

CULP INC  
Form 10-Q  
December 12, 2014

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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 November 2, 2014  
Commission File No. 1-12597

CULP, INC.  
(Exact name of registrant as specified in its charter)

NORTH CAROLINA 56-1001967  
(State or other jurisdiction of (I.R.S. Employer Identification No.)  
incorporation or other organization)

1823 Eastchester Drive  
High Point, North Carolina 27265-1402  
(Address of principal executive offices) (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

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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

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 November 2, 2014: 12,218,521

Par Value: \$0.05 per share

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INDEX TO FORM 10-Q  
For the period ended November 2, 2014

|   | Page        |
|---|-------------|
| Part I - Financial Statements   |             |
| Item 1. Financial Statements: (Unaudited)   |             |
| <u>Consolidated Statements of Net Income -- Three and Six Months Ended November 2, 2014 and October 27, 2013</u>          | <u>I-1</u>  |
| <u>Consolidated Statements of Comprehensive Income - Three and Six Months Ended November 2, 2014 and October 27, 2013</u> | <u>I-2</u>  |
| <u>Consolidated Balance Sheets -- November 2, 2014, October 27, 2013, and April 27, 2014</u>                              | <u>I-3</u>  |
| <u>Consolidated Statements of Cash Flows -- Six Months Ended November 2, 2014 and October 27, 2013</u>                    | <u>I-4</u>  |
| <u>Consolidated Statements of Shareholders' Equity</u>  | <u>I-5</u>  |
| <u>Notes to Consolidated Financial Statements</u>   | <u>I-6</u>  |
| <u>Cautionary Statement Concerning Forward-Looking Information</u>  | <u>I-27</u> |
| <u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                      | <u>I-28</u> |
| <u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>   | <u>I-46</u> |
| <u>Item 4. Controls and Procedures</u>  | <u>I-47</u> |
| Part II - Other Information   |             |
| <u>Item 1. Legal Proceedings</u>  | <u>II-1</u> |
| <u>Item 1A. Risk Factors</u>  | <u>II-1</u> |
| <u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>  | <u>II-1</u> |
| <u>Item 6. Exhibits</u>   | <u>II-2</u> |
| <u>Signatures</u>   | <u>II-3</u> |

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## Item 1: Financial Statements

CULP, INC.  
 CONSOLIDATED STATEMENTS OF NET INCOME  
 FOR THE THREE AND SIX MONTHS ENDED NOVEMBER 2, 2014 AND OCTOBER 27, 2013  
 UNAUDITED  
 (Amounts in Thousands, Except for Per Share Data)

|   |                            | THREE MONTHS ENDED  |                     |
|---|----------------------------|---------------------|---------------------|
|   |                            | November 2,<br>2014 | October 27,<br>2013 |
| Net sales                                       |                            | \$ 73,991           | 70,589              |
| Cost of sales                                   |                            | 61,713              | 58,354              |
|   | Gross profit               | 12,278              | 12,235              |
| Selling, general and<br>administrative expenses |                            | 7,379               | 7,200               |
|   | Income from operations     | 4,899               | 5,035               |
| Interest expense                                |                            | -                   | 99                  |
| Interest income                                 |                            | (153 )              | (102 )              |
| Other expense                                   |                            | 162                 | 224                 |
|   | Income before income taxes | 4,890               | 4,814               |
| Income taxes                                    |                            | 1,889               | 1,718               |
|   | Net income                 | \$ 3,001            | 3,096               |
| Net income per share, basic                     |                            | \$ 0.25             | 0.25                |
| Net income per share, diluted                   |                            | 0.24                | 0.25                |
| Average shares outstanding, basic               |                            | 12,218              | 12,183              |
| Average shares outstanding, diluted             |                            | 12,401              | 12,389              |

|   |                        | SIX MONTHS ENDED    |                     |
|---|------------------------|---------------------|---------------------|
|   |                        | November 2,<br>2014 | October 27,<br>2013 |
| Net sales                                       |                        | \$ 150,051          | 140,730             |
| Cost of sales                                   |                        | 125,058             | 115,422             |
|   | Gross profit           | 24,993              | 25,308              |
| Selling, general and<br>administrative expenses |                        | 14,798              | 14,299              |
|   | Income from operations | 10,195              | 11,009              |

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|                                     |                            |          |        |
|-------------------------------------|----------------------------|----------|--------|
| Interest expense                    |                            | 67       | 239    |
| Interest income                     |                            | (294 )   | (195 ) |
| Other expense                       |                            | 73       | 616    |
|                                     | Income before income taxes | 10,349   | 10,349 |
| Income taxes                        |                            | 4,003    | 4,023  |
|                                     | Net income                 | \$ 6,346 | 6,326  |
| Net income per share, basic         |                            | \$ 0.52  | 0.52   |
| Net income per share, diluted       |                            | 0.51     | 0.51   |
| Average shares outstanding, basic   |                            | 12,215   | 12,165 |
| Average shares outstanding, diluted |                            | 12,403   | 12,391 |

See accompanying notes to consolidated financial statements.

I-1

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
FOR THE THREE AND SIX MONTHS ENDED NOVEMBER 2, 2014 AND OCTOBER 27, 2013  
(UNAUDITED)

|  | THREE MONTHS<br>ENDED  |                     |
|--|------------------------|---------------------|
|  | November<br>2,<br>2014 | October 27,<br>2013 |
| Net income                               | \$3,001                | \$3,096             |
| Other comprehensive (loss) gain          |                        |                     |
| Unrealized (losses) gains on investments | (18 )                  | 22                  |
| Total other comprehensive (loss) gain    | (18 )                  | 22                  |
| Comprehensive income                     | \$2,983                | \$3,118             |
|  |                        |                     |
|  | SIX MONTHS ENDED       |                     |
|  | November<br>2,<br>2014 | October 27,<br>2013 |
| Net income                               | \$6,346                | \$6,326             |
| Other comprehensive loss                 |                        |                     |
| Unrealized losses on investments         | (28 )                  | (113 )              |
| Total other comprehensive loss           | (28 )                  | (113 )              |
| Comprehensive income                     | \$6,318                | \$6,213             |

See accompanying notes to consolidated financial statements.

CULP, INC.  
CONSOLIDATED BALANCE SHEETS  
NOVEMBER 2, 2014, OCTOBER 27, 2013 AND APRIL 27, 2014  
UNAUDITED  
(Amounts in Thousands)

|   | November 2,<br>2014 | October 27,<br>2013 | * April 27,<br>2014 |
|---|---------------------|---------------------|---------------------|
| Current assets:                         |                     |                     |                     |
| Cash and cash equivalents               | \$ 28,953           | 24,267              | 29,303              |
| Short-term investments                  | 6,318               | 6,220               | 6,294               |
| Accounts receivable, net                | 25,045              | 24,937              | 27,409              |
| Inventories                             | 38,228              | 44,882              | 40,674              |
| Deferred income taxes                   | 6,191               | 7,745               | 6,230               |
| Income taxes receivable                 | -                   | -                   | 121                 |
| Other current assets                    | 2,303               | 2,550               | 2,344               |
| Total current assets                    | 107,038             | 110,601             | 112,375             |
|   |                     |                     |                     |
| Property, plant and equipment, net      | 33,204              | 30,559              | 31,376              |
| Goodwill                                | 11,462              | 11,462              | 11,462              |
| Deferred income taxes                   | 508                 | 661                 | 2,040               |
| Long-term investments                   | 1,911               | -                   | 765                 |
| Other assets                            | 2,539               | 2,959               | 2,917               |
| Total assets                            | \$ 156,662          | 156,242             | 160,935             |
|   |                     |                     |                     |
| Current liabilities:                    |                     |                     |                     |
| Current maturities of long-term debt    | \$ 2,200            | 2,200               | 2,200               |
| Accounts payable-trade                  | 25,450              | 28,543              | 26,686              |
| Accounts payable - capital expenditures | 178                 | 66                  | 277                 |
| Accrued expenses                        | 7,723               | 11,672              | 9,181               |
| Income taxes payable - current          | 268                 | 304                 | 442                 |
| Total current liabilities               | 35,819              | 42,785              | 38,786              |
|   |                     |                     |                     |
| Income taxes payable - long-term        | 3,980               | 4,141               | 3,962               |
| Deferred income taxes                   | 1,395               | 5,016               | 1,013               |
| Line of credit                          | -                   | 585                 | 586                 |
| Deferred compensation                   | 3,794               | -                   | 2,644               |
| Long-term debt, less current maturities | -                   | 2,200               | 2,200               |
| Total liabilities                       | 44,988              | 54,727              | 49,191              |

Commitments and Contingencies (Note 16)

|   |            |         |         |
|---|------------|---------|---------|
| Shareholders' equity  |            |         |         |
| Preferred stock, \$0.05 par value, authorized<br>10,000,000   | -          | -       | -       |
| Common stock, \$0.05 par value, authorized<br>40,000,000 shares, issued and<br>outstanding<br>12,218,521 at November 2, 2014;<br>12,250,030<br>at October 27, 2013; and 12,250,030 at<br>April 27, 2014 | 611        | 612     | 612     |
| Capital contributed in excess of par value  | 42,658     | 42,598  | 42,932  |
| Accumulated earnings  | 68,493     | 58,364  | 68,260  |
| Accumulated other comprehensive loss  | (88 )      | (59 )   | (60 )   |
| Total shareholders' equity  | 111,674    | 101,515 | 111,744 |
| Total liabilities and shareholders' equity  | \$ 156,662 | 156,242 | 160,935 |

\* Derived from audited financial statements.

See accompanying notes to consolidated  
financial statements.



CULP, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
FOR THE SIX MONTHS ENDED NOVEMBER 2, 2014 AND OCTOBER 27, 2013  
UNAUDITED  
(Amounts in Thousands)

|   | SIX MONTHS ENDED       |                     |
|---|------------------------|---------------------|
|   | November<br>2,<br>2014 | October 27,<br>2013 |
| Cash flows from operating activities:   |                        |                     |
| Net income  | \$6,346                | 6,326               |
| Adjustments to reconcile net income to net cash provided by operating activities: |                        |                     |
| Depreciation  | 2,812                  | 2,636               |
| Amortization of other assets  | 94                     | 81                  |
| Stock-based compensation  | 291                    | 376                 |
| Excess tax benefit related to stock-based compensation                            | (108 )                 | (143 )              |
| Deferred income taxes   | 2,061                  | 2,140               |
| Gain on sale of equipment   | (35 )                  | (74 )               |
| Foreign currency exchange (gains) losses  | (171 )                 | 203                 |
| Changes in assets and liabilities, net of effects of acquisition of assets:       |                        |                     |
| Accounts receivable   | 2,360                  | (1,419 )            |
| Inventories   | 2,467                  | (6,331 )            |
| Other current assets  | 34                     | (437 )              |
| Other assets  | (36 )                  | (47 )               |
| Accounts payable - trade  | (1,275 )               | 5,923               |
| Accrued expenses and deferred compensation  | (324 )                 | (158 )              |
| Income taxes  | 22                     | 367                 |
| Net cash provided by operating activities   | 14,538                 | 9,443               |
| Cash flows from investing activities:   |                        |                     |
| Capital expenditures  | (5,087 )               | (1,900 )            |
| Net cash paid for acquisition of assets   | -                      | (2,640 )            |
| Proceeds from the sale of equipment   | 391                    | 113                 |
| Proceeds from life insurance policies   | 320                    | -                   |
| Payments on life insurance policies   | -                      | (30 )               |
| Proceeds from the sale of short-term investments                                  | 1,628                  | -                   |
| Purchase of short-term investments  | (1,675 )               | (1,047 )            |
| Purchase of long-term investments   | (1,146 )               | -                   |
| Net cash used in investing activities   | (5,569 )               | (5,504 )            |
| Cash flows from financing activities:   |                        |                     |
| Payments on lines of credit   | (538 )                 | -                   |
| Payments on long-term debt  | (2,200 )               | (2,200 )            |

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|  |          |          |
|--|----------|----------|
| Proceeds from common stock issued                            | 89       | 194      |
| Common stock shares repurchased                              | (745 )   | -        |
| Dividends paid   | (6,113 ) | (979 )   |
| Debt issuance costs  | -        | (62 )    |
| Excess tax benefit related to stock-based compensation       | 108      | 143      |
| Net cash used in financing activities                        | (9,399 ) | (2,904 ) |
| Effect of exchange rate changes on cash and cash equivalents | 80       | (298 )   |
| (Decrease) increase in cash and cash equivalents             | (350 )   | 737      |
| Cash and cash equivalents at beginning of period             | 29,303   | 23,530   |
| Cash and cash equivalents at end of period                   | \$28,953 | 24,267   |

See accompanying notes to consolidated financial statements.

I-4

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

|   | Common Stock |        | Capital<br>Contributed       | Accumulated | Accumulated<br>Other<br>Comprehensive<br>Income | Total<br>Shareholders'<br>Equity |
|---|--------------|--------|------------------------------|-------------|---|----------------------------------|
|   | Shares       | Amount | in Excess<br>of Par<br>Value | Earnings    | (Loss)  |                                  |
| Balance, April 28,<br>2013  | 12,224,894   | \$ 611 | 41,901                       | 53,017      | 54  | \$ 95,583                        |
| Net income  | -            | -      | -                            | 17,447      | -   | 17,447                           |
| Stock-based<br>compensation   | -            | -      | 710                          | -           | -   | 710                              |
| Unrealized loss on<br>investments   | -            | -      | -                            | -           | (114 )  | (114 )                           |
| Excess tax benefit<br>related to stock<br>based<br>compensation           | -            | -      | 143                          | -           | -   | 143                              |
| Fully vested common<br>stock award  | 3,000        | -      | -                            | -           | -   | -                                |
| Common stock<br>issued in connection<br>with exercise of<br>stock options | 23,125       | 1      | 193                          | -           | -   | 194                              |
| Common stock<br>surrendered for<br>withholding taxes<br>payable           | (989 )       | -      | (15 )                        | -           | -   | (15 )                            |
| Dividends paid  | -            | -      | -                            | (2,204 )    | -   | (2,204 )                         |
| Balance, April 27,<br>2014 *  | 12,250,030   | 612    | 42,932                       | 68,260      | (60 )   | 111,744                          |
| Net income  | -            | -      | -                            | 6,346       | -   | 6,346                            |
| Stock-based<br>compensation   | -            | -      | 291                          | -           | -   | 291                              |
| Unrealized loss on<br>investments   | -            | -      | -                            | -           | (28 )   | (28 )                            |
| Excess tax benefit<br>related to stock<br>based<br>compensation           | -            | -      | 108                          | -           | -   | 108                              |
| Common stock<br>repurchased   | (43,014 )    | (2 )   | (743 )                       | -           | -   | (745 )                           |
| Fully vested common<br>stock award  | 3,000        | -      | -                            | -           | -   | -                                |

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|  |            |        |        |          |       |            |
|--|------------|--------|--------|----------|-------|------------|
| Common stock issued in connection with exercise of stock options | 9,500      | 1      | 88     |          |       | 89         |
| Common stock surrendered for withholding taxes payable           | (995 )     | -      | (18 )  | -        | -     | (18 )      |
| Dividends paid   | -          |        | -      | (6,113 ) | -     | (6,113 )   |
| Balance, November 2, 2014  | 12,218,521 | \$ 611 | 42,658 | 68,493   | (88 ) | \$ 111,674 |

\* Derived from audited financial statements.

See accompanying notes to consolidated financial statements.

I-5

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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 six months ended November 2, 2014 and October 27, 2013, represent 27 and 26 week periods, respectively.

2. Significant Accounting Policies

As of November 2, 2014, 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.



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 second quarter of fiscal 2015.

At November 2, 2014, options to purchase 140,700 shares of common stock were outstanding and exercisable, had a weighted average exercise price of \$6.50 per share, and a weighted average contractual term of 3.2 years. At November 2, 2014, the aggregate intrinsic value for options outstanding and exercisable was \$1.8 million.

Culp, Inc.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The aggregate intrinsic value for options exercised for the six months ending November 2, 2014 and October 27, 2013, was \$80,000 and \$224,000, respectively.

At November 2, 2014, there were no unvested incentive stock option awards. Therefore, there was no unrecognized compensation cost related to incentive stock option awards at November 2, 2014.

No compensation expense was recorded on incentive stock options for the six months ended November 2, 2014. We recorded \$8,000 of compensation expense on incentive stock option grants within selling, general, and administrative expense for the six months ended October 27, 2013.

#### 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 six month periods ending November 2, 2014, and October 27, 2013, respectively.

#### Time Vested Restricted Stock Awards

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

We recorded \$4,000 and \$38,000 of compensation expense within selling, general, and administrative expense for time vested restricted stock awards for the six month periods ending November 2, 2014, and October 27, 2013, respectively.

At November 2, 2014, 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 November 2, 2014.

During the six month period ended November 2, 2014, 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 six month period ended October 27, 2013, 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

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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 \$233,000 and \$273,000 within selling, general, and administrative expense for performance based restricted stock units for the six month periods ending November 2, 2014 and October 27, 2013, 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 November 2, 2014, the remaining unrecognized compensation cost related to the performance based restricted stock units was \$1.1 million, which is expected to be recognized over a weighted average vesting period of 2.0 years.

## 5. Accounts Receivable

A summary of accounts receivable follows:

| (dollars in thousands)                           | November<br>2, 2014 | October 27,<br>2013 | April 27,<br>2014 |
|--|---------------------|---------------------|-------------------|
| Customers  | \$26,082            | \$26,022            | \$28,461          |
| Allowance for doubtful accounts                  | (442 )              | (513 )              | (573 )            |
| Reserve for returns and allowances and discounts | (595 )              | (572 )              | (479 )            |
|  | \$25,045            | \$24,937            | \$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)            | Six months ended    |                     |
|-----------------------------------|---------------------|---------------------|
|                                   | November<br>2, 2014 | October 27,<br>2013 |
| Beginning balance                 | \$(573 )            | \$(780 )            |
| Provision for bad debts           | 57                  | 211                 |
| Net write-offs, net of recoveries | 74                  | 56                  |
| Ending balance                    | \$(442 )            | \$(513 )            |

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

| (dollars in thousands)                          | Six months ended    |                     |
|---|---------------------|---------------------|
|   | November<br>2, 2014 | October 27,<br>2013 |
| Beginning balance                               | \$(479 )            | \$(543 )            |
| Provision for returns, allowances and discounts | (1,334 )            | (1,129 )            |
| Credits issued                                  | 1,218               | 1,100               |
| Ending balance                                  | \$(595 )            | \$(572 )            |

## 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) | November<br>2, 2014 | October 27,<br>2013 | April 27,<br>2014 |
|------------------------|---------------------|---------------------|-------------------|
| Raw materials          | \$5,657             | \$5,592             | \$6,707           |
| Work-in-process        | 2,190               | 2,383               | 2,263             |
| Finished goods         | 30,381              | 36,907              | 31,704            |
|                        | \$38,228            | \$44,882            | \$40,674          |

## 7. Other Assets

A summary of other assets follows:

| (dollars in thousands)                | November<br>2, 2014 | October 27,<br>2013 | April 27,<br>2014 |
|---------------------------------------|---------------------|---------------------|-------------------|
| Cash surrender value - life insurance | \$320               | \$649               | \$644             |
| Non-compete agreement                 | 1,017               | 1,054               | 1,041             |
| Customer relationships                | 791                 | 842                 | 817               |
| Other                                 | 411                 | 414                 | 415               |
|                                       | \$2,539             | \$2,959             | \$2,917           |

I-10

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Culp, Inc.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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.

The gross carrying amount of this non-compete agreement was \$2.0 million at November 2, 2014, October 27, 2013 and April 27, 2014, respectively. At November 2, 2014, October 27, 2013, 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 November 2, 2014, \$223,000 pertains to the non-compete agreement that was in place as part of the asset purchase agreement dated August 11, 2008, and \$794,000 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 \$38,000 for the six month periods ended November 2, 2014 and October 27, 2013. The remaining amortization expense for the next five fiscal years and thereafter follows: FY 2015 - \$38,000; 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 13.5 years as of November 2, 2014.

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 gross carrying amount of these customer relationships was \$868,000 at November 2, 2014, October 27, 2013, and April 27, 2014, respectively. Accumulated amortization for these customer relationships was \$77,000, \$26,000, and \$51,000 at November 2, 2014, October 27, 2013, and April 27, 2014, respectively.

The customer relationships are amortized on a straight-line basis over its seventeen year useful life. Amortization expense for the customer relationships was \$26,000 for the six months ending November 2, 2014 and October 27, 2013. The remaining amortization expense for the next five fiscal years and thereafter follows: FY 2015 - \$25,000; 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 15.5 years as of November 2, 2014.

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.

I-11

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Culp, Inc.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

At November 2, 2014, we had one life insurance contract with a death benefit of \$1.4 million. At October 27, 2013 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 \$320,000, \$649,000 and \$644,000 at November 2, 2014, October 27, 2013 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)                         | November<br>2, 2014 | October 27,<br>2013 | April 27,<br>2014 |
|--|---------------------|---------------------|-------------------|
| Compensation, commissions and related benefits | \$4,969             | \$8,567             | \$7,388           |
| Interest                                       | 38                  | 74                  | 71                |
| Other accrued expenses                         | 2,716               | 3,031               | 1,722             |
|  | \$7,723             | \$11,672            | \$9,181           |

## 9. Long-Term Debt and Lines of Credit

A summary of long-term debt follows:

| (dollars in thousands)                                    | November<br>2, 2014 | October 27,<br>2013 | April 27,<br>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 Term Notes

We entered into a note agreement dated August 11, 2008 that provided for the issuance of \$11.0 million of unsecured 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 0.8 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 November 2, 2014, 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 are outstanding under the credit agreement with Culp Europe noted below decrease the \$10.0 million available. Interest is charged at a rate (applicable interest rate of 1.76%, 1.77%, and 1.75% at November 2, 2014, October 27, 2013, 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

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Culp, Inc.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

At November 2, 2014, October 27, 2013, and April 27, 2014, there was a \$195,000 outstanding letter of credit (all of which related to workers compensation). At November 2, 2014, October 27, 2013, and April 27, 2014, there were no borrowings outstanding under the agreement.

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 \$6.5 million USD at November 2, 2014), 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 November 2, 2014, October 27, 2013 and April 27, 2014.

Revolving Credit Agreement – Europe

As of 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 4.38% at April 27, 2014). There was \$586,000 (1.8 million Polish Zloty) in borrowings outstanding under the agreement at April 27, 2014.

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% (applicable interest rate of 2.2% at November 2, 2014).

At November 2, 2014, 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 November 2, 2014, 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 November 2, 2014, the carrying value of our long-term debt was \$2.2 million and the fair value was \$2.3 million. At October 27, 2013, the carrying value of the company's long-term debt was \$4.4 million and the fair value was \$4.6 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:

| (amounts in thousands)      | Fair value measurements at November 2, 2014 using:                                 |  |                                       |         |
|-----------------------------|--|--|---------------------------------------|---------|
|                             | Q u o t e d<br>prices in<br>a c t i v e<br>markets<br>f o r<br>identical<br>assets | Significant<br>other<br>observable<br>inputs | Significant<br>unobservable<br>inputs | Total   |
|                             | Level 1  | Level 2                                      | Level 3                               | Total   |
| Assets:                     |  |  |                                       |         |
| Limited Term Bond Fund      | \$2,576  | N/A  | N/A                                   | \$2,576 |
| Low Duration Bond Fund      | 2,081  | N/A  | N/A                                   | 2,081   |
| Premier Money Market Fund   | 1,818  | N/A  | N/A                                   | 1,818   |
| Intermediate Term Bond Fund | 1,661  | N/A  | N/A                                   | 1,661   |
| Other                       | 93   | N/A  | N/A                                   | 93      |

Fair value measurements at October 27, 2013 using:

| Q u o t e d<br>prices in<br>a c t i v e<br>markets | Significant<br>other<br>observable<br>inputs | Significant<br>unobservable<br>inputs |
|--|--|---------------------------------------|
|--|--|---------------------------------------|

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 identical  
 assets

(amounts in thousands)

|                             | Level 1 | Level 2 | Level 3 | Total   |
|-----------------------------|---------|---------|---------|---------|
| Assets:                     |         |         |         |         |
| Limited Term Bond Fund      | \$2,561 | N/A     | N/A     | \$2,561 |
| Low Duration Bond Fund      | 2,060   | N/A     | N/A     | 2,060   |
| Intermediate Term Bond Fund | 1,599   | N/A     | N/A     | 1,599   |

I-14

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Culp, Inc.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Fair value measurements at April 27, 2014 using:

| (amounts in thousands)      | Fair value measurements at April 27, 2014 using: |         |         | 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 \$6.3 million, \$6.2 million and \$6.3 million at November 2, 2014, October 27, 2013, and April 27, 2014, respectively. Our short-term bond funds had an accumulated unrealized loss totaling \$88,000, \$59,000, and \$60,000 at November 2, 2014, October 27, 2013, and April 27, 2014, respectively. At November 2, 2014, October 27, 2013, 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 \$1.9 million and \$765,000 at November 2, 2014 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.

Nonrecurring Basis

During the six months ended November 2, 2014, 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.

I-15

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Culp, Inc.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Fair value measurements at April 27, 2014 and October 27, 2013 using:

| (amounts in thousands) | Q u o t e d<br>prices in<br>a c t i v e<br>markets<br>f o r<br>identical<br>assets | Significant<br>other<br>observable<br>inputs | Significant<br>unobservable<br>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)  | Six months ended    |                     |
|-------------------------|---------------------|---------------------|
|                         | November<br>2, 2014 | October 27,<br>2013 |
| Interest                | \$180               | \$276               |
| Net income tax payments | 1,943               | 1,515               |

Interest costs of \$82,000 for the construction of qualifying fixed assets were capitalized and are being amortized over the related assets' useful lives for the six months ended November 2, 2014. No interest costs were capitalized for the six months ended October 27, 2013.

During the six months ended November 2, 2014, 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 six months ended October 27, 2013, 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.

## 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:

I-16

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Culp, Inc.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

| (amounts in thousands)                              | Three months ended  |                     |
|---|---------------------|---------------------|
|   | November<br>2, 2014 | October 27,<br>2013 |
| Weighted average common shares outstanding, basic   | 12,218              | 12,183              |
| Dilutive effect of stock-based compensation         | 183                 | 206                 |
| Weighted average common shares outstanding, diluted | 12,401              | 12,389              |

All options to purchase shares of common stock were included in the computation of diluted net income for the three months ended November 2, 2014 and October 27, 2013, 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 October 27, 2013. At November 2, 2014, 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)                              | Six months ended    |                     |
|---|---------------------|---------------------|
|   | November<br>2, 2014 | October 27,<br>2013 |
| Weighted average common shares outstanding, basic   | 12,215              | 12,165              |
| Dilutive effect of stock-based compensation         | 188                 | 226                 |
| Weighted average common shares outstanding, diluted | 12,403              | 12,391              |

All options to purchase shares of common stock were included in the computation of diluted net income for the six months ended November 2, 2014 and October 27, 2013, 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 six months ending October 27, 2013. At November 2, 2014, 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.

### 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.

I-17

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Culp, Inc.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Financial information for the company's operating segments follows:

| (dollars in thousands)   | Three months ended  |                     |
|--|---------------------|---------------------|
|  | November<br>2, 2014 | October 27,<br>2013 |
| Net sales:   |                     |                     |
| Mattress Fabrics   | \$43,038            | \$40,331            |
| Upholstery Fabrics   | 30,953              | 30,258              |
|  | \$73,991            | \$70,589            |
| <br>   |                     |                     |
| Gross profit:  |                     |                     |
| Mattress Fabrics   | \$7,324             | \$7,322             |
| Upholstery Fabrics   | 4,954               | 4,913               |
|  | \$12,278            | \$12,235            |
| <br>   |                     |                     |
| Selling, general, and administrative expenses:                 |                     |                     |
| Mattress Fabrics   | \$2,592             | \$2,620             |
| Upholstery Fabrics   | 3,285               | 3,170               |
| Total segment selling, general, and<br>administrative expenses | 5,877               | 5,790               |
| Unallocated corporate expenses                                 | 1,502               | 1,410               |
|  | \$7,379             | \$7,200             |
| <br>   |                     |                     |
| Income from operations:  |                     |                     |
| Mattress Fabrics   | \$4,733             | \$4,702             |
| Upholstery Fabrics   | 1,668               | 1,743               |
| Total segment income from operations                           | 6,401               | 6,445               |
| Unallocated corporate expenses                                 | (1,502)             | (1,410)             |
| Total income from operations                                   | 4,899               | 5,035               |
| Interest expense   | -                   | (99)                |
| Interest income  | 153                 | 102                 |
| Other expense  | (162)               | (224)               |
| Income before income taxes                                     | \$4,890             | \$4,814             |

Culp, Inc.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

| (dollars in thousands)   | Six months ended    |                     |
|--|---------------------|---------------------|
|  | November<br>2, 2014 | October 27,<br>2013 |
| Net sales:   |                     |                     |
| Mattress Fabrics   | \$85,860            | \$78,494            |
| Upholstery Fabrics   | 64,191              | 62,236              |
|  | \$150,051           | \$140,730           |
| Gross profit:  |                     |                     |
| Mattress Fabrics   | \$14,527            | \$14,713            |
| Upholstery Fabrics   | 10,466              | 10,595              |
|  | \$24,993            | \$25,308            |
| Selling, general, and administrative expenses:                 |                     |                     |
| Mattress Fabrics   | \$5,166             | \$4,994             |
| Upholstery Fabrics   | 6,737               | 6,436               |
| Total segment selling, general, and<br>administrative expenses | 11,903              | 11,430              |
| Unallocated corporate expenses                                 | 2,895               | 2,869               |
|  | \$14,798            | \$14,299            |
| Income from operations:  |                     |                     |
| Mattress Fabrics   | \$9,361             | \$9,719             |
| Upholstery Fabrics   | 3,729               | 4,159               |
| Total segment income from operations                           | 13,090              | 13,878              |
| Unallocated corporate expenses                                 | (2,895)             | (2,869)             |
| Total income from operations                                   | 10,195              | 11,009              |
| Interest expense   | (67)                | (239)               |
| Interest income  | 294                 | 195                 |
| Other expense  | (73)                | (616)               |
| Income before income taxes                                     | \$10,349            | \$10,349            |

Culp, Inc.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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

| (dollars in thousands)            | November<br>2, 2014 | October 27,<br>2013 | April 27,<br>2014 |
|-----------------------------------|---------------------|---------------------|-------------------|
| Segment assets:                   |                     |                     |                   |
| Mattress Fabrics                  |                     |                     |                   |
| Current assets (1)                | \$35,406            | \$37,373            | \$36,229          |
| Non-compete agreement             | 1,017               | 1,054               | 1,041             |
| Customer relationships            | 791                 | 842                 | 817               |
| Goodwill                          | 11,462              | 11,462              | 11,462            |
| Property, plant and equipment (2) | 30,938              | 28,307              | 29,040            |
| Total mattress fabrics assets     | 79,614              | 79,038              | 78,589            |
| Upholstery Fabrics                |                     |                     |                   |
| Current assets (1)                | 27,867              | 32,447              | 31,854            |
| Property, plant and equipment (3) | 1,578               | 1,612               | 1,573             |
| Total upholstery fabrics assets   | 29,445              | 34,059              | 33,427            |
| Total segment assets              | 109,059             | 113,097             | 112,016           |
| Non-segment assets:               |                     |                     |                   |
| Cash and cash equivalents         | 28,953              | 24,267              | 29,303            |
| Short-term investments            | 6,318               | 6,220               | 6,294             |
| Deferred income taxes             | 6,699               | 8,406               | 8,270             |
| Income taxes receivable           | -                   | -                   | 121               |
| Other current assets              | 2,303               | 2,550               | 2,344             |
| Property, plant and equipment (4) | 688                 | 640                 | 763               |
| Long-term investments             | 1,911               | -                   | 765               |
| Other assets                      | 731                 | 1,062               | 1,059             |
| Total assets                      | \$156,662           | \$156,242           | \$160,935         |

| (dollars in thousands)     | Six months ended    |                     |
|----------------------------|---------------------|---------------------|
|                            | November<br>2, 2014 | October 27,<br>2013 |
| Capital expenditures (5):  |                     |                     |
| Mattress Fabrics           | \$4,692             | \$1,199             |
| Upholstery Fabrics         | 258                 | 521                 |
| Unallocated Corporate      | 38                  | 20                  |
| Total capital expenditures | \$4,988             | \$1,740             |
| Depreciation expense:      |                     |                     |
| Mattress Fabrics           | \$2,448             | \$2,331             |
| Upholstery Fabrics         | 364                 | 305                 |
| Total depreciation expense | \$2,812             | \$2,636             |

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

(2)

The \$30.9 million at November 2, 2014, represents property, plant, and equipment of \$22.2 million and \$8.7 million located in the U.S. and Canada, respectively. The \$28.3 million at October 27, 2013, represents property, plant, and equipment of \$20.5 million and \$7.8 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.

Culp, Inc.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

- (3) The \$1.6 million at November 2, 2014, represents property, plant, and equipment of \$977 and \$601 located in the U.S. and China, respectively. The \$1.6 million at October 27, 2013, represents property, plant, and equipment located in the U.S. of \$1.1 million, located in China of \$464, and located in Poland of \$49. 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 \$688, \$640, and \$763 at November 2, 2014, October 27, 2013 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.

#### 14. Income Taxes

##### Effective Income Tax Rate

We recorded income tax expense of \$4.0 million, or 38.7% of income before income tax expense, for the six month period ended November 2, 2014, compared to income tax expense of \$4.0 million, or 38.9% of income before income tax expense, for the six month period ended October 27, 2013. Our effective income tax rates for the six month periods ended November 2, 2014 and October 27, 2013 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 six month period ended November 2, 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 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% for an increase in unrecognized tax benefits.
- The income tax rate increased by 6.7% for stock-based compensation and other miscellaneous items.

The income tax expense for six month period ended October 27, 2013 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 increased 3% 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 totaled \$273,000 and represented a discrete event in which the full tax effects were recorded in the six month period ending October 27, 2013.



Culp, Inc.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

- 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 4% for an increase in unrecognized tax benefits.
- The income tax rate was increased by 3.9% 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 November 2, 2014, we recorded a partial valuation allowance of \$1.1 million, of which \$666,000 pertained to certain U.S. state net operating loss carryforwards and credits and \$456,000 pertained to loss carryforwards associated with our Culp Europe operation located in Poland. Based on our assessment at October 27, 2013, we recorded a partial valuation allowance of \$1.0 million, of which \$722,000 pertained to certain U.S. state net operating loss carryforwards and credits and \$315,000 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 \$977,000, 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 November 2, 2014, October 27, 2013, and April 27, 2014, respectively.

The recorded valuation allowance of \$1.1 million at November 2, 2014, 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 November 2, 2014, 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.





Culp, Inc.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

At November 2, 2014, the deferred tax liability associated with our undistributed earnings from our foreign subsidiaries totaled \$2.2 million, which included U.S. income and foreign withholding taxes totaling \$30.6 million, offset by U.S. foreign income tax credits of \$28.4 million. At October 27, 2013, the deferred tax liability associated with our undistributed earnings from our foreign subsidiaries totaled \$7.1 million, which included U.S. income and foreign withholding taxes totaling \$22.4 million, offset by U.S. foreign income tax credits of \$15.3 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 \$78.9 million, \$57.7 million, and \$72.8 million at November 2, 2014, October 27, 2013, and April 27, 2014, respectively.

#### Overall

At November 2, 2014, the current deferred tax asset of \$6.2 million represents \$5.8 million and \$428,000 from our operations located in the U.S. and China, respectively. At November 2, 2014, the non-current deferred tax asset of \$508,000 pertains to our operations located in China. At November 2, 2014, the non-current deferred tax liability of \$1.4 represents \$886,000 and \$509,000 from our operations located in Canada and the U.S., respectively.

At October 27, 2013, the current deferred tax asset of \$7.8 million represents \$7.4 million and \$386,000 from our operations located in the U.S. and China, respectively. At October 27, 2013, the non-current deferred tax asset of \$661,000 pertains to our operations located in China. At October 27, 2013, the non-current deferred tax liability of \$5.0 million represents \$4.1 million and \$945,000 from operations located in the U.S. and Canada, respectively.

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 November 2, 2014, we had a \$14.1 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 October 27, 2013, we had a \$13.5 million total gross unrecognized tax benefit, of which \$4.1 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.

Culp, Inc.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

At November 2, 2014, we had a \$14.1 million total gross unrecognized tax benefit, of which \$10.1 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 October 27, 2013, we had a \$13.5 million total gross unrecognized tax benefit, of which \$9.4 million and \$4.1 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 \$905,000 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 November 2, 2014, the company's statutory surplus reserve was \$5.1 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 \$5.1 million to assist with debt repayment, capital expenditures, and other expenses of the company's business.

#### 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 Chersonson as Personal Representative of Estate of Alan Chersonson, 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 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.

I-24

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Culp, Inc.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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.

#### Purchase Commitments

At November 2, 2014, October 27, 2013, and April 27, 2014, we had open purchase commitments to acquire equipment for our mattress fabrics segment totaling \$3.0 million, \$1.6 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 first half of fiscal 2015, we repurchased 43,014 shares of our common stock at a cost of \$745,000. During the first half of fiscal 2014, we did not repurchase any shares of common stock.

Culp, Inc.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

18. Dividend Program

During the first half of fiscal 2015, dividend payments totaled \$6.1 million, of which \$4.9 million represented a special cash dividend payment in the first quarter of \$0.40 per share, and \$1.2 million represented first and second quarter dividend payments of \$0.05 per share.

During the first half of fiscal 2014, we paid first and second quarter dividend payments of \$0.04 per share totaling \$979,000.

On December 3, 2014, we announced that our board of directors approved a 20 percent increase in our quarterly cash dividend rate from \$0.05 to \$0.06 per share, commencing in the third quarter of fiscal 2015. This payment will be made on January 16, 2015, to shareholders of record as of January 2, 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.

I-26

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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 six months ended November 2, 2014, and October 27, 2013, represent 27 and 26 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, including costs such as raw material 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  |                     | % Change |    |
|----------------------------|---------------------|---------------------|----------|----|
|                            | November<br>2, 2014 | October 27,<br>2013 |          |    |
| Net sales                  | \$73,991            | \$70,589            | 4.8      | %  |
| Gross profit               | 12,278              | 12,235              | 0.4      | %  |
| Gross profit margin        | 16.6                | % 17.3              | (4.0)    | )% |
| SG&A expenses              | 7,379               | 7,200               | 2.5      | %  |
| Income from operations     | 4,899               | 5,035               | (2.7)    | )% |
| Operating margin           | 6.6                 | % 7.1               | (7.0)    | )% |
| Income before income taxes | 4,890               | 4,814               | 1.6      | %  |
| Income taxes               | 1,889               | 1,718               | 10.0     | %  |
| Net income                 | 3,001               | 3,096               | (3.1)    | )% |



| (dollars in thousands)     | Six Months Ended    |                     |  |  | % Change |
|----------------------------|---------------------|---------------------|--|--|----------|
|                            | November<br>2, 2014 | October 27,<br>2013 |  |  |          |
| Net sales                  | \$ 150,051          | \$ 140,730          |  |  | 6.6 %    |
| Gross profit               | 24,993              | 25,308              |  |  | (1.2 )%  |
| Gross profit margin        | 16.7 %              | 18.0 %              |  |  | (7.2 )%  |
| SG&A expenses              | 14,798              | 14,299              |  |  | 3.5 %    |
| Income from operations     | 10,195              | 11,009              |  |  | (7.4 )%  |
| Operating margin           | 6.8 %               | 7.8 %               |  |  | (12.8 )% |
| Income before income taxes | 10,349              | 10,349              |  |  | -        |
| Income taxes               | 4,003               | 4,023               |  |  | (0.5 )%  |
| Net income                 | 6,346               | 6,326               |  |  | 0.3 %    |

### Net Sales

Our net sales for the second quarter and first six months of fiscal 2015 increased as compared with the same periods a year ago. Our net sales were in line with our expectations, as we continued to experience favorable customer response to our designs and wide range of products in both our business segments. Our focused efforts on product innovation and creativity have been a strategic priority that has led to our net sales growth. In addition, our scalable and flexible manufacturing platform supports our ability to compete in a fashion-driven business that is always changing.

Another factor contributing to the increase in net sales for the first half of fiscal 2015, is the fact that the first six months of fiscal 2015 include 27 weeks compared to 26 weeks for the first six months of fiscal 2014.

### Income Before Income Taxes

Although our net sales increased over last fiscal year as noted above, our income before income taxes was flat for the second quarter and the first six months of fiscal 2015 compared with the same periods a year ago. During the second quarter and first six months of fiscal 2015, our income from operations, gross profit margins and operating margins declined. These declines in profitability were due in part to short-term production challenges associated with our mattress fabrics segment caused by increased demand for premium mattress fabrics. Additionally, the profitability of our upholstery fabrics segment was affected by lower business volume and profitability associated with our Culp Europe operation located in Poland, higher operational costs associated with our operations located in China, and product mix.

The decline in income from operations was partially offset by the decrease in other expense in the second quarter and first six months of fiscal 2015. This decrease in other expense is primarily due to more favorable foreign currency exchange rates associated with our operations located in China in the second quarter and first six months of fiscal 2015 compared with the same periods of fiscal 2014.

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 first half of fiscal 2015.

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

### Liquidity

At November 2, 2014, our cash and cash equivalents and short-term investments totaled \$35.3 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 second quarter, our cash and cash equivalents and short-term investments remained flat compared to \$35.6 million at April 27, 2014, despite spending during the first half of the year of \$6.9 million on dividend payments and common stock repurchases, \$5.1 million on capital expenditures, \$2.7 million on payments on our long-term debt and lines of credit, and \$1.1 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 \$14.5 million, increased 54% compared with \$9.4 million for the first six months of fiscal 2014. This increase is primarily due to improved inventory management in both our business segments.

### Dividend Program

On December 3, 2014, we announced that our board of directors approved a 20 percent increase in our a quarterly cash dividend rate from \$0.05 to \$0.06 per share, commencing in the third quarter of fiscal 2015. The company has doubled its quarterly cash dividend since reinstating the dividend in June 2012. This payment will be made on January 16, 2015, to shareholders of record as of January 2, 2015.

During the first half of fiscal 2015, dividend payments totaled \$6.1 million, of which \$4.9 million represented a special cash dividend payment in the first quarter of \$0.40 per share, and \$1.2 million represented first and second quarter dividend payments of \$0.05 per share.

During the first half of fiscal 2014, we paid first and second quarter dividend payments of \$0.04 per share totaling \$979,000.

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 first half of fiscal 2015, we repurchased 43,014 shares of our common stock at a cost of \$745,000. During the first half of fiscal 2014, we did not repurchase any shares of common stock.

Since June 2011, we have returned a total of \$27 million to shareholders in the form of regular quarterly and special dividend payments and common stock share repurchases.

## Segment Analysis

## Mattress Fabrics Segment

| (dollars in thousands) | Three Months Ended  |                     |          |  |    |  |
|------------------------|---------------------|---------------------|----------|--|----|--|
|                        | November<br>2, 2014 | October 27,<br>2013 | % Change |  |    |  |
| Net sales              | \$43,038            | \$40,331            | 6.7      |  | %  |  |
| Gross profit           | 7,324               | 7,322               | -        |  |    |  |
| Gross profit margin    | 17.0                | % 18.2              | (6.6)    |  | )% |  |
| SG&A expenses          | 2,592               | 2,620               | (1.1)    |  | )% |  |
| Income from operations | 4,733               | 4,702               | 0.7      |  | %  |  |
| Operating margin       | 11.0                | % 11.7              | (6.0)    |  | )% |  |

| (dollars in thousands) | Six Months Ended    |                     |          |  |    |  |
|------------------------|---------------------|---------------------|----------|--|----|--|
|                        | November<br>2, 2014 | October 27,<br>2013 | % Change |  |    |  |
| Net sales              | \$85,860            | \$78,494            | 9.4      |  | %  |  |
| Gross profit           | 14,527              | 14,713              | (1.3)    |  | )% |  |
| Gross profit margin    | 16.9                | % 18.7              | (9.6)    |  | )% |  |
| SG&A expenses          | 5,166               | 4,994               | 3.4      |  | %  |  |
| Income from operations | 9,361               | 9,719               | (3.7)    |  | )% |  |
| Operating margin       | 10.9                | % 12.4              | (12.1)   |  | )% |  |

## Net Sales

Our mattress fabrics net sales for the second quarter and first six months of fiscal 2015 increased as compared with the same periods a year ago. These results reflect our ability to meet the growing demands of our customers with a diverse product offering across most price points. Our strategic focus on design creativity has been a critical factor driving our net sales growth. As the mattress industry has shifted to more fashionable and decorative designs we have further enhanced our design capabilities. We believe we are well positioned to capitalize on the growing demands of our customers and any changes in design trends. Our scalable manufacturing platform and reactive capacity supports our ability to deliver a diverse product mix in line with changing consumer demand.

Another factor contributing to the increase in net sales for the first half of fiscal 2015 is the fact that the first six months of fiscal 2015 include 27 weeks compared to 26 weeks for the first six months of fiscal 2014.

#### Gross Profit and Operating Income

Although our net sales increased over last fiscal year as noted above, our income from operations has remained flat for the second quarter and declined for the first six months of fiscal 2015. Also, our gross profit margins and operating margins declined. With the beginning of the third quarter of fiscal 2014, we have experienced increased demand for premium decorative mattress fabrics, which have amplified our production complexity. As expected, we have had short-term production challenges related to this growth. In order to meet our customer delivery commitments, we have incurred additional overtime expenses that have affected our profitability. We have also utilized contract suppliers at a higher cost to ensure we could meet this higher demand.

Although we have experienced declines in our operating margins in the second quarter and first six months of fiscal 2015 as compared to the same periods a year ago, our operating margins have sequentially improved each quarter since the third quarter of fiscal 2014. Our operating margins were 11.0%, 10.8%, 10.3%, and 8.6% for the second quarter of fiscal 2015, first quarter of fiscal 2015, fourth quarter of fiscal 2014, and third quarter of fiscal 2014, respectively.

We are well underway with our previously announced \$9.5 million expansion plan to increase our production capacity, add finishing capabilities, and improve our overall efficiency and throughput. As we have continued to work through this construction phase, we have experienced some typical disruptions and space constraints as we move equipment and people to accommodate this build-out. This ongoing activity has required additional overtime hours to meet our production schedules. Currently, we expect to complete our expansion plan in the second half of fiscal 2015. Upon completion of our expansion plan, we believe our gross profit and operation margins will improve during the second half of fiscal 2015.

During fiscal 2015, we continued to make progress with the efficiency of our mattress cover operation. With this addition, we are a fully integrated supplier of all product categories in mattress fabrics. We believe this operation will continue to show steady growth and make a positive contribution to our business.

#### 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)            | November<br>2, 2014 | October 27,<br>2013 | April 27,<br>2014 |
|-----------------------------------|---------------------|---------------------|-------------------|
| Accounts receivable and inventory | \$35,406            | \$37,372            | \$36,229          |
| Property, plant & equipment       | 30,938              | 28,307              | 29,040            |
| Goodwill                          | 11,462              | 11,462              | 11,462            |
| Non-compete agreement             | 1,017               | 1,055               | 1,041             |
| Customer Relationships            | 791                 | 842                 | 817               |

#### Accounts Receivable & Inventory

As of November 2, 2014, accounts receivable and inventory for this segment decreased \$2.0 million, or 5%, compared with October 27, 2013. This decrease is primarily due to a decrease of \$3.0 million, or 12%, in this segment's inventory due to improved inventory management. The decrease in inventory was partially offset by an increase of \$1.0 million, or 9%, in this segment's accounts receivable balance. The increase in the accounts receivable balance reflects a 7% increase in net sales in the second quarter of fiscal 2015 compared to the second quarter of fiscal 2014.

As of November 2, 2014, accounts receivable and inventory for this segment decreased 2% compared with April 27, 2014. This decrease reflects a 1.4% decrease in net sales in the second quarter of fiscal 2015 compared to the fourth quarter of fiscal 2014.

#### Property, Plant & Equipment

The \$30.9 million at November 2, 2014, represents property, plant and equipment of \$22.2 million and \$8.7 million located in the U.S. and Canada, respectively. The \$28.3 million at October 27, 2013, represents property, plant, and equipment of \$20.5 million and \$7.8 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 \$9.5 million expansion plan noted above, offset by depreciation expense.

## Upholstery Fabrics Segment

## Net Sales

| (dollars in thousands) | Three Months Ended  |     |   |                     |     |   |          |    |
|------------------------|---------------------|-----|---|---------------------|-----|---|----------|----|
|                        | November 2,<br>2014 |     |   | October 27,<br>2013 |     |   | % Change |    |
| Non U.S. Produced      | \$ 28,563           | 92  | % | \$ 27,540           | 91  | % | 3.7      | %  |
| U.S. Produced          | 2,390               | 8   | % | 2,718               | 9   | % | (12.1)   | )% |
| Total                  | \$ 30,953           | 100 | % | \$ 30,258           | 100 | % | 2.3      | %  |

| (dollars in thousands) | Six Months Ended    |     |   |                     |     |   |          |   |
|------------------------|---------------------|-----|---|---------------------|-----|---|----------|---|
|                        | November 2,<br>2014 |     |   | October 27,<br>2013 |     |   | % Change |   |
| Non U.S. Produced      | \$ 59,019           | 92  | % | \$ 57,526           | 92  | % | 2.6      | % |
| U.S. Produced          | 5,172               | 8   | % | 4,710               | 8   | % | 9.8      | % |
| Total                  | \$ 64,191           | 100 | % | \$ 62,236           | 100 | % | 3.1      | % |

Our net sales for the second quarter and first six months of fiscal 2015 increased as compared with the same periods a year ago. Our designs and focused efforts on product innovation have been a key factor to our net sales growth. Notably, we increased our sales of cut and sewn kits in the second quarter and first six months of fiscal 2015, reflecting increased demand for this product category.

We are also diversifying our customer base, as a result of our marketing strategies to target additional end-user markets for upholstery fabrics, 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. Our China produced fabrics accounted for 92% of our upholstery fabric net sales during the second quarter and first six months of fiscal 2015.

Another factor contributing to the increase in net sales for the first six months of fiscal 2015 is the fact that the first six months of fiscal 2015 include 27 weeks compared to 26 weeks for the first six months of fiscal 2014.

## Gross Profit, Selling, General &amp; Administrative Expenses, and Operating Income

| (dollars in thousands) | Three Months Ended  |                     | % Change |
|------------------------|---------------------|---------------------|----------|
|                        | November 2,<br>2014 | October 27,<br>2013 |          |
| Gross profit           | \$ 4,954            | \$ 4,913            | 0.8 %    |
| Gross profit margin    | 16.0 %              | 16.2 %              | (1.2)%   |
| SG&A expenses          | 3,285               | 3,170               | 3.6 %    |
| Income from operations | 1,668               | 1,743               | (4.3)%   |
| Operating margin       | 5.4 %               | 5.8 %               | (6.9)%   |

| (dollars in thousands) | Six Months Ended    |                     | % Change |
|------------------------|---------------------|---------------------|----------|
|                        | November 2,<br>2014 | October 27,<br>2013 |          |
| Gross profit           | \$ 10,466           | \$ 10,595           | (1.2)%   |
| Gross profit margin    | 16.3 %              | 17.0 %              | (4.1)%   |
| SG&A expenses          | 6,737               | 6,436               | 4.7 %    |
| Income from operations | 3,729               | 4,159               | (10.3)%  |
| Operating margin       | 5.8 %               | 6.7 %               | (13.4)%  |

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 profitability associated with our Culp Europe operation located in Poland, higher operational costs associated with our operations located in China, and product mix.

As previously announced, our sales from Culp Europe have not met our expectations, primarily as a result of the ongoing economic concerns in Europe. After considerable review, we have decided to phase out the finished goods warehouse and distribution facility located in Poznan, Poland. As a result, we incurred a charge of approximately \$200,000 for closing related costs during the second quarter. We expect minimal operating expenses going forward, as this closure is expected to be completed by the end of the third quarter of fiscal 2015. We intend to continue to sell upholstery fabric into the European market and we are assessing the best strategy for taking advantage of this market's opportunities as economic conditions improve.



Our income from operations and operating margins are expected to be affected in the third quarter of fiscal 2015 compared to the third quarter of fiscal 2014, as we experienced exceptionally strong customer demand from customers who anticipated longer lead times due to the Chinese New Year holiday that occurred late in the third quarter of fiscal 2014. In fiscal 2015, the Chinese New Year holiday is during mid-February, therefore potentially causing some customer demand to be shifted from the third quarter to the fourth quarter of fiscal 2015. Additionally, as we previously discussed, we are experiencing higher operating costs associated with our China operations.

#### Segment Assets

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

| (dollars in thousands)               | November<br>2, 2014 | October 27,<br>2013 | April 27,<br>2014 |
|--------------------------------------|---------------------|---------------------|-------------------|
| Accounts receivable and<br>inventory | \$27,867            | \$32,447            | \$31,854          |
| Property, plant &<br>equipment       | 1,578               | 1,612               | 1,573             |

#### Accounts Receivable & Inventory

As of November 2, 2014, accounts receivable and inventory for this segment decreased \$4.6 million, or 14%, compared with October 27, 2013. This decrease is primarily due to a decrease of \$3.6 million, or 18%, in this segment's inventory due to improved inventory management and the reduction of inventory associated with our Culp Europe operation located in Poland. Also, this segment's accounts receivable balance decreased \$1.0 million, or 8%. The decrease in the accounts receivable balance reflects increased net sales with certain customers with discounted payment terms.

As of November 2, 2014, accounts receivable and inventory for this segment decreased \$4.0 million, or 13% compared with April 27, 2014. This decrease is primarily due to a decrease of \$2.9 million, or 15%, in this segment's inventory due to improved inventory management and the reduction of inventory associated with our Culp Europe operation located in Poland. Also, this segment's accounts receivable balance decreased \$1.1 million, or 9%. The decrease in the accounts receivable balance reflects increased net sales with certain customers with discounted payment terms.

#### Property, Plant & Equipment

The \$1.6 million at November 2, 2014, represents property, plant, and equipment of \$977 and \$601 located in the U.S. and China, respectively. The \$1.6 million at October 27, 2013, represents property, plant, and equipment located in the U.S. of \$1.1 million, located in China of \$464, and located in Poland of \$49. 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 \$7.4 million in the second quarter of fiscal 2015 compared to \$7.2 million in the second quarter of fiscal 2014. As a percent of net sales, SG&A expenses were 10.0% in the second quarter of fiscal 2015 compared with 10.2% in the second quarter of fiscal 2014.

SG&A expenses for the company as a whole were \$14.8 million for the first six months of fiscal 2015 compared to \$14.3 million for the first six months of fiscal 2014. This increase is primarily due to the fact that the first six months of fiscal 2015 includes 27 weeks compared with 26 weeks for the first six months of fiscal 2014. As a percent of net sales, SG&A expenses were 9.9% for the first six months of fiscal 2015 compared with 10.2% for the first six months of fiscal 2014.

### Interest Expense

There was no interest expense for the second quarter of fiscal 2015 compared to \$99,000 for the second quarter of fiscal 2014. Interest expense was \$67,000 for the first six months of fiscal 2015 compared with \$239,000 for the first six months of fiscal 2014.

These trends primarily reflect lower outstanding balances of long-term debt. Also, interest expense was reduced by interest costs of \$52,000 and \$82,000 for the mattress fabric expansion plan that were capitalized during the second quarter and the first six months 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 \$153,000 for the second quarter of fiscal 2015 compared to \$102,000 for the second quarter of fiscal 2014. Interest income was \$294,000 for the first six months of fiscal 2015 compared to \$195,000 for the first six months of fiscal 2014.

These increases reflect higher cash and cash equivalent and short-term investment balances held with our foreign subsidiaries during the second quarter and first six months 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 second quarter of fiscal 2015 was \$162,000 compared to \$224,000 during the second quarter of fiscal 2014. Other expense for the first six months of fiscal 2015 was \$73,000 compared with the \$616,000 for the first six months of fiscal 2014.

This improvement is primarily due to more favorable foreign currency exchange rates associated with our operations located in China in the second quarter and first six months of fiscal 2015 compared with the second quarter and first six months of fiscal 2014.

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 first half of fiscal 2015.

## Income Taxes

### Effective Income Tax Rate

We recorded income tax expense of \$4.0 million, or 38.7% of income before income tax expense, for the six month period ended November 2, 2014, compared to income tax expense of \$4.0 million, or 38.9% of income before income tax expense, for the six month period ended October 27, 2013. Our effective income tax rates for the six month periods ended November 2, 2014 and October 27, 2013 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 six month period ended November 2, 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 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% for an increase in unrecognized tax benefits.
- The income tax rate increased by 6.7% for stock-based compensation and other miscellaneous items.

The income tax expense for six month period ended October 27, 2013 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 increased 3% 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 totaled \$273,000 and represented a discrete event in which the full tax effects were recorded in the six month period ending October 27, 2013.

- 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 4% for an increase in unrecognized tax benefits.
- The income tax rate was increased by 3.9% 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 November 2, 2014, we recorded a partial valuation allowance of \$1.1 million, of which \$666,000 pertained to certain U.S. state net operating loss carryforwards and credits and \$456,000 pertained to loss carryforwards associated with our Culp Europe operation located in Poland. Based on our assessment at October 27, 2013, we recorded a partial valuation allowance of \$1.0 million, of which \$722,000 pertained to certain U.S. state net operating loss carryforwards and credits and \$315,000 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 \$977,000, 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 November 2, 2014, October 27, 2013, and April 27, 2014, respectively.

The recorded valuation allowance of \$1.1 million at November 2, 2014, 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 November 2, 2014, 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.

At November 2, 2014, the deferred tax liability associated with our undistributed earnings from our foreign subsidiaries totaled \$2.2 million, which included U.S. income and foreign withholding taxes totaling \$30.6 million, offset by U.S. foreign income tax credits of \$28.4 million. At October 27, 2013, the deferred tax liability associated with our undistributed earnings from our foreign subsidiaries totaled \$7.1 million, which included U.S. income and foreign withholding taxes totaling \$22.4 million, offset by U.S. foreign income tax credits of \$15.3 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 \$78.9 million, \$57.7 million, and \$72.8 million at November 2, 2014, October 27, 2013, and April 27, 2014, respectively.

## Uncertainty In Income Taxes

At November 2, 2014, we had a \$14.1 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 October 27, 2013, we had a \$13.5 million total gross unrecognized tax benefit, of which \$4.1 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 November 2, 2014, we had a \$14.1 million total gross unrecognized tax benefit, of which \$10.1 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 October 27, 2013, we had a \$13.5 million total gross unrecognized tax benefit, of which \$9.4 million and \$4.1 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 \$905,000 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 \$4.0 million in both the first half of fiscal 2015 and the first half of fiscal 2014. Currently, we are not paying income taxes in the United States due to our loss carryforwards that totaled \$45.7 million at April 27, 2014. However, we did have income tax payments of \$1.9 million and \$1.5 million in the first half of fiscal 2015 and first half of 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 the second 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 \$35.3 million at November 2, 2014, 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 November 2, 2014, our cash and cash equivalents and short-term investments totaling \$35.3 million represented \$17.4 million associated with our operations located in China, \$12.2 million associated with our operations located in Canada, \$5.7 million associated with our operations located in the United States, and \$40,000 associated without operations located in Poland.

At November 2, 2014, our cash and cash equivalents and short-term investments totaled \$35.3 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 on our long-term debt due in August 2015.

Our cash and cash equivalents and short-term investments remained flat compared to \$35.6 million at April 27, 2014, despite spending during the first half of the year of \$6.9 million on dividend payments and common stock repurchases, \$5.1 million on capital expenditures, \$2.7 million on payments on our long-term debt and lines of credit, and \$1.1 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 \$14.5 million, increased 54% compared with \$9.4 million for the first six months 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

On December 3, 2014, we announced that our board of directors approved a 20 percent increase in our quarterly cash dividend rate from \$0.05 to \$0.06 per share, commencing in the third quarter of fiscal 2015. The company has doubled its quarterly cash dividend since reinstating the dividend in June 2012. This payment will be made on January 16, 2015, to shareholders of record as of January 2, 2015.

During the first half of fiscal 2015, dividend payments totaled \$6.1 million, of which \$4.9 million represented a special cash dividend payment in the first quarter of \$0.40 per share, and \$1.2 million represented first and second quarter dividend payments of \$0.05 per share.

During the first half of fiscal 2014, we paid first and second quarter dividend payments of \$0.04 per share totaling \$979,000.

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 first half of fiscal 2015, we repurchased 43,014 shares of our common stock at a cost of \$745,000. During the first half of fiscal 2014, we did not repurchase any shares of common stock.

Since June 2011, we have returned a total of \$27 million to shareholders in the form of regular quarterly and special dividend payments and common stock share repurchases.

## Working Capital

Accounts receivable at November 2, 2014, were \$25.0 million and remained flat as compared with \$24.9 million at October 27, 2013. Accounts receivable remained flat despite an increase in net sales of 4.8% in the second quarter of fiscal 2015 compared with the second quarter of fiscal 2014, as days' sales outstanding improved to 31 days from 32 days for the same year over year period.

Inventories as of November 2, 2014, were \$38.2 million, a decrease of \$6.7 million, or 15%, compared with \$44.9 million at October 27, 2013. This decrease reflects improved inventory management by both of our business segments and the reduction of inventory associated with our Culp Europe operation located in Poland. Inventory turns improved to 6.4 for the second quarter of fiscal 2015 from 5.4 for the second quarter of fiscal 2014.

Accounts payable-trade as of November 2, 2014, were \$25.4 million, a decrease of \$3.1 million, or 11%, compared with \$28.5 million at October 27, 2013. This decrease primarily reflects the decrease in inventory noted above.

Operating working capital (comprised of accounts receivable and inventories, less accounts payable-trade and accounts payable-capital expenditures) was \$37.6 million at November 2, 2014 compared with \$41.2 million at October 27, 2013. Operating working capital turnover was 7.2 during the second quarter of fiscal 2015 compared with 7.1 during the second quarter of fiscal 2014.

#### Financing Arrangements

##### Unsecured Term Notes

We entered into a note agreement dated August 11, 2008 that provided for the issuance of \$11.0 million of unsecured 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 0.8 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 November 2, 2014, 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 are outstanding under the credit agreement with Culp Europe noted below decrease the \$10.0 million available. Interest is charged at a rate (applicable interest rate of 1.76%, 1.77%, and 1.75% at November 2, 2014, October 27, 2013, 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 November 2, 2014, October 27, 2013, and April 27, 2014, there was a \$195,000 outstanding letter of credit (all of which related to workers compensation). At November 2, 2014, October 27, 2013, and April 27, 2014, there were no borrowings outstanding under the agreement.

##### 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 \$6.5 million USD at November 2, 2014), 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 November 2, 2014, October 27, 2013 and April 27, 2014.



#### Revolving Credit Agreement – Europe

As of 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 4.38% at April 27, 2014). There were \$586,000 (1.8 million Polish Zloty) in borrowings outstanding under the agreement at April 27, 2014.

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% (applicable interest rate of 2.2% at November 2, 2014).

At November 2, 2014, 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 November 2, 2014, the company was in compliance with these financial covenants.

#### Capital Expenditures and Depreciation

Capital expenditures on a cash basis were \$5.1 million for the first six months of fiscal 2015 compared with \$1.9 million for the first six months of fiscal 2014. Capital expenditures for the first six months 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 \$2.8 million and \$2.6 million for the first six months of fiscal 2015 and 2014, respectively. Depreciation expense for the first six months of fiscal 2015 and 2014, primarily related to the mattress fabrics segment.

For fiscal 2015, we currently expect capital expenditures to be approximately \$10.0 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.

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

As November 2, 2014, 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 November 2, 2014, 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.

#### 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. As discussed in our Form 10-K for the year ended April 27, 2014 (see “Segment Analysis”), significant increases in raw material costs led to lower profit margins for both of our business segments during fiscal 2012.

### 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 November 2, 2014, 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 November 2, 2014, 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 November 2, 2014, 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 November 2, 2014, 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 November 2, 2014, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

I-47

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## Part II – Other Information

## Item 1. Legal Proceedings

There have not been any material changes to our legal proceedings during the three months ended November 2, 2014. 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 November 2, 2014. 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

|   | (a)                                       | (b)                                | (c)  | (d)   |
|---|---|------------------------------------|--|---|
| Period                                  | Total<br>Number of<br>Shares<br>Purchased | Average<br>Price Paid<br>per Share | Total Number of<br>Shares Purchased<br>as Part of Publicly<br>Announced Plans<br>or Programs | Approximate<br>Dollar Value of<br>Shares that May<br>Yet Be Purchased<br>Under the Plans or<br>Programs (1) |
| August 4, 2014 to<br>September 7, 2014  | 801                                       | \$17.21                            | 801  | \$4,430,205   |
| September 8, 2014 to<br>October 5, 2014 | 6,889                                     | 17.50                              | 6,889  | \$4,309,677   |
| October 6, 2014 to<br>November 2, 2014  | 3,055                                     | 17.49                              | 3,055  | \$4,256,235   |
| Total                                   | 10,745                                    | \$17.47                            | 10,745   | \$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: December 12, 2014

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   |
|----------------|---|
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