in Canada and China.

The income tax rate increased by 4% for an increase in unrecognized tax benefits.

The income tax rate increased by 1.6% for stock-based compensation and other miscellaneous items.

The income tax expense for nine month period ended January 26, 2014 is different from the amount obtained by applying our statutory rate of 34% to income before income taxes for the following reasons:

The income tax rate decreased 36% for an income tax benefit of \$5.4 million to record the U.S. income tax effects of the undistributed earnings from our foreign subsidiaries located in China. The \$5.4 million income tax benefit recognized U.S. foreign income tax credits of \$9.9 million offset by the U.S. income tax effects of the undistributed earnings from our China operations and foreign withholding taxes of \$4.5 million. The \$5.4 million income tax benefit was treated as a discrete event in which the full income tax effects of this adjustment were recorded in the three and nine month periods ended January 26, 2014, as it pertained to a change in judgment on prior periods' accumulated earnings and profits associated with our subsidiaries located in China.

Culp, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

The income tax rate increased 2% for adjustments primarily made to our state of North Carolina loss carryforwards for the decrease in future North Carolina corporate income tax rates commencing in fiscal 2015 and beyond. These adjustments were recorded in the first quarter of fiscal 2014, totaled \$273,000, and represented a discrete event in which the full tax effects were recorded in the nine month period ending January 26, 2014.

The income tax rate decreased by 7% for taxable income subject to lower statutory income tax rates in foreign jurisdictions (Canada and China) compared with the statutory income tax rate of 34% for the United States.

The income tax rate increased 4% for an increase in unrecognized tax benefits.

The income tax rate was increased by 4.4% for stock-based compensation and other miscellaneous items.

Deferred Income Taxes

Valuation Allowance

In accordance with ASC Topic 740, we evaluate our deferred income taxes to determine if a valuation allowance is required. ASC Topic 740 requires that companies assess whether a valuation allowance should be established based on the consideration of all available evidence using a “more likely than not” standard, with significant weight being given to evidence that can be objectively verified. Since the company operates in multiple jurisdictions, we assess the need for a valuation allowance on a jurisdiction-by-jurisdiction basis, taking into account the effects of local tax law. Based on our assessment at February 1, 2015, we recorded a partial valuation allowance of \$1.0 million, of which \$596,000 pertained to certain U.S. state net operating loss carryforwards and credits and \$400,000 pertained to loss carryforwards associated with our Culp Europe operation located in Poland. Based on our assessment at January 26, 2014, we recorded a partial valuation allowance of \$1.0 million, of which \$715,000 pertained to certain U.S. state net operating loss carryforwards and credits and \$291,000 pertained to loss carryforwards associated with our Culp Europe operation located in Poland. Based on our assessment at April 27, 2014, we recorded a partial valuation allowance of \$1.0 million, of which \$666,000 pertained to certain U.S. state net operating loss carryforwards and credits and \$311,000 pertained to loss carryforwards associated with our Culp Europe operation located in Poland.

No valuation allowance was recorded against our net deferred tax assets associated with our operations located in China and Canada at February 1, 2015, January 26, 2014, and April 27, 2014, respectively.

The recorded valuation allowance of \$1.0 million at February 1, 2015, has no effect on our operations, loan covenant compliance, or the possible realization of certain U.S. state net operating loss carryforwards and credits and our loss carryforwards associated with our Culp Europe operation located in Poland. If it is determined that it is more-likely-than-not that we will realize any of these deferred tax assets, an income tax benefit will be recognized at that time.

Culp, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Undistributed Earnings

In accordance with ASC Topic 740, we assess whether the undistributed earnings from our foreign subsidiaries will be reinvested indefinitely or eventually distributed to our U.S. parent company. ASC Topic 740 requires that a deferred tax liability should be recorded for undistributed earnings from foreign subsidiaries that will not be reinvested indefinitely. Based on our assessment as of February 1, 2015, it is our intention not to permanently invest our undistributed earnings from our foreign subsidiaries. Also, we assess the recognition of U.S. foreign income tax credits associated with foreign withholding and income tax payments and whether it is more-likely-than-not that our foreign income tax credits will not be realized. If it is determined that any foreign income tax credits need to be recognized or it is more-likely-than-not our foreign income tax credits will not be realized, an adjustment to our provision for income taxes will be recognized at that time.

During the third quarter of fiscal 2014, our operations located in China achieved positive accumulated earnings and profits for both U.S. income tax and financial reporting purposes for the first time since we determined our undistributed earnings from our foreign subsidiaries would not be reinvested indefinitely in the second quarter of fiscal 2013. As a result, we recorded an income tax benefit of \$5.4 million to recognize U.S. foreign income tax credits of \$9.9 million offset by the U.S. income tax effects of the undistributed earnings from our China operations and foreign withholding taxes totaling \$4.5 million. This \$5.4 million income tax benefit was treated as a discrete event in which the full income tax effects of this adjustment were recorded in the three and nine month periods ended January 26, 2014, as it pertained to a change in judgment on prior periods' accumulated earnings and profits associated with our subsidiaries located in China.

At February 1, 2015, the deferred tax liability associated with our undistributed earnings from our foreign subsidiaries totaled \$2.4 million, which included U.S. income and foreign withholding taxes totaling \$32.1 million, offset by U.S. foreign income tax credits of \$29.7 million. At January 26, 2014, the deferred tax liability associated with our undistributed earnings from our foreign subsidiaries totaled \$1.7 million, which included U.S. income and foreign withholding taxes totaling \$26.9 million, offset by U.S. foreign income tax credits of \$25.2 million. At April 27, 2014, the deferred tax liability associated with our undistributed earnings from our foreign subsidiaries totaled \$2.0 million, which included U.S. income and foreign withholding taxes totaling \$28.1 million, offset by U.S. foreign income tax credits of \$26.1 million.

We had accumulated earnings from our foreign subsidiaries totaling \$82.4 million, \$69.8 million, and \$72.8 million at February 1, 2015, January 26, 2014, and April 27, 2014, respectively.

Overall

At February 1, 2015, the current deferred tax asset of \$7.0 million represents \$6.7 million and \$294,000 from our operations located in the U.S. and China, respectively. At February 1, 2015, the non-current deferred tax asset of \$482,000 pertains to our operations located in China. At February 1, 2015, the non-current deferred tax liability of \$3.4 million represents \$2.5 million and \$886,000 from our operations located in the U.S. and Canada, respectively.

At January 26, 2014, the current deferred tax asset of \$7.5 million represents \$7.3 million and \$217,000 from our operations located in the U.S. and China, respectively. At January 26, 2014, the non-current deferred tax asset of \$1.2 million represents \$600,000 and \$627,000 from our operations located in the U.S. and China, respectively. At January

26, 2014, the non-current deferred tax liability of \$945,000 pertains to our operations located in Canada.

I-23

Culp, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

At April 27, 2014, the current deferred tax asset of \$6.2 million represents \$5.8 million and \$372,000 from our operations located in the U.S. and China, respectively. At April 27, 2014, the non-current deferred tax asset of \$2.0 million represents \$1.4 million and \$572,000 from our operations located in the U.S. and China, respectively. At April 27, 2014, the non-current deferred tax liability of \$1.0 million pertained to our operations located in Canada.

Uncertainty In Income Taxes

At February 1, 2015, we had a \$13.9 million total gross unrecognized tax benefit, of which \$3.6 million represents the amount of gross unrecognized tax benefits that, if recognized, would favorably affect the income tax rate in future periods. At January 26, 2014, we had a \$13.6 million total gross unrecognized tax benefit, of which \$4.0 million represents the amount of gross unrecognized tax benefits that, if recognized, would favorably affect the income tax rate in future periods. At April 27, 2014, we had a \$13.7 million total gross unrecognized tax benefit, of which \$4.0 million represents the amount of gross unrecognized tax benefits that, if recognized, would favorably affect the income tax rate in future periods.

At February 1, 2015, we had a \$13.9 million total gross unrecognized tax benefit, of which \$10.3 million and \$3.6 million were classified as net non-current deferred income taxes and income taxes payable – long-term, respectively, in the accompanying consolidated balance sheets. At January 26, 2014, we had a \$13.6 million total gross unrecognized tax benefit, of which \$9.6 million and \$4.0 million were classified as net non-current deferred income taxes and income taxes payable – long-term, respectively, in the accompanying consolidated balance sheets. At April 27, 2014, we had \$13.7 million of total gross unrecognized tax benefit, of which \$9.7 million and \$4.0 million were classified as net non-current deferred income taxes and income taxes payable – long-term, respectively, in the accompanying consolidated balance sheets.

We estimate that the amount of gross unrecognized tax benefits will increase by approximately \$706,000 for fiscal 2015. This increase primarily relates to double taxation under applicable tax treaties with foreign tax jurisdictions.

15. Statutory Reserves

Our subsidiaries located in China are required to transfer 10% of their net income, as determined in accordance with the People's Republic of China (PRC) accounting rules and regulations, to a statutory surplus reserve fund until such reserve balance reaches 50% of the company's registered capital.

The transfer to this reserve must be made before distributions of any dividend to shareholders. As of February 1, 2015, the company's statutory surplus reserve was \$5.4 million, representing 10% of accumulated earnings and profits determined in accordance with PRC accounting rules and regulations. The surplus reserve fund is non-distributable other than during liquidation and can be used to fund previous years' losses, if any, and may be utilized for business expansion or converted into share capital by issuing new shares to existing shareholders in proportion to their shareholding or by increasing the par value of the shares currently held by them provided that the remaining reserve balance after such issue is not less than 25% of the registered capital.

Our subsidiaries located in China can transfer funds to the parent company with the exception of the statutory surplus reserve of \$5.4 million to assist with debt repayment, capital expenditures, and other expenses of the company's business.

Culp, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

16. Commitments and Contingencies

Chromatex Environmental Claim

A lawsuit was filed against us and other defendants (Chromatex, Inc., Rossville Industries, Inc., Rossville Companies, Inc. and Rossville Investments, Inc.) on February 5, 2008 in the United States District Court for the Middle District of Pennsylvania. The plaintiffs are Alan Shulman, Stanley Siegel, Ruth Cherenson as Personal Representative of Estate of Alan Cherenson, and Adrienne Rolla and M.F. Rolla as Executors of the Estate of Joseph Byrnes. The plaintiffs were partners in a general partnership that formerly owned a manufacturing plant in West Hazleton, Pennsylvania (the "Site"). Approximately two years after this general partnership sold the Site to defendants Chromatex, Inc. and Rossville Industries, Inc., we leased and operated the Site as part of our Rossville/Chromatex division. The lawsuit involved court judgments that were entered against the plaintiffs and against defendant Chromatex, Inc. requiring them to pay costs incurred by the United States Environmental Protection Agency ("USEPA") responding to environmental contamination at the Site, in amounts approximating \$14 million, plus unspecified future environmental costs. Neither USEPA nor any other governmental authority asserted any claim against us on account of these matters. The plaintiffs sought contribution from us and other defendants and declaring that the company and the other defendants were responsible for environmental response costs under environmental laws and certain agreements. The plaintiffs also asserted that we tortiously interfered with contracts between them and other defendants in the case and diverted assets to prevent the plaintiffs from being paid monies owed to them. We defended ourselves vigorously with regards to the matters described in this litigation.

In the first quarter of fiscal 2014, the parties to this lawsuit reached a settlement of all matters, which required us to contribute cash to a global settlement fund. Consequently, we recorded a charge of \$206,000 to other expense in the fiscal 2014 Consolidated Statement of Net Income. In the fourth quarter of fiscal 2014, we paid the \$206,000 settlement amount. Subsequently, the settlement was reviewed by the government and during the first quarter of fiscal 2015 the court approved the final agreement by the parties involved. The lawsuit was dismissed on June 5, 2014.

Other Litigation

The company is involved in legal proceedings and claims which have arisen in the ordinary course of business. Management has determined that it is not reasonably possible that these actions, when ultimately concluded and settled, will have a material adverse effect upon the financial position, results of operations, or cash flows of the company.

Lease

We lease a plant facility associated with our mattress fabrics segment from a partnership owned by certain shareholders and officers of the company and their immediate families. At April 27, 2014, this lease was on a month to month basis payable at an amount of \$12,704 per month.

Effective October 1, 2014, we entered into new lease agreement with the partnership noted above. The new lease agreement requires monthly payments of \$13,000 for a three year term commencing on October 1, 2014 through September 30, 2017. This lease contains two successive options to renew the lease with each renewal period being three years. The first and second renewal terms would require monthly payments of \$13,100 and \$13,200,

respectively.

I-25

Culp, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Purchase Commitments

At February 1, 2015, January 26, 2014, and April 27, 2014, we had open purchase commitments to acquire equipment for our mattress fabrics segment totaling \$3.8 million, \$3.8 million, and \$3.4 million, respectively.

17. Common Stock Repurchase Program

On February 25, 2014, we announced that our board of directors approved an authorization for us to acquire up to \$5.0 million of our common stock. Under the common stock repurchase program, shares may be purchased from time to time in open market transactions, block trades, through plans established under the Securities Exchange Act Rule 10b5-1, or otherwise. The amount of shares purchased and the timing of such purchases will be based on working capital requirements, market and general business conditions, and other factors including alternative investment opportunities.

During the nine months ended February 1, 2015, we repurchased 43,014 shares of our common stock at a cost of \$745,000, all of which were purchased in the first and second quarters. During the nine months ended January 26, 2014, we did not repurchase any shares of common stock.

At February 1, 2015, we had \$4.3 million available for additional repurchases of our common stock.

18. Dividend Program

During the nine months ended February 1, 2015, dividend payments totaled \$6.8 million, of which \$4.9 million represented a special cash dividend payment in the first quarter of \$0.40 per share, and \$1.9 million represented our regular quarterly cash dividend payments ranging from \$0.05 to \$0.06 per share.

During the nine months ended January 26, 2014, we paid quarterly cash dividend payments totaling \$1.6 million that ranged from \$0.04 to \$0.05 per share.

On March 4, 2015, we announced that our board of directors approved the payment of a quarterly cash dividend of \$0.06 per share. This dividend will be paid on or about April 15, 2015, to shareholders of record as of April 1, 2015.

Future dividend payments are subject to board approval and may be adjusted at the board's discretion as business needs or market conditions change.

CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING INFORMATION

This report and the exhibits attached hereto contain “forward-looking statements” within the meaning of the federal securities laws, including the Private Securities Litigation Reform Act of 1995 (Section 27A of the Securities Act of 1933 and Section 21E of the Securities and Exchange Act of 1934). Such statements are inherently subject to risks and uncertainties. Further, forward looking statements are intended to speak only as of the date on which they are made, and we disclaim any duty to update such statements. Forward-looking statements are statements that include projections, expectations or beliefs about future events or results or otherwise are not statements of historical fact. Such statements are often but not always characterized by qualifying words such as “expect,” “believe,” “estimate,” “plan” and “project” and their derivatives, and include but are not limited to statements about expectations for our future operations, production levels, sales, profit margins, profitability, operating income, SG&A or other expenses, pre-tax income, earnings, cash flow, and other performance or liquidity measures, as well as any statements regarding future economic or industry trends or future developments. Factors that could influence the matters discussed in such statements include the level of housing starts and sales of existing homes, consumer confidence, trends in disposable income, and general economic conditions. Decreases in these economic indicators could have a negative effect on our business and prospects. Likewise, increases in interest rates, particularly home mortgage rates, and increases in consumer debt or the general rate of inflation, could affect us adversely. Changes in consumer tastes or preferences toward products not produced by us could erode demand for our products. Changes in the value of the U.S. dollar versus other currencies can affect our financial results because a significant portion of our operations are located outside the United States. Strengthening of the U.S. dollar against other currencies could make our products less competitive on the basis of price in markets outside the United States, and strengthening of currencies in Canada and China can have a negative impact on our sales of products produced in those places. Also, economic and political instability in international areas could affect our operations or sources of goods in those areas, as well as demand for our products in international markets. Further information about these factors, as well as other factors that could affect our future operations or financial results and the matters discussed in forward-looking statements, is included in Item 1A “Risk Factors” section in our Form 10-K filed with the Securities and Exchange Commission on July 11, 2014, for the fiscal year ended April 27, 2014.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following analysis of financial condition and results of operations should be read in conjunction with the Financial Statements and Notes and other exhibits included elsewhere in this report.

General

Our fiscal year is the 52 or 53 week period ending on the Sunday closest to April 30. The nine months ended February 1, 2015, and January 26, 2014, represent 40 and 39 week periods, respectively. Our operations are classified into two business segments: mattress fabrics and upholstery fabrics. The mattress fabrics segment manufactures, sources and sells fabrics and mattress covers to bedding manufacturers. The upholstery fabrics segment manufactures, sources, and sells fabrics primarily to residential furniture manufacturers.

We evaluate the operating performance of our segments based upon income from operations before certain unallocated corporate expenses and other non-recurring items. Cost of sales in both segments include costs to manufacture or source our products, raw material costs and finished goods purchases, direct and indirect labor, overhead and incoming freight charges. Unallocated corporate expenses represent primarily compensation and benefits for certain executive officers and all costs related to being a public company.

Executive Summary

Results of Operations

(dollars in thousands)	Three Months Ended		
	February 1, 2015	January 26, 2014	% Change
Net sales	\$ 81,269	\$ 72,389	12.3 %
Gross profit	14,402	11,837	21.7 %
Gross profit margin	17.7 %	16.4 %	7.9 %
SG&A expenses	8,375	7,041	18.9 %
Income from operations	6,027	4,796	25.7 %
Operating margin	7.4 %	6.6 %	12.1 %
Income before income taxes	5,922	4,574	29.5 %
Income taxes	2,110	(3,807)	N.M.
Net income	3,812	8,381	(54.5)%

Nine Months Ended

(dollars in thousands)	February 1, 2015	January 26, 2014	% Change
Net sales	\$ 231,320	\$ 213,119	8.5 %
Gross profit	39,395	37,145	6.1 %
Gross profit margin	17.0 %	17.4 %	(2.3)%
SG&A expenses	23,173	21,340	8.6 %
Income from operations	16,222	15,805	2.6 %
Operating margin	7.0 %	7.4 %	(5.4)%
Income before income taxes	16,270	14,923	9.0 %
Income taxes	6,113	216	N.M.
Net income	10,157	14,707	(30.9)%

Net Sales

Our net sales for the third quarter and first nine months of fiscal 2015 increased as compared with the same periods a year ago. The higher sales reflect the continued favorable customer response to our designs and wide range of products in both our business segments. These results demonstrate the benefits of our top strategic priority—to drive product innovation and creativity throughout our company. In addition, our scalable and flexible manufacturing platform supports our ability to compete in a fashion-driven business that is always changing.

The nine month period of fiscal 2015 includes 40 weeks compared to 39 weeks for the nine month period fiscal 2014, which also contributed to the higher net sales.

Income Before Income Taxes

The increase in our income before income taxes primarily reflects the increase in net sales noted above and the significant improvement in our mattress fabric segment's operating results in the third quarter of fiscal 2015. During the third quarter and the nine month period of fiscal 2014, our mattress fabric segment's income from operations were affected by higher than expected transition costs associated with our mattress cover operation, as well as higher than expected sampling and developments costs in support of new customer roll-outs in in early calendar 2014. These costs did not occur in fiscal 2015. In addition, our mattress fabric segment's income from operations improved in fiscal 2015 due to operating efficiencies gained as we near the completion of our previously announced \$9.5 million capital expansion project.

Our income before income taxes was also affected by a decline in profitability of our upholstery fabrics segment in fiscal 2015 compared to fiscal 2014 due primarily to lower business volume and operating losses associated with our Culp Europe operation located in Poland, higher operational costs associated with our operations located in China, and product mix.

Additionally, income before income taxes for the nine month period of fiscal 2015 was also impacted by the decrease in other expense in comparison to the same period a year ago. Other expense was \$380,000 and \$895,000 for the nine month periods of fiscal 2015 and 2014, respectively. This decrease was primarily due to more favorable foreign currency exchange rates associated with our operations located in China for the nine month period of fiscal 2015 compared with the same period a year ago. Also, a non-recurring charge of \$206,000 was recorded in the first quarter of fiscal 2014 for the settlement of litigation relating to environmental claims associated with a closed facility, and there was no comparable charge in the nine month period of fiscal 2015.

See the Segment Analysis section located in the Results of Operations for further details.

Income Taxes

We reported income tax expense of \$2.1 million in the third quarter of fiscal 2015 compared to an income tax benefit of \$3.8 million in the third quarter of fiscal 2014. We reported income tax expense of \$6.1 million for the nine month period of fiscal 2015 compared to \$216,000 for the same period a year ago. The income tax provisions fiscal 2014, included an income tax benefit of \$5.4 million to record the U.S. income tax effects of the undistributed earnings from our foreign subsidiaries located in China, which was treated as discrete even in which the full income tax effects of this adjustment were recorded in the three and nine months periods ended January 26, 2014, as it pertained to a change in judgment on prior period's accumulated earnings and profits.

See the Income Taxes section located in the Results of Operations and Note 14 of the consolidated financial statements for further details.

Liquidity

At February 1, 2015, our cash and cash equivalents and short-term investments totaled \$37.2 million and exceeded our total debt (all of which is classified in current maturities of long-term debt) of \$2.2 million. We currently have one remaining annual \$2.2 million principal payment due on our long-term debt in August 2015.

As of the end of the third quarter of fiscal 2015, our cash and cash equivalents and short-term investments increased to \$37.2 million from \$35.6 million at April 27, 2014, despite spending thus far in fiscal 2015 \$8.2 million on capital expenditures, \$7.6 million on dividend payments and common stock repurchases, \$2.7 million on payments on our long-term debt and lines of credit, and \$1.3 million on long-term investment purchases associated with our Rabbi Trust that is partially funding our deferred compensation plan.

Our net cash provided by operating activities of \$20.7 million for the first nine months of fiscal 2015, increased 88% compared with \$11.0 million for the first nine months of fiscal 2014. This increase is primarily due to improved inventory management in both our business segments.

Dividend Program

During the nine months ended February 1, 2015, dividend payments totaled \$6.8 million, of which \$4.9 million represented a special cash dividend payment in the first quarter of \$0.40 per share, and \$1.9 million represented our regular quarterly cash dividend payments ranging from \$0.05 to \$0.06 per share.

During the nine months ended January 26, 2014, we paid quarterly cash dividend payments totaling \$1.6 million that ranged from \$0.04 to \$0.05 per share.

On March 4, 2015, we announced that our board of directors approved the payment of a quarterly cash dividend of \$0.06 per share. This dividend will be paid on or about April 15, 2015, to shareholders of record as of April 1, 2015.

Future dividend payments are subject to board approval and may be adjusted at the board's discretion as business needs or market conditions change.

Common Stock Repurchase Program

On February 25, 2014, we announced that our board of directors approved an authorization for us to acquire up to \$5.0 million of our common stock. Under the common stock repurchase program, shares may be purchased from time to time in open market transactions, block trades, through plans established under the Securities Exchange Act Rule 10b5-1, or otherwise. The amount of shares purchased and the timing of such purchases will be based on working capital requirements, market and general business conditions, and other factors including alternative investment opportunities.

During the nine months ended February 1, 2015, we repurchased 43,014 shares of our common stock at a cost of \$745,000, all of which were purchased in the first and second quarters. During the nine months ended January 26, 2014, we did not repurchase any shares of common stock.

At February 1, 2015, we had \$4.3 million available for additional repurchases of our common stock.

Since June 2011, we have returned a total of \$28 million to shareholders in the form of regular quarterly and special dividend payments and common stock share repurchases.

Segment Analysis

Mattress Fabrics Segment

Three Months Ended

(dollars in thousands)	February 1, 2015	January 26, 2014	% Change
Net sales	\$ 45,683	\$ 38,541	18.5 %
Gross profit	8,076	5,599	44.2 %
Gross profit margin	17.7 %	14.5 %	22.1 %
SG&A expenses	2,853	2,286	24.8 %
Income from operations	5,223	3,313	57.7 %
Operating margin	11.4 %	8.6 %	32.6 %

Nine Months Ended

(dollars in thousands)	February 1, 2015	January 26, 2014	% Change
Net sales	\$ 131,543	\$ 117,035	12.4 %
Gross profit	22,603	20,312	11.3 %
Gross profit margin	17.2 %	17.4 %	(1.1)%
SG&A expenses	8,019	7,280	10.2 %
Income from operations	14,584	13,033	11.9 %
Operating margin	11.1 %	11.1 %	-

Net Sales

Our mattress fabric net sales for the third quarter and the first nine months of fiscal 2015 increased as compared with the same periods a year ago. These results reflect higher than expected demand caused by an improved business environment, some market share gains, and some advanced sales to major customers at the end of the third quarter as they prepared to launch their flagship brands ahead of major bedding events. Also contributing to the year to date sales gain as compared to the previous year was the fact that fiscal 2015 had 40 weeks compared to 39 weeks for fiscal 2014.

Design and innovation have been top strategic priorities that have allowed us to keep up with the latest fashion trends and meet customer style preferences. We have continued to expand our design team and have invested in the latest technical software and website development to support and strengthen our brand. As a result, we have been able to offer a diverse product line across all price points and meet growing consumer demand. Our scalable manufacturing platform and reactive capacity supports our ability to deliver a diverse product mix in line with changing consumer demand.

I-32

Gross Profit and Operating Income

Gross profit and operating income for the mattress fabrics segment increased for the third quarter and the first nine months of fiscal 2015 as compared to the same periods a year ago. These results reflect the impact from the increase in net sales noted above, as well as from the improvement in operating efficiencies as compared to the previous year.

Contributing to this year over year operational improvement has been the benefits from our \$9.5 million expansion plan to increase our production capacity, add finishing capabilities, and improve our overall efficiency and throughput. As a result of this expansion plan we have made steady progress in our operating performance since the third quarter of fiscal 2014. Our operating margins were 11.4%, 11.0%, 10.8%, 10.3%, and 8.6% for the third quarter of fiscal 2015, second quarter of fiscal 2015, first quarter of fiscal 2015, fourth quarter of fiscal 2014, and third quarter of fiscal 2014, respectively. As we near completion of this project, we expect to more fully benefit from these operational improvements and additional equipment in the fourth quarter of fiscal 2015.

Another factor contributing to the increase profit as compared to the previous year, especially in the third quarter, was the significant operational improvement in the mattress cover business. The significant labor inefficiencies and unfavorable product mix that pressured performance last year did not impact this quarter's performance. We believe this operation will continue to mature and is trending toward becoming a meaningful contributor to our overall business platform.

Segment assets

Segment assets consist of accounts receivable, inventory, property, plant and equipment, goodwill, a non-compete agreement and customer relationships associated with an acquisition.

(dollars in thousands)	February 1, 2015	January 26, 2014	April 27, 2014
Accounts receivable and inventory	\$ 36,658	\$ 36,818	\$ 36,229
Property, plant & equipment	33,046	27,822	29,040
Goodwill	11,462	11,462	11,462
Non-compete agreement	998	1,047	1,041
Customer Relationships	779	830	817

Accounts Receivable & Inventory

As of February 1, 2015, accounts receivable for this segment were \$17.6 million, an increase of \$3.4 million or 24%, compared with \$14.2 million as of January 26, 2014. This increase is primarily due to the increase in net sales for the third quarter of fiscal 2015 compared to the third quarter of fiscal 2014. Net sales for the third quarter of fiscal 2015 were \$45.7 million compared to \$38.5 million for the third quarter of fiscal 2014.

As of February 1, 2015, accounts receivable for this segment were \$17.6 million, an increase of \$3.0 million or 21%, compared with \$14.6 million as of April 27, 2014. This increase is primarily due to the increase in net sales for the third quarter of fiscal 2015 compared to the fourth quarter of fiscal 2014. Net sales for the third quarter of fiscal 2015 were \$45.7 million compared to \$43.7 million for the fourth quarter of fiscal 2014.

As of February 1, 2015, inventory for this segment was \$19.1 million, a decrease of \$3.5 million or 16%, compared with \$22.6 million as of January 26, 2014. This decrease is primarily due to improved inventory management in fiscal 2015 compared to fiscal 2014.

As of February 1, 2015, inventory for this segment was \$19.1 million, a decrease of \$2.6 million or 12%, compared with \$21.7 million as of April 27, 2014. This decrease is primarily due to improved inventory management in fiscal 2015 compared to fiscal 2014.

Property, Plant & Equipment

The \$33.0 million at February 1, 2015, represents property, plant and equipment of \$23.5 million and \$9.5 million located in the U.S. and Canada, respectively. The \$27.8 million at January 26, 2014, represents property, plant, and equipment of \$20.1 million and \$7.7 million located in the U.S. and Canada, respectively. The \$29.0 million at April 27, 2014, represents property, plant, and equipment of \$20.6 million and \$8.4 million located in the U.S. and Canada, respectively.

The increase in property, plant, and equipment for this segment is primarily due to the capital expansion plan noted above, offset by depreciation expense.

Upholstery Fabrics Segment

Net Sales

(dollars in thousands)	Three Months Ended							
	February 1, 2015			January 26, 2014			% Change	
Non U.S. Produced	\$ 32,585	92	%	\$ 31,108	92	%	4.7	%
U.S. Produced	3,001	8	%	2,740	8	%	9.5	%
Total	\$ 35,586	100	%	\$ 33,848	100	%	5.1	%

(dollars in thousands)	Nine Months Ended							
	February 1, 2015			January 26, 2014			% Change	
Non U.S. Produced	\$ 91,604	92	%	\$ 88,634	92	%	3.4	%
U.S. Produced	8,173	8	%	7,450	8	%	9.7	%
Total	\$ 99,777	100	%	\$ 96,084	100	%	3.8	%

Our net sales for the third quarter and the nine month period of fiscal 2015 increased as compared with the same periods a year ago. We have continued to see favorable customer response to our innovative designs and diverse product offering. Our sales were especially strong at the end of the third quarter, as many customers anticipated longer lead times related to the Chinese New Year holiday, which occurred in February. Sales of China produced fabrics accounted for 92% of upholstery fabric sales in the third quarter and the nine month period of fiscal 2015. Also contributing to the year to date sales gain as compared to the previous year was the fact that fiscal 2015 had 40 weeks compared to 39 weeks for fiscal 2015.

We have also realized the benefits of our diversification strategy to expand our customer base, including the hospitality market and the lifestyle retail category. Our 100% owned China platform supports our marketing efforts and allows us to quickly adapt to changing market trends and consumer style preferences at different price points.

Edgar Filing: CULP INC - Form 10-Q

Gross Profit, Selling, General & Administrative Expenses, and Operating Income

Three Months Ended

(dollars in thousands)	February 1, 2015	January 26, 2014	% Change
Gross profit	\$ 6,326	\$ 6,238	1.4 %
Gross profit margin	17.8 %	18.4 %	(3.3)%
SG&A expenses	3,781	3,572	5.9 %
Income from operations	2,545	2,666	(4.5)%
Operating margin	7.2 %	7.9 %	(8.9)%

Nine Months Ended

(dollars in thousands)	February 1, 2015	January 26, 2014	% Change
Gross profit	\$ 16,792	\$ 16,833	(0.2)%
Gross profit margin	16.8 %	17.5 %	(4.0)%
SG&A expenses	10,518	10,007	5.1 %
Income from operations	6,274	6,825	(8.1)%
Operating margin	6.3 %	7.1 %	(11.3)%

Although our net sales increased over last fiscal year as noted above, our income from operations and gross profit margins and operating margins declined. Our profitability was affected by lower business volume and operating losses associated with our Culp Europe operation located in Poland, higher operational costs associated with operations located in China, and product mix.

As previously announced at the end of the third quarter, we closed our finished goods warehouse and distribution facility located in Poznan, Poland, primarily as a result of the ongoing economic concerns in Europe. As a result, we incurred a charge of approximately \$200,000 for closing related costs during fiscal 2015. Currently, we remain very interested in developing business in Europe, and we are assessing the best strategy for selling upholstery fabric into this market as business conditions improve.

Because the Chinese New Year holiday falls entirely in the fourth quarter of fiscal 2015, our sales and production schedules will be interrupted by the extended break.

Segment Assets

Segment assets consist of accounts receivable, inventory, and property, plant, and equipment.

(dollars in thousands)	February 1, 2015	January 26, 2014	April 27, 2014
Accounts receivable and inventory	\$ 32,129	\$ 33,261	\$ 31,854
Property, plant & equipment	1,522	1,649	1,573

Accounts Receivable & Inventory

As of February 1, 2015, accounts receivable for this segment were \$13.2 million, an increase of \$1.0 million or 8%, compared with \$12.2 million as of January 26, 2014. This increase is primarily due to the increase in net sales for the third quarter of fiscal 2015 compared to the third quarter of fiscal 2014. Net sales for the third quarter of fiscal 2015 were \$35.6 million compared to \$33.8 million for the third quarter of fiscal 2014.

As of February 1, 2015, inventory for this segment was \$18.9 million, a decrease of \$2.2 million or 10%, compared with \$21.1 million as of January 26, 2014. This decrease is primarily due to improved inventory management and the reduction of inventory associated with the closure of our Culp Europe operation located in Poland.

As of February 1, 2015, accounts receivable for this segment were \$13.2 million compared with \$12.8 million as of April 27, 2014. This slight increase is due to the increase in net sales for the third quarter of fiscal 2015 compared to the fourth quarter of fiscal 2014, offset by increased sales with customers with discounted payment terms. Net sales for the third quarter of fiscal 2015 were \$35.6 million, an increase of 17% compared to \$30.4 million for the fourth quarter of fiscal 2014. Days' sales outstanding for this segment was 31 days for the third quarter of fiscal 2015 compared with 38 days for the fourth quarter of fiscal 2014.

As of February 1, 2015, inventory for this segment was \$18.9 million compared with \$19.0 million as of April 27, 2014. This slight decrease in inventory represents the reduction of inventory associated with the closure of our Culp Europe operation located in Poland, partially offset by the increase in inventory associated with projected demand as a result of the Chinese New Year holiday.

Property, Plant & Equipment

The \$1.5 million at February 1, 2015, represents property, plant, and equipment of \$877 and \$645 located in the U.S. and China, respectively. The \$1.6 million at January 26, 2014, represents property, plant, and equipment located in the U.S. of \$1.0 million, located in China of \$561, and located in Poland of \$47. The \$1.6 million at April 27, 2014, represents property, plant, and equipment located in the U.S. of \$957, located in China of \$572, and located in Poland of \$44.

Other Income Statement Categories

Selling, General and Administrative Expenses

SG&A expenses for the company as a whole were \$8.4 million in the third quarter of fiscal 2015 compared to \$7.0 million in the third quarter of fiscal 2014. SG&A expenses for the company as a whole were \$23.2 million for the nine month period of fiscal 2015 compared to \$21.3 million for the same period a year ago. This increase is primarily due to higher incentive compensation expense reflecting stronger financial results in relation to pre-established performance targets in fiscal 2015 compared to fiscal 2014, and the increase in net sales noted above.

As a percent of net sales, SG&A expenses were 10.3% in the third quarter of fiscal 2015 compared with 9.7% in the third quarter of fiscal 2014. As a percent of net sales, SG&A expenses were 10.0% for the nine month periods of fiscal 2015 and 2014.

Interest Expense

There was no interest expense for the third quarter of fiscal 2015 compared to \$91,000 for the third quarter of fiscal 2014. Interest expense was \$50,000 for the nine month period of fiscal 2015 compared with \$330,000 for the same period a year ago.

These trends primarily reflect lower outstanding balances of long-term debt. Also, interest expense was reduced by interest costs of 60,000 and \$141,000 for the mattress fabric expansion plan that were capitalized during the third quarter and the nine month period of fiscal 2015, respectively. These interest costs will be depreciated over the related assets' useful lives. No interest costs were capitalized during fiscal 2014.

Interest Income

Interest income was \$202,000 for the third quarter of fiscal 2015 compared to \$148,000 for the third quarter of fiscal 2014. Interest income was \$478,000 for the nine month period of fiscal 2015 compared to \$343,000 for the same period a year ago.

These increases reflect higher cash and cash equivalent and short-term investment balances held with our foreign subsidiaries during the third quarter and nine month period of fiscal 2015 compared to the prior year. Cash and cash equivalents and short-term investment balances held by our foreign subsidiaries earn higher interest rates as compared to our cash and cash equivalents and short-term investment balances held in the United States.

Other Expense

Other expense for the third quarter of fiscal 2015 was \$307,000 compared to \$279,000 during the third quarter of fiscal 2014. Other expense for the nine month period of fiscal 2015 was \$380,000 compared with the \$895,000 for the same period a year ago. This decrease in other expense for the nine month period of fiscal 2015 is primarily due to more favorable foreign currency exchange rates associated with our operations located in China in fiscal 2015 compared with the same period a year ago.

We have been able to mitigate the effects of foreign exchange rate fluctuations associated with our subsidiaries domiciled in Canada and Poland through maintenance of a natural hedge by keeping a balance of assets and liabilities denominated in foreign currencies other than the U.S. dollar. Although we will continue to try and maintain this natural hedge, there is no assurance that we will be able to continue to do so in the future reporting periods.

In addition, a non-recurring charge of \$206,000 was recorded in the first quarter of fiscal 2014 for the settlement of litigation relating to environmental claims associated with a closed facility, and there was no comparable charge in the third quarter and the nine month period of fiscal 2015.

Income Taxes

Effective Income Tax Rate

We recorded income tax expense of \$6.1 million, or 37.6% of income before income tax expense, for the nine month period ended February 1, 2015, compared to income tax expense of \$216,000 or 1.4% of income before income tax expense, for the nine month period ended January 26, 2014. Our effective income tax rates for the nine month periods ended February 1, 2015 and January 26, 2014, were based upon the estimated effective income tax rate applicable for the full year after giving effect to any significant items related specifically to interim periods. The effective income tax rate can be affected over the fiscal year by the mix and timing of actual earnings from our U.S. operations and foreign sources versus annual projections and changes in foreign currencies in relation to the U.S. dollar.

The income tax expense for the nine month period ended February 1, 2015 is different from the amount obtained by applying our statutory rate of 34% to income before income taxes for the following reasons:

The income tax rate decreased by 6% for taxable income subject to lower statutory income tax rates in foreign jurisdictions (Canada and China) compared with the statutory income tax rate of 34% for the United States.

The income tax rate increased by 4% to record the income tax effects of the undistributed earnings from our foreign subsidiaries located in Canada and China.

The income tax rate increased by 4% for an increase in unrecognized tax benefits.

The income tax rate increased by 1.6% for stock-based compensation and other miscellaneous items.

The income tax expense for nine month period ended January 26, 2014 is different from the amount obtained by applying our statutory rate of 34% to income before income taxes for the following reasons:

The income tax rate decreased 36% for an income tax benefit of \$5.4 million to record the U.S. income tax effects of the undistributed earnings from our foreign subsidiaries located in China. The \$5.4 million income tax benefit recognized U.S. foreign income tax credits of \$9.9 million offset by the U.S. income tax effects of the undistributed earnings from our China operations and foreign withholding taxes of \$4.5 million. The \$5.4 million income tax benefit was treated as a discrete event in which the full income tax effects of this adjustment were recorded in the three and nine month periods ended January 26, 2014, as it pertained to a change in judgment on prior periods' accumulated earnings and profits associated with our subsidiaries located in China.

The income tax rate increased 2% for adjustments primarily made to our state of North Carolina loss carryforwards for the decrease in future North Carolina corporate income tax rates commencing in fiscal 2015 and beyond. These adjustments were recorded in the first quarter of fiscal 2014, totaled \$273,000, and represented a discrete event in which the full tax effects were recorded in the nine month period ending January 26, 2014.

The income tax rate decreased by 7% for taxable income subject to lower statutory income tax rates in foreign jurisdictions (Canada and China) compared with the statutory income tax rate of 34% for the United States.

The income tax rate increased 4% for an increase in unrecognized tax benefits.

The income tax rate was increased by 4.4% for stock-based compensation and other miscellaneous items.

Deferred Income Taxes

Valuation Allowance

In accordance with ASC Topic 740, we evaluate our deferred income taxes to determine if a valuation allowance is required. ASC Topic 740 requires that companies assess whether a valuation allowance should be established based on the consideration of all available evidence using a “more likely than not” standard, with significant weight being given to evidence that can be objectively verified. Since the company operates in multiple jurisdictions, we assess the need for a valuation allowance on a jurisdiction-by-jurisdiction basis, taking into account the effects of local tax law. Based on our assessment at February 1, 2015, we recorded a partial valuation allowance of \$1.0 million, of which \$596,000 pertained to certain U.S. state net operating loss carryforwards and credits and \$400,000 pertained to loss carryforwards associated with our Culp Europe operation located in Poland. Based on our assessment at January 26, 2014, we recorded a partial valuation allowance of \$1.0 million, of which \$715,000 pertained to certain U.S. state net operating loss carryforwards and credits and \$291,000 pertained to loss carryforwards associated with our Culp Europe operation located in Poland. Based on our assessment at April 27, 2014, we recorded a partial valuation allowance of \$1.0 million, of which \$666,000 pertained to certain U.S. state net operating loss carryforwards and credits and \$311,000 pertained to loss carryforwards associated with our Culp Europe operation located in Poland.

No valuation allowance was recorded against our net deferred tax assets associated with our operations located in China and Canada at February 1, 2015, January 26, 2014, and April 27, 2014, respectively.

The recorded valuation allowance of \$1.0 million at February 1, 2015, has no effect on our operations, loan covenant compliance, or the possible realization of certain U.S. state net operating loss carryforwards and credits and our loss carryforwards associated with our Culp Europe operation located in Poland. If it is determined that it is more-likely-than-not that we will realize any of these deferred tax assets, an income tax benefit will be recognized at that time.

Undistributed Earnings

In accordance with ASC Topic 740, we assess whether the undistributed earnings from our foreign subsidiaries will be reinvested indefinitely or eventually distributed to our U.S. parent company. ASC Topic 740 requires that a deferred tax liability should be recorded for undistributed earnings from foreign subsidiaries that will not be reinvested indefinitely. Based on our assessment as of February 1, 2015, it is our intention not to permanently invest our undistributed earnings from our foreign subsidiaries. Also, we assess the recognition of U.S. foreign income tax credits associated with foreign withholding and income tax payments and whether it is more-likely-than-not that our foreign income tax credits will not be realized. If it is determined that any foreign income tax credits need to be recognized or it is more-likely-than-not our foreign income tax credits will not be realized, an adjustment to our

provision for income taxes will be recognized at that time.

I-40

During the third quarter of fiscal 2014, our operations located in China achieved positive accumulated earnings and profits for both U.S. income tax and financial reporting purposes for the first time since we determined our undistributed earnings from our foreign subsidiaries would not be reinvested indefinitely in the second quarter of fiscal 2013. As a result, we recorded an income tax benefit of \$5.4 million to recognize U.S. foreign income tax credits of \$9.9 million offset by the U.S. income tax effects of the undistributed earnings from our China operations and foreign withholding taxes totaling \$4.5 million. This \$5.4 million income tax benefit was treated as a discrete event in which the full income tax effects of this adjustment were recorded in the three and nine month periods ended January 26, 2014, as it pertained to a change in judgment on prior periods' accumulated earnings and profits associated with our subsidiaries located in China.

At February 1, 2015, the deferred tax liability associated with our undistributed earnings from our foreign subsidiaries totaled \$2.4 million, which included U.S. income and foreign withholding taxes totaling \$32.1 million, offset by U.S. foreign income tax credits of \$29.7 million. At January 26, 2014, the deferred tax liability associated with our undistributed earnings from our foreign subsidiaries totaled \$1.7 million, which included U.S. income and foreign withholding taxes totaling \$26.9 million, offset by U.S. foreign income tax credits of \$25.2 million. At April 27, 2014, the deferred tax liability associated with our undistributed earnings from our foreign subsidiaries totaled \$2.0 million, which included U.S. income and foreign withholding taxes totaling \$28.1 million, offset by U.S. foreign income tax credits of \$26.1 million.

We had accumulated earnings from our foreign subsidiaries totaling \$82.4 million, \$69.8 million, and \$72.8 million at February 1, 2015, January 26, 2014, and April 27, 2014, respectively.

Overall

At February 1, 2015, the current deferred tax asset of \$7.0 million represents \$6.7 million and \$294,000 from our operations located in the U.S. and China, respectively. At February 1, 2015, the non-current deferred tax asset of \$482,000 pertains to our operations located in China. At February 1, 2015, the non-current deferred tax liability of \$3.4 million represents \$2.5 million and \$886,000 from our operations located in the U.S. and Canada, respectively.

At January 26, 2014, the current deferred tax asset of \$7.5 million represents \$7.3 million and \$217,000 from our operations located in the U.S. and China, respectively. At January 26, 2014, the non-current deferred tax asset of \$1.2 million represents \$600,000 and \$627,000 from our operations located in the U.S. and China, respectively. At January 26, 2014, the non-current deferred tax liability of \$945,000 pertains to our operations located in Canada.

At April 27, 2014, the current deferred tax asset of \$6.2 million represents \$5.8 million and \$372,000 from our operations located in the U.S. and China, respectively. At April 27, 2014, the non-current deferred tax asset of \$2.0 million represents \$1.4 million and \$572,000 from our operations located in the U.S. and China, respectively. At April 27, 2014, the non-current deferred tax liability of \$1.0 million pertained to our operations located in Canada.

Uncertainty In Income Taxes

At February 1, 2015, we had a \$13.9 million total gross unrecognized tax benefit, of which \$3.6 million represents the amount of gross unrecognized tax benefits that, if recognized, would favorably affect the income tax rate in future periods. At January 26, 2014, we had a \$13.6 million total gross unrecognized tax benefit, of which \$4.0 million represents the amount of gross unrecognized tax benefits that, if recognized, would favorably affect the income tax rate in future periods. At April 27, 2014, we had a \$13.7 million total gross unrecognized tax benefit, of which \$4.0 million represents the amount of gross unrecognized tax benefits that, if recognized, would favorably affect the income tax rate in future periods.

At February 1, 2015, we had a \$13.9 million total gross unrecognized tax benefit, of which \$10.3 million and \$3.6 million were classified as net non-current deferred income taxes and income taxes payable – long-term, respectively, in the accompanying consolidated balance sheets. At January 26, 2014, we had a \$13.6 million total gross unrecognized tax benefit, of which \$9.6 million and \$4.0 million were classified as net non-current deferred income taxes and income taxes payable – long-term, respectively, in the accompanying consolidated balance sheets. At April 27, 2014, we had \$13.7 million of total gross unrecognized tax benefit, of which \$9.7 million and \$4.0 million were classified as net non-current deferred income taxes and income taxes payable – long-term, respectively, in the accompanying consolidated balance sheets.

We estimate that the amount of gross unrecognized tax benefits will increase by approximately \$706,000 for fiscal 2015. This increase primarily relates to double taxation under applicable tax treaties with foreign tax jurisdictions.

Income Taxes Paid

We reported income tax expense of \$6.1 million and \$216,000 in the nine month periods of fiscal 2015 and fiscal 2014, respectively. Currently, we are not paying income taxes in the United States due to our loss carryforwards that totaled \$44.6 million at April 27, 2014. However, we did have income tax payments of \$3.0 million and \$2.3 million in the nine month periods of fiscal 2015 and fiscal 2014, respectively. Our income tax payments are associated with our subsidiaries located in China and Canada.

Liquidity and Capital Resources

Liquidity

At the end of our third quarter, our sources of liquidity include cash and cash equivalents, short-term investments, cash flow from operations, and amounts available under our unsecured revolving credit lines. These sources have been adequate for day-to-day operations, capital expenditures, debt payments, common stock repurchases, and dividend payments. We believe our present cash and cash equivalents and short-term investment balance of \$37.2 million at February 1, 2015, cash flow from operations, and the current availability under our unsecured revolving credit lines will be sufficient to fund our foreseeable business needs and contractual obligations.

At February 1, 2015, our cash and cash equivalents and short-term investments totaling \$37.2 million represented \$20.6 million associated with our operations located in China, \$10.8 million associated with our operations located in Canada, \$5.8 million associated with our operations located in the United States, and \$22,000 associated with our operations located in Poland.

At February 1, 2015, our cash and cash equivalents and short-term investments exceeded our total debt (all of which is classified in current maturities of long-term debt) of \$2.2 million. We currently have one remaining annual \$2.2 million principal payment on our long-term debt due in August 2015.

As of the end of the third quarter of fiscal 2015, our cash and cash equivalents and short-term investments increased to \$37.2 million from \$35.6 million at April 27, 2014, despite spending thus far in fiscal 2015 \$8.2 million on capital expenditures, \$7.6 million on dividend payments and common stock repurchases, \$2.7 million on payments on our long-term debt and lines of credit, and \$1.3 million on long-term investment purchases associated with our Rabbi Trust that is partially funding our deferred compensation plan.

Our net cash provided by operating activities of \$20.7 million for the first nine months of fiscal 2015, increased 88% compared with \$11.0 million for the nine month period of fiscal 2014. This increase is primarily due to improved inventory management in both our business segments.

Our cash and cash equivalents and short-term investment balance may be adversely affected by factors beyond our control, such as weakening industry demand and delays in receipt of payment on accounts receivable.

Dividend Program

During the nine months ended February 1, 2015, dividend payments totaled \$6.8 million, of which \$4.9 million represented a special cash dividend payment in the first quarter of \$0.40 per share, and \$1.9 million represented our regular quarterly cash dividend payments ranging from \$0.05 to \$0.06 per share.

During the nine months ended January 26, 2014, we paid quarterly cash dividend payments totaling \$1.6 million that ranged from \$0.04 to \$0.05 per share.

On March 4, 2015, we announced that our board of directors approved the payment of a quarterly cash dividend of \$0.06 per share. This dividend will be paid on or about April 15, 2015, to shareholders of record as of April 1, 2015.

Future dividend payments are subject to board approval and may be adjusted at the board's discretion as business needs or market conditions change.

Common Stock Repurchase Program

On February 25, 2014, we announced that our board of directors approved an authorization for us to acquire up to \$5.0 million of our common stock. Under the common stock repurchase program, shares may be purchased from time to time in open market transactions, block trades, through plans established under the Securities Exchange Act Rule 10b5-1, or otherwise. The amount of shares purchased and the timing of such purchases will be based on working capital requirements, market and general business conditions, and other factors including alternative investment opportunities.

During the nine months ended February 1, 2015, we repurchased 43,014 shares of our common stock at a cost of \$745,000, all of which were purchased in the first and second quarters. During the nine months ended January 26, 2014, we did not repurchase any shares of common stock.

At February 1, 2015, we had \$4.3 million available for additional repurchases of our common stock.

Since June 2011, we have returned a total of \$28 million to shareholders in the form of regular quarterly and special dividend payments and common stock share repurchases.

Working Capital

Accounts receivable at February 1, 2015, were \$30.8 million, an increase of \$4.4 million, or 17%, compared with \$26.4 million at January 26, 2014. This increase primarily reflects an increase in net sales of 12% in the third quarter of fiscal 2015 compared with the third quarter of fiscal 2014. Days' sales outstanding were 32 days for the third quarter of fiscal 2015 compared with 31 days for the third quarter of fiscal 2014.

Inventories as of February 1, 2015, were \$38.0 million, a decrease of \$5.7 million, or 13%, compared with \$43.7 million at January 26, 2014. This decrease reflects improved inventory management by both of our business segments and a reduction of inventory associated with the closure of our Culp Europe operation located in Poland. Inventory turns improved to 7.0 for the third quarter of fiscal 2015 from 5.4 for the third quarter of fiscal 2014.

Accounts payable-trade as of February 1, 2015, were \$28.6 million, an increase of \$3.4 million, or 14%, compared with \$25.2 million at January 26, 2014. This increase primarily reflects an increase in net sales in the third quarter of fiscal 2015 compared with the third quarter of fiscal 2014 and the timing of payments to suppliers associated with our operations located in China. The Chinese New Year holiday falls entirely in the fourth quarter of fiscal 2015 as opposed to a portion of the holiday falling in the third quarter of fiscal 2014. As a result, more payments to suppliers due around the Chinese New Year holiday were made in the third quarter of fiscal 2014 when compared to the fourth quarter of fiscal 2015.

Operating working capital (comprised of accounts receivable and inventories, less accounts payable-trade and accounts payable-capital expenditures) was \$39.4 million at February 1, 2015 compared with \$44.7 million at January 26, 2014. Operating working capital turnover was 7.5 during the third quarter of fiscal 2015 compared with 7.0 during the third quarter of fiscal 2014.

Financing Arrangements

Unsecured Senior Term Notes

We entered into a note agreement dated August 11, 2008 that provided for the issuance of \$11.0 million of unsecured senior term notes with a fixed interest rate of 8.01% and a term of seven years. Principal payments of \$2.2 million per year are due on the notes beginning August 11, 2011. The remaining principal payments are payable over an average term of 0.5 years through August 11, 2015. Any principal pre-payments would be assessed a penalty as defined in the agreement. The agreement contains customary financial and other covenants as defined in the agreement.

As of February 1, 2015, we have one remaining annual payment of \$2.2 million due on August 11, 2015.

Revolving Credit Agreement – United States

We have an unsecured credit agreement with Wells Fargo Bank, N.A. (“Wells Fargo”) that provides for an unsecured revolving loan commitment of \$10.0 million to be used to finance working capital and general corporate purposes. The amount of borrowings that were outstanding under the credit agreement with Culp Europe at January 26, 2014 and April 27, 2014, noted below decreased the \$10.0 million available. Interest is charged at a rate (applicable interest rate of 1.77%, 1.76%, and 1.75% at February 1, 2015, January 26, 2014, and April 27, 2014, respectively) equal to the one-month LIBOR rate plus a spread based on our ratio of debt to EBITDA as defined in the agreement. The credit agreement contains customary financial and other covenants as defined in the agreement and expires on August 31, 2015.

At February 1, 2015, there was a \$250,000 outstanding letter of credit (all of which related to workers compensation). At January 26, 2014, and April 27, 2014, there was a \$195,000 outstanding letter of credit (all of which related to workers compensation). At February 1, 2015, January 26, 2014, and April 27, 2014, there were no borrowings outstanding under the credit agreement.

Our credit agreement with Wells Fargo contains a financial covenant that limits our capital expenditures to \$10 million in any fiscal year. In the fourth quarter of fiscal 2015, we expect our capital expenditures to exceed \$10 million for fiscal 2015 as a result of the capital expansion project associated with our mattress fabrics segment. As a result, effective March 3, 2015, Wells Fargo increased our capital expenditure limit from \$10 million to \$12 million for fiscal 2015.

Revolving Credit Agreement – China

We have an unsecured credit agreement associated with our operations in China that provides for a line of credit of up to 40 million RMB (approximately \$6.4 million USD at February 1, 2015), expiring on May 9, 2015. This agreement has an interest rate determined by the Chinese government. There were no borrowings outstanding under the agreement as of February 1, 2015, January 26, 2014, and April 27, 2014.

Revolving Credit Agreement – Europe

At January 26, 2014 and April 27, 2014, we had an unsecured credit agreement with Wells Fargo that incurred interest at WIBOR (Warsaw Interbank Offered Rate) plus 2% (applicable interest rate of 4.5% and 4.38% at January 26, 2014 and April 27, 2014, respectively). There was \$573,000 and \$586,000 (1.8 million Polish Zloty) in borrowings outstanding under the agreement at January 26, 2014 and April 27, 2014, respectively.

Effective May 2, 2014, we converted our 1.8 million Polish Zloty denominated borrowings under the credit agreement to EURO denominated borrowings totaling €424,000 (\$569,000 USD). In addition, the applicable interest rate was converted to EURO LIBOR plus 2%.

At February 1, 2015, no borrowings were outstanding under this agreement, as the outstanding balance was paid in full during the second quarter of fiscal 2015.

Overall

Our loan agreements require, among other things, that we maintain compliance with certain financial covenants. At February 1, 2015, the company was in compliance with these financial covenants.

Capital Expenditures and Depreciation

Capital expenditures on a cash basis were \$8.2 million for the nine month period of fiscal 2015 compared with \$2.7 million for the same period a year ago. Capital expenditures for the nine month periods of fiscal 2015 and 2014 were primarily related to our mattress fabrics segment.

We acquired equipment for our mattress fabrics segment totaling \$890,000 in connection with the May 2013 Bodet & Horst asset purchase agreement during the first quarter of fiscal 2014.

Depreciation expense was \$4.2 million and \$4.0 million for the nine month periods of fiscal 2015 and 2014, respectively. Depreciation expense for the nine month periods of fiscal 2015 and 2014, primarily related to the mattress fabrics segment.

For fiscal 2015, we currently expect capital expenditures to be approximately \$11.0 million compared with \$5.3 million in fiscal 2014 and \$4.5 million in fiscal 2013. Planned capital expenditures for fiscal 2015 primarily relate to our previously announced mattress fabrics segment expansion plan. For fiscal 2015, depreciation expense is projected to be \$6.0 million, which primarily relates to the mattress fabrics segment.

For fiscal 2016, our preliminary estimate for capital expenditures is in the range of \$6 million to \$8.0 million and mostly related to our mattress fabrics segment.

These are management's current expectations only, and changes in our business needs could cause changes in plans for capital expenditures and expectations for related depreciation expense.

Critical Accounting Policies and Recent Accounting Developments

At February 1, 2015, there were no changes in the nature of our significant accounting policies or the application of those policies from those reported in our annual report on Form 10-K for the year ended April 27, 2014.

Refer to Note 2 located in the notes to the consolidated financial statements for recently adopted and issued accounting pronouncements since the filing of our Form 10-K for the year ended April 27, 2014.

Contractual Obligations

As of February 1, 2015, there were no significant or new contractual obligations from those reported in our annual report on Form 10-K for the year ended April 27, 2014, with the exception of the below lease agreement.

We lease a plant facility associated with our mattress fabrics segment from a partnership owned by certain shareholders and officers of the company and their immediate families. At April 27, 2014, this lease was on a month to month basis payable at an amount of \$12,704 per month. Effective October 1, 2014, we entered into new lease agreement with the partnership noted above. The new lease agreement requires monthly payments of \$13,000 for a three year term commencing on October 1, 2014 through September 30, 2017. This lease contains two successive options to renew the lease with each renewal period being three years. The first and second renewal terms would require monthly payments of \$13,100 and \$13,200, respectively.

Inflation

Any significant increase in our raw material costs, utility/energy costs and general economic inflation could have a material adverse impact on the company, because competitive conditions have limited our ability to pass significant operating increases on to customers.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risk from changes in interest rates on our revolving credit lines.

At February 1, 2015, our U.S. revolving credit agreement had an interest rate equal to the one-month LIBOR rate plus a spread based on our ratio of debt to EBITDA as defined in the agreement. Our revolving credit line associated with our China subsidiaries bears interest at a rate determined by the Chinese government. Our revolving credit line associated with our operation located in Poland bears interest at the EURO LIBOR plus 2%. At February 1, 2015, there were no borrowings outstanding under any of our revolving credit lines.

We are not exposed to market risk from changes in interest rates on our long-term debt. Our unsecured term notes have a fixed interest rate of 8.01%.

We are exposed to market risk from changes in the value of foreign currencies for our subsidiaries domiciled in China, Canada, and Poland. We try to maintain a natural hedge by keeping a balance of our assets and liabilities denominated in the local currency of our subsidiaries domiciled in Canada and Poland, although there is no assurance that we will be able to continually maintain this natural hedge. Our foreign subsidiaries use the United States dollar as their functional currency. A substantial portion of the company's imports purchased outside the United States are denominated in U.S. dollars. A 10% change in the above exchange rates at February 1, 2015, would not have had a significant impact on our results of operations or financial position.

ITEM 4. CONTROLS AND PROCEDURES

We have conducted an evaluation of the effectiveness of our disclosure controls and procedures as of February 1, 2015, the end of the period covered by this report. This evaluation was conducted under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer. Based upon that evaluation, we have concluded that these disclosure controls and procedures are effective to ensure that information required to be disclosed in the reports filed by us and submitted under the Securities Exchange Act of 1934, as amended (the "Exchange Act") is recorded, processed, summarized, and reported as and when required. Further, we concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed in reports filed by us under the Exchange Act is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, in a manner to allow timely decisions regarding the required disclosures.

There has been no change in our internal control over financial reporting that occurred during the quarter ended February 1, 2015, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

I-48

Part II – Other Information

Item 1. Legal Proceedings

There have not been any material changes to our legal proceedings during the three months ended February 1, 2015. Our legal proceedings are disclosed in the company's annual report on Form 10-K filed with the Securities and Exchange Commission on July 11, 2014 for the fiscal year ended April 27, 2014.

Item 1A. Risk Factors

There have not been any material changes to our risk factors during the three months ended February 1, 2015. Our risk factors are disclosed in the company's annual report on Form 10-K filed with the Securities and Exchange Commission on July 11, 2014 for the fiscal year ended April 27, 2014.

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

ISSUER PURCHASES OF EQUITY SECURITIES

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (1)
November 3, 2014 to December 7, 2014	-	-	-	\$ 4,256,235
December 8, 2014 to January 4, 2015	-	-	-	\$ 4,256,235
January 5, 2015 to February - 1, 2015	-	-	-	\$ 4,256,235
Total	-	-	-	\$ 4,256,235

(1) On February 25, 2014, we announced that our board of directors approved an authorization for us to acquire up to \$5.0 million of our common stock.

Item 6. Exhibits

The following exhibits are submitted as part of this report.

- | | |
|---------|--|
| 3(i) | Articles of Incorporation of the company, as amended, were filed as Exhibit 3(i) to the company's Form 10-Q for the quarter ended July 28, 2002, filed September 11, 2002 (Commission File No. 001-12597), and are incorporated herein by reference. |
| 3 (ii) | Restated and Amended Bylaws of the company, as amended November 12, 2007, were filed as Exhibit 3.1 to the company's Form 8-K dated November 12, 2007, and incorporated herein by reference. |
| 31.1 | Certification of Chief Executive Officer Pursuant to Section 302 of Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Chief Financial Officer Pursuant to Section 302 of Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of Chief Executive Officer Pursuant to Section 906 of Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification of Chief Financial Officer Pursuant to Section 906 of 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.LAB | XBRL Taxonomy Extension Label Linkbase Document |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document |
| 101.DEF | XBRL Taxonomy Extension Definition 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.

CULP, INC.
(Registrant)

Date: March 13, 2015

By:

/s/ Kenneth R. Bowling
Kenneth R. Bowling
Vice President and Chief Financial Officer
(Authorized to sign on behalf of the registrant
and also signing as principal financial officer)

By:

/s/ Thomas B. Gallagher, Jr.
Thomas B. Gallagher, Jr.
Corporate Controller
(Authorized to sign on behalf of the registrant
and also signing as principal accounting
officer)

EXHIBIT INDEX

Exhibit Number	Exhibit
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer Pursuant to Section 906 of Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer Pursuant to Section 906 of 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.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document