

CULP INC
Form 10-Q
March 08, 2013

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 January 27, 2013
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. x
YES NO o

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). x
YES NO o

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 x Non-accelerated filer

Smaller Reporting Company o

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 January 27, 2013: 12,224,894
Par Value: \$0.05 per share

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For the period ended January 27, 2013

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Item 1: Financial Statements

CULP, INC.

CONSOLIDATED STATEMENTS OF NET INCOME
FOR THE THREE AND NINE MONTHS ENDED JANUARY 27, 2013 AND JANUARY 29, 2012
UNAUDITED
(Amounts in Thousands, Except for Per Share Data)

| | THREE MONTHS ENDED | |
|---|---------------------|---------------------|
| | January 27, 2013 | January 29, 2012 |
| Net sales | \$63,695 | 60,450 |
| Cost of sales | 52,010 | 51,939 |
| Gross profit | 11,685 | 8,511 |
| Selling, general and administrative expenses | 6,822 | 5,518 |
| Income from operations | 4,863 | 2,993 |
| Interest expense | 145 | 181 |
| Interest income | (105 |) (148 |
| Other expense | 300 | 83 |
| Income before income taxes | 4,523 | 2,877 |
| Income taxes | 1,700 | 1,075 |
| Net income | \$2,823 | 1,802 |
| Net income per share, basic | \$0.23 | 0.14 |
| Net income per share, diluted | 0.23 | 0.14 |
| Average shares outstanding, basic | 12,095 | 12,536 |
| Average shares outstanding, diluted | 12,290 | 12,677 |

NINE MONTHS ENDED

| | January 27, 2013 | January 29, 2012 |
|----------------------|---------------------|---------------------|
| Net sales | \$198,439 | 178,733 |
| Cost of sales | 161,757 | 152,698 |
| Gross profit | 36,682 | 26,035 |
| Selling, general and | | |

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| | | | | |
|-------------------------------------|----------|---|---------|---|
| administrative expenses | 21,672 | | 16,995 | |
| Income from operations | 15,010 | | 9,040 | |
| Interest expense | 491 | | 590 | |
| Interest income | (328) |) | (387) |) |
| Other expense | 421 | | 132 | |
| Income before income taxes | 14,426 | | 8,705 | |
| Income taxes | (188) |) | (1,168) |) |
| Net income | \$14,614 | | 9,873 | |
| Net income per share, basic | \$1.19 | | 0.77 | |
| Net income per share, diluted | 1.17 | | 0.76 | |
| Average shares outstanding, basic | 12,279 | | 12,777 | |
| Average shares outstanding, diluted | 12,467 | | 12,918 | |

See accompanying notes to consolidated financial statements.

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CULP, INC.
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
 FOR THE THREE AND NINE MONTHS ENDED JANUARY 27, 2013 AND JANUARY 29, 2012
 (UNAUDITED)
 (AMOUNTS IN THOUSANDS)

| | THREE MONTHS ENDED | |
|---|---------------------|---------------------|
| | January 27, 2013 | January 29, 2012 |
| Net income | \$2,823 | \$1,802 |
| Other comprehensive loss | | |
| Unrealized loss on short-term investments | (34) | - |
| Total other comprehensive loss | (34) | - |
| Comprehensive income | \$2,789 | \$1,802 |

| | NINE MONTHS ENDED | |
|---|---------------------|---------------------|
| | January 27, 2013 | January 29, 2012 |
| Net income | \$14,614 | \$9,873 |
| Other comprehensive income | | |
| Unrealized gain on short-term investments | 10 | 7 |
| Total other comprehensive income | 10 | 7 |
| Comprehensive income | \$14,624 | \$9,880 |

See accompanying notes to consolidated financial statements.

CULP, INC.
CONSOLIDATED BALANCE SHEETS
JANUARY 27, 2013, JANUARY 29, 2012, AND APRIL 29, 2012
UNAUDITED
(Amounts in Thousands)

| | January 27, 2013 | January 29, 2012 | * April 29, 2012 |
|---|---------------------|---------------------|---------------------|
| Current assets: | | | |
| Cash and cash equivalents | \$19,489 | 15,096 | 25,023 |
| Short-term investments | 5,237 | 8,511 | 5,941 |
| Accounts receivable, net | 24,257 | 22,012 | 25,055 |
| Inventories | 42,177 | 32,910 | 36,373 |
| Deferred income taxes | 4,098 | 2,767 | 2,467 |
| Assets held for sale | - | 45 | 15 |
| Other current assets | 1,655 | 2,522 | 1,989 |
| Total current assets | 96,913 | 83,863 | 96,863 |
| Property, plant and equipment, net | | | |
| Goodwill | 30,055 | 30,285 | 31,279 |
| Deferred income taxes | 11,462 | 11,462 | 11,462 |
| Other assets | 4,172 | 3,903 | 3,205 |
| | 1,195 | 1,944 | 1,907 |
| Total assets | \$143,797 | 131,457 | 144,716 |
| Current liabilities: | | | |
| Current maturities of long-term debt | \$2,366 | 2,400 | 2,404 |
| Line of credit | 576 | 875 | 889 |
| Accounts payable-trade | 26,220 | 23,489 | 30,663 |
| Accounts payable - capital expenditures | - | 15 | 169 |
| Accrued expenses | 12,823 | 7,594 | 9,321 |
| Accrued restructuring costs | - | 40 | 40 |
| Income taxes payable - current | 395 | 208 | 642 |
| Total current liabilities | 42,380 | 34,621 | 44,128 |
| Income taxes payable - long-term | 4,195 | 4,040 | 4,164 |
| Deferred income taxes | 856 | 659 | 705 |
| Long-term debt, less current maturities | 4,400 | 6,766 | 6,719 |
| Total liabilities | 51,831 | 46,086 | 55,716 |
| Commitments and Contingencies (Note 15) | | | |
| Shareholders' equity | 91,966 | 85,371 | 89,000 |

| | | | |
|---|-----------|---------|---------|
| Total liabilities and shareholders' equity | \$143,797 | 131,457 | 144,716 |
| Shares outstanding | 12,225 | 12,693 | 12,703 |

* Derived from audited financial statements.

See accompanying notes to consolidated financial statements.

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CULP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED JANUARY 27, 2013 AND JANUARY 29, 2012
UNAUDITED
(Amounts in Thousands)

| | NINE MONTHS ENDED | |
|---|---------------------|---------------------|
| | January 27, 2013 | January 29, 2012 |
| Cash flows from operating activities: | | |
| Net income | \$14,614 | 9,873 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 3,818 | 3,600 |
| Amortization of other assets | 178 | 183 |
| Stock-based compensation | 308 | 258 |
| Excess tax benefit related to stock-based compensation | (77) | (39) |
| Deferred income taxes | (2,370) | (2,751) |
| Gain on sale of equipment | - | (157) |
| Foreign currency exchange gains | 153 | (196) |
| Changes in assets and liabilities: | | |
| Accounts receivable | 776 | (1,769) |
| Inventories | (5,794) | (4,045) |
| Other current assets | 353 | (159) |
| Other assets | (92) | (49) |
| Accounts payable - trade | (4,395) | (1,709) |
| Accrued expenses | 3,526 | (1) |
| Accrued restructuring | (40) | (4) |
| Income taxes | (141) | (305) |
| Net cash provided by operating activities | 10,817 | 2,730 |
| Cash flows from investing activities: | | |
| Capital expenditures | (2,763) | (3,715) |
| Proceeds from the sale of equipment | - | 188 |
| Proceeds from life insurance policies | 626 | - |
| Purchase of short-term investments | (84) | (4,821) |
| Proceeds from the sale of short-term investments | 795 | 4,096 |
| Net cash used in investing activities | (1,426) | (4,252) |
| Cash flows from financing activities: | | |
| Proceeds from lines of credit | 1,000 | 6,323 |
| Payments on lines of credit | (1,325) | (5,500) |
| Payments on long-term debt | (2,350) | (2,354) |
| Proceeds from common stock issued | 205 | 237 |
| Common stock repurchased | (5,022) | (5,384) |

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| | | | | |
|--|----------|---|--------|---|
| Dividends paid | (7,226 |) | - | |
| Debt issuance costs | - | | (26 |) |
| Excess tax benefit related to stock-based compensation | 77 | | 39 | |
| Net cash used in financing activities | (14,641 |) | (6,665 |) |
| Effect of exchange rate changes on cash and cash equivalents | (284 |) | 102 | |
| Decrease in cash and cash equivalents | (5,534 |) | (8,085 |) |
| Cash and cash equivalents at beginning of period | 25,023 | | 23,181 | |
| Cash and cash equivalents at end of period | \$19,489 | | 15,096 | |

See accompanying notes to consolidated financial statements.

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

| | Common Stock | | Capital Contributed | Accumulated Other | | Total |
|--|--------------|--------|------------------------------|-------------------------|-------------------------|-------------------------|
| | Shares | Amount | in Excess of Par Value | Accumulated Earnings | Comprehensive Income | Shareholders' Equity |
| Balance, May 1, 2011 | | | | | | |
| * | 13,264,458 | \$ 663 | 50,681 | 28,997 | - | \$ 80,341 |
| Net income | - | - | - | 13,296 | - | 13,296 |
| Stock-based compensation | - | - | 349 | - | - | 349 |
| Unrealized gain on short-term investments | - | - | - | - | 16 | 16 |
| Excess tax benefit related to stock based compensation | - | - | 64 | - | - | 64 |
| Common stock repurchased | (624,127) | (31) | (5,353) | | | (5,384) |
| Fully vested common stock award | 3,075 | - | - | - | - | - |
| Common stock issued in connection with stock option plans | 59,400 | 3 | 315 | - | - | 318 |
| Balance, April 29, 2012 * | 12,702,806 | 635 | 46,056 | 42,293 | 16 | 89,000 |
| Net income | - | - | - | 14,614 | - | 14,614 |
| Stock-based compensation | - | - | 308 | - | - | 308 |
| Unrealized gain on short-term investments | - | - | - | - | 10 | 10 |
| Excess tax benefit related to stock based compensation | - | - | 77 | - | - | 77 |
| Common stock repurchased | (502,595) | (25) | (4,997) | - | - | (5,022) |
| Fully vested common stock award | 1,658 | - | - | - | - | - |
| Common stock issued in connection with stock option plans | 23,025 | 1 | 204 | - | - | 205 |
| Dividends paid | - | - | - | (7,226) | - | (7,226) |
| | 12,224,894 | \$ 611 | 41,648 | 49,681 | 26 | \$ 91,966 |

Balance, January 27,
2013

* Derived from audited financial statements.

See accompanying notes to consolidated financial statements.

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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 except as disclosed in note 13 to the consolidated financial statements. 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 12, 2012 for the fiscal year ended April 29, 2012.

The company’s nine months ended January 27, 2013 and January 29, 2012, represent 39 week periods, respectively.

2. Significant Accounting Policies

As of January 27, 2013, 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 29, 2012.

Recently Adopted and Issued Accounting Pronouncements

ASC Topic 220

In June 2011, the FASB issued ASU No. 2011-05 “Comprehensive Income – Presentation of Comprehensive Income.” ASU No. 2011-05 requires comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. This update eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders’ equity. The amendments in this update do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. The amendments in this update should be applied retrospectively and is effective for interim and annual reporting periods beginning after December 15, 2011. We adopted this guidance in the first quarter of fiscal 2013. The adoption of ASU 2011-05 is for presentation purposes only and had no impact on our consolidated financial statements.

In February 2013, the FASB issued accounting guidance related to reporting amounts reclassified out of accumulated other comprehensive income. The guidance amends the comprehensive income reporting standards to require items that are reclassified in their entirety to net income from accumulated other comprehensive income in the same reporting period to be reported separately from other amounts in other comprehensive income. These amounts may be disclosed on the face of the financial statements where net income is presented or in the notes to the financial statements. The guidance does not amend any existing disclosures around net income or other comprehensive income it is only intended to improve the transparency of items in other comprehensive income. The guidance will be effective for our fourth quarter fiscal 2013 financial statements and is not currently expected to have an impact on our consolidated financial statements.

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

3. Stock-Based Compensation

Incentive Stock Option Awards

On October 8, 2012, we granted to an outside director 2,000 options to purchase shares of common stock at the fair market value on the date of grant. These options vested immediately and expire ten years after the date of grant. The fair value of this option award was estimated on the date of grant using the Black-Scholes option pricing model. The fair value of stock options granted to this outside director during the nine month period ended January 27, 2013 was \$ 5.03 per share using the following assumptions.

| | Grant on October 8, 2012 | |
|--------------------------|--------------------------|---|
| Risk-free interest rate | 0.67 | % |
| Dividend yield | 3.00 | % |
| Expected volatility | 61.70 | % |
| Expected term (in years) | 5 | |

The assumptions utilized in the model are evaluated and revised, as necessary, to reflect market conditions, actual historical experience, and groups of employees that have similar exercise patterns that are considered separately for valuation purposes. The risk-free interest rate for periods within the contractual life of the option was based on the U.S. Treasury yield curve in effect at the time of grant. The dividend yield rate is based on historical experience and future dividend yields in effect at the time of grant. The expected volatility was derived using a term structure based on historical volatility and the volatility implied by exchange-traded options on the company's common stock. The expected term of the options is based on the contractual term of the stock option award and expected participant exercise trends.

At January 27, 2013, options to purchase 182,825 shares of common stock were outstanding, had a weighted average exercise price of \$6.99 per share, and a weighted average contractual term of 4.6 years. At January 27, 2013, the aggregate intrinsic value for options outstanding was \$1.8 million.

At January 27, 2013, outstanding options to purchase 169,825 shares of common stock were exercisable, had a weighted average exercise price of \$7.23 per share, and a weighted average contractual term of 4.6 years. At January 27, 2013, the aggregate intrinsic value for options exercisable was \$1.6 million.

The aggregate intrinsic value for options exercised for the nine months ended January 27, 2013 and January 29, 2012, was \$90,000 and \$196,000, respectively.

The remaining unrecognized compensation cost related to incentive stock option awards at January 27, 2013, was \$19,000 which is expected to be recognized over a weighted average period of 0.7 years.

We recorded \$53,000 and \$101,000 of compensation expense on incentive stock option grants within selling, general, and administrative expense for the nine months ended January 27, 2013, and January 29, 2012, respectively.

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

Common Stock Awards

On October 8, 2012, we granted a total of 1,658 shares of common stock to certain outside directors. These shares of common stock vested immediately and were measured at \$12.13 per share, which represents the closing price of the company's common stock at the date of grant.

On October 1, 2011, we granted a total of 3,075 shares of common stock to our board of directors. These shares of common stock vested immediately and were measured at \$8.45 per share, which represents the closing price of the company's common stock at the date of grant.

We recorded \$20,000 and \$26,000 of compensation expense within selling, general, and administrative expense for these common stock awards for the nine month period ending January 27, 2013 and January 29, 2012, respectively.

Time Vested Restricted Stock Awards

We did not grant any time vested restricted stock awards through the third quarter of fiscal 2013.

We recorded \$116,000 and \$131,000 of compensation expense within selling, general, and administrative expense for time vested restricted stock awards for the nine month periods ending January 27, 2013, and January 29, 2012, respectively.

At January 27, 2013, there were 123,335 shares of time vested restricted stock outstanding and unvested. Of the 123,335 shares outstanding and unvested, 70,000 shares (granted on January 7, 2009) vest in equal installments on May 1, 2013 and 2014, respectively. The remaining 53,335 shares (granted on July 1, 2009) vest in equal installments on July 1, 2013, and 2014, respectively. At January 27, 2013, the weighted average fair value of these outstanding and unvested shares was \$4.06 per share.

During the nine month period ended January 27, 2013, 61,665 shares of time vested restricted stock vested and had a weighted average fair value of \$232,000 or \$3.76 per share. During the nine month period ended January 29, 2012, 10,000 shares of time vested restricted stock vested and had a weighted average fair value of \$18,800 or \$1.88 per share.

At January 27, 2013, the remaining unrecognized compensation cost related to the unvested restricted stock awards was \$86,000, which is expected to be recognized over a weighted average vesting period of 1.1 years.

Performance Based Restricted Stock Units

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 agreement. These awards were valued based on the fair market value on the date of grant. The fair value of these awards was \$10.21, 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.

The company recorded compensation expense of \$119,000 within selling, general, and administrative expense for performance based restricted stock units for the nine month period ending January 27, 2013. No compensation expense was recorded for performance based restricted stock units for the nine month period ending January 29, 2012, as the performance based restricted stock units granted in fiscal 2009 were fully vested in fiscal 2011 and no performance based restricted stock units were granted in fiscal years 2010 through 2012. 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.

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

As of January 27, 2013, the remaining unrecognized compensation cost related to the performance based restricted stock units was \$493,000, which is expected to be recognized over a weighted average vesting period of 2.4 years.

Other Share-Based Arrangements

Effective May 2, 2011, we entered into an agreement in which we granted a non-employee a stock appreciation right that is indexed on 70,000 shares of our common stock. This agreement requires us to settle in cash an amount equal to \$35,000, plus the excess, if any, over a stock appreciation right value of \$700,000 at May 2, 2011. This stock appreciation right value of \$700,000 represents the 70,000 indexed shares of common stock noted above measured at the closing price per share of \$10 at May 2, 2011. The cash settlement in connection with the stock appreciation right value would represent the difference between a stock appreciation right value that is indexed on the 70,000 shares of common stock noted above and based on the highest closing price per share of our common stock for the period May 2, 2011 through June 30, 2012 (limited to \$12 per share) and the \$700,000 stock appreciation right value at May 2, 2011. During the first quarter of fiscal 2013, this award fully vested and was paid out at a fair value totaling \$174,000.

Compensation expense associated with this agreement was \$40,000 and \$44,000 for the nine months ended January 27, 2013, and January 29, 2012, respectively.

4. Accounts Receivable

A summary of accounts receivable follows:

| (dollars in thousands) | January 27, 2013 | April 29, 2012 |
|--|---------------------|-------------------|
| Customers | \$25,533 | \$26,100 |
| Allowance for doubtful accounts | (696) | (567) |
| Reserve for returns and allowances and discounts | (580) | (478) |
| | \$24,257 | \$25,055 |

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

| (dollars in thousands) | Nine months ended | |
|-----------------------------------|---------------------|---------------------|
| | January 27, 2013 | January 29, 2012 |
| Beginning balance | \$(567) | \$(776) |
| Provision for bad debts | (193) | 18 |
| Net write-offs, net of recoveries | 64 | 197 |
| Ending balance | \$(696) | \$(561) |

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

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

| (dollars in thousands) | Nine months ended | |
|---|-------------------|------------------|
| | January 27, 2013 | January 29, 2012 |
| Beginning balance | \$ (478) | \$ (577) |
| Provision for returns, allowances and discounts | (2,146) | (1,929) |
| Credits issued | 2,044 | 1,966 |
| Ending balance | \$ (580) | \$ (540) |

5. 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) | January 27, 2013 | April 29, 2012 |
|------------------------|---------------------|-------------------|
| Raw materials | \$6,037 | \$5,534 |
| Work-in-process | 2,772 | 3,631 |
| Finished goods | 33,368 | 27,208 |
| | \$42,177 | \$36,373 |

6. Other Assets

A summary of other assets follows:

| (dollars in thousands) | January 27, 2013 | April 29, 2012 |
|---------------------------------------|---------------------|-------------------|
| Cash surrender value – life insurance | \$700 | \$1,327 |
| Non-compete agreement, net | 222 | 333 |
| Other | 273 | 247 |
| | \$1,195 | \$1,907 |

Non-Compete Agreement

We recorded a non-compete agreement in connection with our asset purchase agreement with Bodet & Horst (acquired in 2008) at its fair value based on valuation techniques. The non-compete agreement associated with Bodet & Horst is amortized on a straight line basis over the six year life of the agreement and requires quarterly payments of \$12,500 over the life of the agreement. As of January 27, 2013, the total remaining non-compete payments were \$75,000.

The gross carrying amount of this non-compete agreement was \$1.1 million at January 27, 2013 and April 29, 2012, respectively. At January 27, 2013 and April 29, 2012, accumulated amortization for the non-compete agreement was \$890,000 and \$741,000, respectively. Amortization expense for the non-compete agreement was \$148,000 for the nine month periods ended January 27, 2013 and January 29, 2012, respectively. The remaining amortization expense (which includes the total remaining Bodet & Horst non-compete payments of \$75,000) for the next three fiscal years follows: FY 2013 - \$50,000; FY 2014 - \$198,000; and FY 2015 - \$49,000. The weighted average amortization period for the non-compete agreement is 1.5 years as of January 27, 2013.

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

Cash Surrender Value – Life Insurance

On December 27, 2012, we entered into an agreement (the “Agreement”) with our Chairman of the Board and his irrevocable trust (the “Trust”) dated December 11, 2012. As a result of this agreement, a previous split dollar life insurance agreement in which we purchased a policy on the life of our Chairman of the Board and his spouse, in which we retained ownership of the policy, paid premiums to support the policy, had the right to receive the cash surrender value of the policy upon the second to die of our Chairman of the Board and his spouse, with the Trust receiving the remainder of the policy’s death benefit (\$8.0 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 of the policy totaling \$626,000.

Also, the Agreement required us to pay our Chairman of the Board during the period of his continued employment, but in an event no longer than twelve years, additional compensation totaling \$60,000 annually.

At January 27, 2013, we had three life insurance contracts with death benefits to the respective insured totaling \$4.9 million. At April 29, 2012, we had four life insurance contracts with death benefits to the respective insured totaling \$12.9 million. Our cash surrender value – life insurance balances of \$700,000 and \$1.3 million at January 27, 2013 and April 29, 2012, respectively, are collectible upon death of the respective insured.

7. Accrued Expenses

A summary of accrued expenses follows:

| (dollars in thousands) | January 27, 2013 | April 29, 2012 |
|--|---------------------|-------------------|
| Compensation, commissions and related benefits | \$9,417 | \$7,293 |
| Interest | 243 | 147 |
| Other accrued expenses | 3,163 | 1,881 |
| | \$12,823 | \$9,321 |

8. Long-Term Debt and Lines of Credit

A summary of long-term debt and lines of credit follows:

| (dollars in thousands) | January 27, 2013 | April 29, 2012 |
|---|---------------------|-------------------|
| Unsecured senior term notes | \$6,600 | \$8,800 |
| Canadian government loan | 166 | 323 |
| | 6,766 | 9,123 |
| Current maturities of long-term debt | (2,366) | (2,404) |
| Long-term debt, less current maturities of long-term debt | \$4,400 | \$6,719 |

Unsecured Term Notes

In connection with the 2008 Bodet & Horst acquisition, we entered into a note agreement dated August 11, 2008. This agreement 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 principal payments are payable over an average term of 2.5 years through August 11, 2015. This agreement contains customary financial and other covenants as defined in the agreement.

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We have paid the required principal payment total of \$4.4 million associated with this note agreement, of which \$2.2 million was paid on August 11, 2012 and August 11, 2011, respectively.

Government of Quebec Loan

We have an agreement with the Government of Quebec for a term loan that is non-interest bearing and is payable in 48 equal monthly installments (denominated in Canadian dollars) commencing December 1, 2009. The proceeds were used to partially finance capital expenditures at our Rayonese facility located in Quebec, Canada.

Revolving Credit Agreement – United States

We have an unsecured Amended and Restated Credit Agreement that provides for a revolving loan commitment of \$7.6 million and is set to expire on August 25, 2013. This agreement provides for a pricing matrix to determine the interest rate payable on loans made under the agreement (applicable interest rate of 1.8% at January 27, 2013). At January 27, 2013, there was a \$195,000 outstanding letter of credit (all of which related to workers compensation). As of April 29, 2012, there were no outstanding letters of credit. At January 27, 2013 and April 29, 2012, 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 \$6.4 million USD at January 27, 2013), expiring on September 2, 2013. This agreement has an interest rate determined by the Chinese government. There were no borrowings outstanding under the agreement as of January 27, 2013 and April 29, 2012.

Revolving Credit Agreement – Europe

On January 17, 2012, we entered into an unsecured credit agreement associated with our operations in Poland that provides for a line of credit of up to 6.8 million Polish Zloty (approximately \$2.2 million USD at January 27, 2013). This agreement bears interest at WIBOR (Warsaw Interbank Offered Rate) plus 2% (applicable interest rate of 6.0% at January 27, 2013). On January 8, 2013, this agreement was amended to extend the expiration date from January 15, 2013 to August 25, 2013.

At January 27, 2013, \$576,000 (1.8 million Polish Zloty) in borrowings were outstanding under this agreement. At April 29, 2012, \$889,000 (2.8 million Polish Zloty) in borrowings were outstanding under this agreement.

Overall

Our loan agreements require, among other things, that we maintain compliance with certain financial covenants. At January 27, 2013, the company was in compliance with these financial covenants.

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At January 27, 2013, the principal payment requirements of long-term debt during the next three years are: Year 1 – \$2.4 million; Year 2 - \$2.2 million; and Year 3 - \$2.2 million.

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 January 27, 2013, the carrying value of the company's long-term debt was \$6.8 million and the fair value was \$6.1 million. At April 29, 2012, the carrying value of the company's long-term debt was \$9.1 million and the fair value was \$8.1 million.

9. 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.

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

Fair value measurements at January 27, 2013 using:

| (amounts in thousands) | Quoted prices in active markets for identical assets | Significant other observable inputs | Significant unobservable inputs | Total |
|-----------------------------|--|--|---------------------------------------|----------|
| | Level 1 | Level 2 | Level 3 | |
| Assets: | | | | |
| Low Duration Bond Fund | \$ 2,066 | N/A | N/A | \$ 2,066 |
| Limited Term Bond Fund | 2,070 | N/A | N/A | 2,070 |
| Intermediate Term Bond Fund | 1,101 | N/A | N/A | 1,101 |

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Fair value measurements at April 29, 2012 using:

| (amounts in thousands) | Quoted prices in active markets for identical assets | Significant other observable inputs | Significant unobservable inputs | Total |
|-----------------------------|--|--|---------------------------------------|----------|
| | Level 1 | Level 2 | Level 3 | |
| Assets: | | | | |
| Low Duration Bond Fund | \$ 2,049 | N/A | N/A | \$ 2,049 |
| Limited Term Bond Fund | 2,037 | N/A | N/A | 2,037 |
| Intermediate Term Bond Fund | 1,058 | N/A | N/A | 1,058 |

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.

Short-term investments include short-term bond funds and deposit accounts that have maturities of less than one year. Our short-term bond funds are classified as available-for-sale and their unrealized gains or losses are included in other comprehensive income. Our short-term bond funds were recorded at their fair value of \$5.2 million and \$5.1 million at January 27, 2013 and April 29, 2012, respectively. Our short-term bond funds had accumulated unrealized gains totaling \$26,000 and \$16,000 at January 27, 2013 and April 29, 2012. At January 27, 2013 and April 29, 2012, the fair value of our short-term bond funds approximated its cost basis.

The carrying amount of cash and cash equivalents, short-term investments that pertain to interest bearing deposit accounts, accounts receivable, other current assets, accounts payable and accrued expenses approximates fair value because of the short maturity of these financial instruments.

10. Cash Flow Information

Payments for interest and income taxes follows:

| (dollars in thousands) | Nine months ended | |
|-------------------------|---------------------|---------------------|
| | January 27, 2013 | January 29, 2012 |
| Interest | \$395 | \$449 |
| Net income tax payments | 2,305 | 1,886 |

11. 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:

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| (amounts in thousands) | Three months ended | |
|---|--------------------|------------------|
| | January 27, 2013 | January 29, 2012 |
| Weighted average common shares outstanding, basic | 12,095 | 12,536 |
| Dilutive effect of stock-based compensation | 195 | 141 |
| Weighted average common shares outstanding, diluted | 12,290 | 12,677 |

All options to purchase shares of common stock were included in the computation of diluted net income for the three months ended January 27, 2013, as the exercise price of the options was less than the average market price of the common shares. Options to purchase 142,750 shares of common stock were not included in the computation of diluted net income per share for the three months ended January 29, 2012, as the exercise price of the options was greater than the average market price of the common shares.

The computations of basic net income per share did not include 123,335 and 185,000 shares of time vested restricted common stock as these shares were unvested for the three months ending January 27, 2013 and January 29, 2012, respectively.

| (amounts in thousands) | Nine months ended | |
|---|-------------------|------------------|
| | January 27, 2013 | January 29, 2012 |
| Weighted average common shares outstanding, basic | 12,279 | 12,777 |
| Dilutive effect of stock-based compensation | 188 | 141 |
| Weighted average common shares outstanding, diluted | 12,467 | 12,918 |

Options to purchase 2,000 and 142,750 shares of common stock were not included in the computation of diluted net income per share for the nine months ended January 27, 2013 and January 29, 2012, respectively as the exercise price of the options was greater than the average market price of the common shares.

The computations of basic net income per share did not include 123,335 and 185,000 shares of time vested restricted common stock as these shares were unvested for the nine months ending January 27, 2013 and January 29, 2012, respectively.

12. Segment Information

Our operations are classified into two business segments: mattress fabrics and upholstery fabrics. The mattress fabrics segment manufactures and sells fabrics to bedding manufacturers. The upholstery fabrics segment manufactures and sells fabrics primarily to residential and commercial (contract) furniture manufacturers.

We evaluate the operating performance of our segments based upon income (loss) 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 and a non-compete agreements associated with an acquisition.

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Financial information for the company's operating segments follows:

| (dollars in thousands) | Three months ended | |
|---|--------------------|------------------|
| | January 27, 2013 | January 29, 2012 |
| Net sales: | | |
| Mattress Fabrics | \$ 35,513 | \$ 34,719 |
| Upholstery Fabrics | 28,182 | 25,731 |
| | \$ 63,695 | \$ 60,450 |
| Gross profit: | | |
| Mattress Fabrics | \$ 6,548 | \$ 5,104 |
| Upholstery Fabrics | 5,137 | 3,407 |
| | \$ 11,685 | \$ 8,511 |
| Selling, general, and administrative expenses: | | |
| Mattress Fabrics | \$ 2,382 | \$ 1,970 |
| Upholstery Fabrics | 3,360 | 2,653 |
| Total segment selling, general, and administrative expenses | 5,742 | 4,623 |
| Unallocated corporate expenses | 1,080 | 895 |
| | \$ 6,822 | \$ 5,518 |
| Income from operations: | | |
| Mattress Fabrics | \$ 4,166 | \$ 3,134 |
| Upholstery Fabrics | 1,777 | 754 |
| Total segment income from operations | 5,943 | 3,888 |
| Unallocated corporate expenses | (1,080) | (895) |
| Total income from operations | 4,863 | 2,993 |
| Interest expense | (145) | (181) |
| Interest income | 105 | 148 |
| Other expense | (300) | (83) |
| Income before income taxes | \$ 4,523 | \$ 2,877 |

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| (dollars in thousands) | Nine months ended | |
|---|-------------------|---------------------|
| | January 27, 2013 | January 29, 2012 |
| Net sales: | | |
| Mattress Fabrics | \$ 113,175 | \$ 102,130 |
| Upholstery Fabrics | 85,264 | 76,603 |
| | \$ 198,439 | \$ 178,733 |
| Gross profit: | | |
| Mattress Fabrics | \$ 21,708 | \$ 16,180 |
| Upholstery Fabrics | 14,974 | 9,932 |
| Total segment gross profit | \$ 36,682 | \$ 26,112 |
| Other non-recurring charges | - | (77) |
| | \$ 36,682 | \$ 26,035 |
| | |) (1) |
| Selling, general, and administrative expenses: | | |
| Mattress Fabrics | \$ 7,197 | \$ 6,094 |
| Upholstery Fabrics | 9,857 | 8,186 |
| Total segment selling, general, and administrative expenses | 17,054 | 14,280 |
| Unallocated corporate expenses | 4,618 | 2,715 |
| | \$ 21,672 | \$ 16,995 |
| Income from operations: | | |
| Mattress Fabrics | \$ 14,512 | \$ 10,087 |
| Upholstery Fabrics | 5,116 | 1,745 |
| Total segment income from operations | 19,628 | 11,832 |
| Unallocated corporate expenses | (4,618) | (2,715) |
| Other non-recurring charges | - | (77) |
| Total income from operations | 15,010 | 9,040 |
| Interest expense | (491) | (590) |
| Interest income | 328 | 387 |
| Other expense | (421) | (132) |
| Income before income taxes | \$ 14,426 | \$ 8,705 |

(1) Other non-recurring charges represent employee termination benefits associated with our Anderson, SC plant facility. This non-recurring charges relates to the Upholstery Fabrics segment.

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

| (dollars in thousands) | January 27, 2013 | April 29, 2012 |
|------------------------|------------------|----------------|
|------------------------|------------------|----------------|

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| | | |
|-----------------------------------|------------|------------|
| Segment assets: | | |
| Mattress Fabrics | | |
| Current assets (1) | \$ 34,595 | \$ 29,909 |
| Assets held for sale | - | 15 |
| Non-compete agreements, net | 222 | 333 |
| Goodwill | 11,462 | 11,462 |
| Property, plant and equipment (2) | 28,116 | 29,237 |
| Total mattress fabrics assets | 74,395 | 70,956 |
| Upholstery Fabrics | | |
| Current assets (1) | 31,839 | 31,519 |
| Property, plant and equipment (3) | 1,147 | 1,124 |
| Total upholstery fabrics assets | 32,986 | 32,643 |
| Total segment assets | 107,381 | 103,599 |
| Non-segment assets: | | |
| Cash and cash equivalents | 19,489 | 25,023 |
| Short-term investments | 5,237 | 5,941 |
| Deferred income taxes | 8,270 | 5,672 |
| Other current assets | 1,655 | 1,989 |
| Property, plant and equipment (4) | 792 | 918 |
| Other assets | 973 | 1,574 |
| Total assets | \$ 143,797 | \$ 144,716 |

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| (dollars in thousands) | Nine months ended | |
|----------------------------|-------------------|------------------|
| | January 27, 2013 | January 29, 2012 |
| Capital expenditures (5): | | |
| Mattress Fabrics | \$ 2,223 | \$ 2,761 |
| Upholstery Fabrics | 222 | 481 |
| Unallocated Corporate | 149 | 351 |
| Total capital expenditures | \$ 2,594 | \$ 3,593 |
| Depreciation expense: | | |
| Mattress Fabrics | \$ 3,344 | \$ 3,163 |
| Upholstery Fabrics | 474 | 437 |
| Total depreciation expense | \$ 3,818 | \$ 3,600 |

- (1) Current assets represent accounts receivable and inventory for the respective segment.
- (2) The \$28.1 million at January 27, 2013, represents property, plant, and equipment of \$20.6 million and \$7.5 million located in the U.S. and Canada, respectively. The \$29.2 million at April 29, 2012, represents property, plant, and equipment of \$21.2 million and \$8.0 million located in the U.S. and Canada, respectively.
- (3) The \$1.1 million at January 27, 2013, represents property, plant, and equipment located in the U.S. of \$906, located in China of \$155, and located in Poland of \$86. The \$1.1 million at April 29, 2012, represents property, plant, and equipment located in the U.S. of \$837, located in China of \$183, and located in Poland of \$104.
- (4) The \$792 and \$918 at January 27, 2013 and April 29, 2012, 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 Statement of Cash Flows for capital expenditure amounts on a cash basis.

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13. Income Taxes

Effective Income Tax Rate

We recorded an income tax benefit of \$188,000, or 1.3% of income before income tax expense, for the nine month period ended January 27, 2013, compared to an income tax benefit of \$1.2 million, or 13.4% of income before income tax expense, for the nine month period ended January 29, 2012. Our effective income tax rates for the nine month periods ended January 27, 2013 and January 29, 2012 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 benefit for the nine month period ended January 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 was reduced by 84% for a reduction in our valuation allowance associated with our U.S. net deferred income tax assets. This 84% reduction in our income tax rate is due to a change in judgment about the realization of our U.S. net deferred income tax assets in future years. Since the realization of our U.S. net deferred income tax assets is a result of a change in judgment about future years we recorded an income tax benefit of \$12.1 million that represents a discrete event in which the full tax effects were recorded for the nine month period ending January 27, 2013.

The income tax rate was increased by 46% for the establishment of a deferred tax liability for U.S. income taxes that will be paid upon repatriation of undistributed earnings from our foreign subsidiaries located in Canada and China. This 46% increase in our income tax rate is due to a change in judgment in which our prior years' accumulated earnings and profits associated with our subsidiaries located in Canada and China are no longer considered indefinitely reinvested. Since the establishment of our deferred tax liability is a result of a change in judgment about prior years' accumulated earnings and profits we recorded an income tax charge of \$6.6 million that represents a discrete event in which the full tax effects were recorded for the nine month period ending January 27, 2013.

The income tax rate was reduced 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 was increased by 5% for an increase in unrecognized tax benefits.

The income tax rate was increased by 1% for the establishment of a valuation allowance against our net deferred tax assets associated with our Culp Europe operation located in Poland.

The income tax rate was increased by 2.7% for stock-based compensation and other miscellaneous items.

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The income tax benefit for the nine month period ended January 29, 2012 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 was reduced by 50% for a reduction in our valuation allowance associated with our U.S. net deferred income tax assets. This 50% reduction in our income tax rate is due to a change in judgment about the realization of our U.S. net deferred income tax assets in future years. Since the realization of our U.S. net deferred income tax assets is a result of a change in judgment about future years we recorded an income tax benefit of \$4.4 million that represents a discrete event in which the full tax effects were recorded for nine month period ending January 29, 2012.

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

The income tax rate was increased by 7% for an increase in unrecognized tax benefits.

The income tax rate was increased by 2.6% for stock-based compensation and other miscellaneous items.

Deferred Income Taxes

Summary

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 January 27, 2013, we recorded a partial valuation allowance of \$926,000, of which \$719,000 pertained to certain U.S. state net operating loss carryforwards and credits and \$207,000 pertained to loss carryforwards associated with our Culp Europe operation located in Poland. Based on our assessment at April 29, 2012, we recorded a partial valuation allowance of \$12.8 million against our net deferred tax assets associated with our U.S. operations.

No valuation allowance was recorded against our net deferred tax assets associated with our operations located in China and Canada at January 27, 2013 and April 29, 2012, respectively.

United States

Our net deferred tax asset regarding our U.S. operations primarily pertained to incurring significant U.S. pre-tax losses over prior fiscal years, with U.S. loss carryforwards totaling \$59.9 million at April 29, 2012. Due to the favorable results of our multi-year restructuring process and profit improvements made in our upholstery fabric operations and key acquisitions and capital investments made for our mattress fabric segment, on a cumulative three-year basis ending April 29, 2012 (the end of our fiscal 2012), our U.S. operations earned a pre-tax income of \$11.9 million. This trend continued through the second quarter of fiscal 2013, as our U.S. operations earned a pretax income of \$3.4 million.

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This continued earnings improvement from our U.S. operations was driven primarily by our mattress fabric operations (which primarily resides in the U.S.). Through the second quarter of fiscal 2013, our mattress fabric operations had net sales totaling \$77.7 million, an increase of 15% compared with \$67.4 million through the second quarter of fiscal 2012. In addition, our mattress fabric operations reported operating income of \$10.3 million through the second quarter of fiscal 2013, an increase of 49% compared with \$7.0 million through the second quarter of fiscal 2012. These improved results through the second quarter of fiscal 2013, which were better than expected, can be attributed to increased sales from our sales and marketing initiatives with customers who are leading suppliers in the bedding industry, the recent evolution of the bedding industry into a more decorative business with growing consumer demand for better bedding and a higher quality mattress fabric, and the recent stabilization of raw material prices.

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. Prior to the second quarter of fiscal 2013, it was management's intention to indefinitely reinvest all of our undistributed foreign earnings. Accordingly, no deferred tax liability had been recorded in connection with the future repatriation of these earnings.

During the second quarter of fiscal 2013, we assessed the financial requirements of our U.S. parent company and foreign subsidiaries and determined that our undistributed earnings from our foreign subsidiaries totaling \$55.6 million will not be reinvested indefinitely and will be eventually distributed to our U.S. parent company. The financial requirements of the U.S. parent company have recently changed to provide its shareholders a return on their investment through dividend payments and common stock repurchases. Also, in order to keep up with the recent growth in consumer demand for better bedding and a higher quality mattress fabric, it is our intention to continue our investment in our domestic mattress fabric operations.

As a result of our assessment during the second quarter of fiscal 2013, we recorded a deferred tax liability and corresponding income tax charge of \$6.6 million. This \$6.6 million income tax charge was treated as a discrete event in which the full tax effects of this adjustment were recorded in the nine month period ended January 27, 2013, as it pertained to a change in judgment on prior periods' earnings of a foreign subsidiary that will be indefinitely reinvested.

At January 27, 2013, we had accumulated earnings and profits from our foreign subsidiaries totaling \$56.3 million. At January 27, 2013, the deferred tax liability associated with our undistributed earnings from our foreign subsidiaries included U.S. income and foreign withholding taxes totaling \$21.9 million offset by U.S. foreign income tax credits of \$15.1 million.

Based on the positive evidence at the end of our second quarter of fiscal 2013, as supported by our cumulative earnings history, current and expected earnings improvement driven by our U.S. mattress fabric operations, and the significant source of U.S. taxable income from the undistributed earnings of our foreign subsidiaries, we recorded an income tax benefit of \$12.2 million to reverse primarily all of the valuation allowance against our U.S. net deferred tax assets. In the third quarter of fiscal 2013, we recorded an income tax charge of \$103,000, due to a change in our second quarter estimate of the recoverability of our U.S. state net loss operating carryforwards. This total \$12.1 million income tax benefit was treated as a discrete event in which the full tax effects of this adjustment were recorded in the nine month period ended January 27, 2013, as it pertained to a change in judgment about future years.

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After our valuation allowance reversal of \$12.1 million, we have a remaining valuation allowance against our U.S. net deferred tax assets totaling \$719,000 as of January 27, 2013. This valuation allowance pertains to certain U.S. state net operating loss carryforwards and credits in which it is “more likely than not” that these U.S. state net operating loss carryforwards and credits will not be realized prior to their respective expiration dates.

Poland

During the third quarter of fiscal 2011, we established Culp Europe, a wholly-owned subsidiary located in Poland. Due to the initial start up costs of setting up this operation and the current state of the European economy, this operation had recorded cumulative pre-tax losses totaling \$1.1 million through the second quarter of fiscal 2013.

Based on the negative evidence at the end of our second quarter of fiscal 2013, as supported by our cumulative loss history and the short carryforward period of 5 years imposed by the Polish government, we recorded a full valuation allowance and corresponding income tax charge of \$207,000 against Culp Europe’s net deferred tax assets. Of this \$207,000 income tax charge, \$115,000 was treated as a discrete event in which the full tax effects of this adjustment were recorded in the nine month period ended January 27, 2013, as it pertained to a change in judgment about future years. The remaining income tax charge of \$92,000 was included in the computation of the annual effective rate for fiscal 2013 as the pre-tax net loss associated with this income tax charge originated during the current fiscal year.

Overall

At January 27, 2013, the current deferred tax asset of \$4.1 million represents \$3.8 million and \$329,000 from our operations located in the U.S. and China, respectively. At April 29, 2012, the current deferred tax asset of \$2.5 million represents \$2.1 million and \$405,000 from our operations located in the U.S. and China, respectively. At January 27, 2013, the non-current deferred tax asset of \$4.2 million represents \$3.4 million and \$793,000 from our operations located in the U.S. and China, respectively. At April 29, 2012, the non-current deferred tax asset of \$3.2 million represents \$2.1 million, \$1.0 million, and \$115,000 from our operations located in the U.S., China, and Poland, respectively. At January 27, 2013 and April 29, 2012, the non-current deferred tax liability of \$856,000 and \$705,000, respectively, pertains to our operation located in Canada.

Uncertainty In Income Taxes

At January 27, 2013, we had \$13.1 million of total gross unrecognized tax benefits, of which \$4.2 million represents the amount of gross unrecognized tax benefits that, if recognized, would favorably affect the income tax rate in future periods. Of the \$13.1 million in gross unrecognized tax benefits as of January 27, 2013, \$8.9 million were classified as net non-current deferred income taxes and \$4.2 million were classified as income taxes payable –long-term in the accompanying consolidated balance sheets.

We estimate that the amount of gross unrecognized tax benefits will increase by approximately \$821,000 for fiscal 2013. This increase primarily relates to double taxation under applicable tax treaties with foreign tax jurisdictions.

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14. 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 January 27, 2013, the company's statutory surplus reserve was \$3.8 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 \$3.8 million to assist with debt repayment, capital expenditures, and other expenses of the company's business.

15. 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 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 involves court judgments that have been 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 \$8.6 million, plus unspecified future environmental costs. We understand that the USEPA's costs now exceed \$13 million, but are not expected to increase significantly in the future. Neither USEPA nor any other governmental authority has asserted any claim against us on account of these matters. The plaintiffs seek contribution from us and other defendants and a declaration that the company and the other defendants are responsible for environmental response costs under environmental laws and certain agreements. The plaintiffs also assert 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 do not believe we have any liability for the matters described in this litigation and intend to defend ourselves vigorously. In addition, we have an indemnification agreement with certain other defendants in the litigation pursuant to which the other defendants agreed to indemnify us for any damages we incur as a result of the environmental matters that are the subject of this litigation, although it is unclear whether the indemnitors have significant assets at this time. Since the loss is not probable and cannot be estimated, no reserve has been recorded.

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

Other Litigation

The company is involved in legal proceedings and claims which have arisen in the ordinary course of business. These actions, when ultimately concluded and settled, will not, in the opinion of management, have a material adverse effect upon the financial position, results of operations or cash flows of the company.

Purchase Commitments

At January 27, 2013 and April 29, 2012, we had open purchase commitments to acquire equipment for our mattress fabrics segment totaling \$1.1 million and \$1.2 million, respectively.

Joint Product, Sales and Marketing Agreement

In order to expand our product offerings and keep pace with the changing customer demand trends within the bedding industry, we entered into a joint product development, sales and marketing agreement with A. Lava & Son Co. (Lava) on May 21, 2012. This agreement formed a new business named Culp-Lava Applied Sewn Solutions (Culp-Lava) and has provided us an opportunity to enter the business of designing, producing, and marketing sewn mattress covers. As we enter the business of sewn mattress covers, we will be able to leverage our design capabilities and expand our product offerings from mattress fabrics to finished covers. In connection with this agreement, Lava is providing us with technical assistance and know-how for the start-up of the business and is working with us on the design, sales and marketing of sewn mattress covers.

As part of the agreement, the new business will be fully funded and 100% owned by us. We have established a manufacturing facility located in Stokesdale, North Carolina that is adjacent to our mattress fabric headquarters, providing favorable operating synergies with management and production in the same location. As a result, we will have two mirrored manufacturing facilities to serve our customer base and meet current and expected demand trends in the bedding industry. We have responsibility for all operating control of the new business, including capital expenditures and production and operating costs. We are currently projecting our capital investment in this facility to be approximately \$600,000 for fiscal years 2013 and 2014. Lava is not required to invest capital into Culp-Lava.

During the second quarter of fiscal 2013, we have completed the initial equipment installation and conducted training for the start-up associates in this location. We commenced production in November 2012, and we currently expect to incrementally add more capacity for this product category to meet anticipated demand.

16. Common Stock Repurchase Program

On June 13, 2012, we announced that our board of directors approved authorization for us to acquire up to \$5.0 million of our common stock. This action replaced prior authorizations to acquire up to \$7.0 million of our common stock in fiscal 2012, of which \$5.4 million had been used during fiscal 2012.

On August 29, 2012, we announced that our board of directors approved a new authorization for us to acquire up to \$2.0 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.

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During the nine months ended January 27, 2013, we purchased 502,595 shares of our common stock at a cost of \$5.0 million, and as a result, we reached the \$5.0 million limit that was authorized on June 13, 2012. As of January 27, 2013, there have been no repurchases of common stock on the \$2.0 million limit that was authorized on August 29, 2012.

Since our common stock repurchase program was implemented in fiscal 2012, we have repurchased 1.1 million shares of common stock at a cost of \$10.4 million.

17. Dividend Program

On June 13, 2012, we announced that our board of directors approved the payment of a cash dividend of \$0.03 per share in the first quarter of fiscal 2013. These \$0.03 per share quarterly cash dividend payments continued into the second and third quarters of fiscal 2013. On November 27, 2012, we announced that our board of directors approved the payment of a special cash dividend of \$0.50 per share, which was paid on December 28, 2012.

During the nine month period ending January 27, 2013, dividend payments totaled \$7.2 million, of which \$6.1 million represented the special cash dividend payment of \$0.50 per share, and \$1.1 million represented the quarterly dividend payments of \$0.03 per share, respectively.

On February 27, 2013, we announced that our board of directors approved the payment of a quarterly cash dividend of \$0.03 per share, to be paid on or about April 15, 2013, to shareholders of record as of the close of business on April 1, 2013.

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

CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING INFORMATION

This report and the exhibits attached hereto contain “forward-looking statements” within the meaning of the federal securities laws, including the Private Securities Litigation Reform Act of 1995 (Section 27A of the Securities Act of 1933 and Section 27A 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, gross profit margins, operating income, SG&A or other expenses, earnings, 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 are included in Item 1A “Risk Factors” section in our Form 10-K filed with the Securities and Exchange Commission on July 12, 2012 for the fiscal year ended April 29, 2012.

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

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.

Overview

Our fiscal year is the 52 or 53 week period ending on the Sunday closest to April 30. The nine months ended January 27, 2013, and January 29, 2012, represent 39 week periods, respectively. Our operations are classified into two business segments: mattress fabrics and upholstery fabrics. The mattress fabrics segment manufactures, sources and sells fabrics to bedding manufacturers. The upholstery fabrics segment sources, manufactures and sells fabrics primarily to residential and commercial (contract) furniture manufacturers.

We evaluate the operating performance of our segments based upon income (loss) 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.

We reported net sales of \$63.7 million for the third quarter of fiscal 2013, an increase of 5% compared with \$60.4 million for the third quarter of fiscal 2012. Net sales were \$198.4 million for the nine months ended January 27, 2013, an increase of 11% compared with \$178.7 million for the nine months ended January 29, 2012. The higher sales primarily reflect improved demand and favorable customer response to our innovative designs and our diverse product line. Our global manufacturing platform has enhanced our ability to develop new products and meet the changing style demands of our customers.

We reported income before income taxes of \$4.5 million in the third quarter of fiscal 2013, an increase of 57% compared with \$2.9 million for the third quarter of fiscal 2012. We reported income before income taxes of \$14.4 million for the nine months ended January 27, 2013, an increase of 66% compared with \$8.7 million for the nine months ended January 29, 2012. These results primarily reflect the increase in net sales noted above and lower raw material costs in both of our business segments as compared to prior periods. The effects of these factors were partially offset by higher selling, general, and administrative expenses (SG&A). SG&A primarily increased due to higher incentive compensation accruals reflecting stronger financial results in relation to pre-established performance targets.

We reported net income of \$2.8 million, or \$0.23 per diluted share, in the third quarter of fiscal 2013, compared with net income of \$1.8 million, or \$0.14 per diluted share, in the third quarter of fiscal 2012. Net income for the third quarter of fiscal 2013 included income tax expense of \$1.7 million, compared with income tax expense of \$1.1 million for the third quarter of fiscal 2012.

We reported net income of \$14.6 million, or \$1.17 per diluted share, for the nine months ended January 27, 2013, compared with net income of \$9.9 million, or \$0.76 per diluted share, for the nine months ended January 29, 2012. Net income for the nine months ended January 27, 2013, included an income tax benefit of \$188,000. This income tax benefit included a \$12.1 million income tax benefit that was mostly recorded in the second quarter to reverse primarily all of the valuation allowance against our U.S. net deferred tax assets, offset by an income tax charge of \$6.6 million in the second quarter to record the U.S. income tax effects of the undistributed earnings from our foreign subsidiaries

located in Canada and China. Net income for the nine months ended January 29, 2012, included an income tax benefit of \$1.2 million, which included a \$4.4 million reversal that was recorded in the second quarter for a portion of the valuation allowance associated with our U.S. net deferred tax assets.

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At January 27, 2013, our cash and cash equivalents and short-term investments totaled \$24.7 million and exceeded our total debt (current maturities of long-term debt, long-term debt, and line of credit) of \$7.3 million. Our cash and cash equivalents and short-term investments have decreased from \$31.0 million at April 29, 2012, after spending \$7.2 million for dividend payments, \$5.0 million for common stock repurchases, \$2.8 million for capital expenditures, and \$2.4 million on long-term debt principal payments. This spending was significantly offset by net cash provided by operating activities of \$10.8 million as compared to the \$2.7 million for the nine months ended January 29, 2012.

On June 13, 2012, we announced that our board of directors approved authorization for us to acquire up to \$5.0 million of our common stock. This action replaced prior authorizations to acquire up to \$7.0 million of our common stock in fiscal 2012, of which \$5.4 million had been used during fiscal 2012.

On August 29, 2012, we announced that our board of directors approved a new authorization for us to acquire up to \$2.0 million of our common stock. Under the common stock repurchase program, shares may be purchased from time to time in open market transactions, block trades, through plans established under the Securities Exchange Act Rule 10b5-1, or otherwise. The amount of shares purchased and the timing of such purchases will be based on working capital requirements, market and general business conditions, and other factors including alternative investment opportunities.

During the nine months ended January 27, 2013, we purchased 502,595 shares of our common stock at a cost of \$5.0 million and, as a result, we reached the \$5.0 million limit authorized on June 13, 2012. As of January 27, 2013, there have been no repurchases of common stock on the \$2.0 million limit that was authorized on August 29, 2012.

Since our common stock repurchase program was implemented in fiscal 2012, we have repurchased 1.1 million shares of common stock at a cost of \$10.4 million.

On June 13, 2012, we announced that our board of directors approved the payment of a cash dividend of \$0.03 per share in the first quarter of fiscal 2013. These \$0.03 per share quarterly cash dividend payments continued into the second and third quarters of fiscal 2013. On November 27, 2012, we announced that our board of directors approved the payment of a special cash dividend of \$0.50 per share, which was paid on December 28, 2012.

During the nine month period ending January 27, 2013, dividend payments totaled \$7.2 million, of which \$6.1 million represented the special cash dividend payment of \$0.50 per share, and \$1.1 million represented the quarterly dividend payments of \$0.03 per share, respectively.

On February 27, 2013, we announced that our board of directors approved the payment of a quarterly cash dividend of \$0.03 per share, to be paid on or about April 15, 2013, to shareholders of record as of the close of business on April 1, 2013.

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

Segment Analysis

The following tables set forth the company's statement of operations by segment for the three and nine months ended January 27, 2013, and January 29, 2012.

CULP, INC.
 STATEMENTS OF OPERATIONS BY SEGMENT
 FOR THE THREE MONTHS ENDED JANUARY 27, 2013 AND JANUARY 29, 2012
 (Unaudited)

(Amounts in thousands)

THREE MONTHS ENDED

| | Amounts | | | | Percent of Total Sales | | | |
|---|---------------------|---------------------|-------|---|--------------------------------|------------------------|------------------------|---|
| | January 27, 2013 | January 29, 2012 | | | % Over (Under) | January 27, 2013 | January 29, 2012 | |
| Net Sales by Segment | | | | | | | | |
| Mattress Fabrics | \$ 35,513 | 34,719 | 2.3 | % | 55.8 | % | 57.4 | % |
| Upholstery Fabrics | 28,182 | 25,731 | 9.5 | % | 44.2 | % | 42.6 | % |
| Net Sales | \$ 63,695 | 60,450 | 5.4 | % | 100.0 | % | 100.0 | % |
| Gross Profit by Segment | | | | | Gross Profit Margin | | | |
| Mattress Fabrics | \$ 6,548 | 5,104 | 28.3 | % | 18.4 | % | 14.7 | % |
| Upholstery Fabrics | 5,137 | 3,407 | 50.8 | % | 18.2 | % | 13.2 | % |
| Gross Profit | \$ 11,685 | 8,511 | 37.3 | % | 18.3 | % | 14.1 | % |
| Selling, General and Administrative expenses by Segment | | | | | Percent of Sales | | | |
| Mattress Fabrics | \$ 2,382 | 1,970 | 20.9 | % | 6.7 | % | 5.7 | % |
| Upholstery Fabrics | 3,360 | 2,653 | 26.6 | % | 11.9 | % | 10.3 | % |
| Unallocated Corporate expenses | 1,080 | 895 | 20.7 | % | 1.7 | % | 1.5 | % |
| Selling, General and Administrative expenses | 6,822 | 5,518 | 23.6 | % | 10.7 | % | 9.1 | % |
| Operating Income (loss) by Segment | | | | | Operating Income (Loss) Margin | | | |
| Mattress Fabrics | \$ 4,166 | 3,134 | 32.9 | % | 11.7 | % | 9.0 | % |
| Upholstery Fabrics | 1,777 | 754 | 135.7 | % | 6.3 | % | 2.9 | % |
| | (1,080) | (895) | 20.7 | % | (1.7) | % | (1.5) | % |

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Unallocated corporate expenses

| | | | | | | | | |
|------------------|----------|-------|------|---|-----|---|-----|---|
| Operating income | \$ 4,863 | 2,993 | 62.5 | % | 7.6 | % | 5.0 | % |
|------------------|----------|-------|------|---|-----|---|-----|---|

Depreciation by Segment

| | | | | |
|--------------------|----------|-------|------|---|
| Mattress Fabrics | \$ 1,125 | 1,081 | 4.1 | % |
| Upholstery Fabrics | 154 | 133 | 15.8 | % |
| Consolidated | 1,279 | 1,214 | 5.4 | % |

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CULP, INC.
 STATEMENTS OF OPERATIONS BY SEGMENT
 FOR THE NINE MONTHS ENDED JANUARY 27, 2013 AND JANUARY 29, 2012
 (Unaudited)

(Amounts in thousands)

NINE MONTHS ENDED

| | Amounts | | % Over (Under) | | Percent of Total Sales | | | | |
|---|---------------------|---------------------|-------------------|----------|--------------------------------|------------------------|-------|--------|---|
| | January 27, 2013 | January 29, 2012 | | | January 27, 2013 | January 29, 2012 | | | |
| Net Sales by Segment | | | | | | | | | |
| Mattress Fabrics | \$ 113,175 | 102,130 | 10.8 | % | 57.0 | % | 57.1 | % | |
| Upholstery Fabrics | 85,264 | 76,603 | 11.3 | % | 43.0 | % | 42.9 | % | |
| Net Sales | \$ 198,439 | 178,733 | 11.0 | % | 100.0 | % | 100.0 | % | |
| Gross Profit by Segment | | | | | | | | | |
| | | | | | Gross Profit Margin | | | | |
| Mattress Fabrics | \$ 21,708 | 16,180 | 34.2 | % | 19.2 | % | 15.8 | % | |
| Upholstery Fabrics | 14,974 | 9,932 | 50.8 | % | 17.6 | % | 13.0 | % | |
| Subtotal | 36,682 | 26,112 | 40.5 | % | 18.5 | % | 14.6 | % | |
| Other non-recurring charges | - | (77) | (1) | (100.0) | % | 0.0 | % | (0.0) | % |
| Gross Profit | 36,682 | 26,035 | 40.9 | % | 18.5 | % | 14.6 | % | |
| Selling, General and Administrative expenses by Segment | | | | | | | | | |
| | | | | | Percent of Sales | | | | |
| Mattress Fabrics | \$ 7,197 | 6,094 | 18.1 | % | 6.4 | % | 6.0 | % | |
| Upholstery Fabrics | 9,857 | 8,186 | 20.4 | % | 11.6 | % | 10.7 | % | |
| Unallocated | | | | | | | | | |
| Corporate expenses | 4,618 | 2,715 | 70.1 | % | 2.3 | % | 1.5 | % | |
| Consolidated | 21,672 | 16,995 | 27.5 | % | 10.9 | % | 9.5 | % | |
| Operating Income (loss) by Segment | | | | | | | | | |
| | | | | | Operating Income (Loss) Margin | | | | |
| Mattress Fabrics | \$ 14,512 | 10,087 | 43.9 | % | 12.8 | % | 9.9 | % | |

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| | | | | | | | | | |
|--------------------------------|-----------|----------|-------|----------|--------|-----|--------|--------|---|
| Upholstery Fabrics | 5,116 | 1,745 | 193.2 | % | 6.0 | % | 2.3 | % | |
| Unallocated corporate expenses | (4,618) | (2,715) | 70.1 | % | (2.3) | % | (1.5) | % | |
| Subtotal | 15,010 | 9,117 | 64.6 | % | 7.6 | % | 5.1 | % | |
| Other non-recurring charges | - | (77) | (1) | (100.0) | % | 0.0 | % | (0.0) | % |
| Operating income | \$ 15,010 | 9,040 | 66.0 | % | 7.6 | % | 5.1 | % | |
| Depreciation by Segment | | | | | | | | | |
| Mattress Fabrics | \$ 3,344 | 3,163 | 5.7 | % | | | | | |
| Upholstery Fabrics | 474 | 437 | 8.5 | % | | | | | |
| Consolidated | 3,818 | 3,600 | 6.1 | % | | | | | |

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Three and Nine months ended January 27, 2013 compared with the Three and Nine Months ended January 29, 2012

Mattress Fabrics Segment

Net Sales

Mattress fabrics sales for the third quarter of fiscal 2013 were \$35.5 million, an increase of 2% compared with \$34.7 million for the third quarter of fiscal 2012. Net sales were \$113.2 million for the nine months ended January 27, 2013, an increase of 11% compared with \$102.1 million for the nine months ended January 29, 2012. We believe these results reflect the growing consumer demand for higher-end bedding and more decorative mattress fabrics such as those we produce. We are well positioned to meet this growing consumer demand with a manufacturing platform and flexible capacity that can produce a diverse line of products. In addition, we have the ability to leverage our design capabilities and expertise in the upholstery fabric business to enhance our product offering, as more upholstery type fabrics are being used in bedding products.

Although mattress fabrics sales have increased in comparison to prior periods, the rate of growth has slowed. This trend was especially pronounced in the later weeks of the third quarter, and appeared to be related to the softening demand in the bedding industry as compared to a year ago. Based on current business trends, we believe this overall decline in demand is continuing into the fourth quarter. This leads us to expect modestly lower net sales in the fourth quarter of fiscal 2013 compared to mattress fabric sales in the fourth quarter of fiscal 2012.

Sales and Marketing Initiatives

In order to expand our product offerings and keep pace with the changing customer demand trends within the bedding industry, we entered into a joint product development, sales and marketing agreement with A. Lava & Son Co. (Lava) on May 21, 2012. This agreement formed a new business named Culp-Lava Applied Sewn Solutions (Culp-Lava) and has provided us an opportunity to enter the business of designing, producing, and marketing sewn mattress covers. As we enter the business of sewn mattress covers, we will be able to leverage our design capabilities and expand our product offerings from mattress fabrics to finished covers. In connection with this agreement, Lava is providing us with technical assistance and know-how for the start-up of the business and is working with us on the design, sales and marketing of sewn mattress covers.

As part of the agreement, the new business will be fully funded and 100% owned by us. We have established a manufacturing facility located in Stokesdale, North Carolina, that is adjacent to our mattress fabric headquarters, providing favorable operating synergies with management and production in the same location. As a result, we will have two mirrored manufacturing facilities to serve our customer base and meet current and expected demand trends in the bedding industry. We have responsibility for all operating control of the new business, including capital expenditures and production and operating costs. We are currently projecting our capital investment in this facility to be approximately \$600,000 for fiscal years 2013 and 2014. Lava is not required to invest capital into Culp-Lava.

During the second quarter of fiscal 2013, we have completed the initial equipment installation and conducted training for the start-up associates in this location. We commenced production in November 2012, and we currently expect to incrementally add more capacity for this product category to meet anticipated demand.

Gross Profit and Operating Income

For the third quarter of fiscal 2013, the mattress fabrics segment reported a gross profit of \$6.5 million, an increase of 28% compared with \$5.1 million for the third quarter of fiscal 2012. Gross profit margins were 18.4% and 14.7% of net sales in the third quarter of fiscal 2013 and 2012, respectively. SG&A for the third quarter of fiscal 2013 was \$2.4

million or 7% of net sales, compared with \$2.0 million, or 6% of net sales, for the third quarter of fiscal 2012. Operating income was \$4.2 million for the third quarter of fiscal 2013, an increase of 33% compared with \$3.1 million for the third quarter of fiscal 2012. Operating margins were 12% and 9% of net sales in the third quarter of fiscal 2013 and 2012, respectively.

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For the nine months ended January 27, 2013, the mattress fabrics segment reported a gross profit of \$21.7 million, an increase of 34% compared with \$16.2 million for the nine months ended January 29, 2012. Gross profit margins were 19% and 16% of net sales for the nine months ended in January 27, 2013 and January 29, 2012, respectively. SG&A for the nine months ended January 27, 2013, was \$7.2 million, or 6.4% of net sales, compared with \$6.1 million, or 6.0% of net sales, for the nine months ended January 29, 2012. Operating income was \$14.5 million for the nine months ended January 27, 2013 an increase of 44% compared with \$10.1 million for the nine months ended January 29, 2012. Operating margins were 13% and 10% of net sales for the nine months ended January 27, 2013 and January 29, 2012, respectively.

Our increase in profitability represents higher sales volume and a more favorable product mix, operating efficiencies from our manufacturing platform, and the recent stabilization of raw material costs. In order to sustain our operating efficiencies from our manufacturing platform, we have worked diligently to take advantage of the newest technologies available and have continued to modernize our equipment. We have also continued to merchandise new products with alternative sources of yarns and raw materials without compromising quality and value for our customers. Our profitability also reflects increased SG&A due to higher incentive compensation accruals reflecting stronger financial results in relation to pre-established performance targets.

Although our gross profit and operating income have increased in comparison to prior periods, net sales moderated later in our third quarter in connection with the softening industry demand, as noted above. Our growth in profitability did not slow in the third quarter as much as net sales did, due to higher profit margins. However, we do expect the slowing trend in year-over-year demand to affect our profit margins in the fourth quarter of fiscal 2013. Although we are currently projecting sequential growth in profits compared to the third quarter of this year, the current trends in demand are expected to result in a negative affect on the recent year-over-year growth trends in gross profit and operating income for this segment.

Segment assets

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

As of January 27, 2013, accounts receivable and inventory totaled \$34.6 million compared with \$29.9 million at April 29, 2012. This increase primarily reflects increased business volume in fiscal 2013 compared to fiscal 2012.

As of January 27, 2013, property, plant and equipment totaled \$28.1 million compared with \$29.2 million at April 29, 2012. The \$28.1 million at January 27, 2013, represents property, plant, and equipment of \$20.6 million and \$7.5 million located in the U.S. and Canada, respectively. The \$29.2 million at April 29, 2012, represents property, plant, and equipment of \$21.2 million and \$8.0 million located in the U.S. and Canada, respectively. The change in this segment's property, plant, and equipment balance at January 27, 2013 compared with April 29, 2012, is due to depreciation expense of \$3.3 million offset by capital spending of \$2.2 million.

As of January 27, 2013 and April 29, 2012, the carrying value of the segment's goodwill was \$11.5 million. As of January 27, 2013, and April 29, 2012, the carrying values of the non-compete agreement were \$222,000 and \$333,000, respectively.

Upholstery Fabrics Segment

Net Sales

Upholstery fabric net sales (which include both fabric and cut and sewn kits) for the third quarter of fiscal 2013 were \$28.2 million, a 10% increase compared with \$25.7 million in the third quarter of fiscal 2012. Net sales of upholstery fabrics produced outside our U.S. manufacturing operations were \$25.4 million in the third quarter of fiscal 2013, a 12% increase compared with \$22.6 million in the third quarter of fiscal 2012. Net sales of upholstery fabrics produced by our U.S. manufacturing operations were \$2.8 million in the third quarter of fiscal 2013, an 8% decrease compared with \$3.1 million in the third quarter of fiscal 2012.

Upholstery fabric net sales for the nine months ended January 27, 2013 were \$85.3 million, an 11% increase compared with \$76.6 million for the nine months ended January 29, 2012. Net sales of upholstery fabrics produced outside our U.S. manufacturing operations were \$75.6 million for the nine months ended January 27, 2013 a 12% increase compared with \$67.3 million for the nine months ended January 29, 2012. Net sales of upholstery fabrics produced by our U.S. manufacturing operations were \$9.7 million for the nine months ended January 27, 2013 a 4% increase compared with \$9.3 million for the nine months ended January 29, 2012.

These results reflect improved demand, a positive customer response to our innovative designs, and new product introductions for key customers. Our design capabilities and capacity to offer innovative products at key price points has been an important advantage for us in expanding our sales in the global marketplace.

Our China produced fabrics continued to drive the growth of our non-U.S. produced sales, which accounted for 90% and 89% of our total upholstery fabric sales for the third quarter and the nine months ended January 27, 2013, respectively. Our China produced fabrics accounted for 88% of our total upholstery fabric sales in the third quarter and nine months ended January 29, 2012, respectively. Our China platform, now in its tenth year of operation, plays a major role in our global sales efforts, and we are pleased with the increasing level of fabric placements with customers in the U.S., China, and other countries.

Although our total net sales of upholstery fabrics have increased in comparison to prior periods, we currently expect net sales to be moderately lower in the fourth quarter of fiscal 2013 compared to fiscal 2012. This is partly due to the Chinese New Year holiday occurring in the fourth quarter of fiscal 2013 compared with occurring in the third quarter of fiscal 2012. In addition, we are not expecting industry demand to be as strong in the fourth quarter of fiscal 2013 compared with the fourth quarter of fiscal 2012.

Gross Profit and Operating Income

For the third quarter of fiscal 2013, the upholstery fabrics segment reported a gross profit of \$5.1 million, an increase of 51% compared with \$3.4 million for the third quarter of fiscal 2012. Gross profit margins were 18% and 13% of net sales in the third quarter of fiscal 2013 and 2012, respectively. SG&A for the third quarter of fiscal 2013 was \$3.4 million or 12% of net sales, compared with \$2.7 million or 10% of net sales for the third quarter of fiscal 2012. Operating income was \$1.8 million for the third quarter of fiscal 2013, compared with \$754,000 for the third quarter of fiscal 2012. Operating margins were 6% and 3% of net sales in the third quarter of fiscal 2013 and 2012, respectively.

For the nine months ended January 27, 2013, the upholstery fabrics segment reported a gross profit of \$15.0 million, an increase of 51% compared with \$9.9 million for the nine months ended January 29, 2012. Gross profit margins were 18% and 13% of net sales for the nine months ended January 27, 2013 and January 29, 2012, respectively. SG&A for the nine months ended January 27, 2013 was \$9.9 million or 11.6% of net sales, compared with

\$8.2 million, or 10.7% of net sales for the nine months ended January 29, 2012, respectively. Operating income was \$5.1 million for the nine months ended January 27, 2013, compared with \$1.7 million for the nine months ended January 29, 2012, respectively. Operating margins were 6% and 2% of net sales for the nine months ended January 27, 2013 and January 29, 2012, respectively.

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Our increase in profitability represents higher sales volume, improved operating efficiencies from both our China and domestic manufacturing operations, improved margins on new products and the recent stabilization of raw material costs. However, results reflect increased SG&A due to an increase in incentive compensation accruals reflecting stronger financial results in relation to pre-established performance targets.

We experienced modest sales and significant profit improvement during the first nine months of fiscal 2013 from our U.S. operations, with increased demand for both velvet and woven texture fabrics. These demand trends did not continue into the third quarter of fiscal 2013, as U.S. produced sales fell slightly. However, the U.S. upholstery operating income has continued to report significantly higher profits throughout the first three quarters of the year. As a result of our efforts to improve productivity, we have a much more efficient operation with higher capacity utilization than a year ago. In addition, raw material costs have stabilized compared to previous quarters. We have continued to work to manage our production costs and introduce new value-added products. All of these factors had a favorable impact on the performance of our U.S. upholstery fabric operation, resulting in significantly higher profit margins.

During fiscal 2013, we continued our efforts to develop our Culp Europe operation located in Poland. However, the ongoing uncertainties related to the European economy have affected this business. While this is creating challenges for the near term, we remain optimistic about the future opportunities for Culp Europe to enhance our global sales as business conditions improve.

As noted above, several factors lead us to expect moderately lower upholstery fabrics net sales in the fourth quarter of fiscal 2013 as compared to the fourth quarter of fiscal 2012. This trend in net sales, including lower industry demand in the quarter as compared to a year ago, is expected to negatively affect the recent year-over-year growth trends in gross profit and operating income for the upholstery fabrics segment.

Also, we currently expect our results in the fourth quarter of fiscal 2013 to include a decrease in SG&A as compared to each of the first three quarters of fiscal 2013. This decrease is primarily due to a larger portion of our incentive compensation has been incurred during the first nine months of fiscal 2013 than in fiscal 2012, in which most of the incentive compensation was incurred during the last six months of that year.

Segment Assets

Segment assets consist of accounts receivable, inventory, and property, plant, and equipment. As of January 27, 2013, accounts receivable and inventory totaled \$31.8 million compared to \$31.5 million at April 29, 2012. This increase primarily reflects increased business volume in fiscal 2013 compared to fiscal 2012.

As of January 27, 2013 and April 29, 2012, property, plant, and equipment totaled \$1.1 million. The \$1.1 million at January 27, 2013, represents property, plant, and equipment located in the U.S. of \$906,000, located in China of \$155,000, and located in Poland of \$86,000. The \$1.1 million at April 29, 2012, represents property, plant, and equipment located in the U.S. of \$837,000, located in China of \$183,000, and located in Poland of \$104,000.

Other Income Statement Categories

Selling, General and Administrative Expenses

Selling, general, and administrative (SG&A) expenses for the company as a whole were \$6.8 million for the third quarter of fiscal 2013 and increase of 24% compared with \$5.5 million for the third quarter of fiscal 2012. As a percent of net sales, SG&A expenses were 11.0% in the third quarter of fiscal 2013 compared with 9% in the third quarter of fiscal 2012. SG&A expenses for the company as a whole were \$21.7 million for the nine months ended

January 27, 2013, compared with \$17.0 million for the nine months ended January 29, 2012. As a percent of net sales, SG&A expenses were 10.9% for the nine months ended January 27, 2013, compared with 9.5% for the nine months ended January 29, 2012.

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These increases in SG&A primarily represent an increase in our incentive compensation accruals reflecting stronger financial results in relation to pre-established performance targets in fiscal 2013 compared to the same periods in fiscal 2012.

However, this trend is not expected to continue in the fourth quarter of fiscal 2013, as a larger portion of the incentive compensation has been incurred during the first nine months of fiscal 2013, than in fiscal 2012, in which most of the incentive compensation was incurred during the last six months of that year.

Interest Expense (Income)

Interest expense for the third quarter of fiscal 2013 was \$145,000 compared with \$181,000 for the third quarter of fiscal 2012. Interest expense for the nine months ended January 27, 2013 was \$491,000 compared with \$590,000 for the nine months ended January 29, 2012. This trend reflects lower outstanding balances of long-term debt.

Interest income was \$105,000 for the third quarter of fiscal 2013 compared to \$148,000 for the third quarter of fiscal 2012. Interest income was \$328,000 for the nine months ended January 27, 2013 compared with \$387,000 for the nine months ended January 29, 2012. This trend reflects lower cash and cash equivalents and short term investment balances in fiscal 2013 compared with fiscal 2012. Our cash and cash equivalents and short term investment balances are lower in fiscal 2013 compared with fiscal 2012 due to common stock repurchases and dividend payments totaling \$12.2 million in fiscal 2013, compared with common stock repurchases totaling \$5.4 million in fiscal 2012. We did not have dividend payments in fiscal 2012.

Other Expense

Other expense for the third quarter of fiscal 2013 was \$300,000 compared with \$83,000 for the third quarter of fiscal 2012. Other expense for the nine months ended January 27, 2013 was \$421,000 compared with \$132,000 for the nine months ended January 29, 2012. This change in other expense primarily reflects fluctuations in the foreign currency exchange rates of our subsidiaries domiciled in China.

Income Taxes

Effective Income Tax Rate

We recorded an income tax benefit of \$188,000, or 1.3% of income before income tax expense, for the nine month period ended January 27, 2013, compared to an income tax benefit of \$1.2 million, or 13.4% of income before income tax expense, for the nine month period ended January 29, 2012. Our effective income tax rates for the nine month periods ended January 27, 2013 and January 29, 2012 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 benefit for the nine month period ended January 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 was reduced by 84% for a reduction in our valuation allowance associated with our U.S. net deferred income tax assets. This 84% reduction in our income tax rate is due to a change in judgment about the realization of our U.S. net deferred income tax assets in future years. Since the realization of our U.S. net deferred income tax assets is a result of a change in judgment about future years we recorded an income tax benefit of

\$12.1 million that represents a discrete event in which the full tax effects were recorded for the nine month period ending January 27, 2013.

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The income tax rate was increased by 46% for the establishment of a deferred tax liability for U.S. income taxes that will be paid upon repatriation of undistributed earnings from our foreign subsidiaries located in Canada and China. This 46% increase in our income tax rate is due to a change in judgment in which our prior years' accumulated earnings and profits associated with our subsidiaries located in Canada and China are no longer considered indefinitely reinvested. Since the establishment of our deferred tax liability is a result of a change in judgment about prior years' accumulated earnings and profits we recorded an income tax charge of \$6.6 million that represents a discrete event in which the full tax effects were recorded for the nine month period ending January 27, 2013.

The income tax rate was reduced 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 was increased by 5% for an increase in unrecognized tax benefits.

The income tax rate was increased by 1% for the establishment of a valuation allowance against our net deferred tax assets associated with our Culp Europe operation located in Poland.

The income tax rate was increased by 2.7% for stock-based compensation and other miscellaneous items.

The income tax benefit for the nine month period ended January 29, 2012 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 was reduced by 50% for a reduction in our valuation allowance associated with our U.S. net deferred income tax assets. This 50% reduction in our income tax rate is due to a change in judgment about the realization of our U.S. net deferred income tax assets in future years. Since the realization of our U.S. net deferred income tax assets is a result of a change in judgment about future years we recorded an income tax benefit of \$4.4 million that represents a discrete event in which the full tax effects were recorded for nine month period ending January 29, 2012.

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

The income tax rate was increased by 7% for an increase in unrecognized tax benefits.

The income tax rate was increased by 2.6% for stock-based compensation and other miscellaneous items.

Deferred Income Taxes

Summary

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 January 27, 2013, we recorded a partial valuation allowance of \$926,000, of which \$719,000 pertained to certain U.S. state net operating loss carryforwards and credits and \$207,000 pertained to loss carryforwards associated with our Culp Europe operation located in Poland. Based on our assessment at April 29, 2012, we recorded a partial valuation allowance of \$12.8 million against our net deferred tax assets associated with

our U.S. operations.

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No valuation allowance was recorded against our net deferred tax assets associated with our operations located in China and Canada at January 27, 2013 and April 29, 2012, respectively.

United States

Our net deferred tax asset regarding our U.S. operations primarily pertained to incurring significant U.S. pre-tax losses over prior fiscal years, with U.S. loss carryforwards totaling \$59.9 million at April 29, 2012. Due to the favorable results of our multi-year restructuring process and profit improvements made in our upholstery fabric operations and key acquisitions and capital investments made for our mattress fabric segment, on a cumulative three-year basis ending April 29, 2012 (the end of our fiscal 2012), our U.S. operations earned a pre-tax income of \$11.9 million. This trend continued through the second quarter of fiscal 2013, as our U.S. operations earned a pretax income of \$3.4 million.

This continued earnings improvement from our U.S. operations was driven primarily by our mattress fabric operations (which primarily resides in the U.S.). Through the second quarter of fiscal 2013, our mattress fabric operations had net sales totaling \$77.7 million, an increase of 15% compared with \$67.4 million through the second quarter of fiscal 2012. In addition, our mattress fabric operations reported operating income of \$10.3 million through the second quarter of fiscal 2013, an increase of 49% compared with \$7.0 million through the second quarter of fiscal 2012. These improved results through the second quarter of fiscal 2013, which were better than expected, can be attributed to increased sales from our sales and marketing initiatives with customers who are leading suppliers in the bedding industry, the recent evolution of the bedding industry into a more decorative business with growing consumer demand for better bedding and a higher quality mattress fabric, and the recent stabilization of raw material prices.

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. Prior to the second quarter of fiscal 2013, it was management's intention to indefinitely reinvest all of our undistributed foreign earnings. Accordingly, no deferred tax liability had been recorded in connection with the future repatriation of these earnings.

During the second quarter of fiscal 2013, we assessed the financial requirements of our U.S. parent company and foreign subsidiaries and determined that our undistributed earnings from our foreign subsidiaries totaling \$55.6 million will not be reinvested indefinitely and will be eventually distributed to our U.S. parent company. The financial requirements of the U.S. parent company have recently changed to provide its shareholders a return on their investment through dividend payments and common stock repurchases. Also, in order to keep up with the recent growth in consumer demand for better bedding and a higher quality mattress fabric, it is our intention to continue our investment in our domestic mattress fabric operations.

As a result of our assessment during the second quarter of fiscal 2013, we recorded a deferred tax liability and corresponding income tax charge of \$6.6 million. This \$6.6 million income tax charge was treated as a discrete event in which the full tax effects of this adjustment were recorded in the nine month period ended January 27, 2013, as it pertained to a change in judgment on prior periods' earnings of a foreign subsidiary that will be indefinitely reinvested.

At January 27, 2013, we had accumulated earnings and profits from our foreign subsidiaries totaling \$56.3 million. At January 27, 2013, the deferred tax liability associated with our undistributed earnings from our foreign subsidiaries included U.S. income and foreign withholding taxes totaling \$21.9 million offset by U.S. foreign income tax credits of \$15.1 million.

Based on the positive evidence at the end of our second quarter of fiscal 2013, as supported by our cumulative earnings history, current and expected earnings improvement driven by our U.S. mattress fabric operations, and the significant source of U.S. taxable income from the undistributed earnings of our foreign subsidiaries, we recorded an income tax benefit of \$12.2 million to reverse primarily all of the valuation allowance against our U.S. net deferred tax assets. In the third quarter of fiscal 2013, we recorded an income tax charge of \$103,000, due to a change in our second quarter estimate of the recoverability of our U.S. state net loss operating carryforwards. This total \$12.1 million income tax benefit was treated as a discrete event in which the full tax effects of this adjustment were recorded in the nine month period ended January 27, 2013, as it pertained to a change in judgment about future years.

After our valuation allowance reversal of \$12.1 million, we have a remaining valuation allowance against our U.S. net deferred tax assets totaling \$719,000 as of January 27, 2013. This valuation allowance pertains to certain U.S. state net operating loss carryforwards and credits in which it is “more likely than not” that these U.S. state net operating loss carryforwards and credits will not be realized prior to their respective expiration dates.

Poland

During the third quarter of fiscal 2011, we established Culp Europe, a wholly-owned subsidiary located in Poland. Due to the initial start up costs of setting up this operation and the current state of the European economy, this operation had recorded cumulative pre-tax losses totaling \$1.1 million through the second quarter of fiscal 2013.

Based on the negative evidence at the end of our second quarter of fiscal 2013, as supported by our cumulative loss history and the short carryforward period of 5 years imposed by the Polish government, we recorded a full valuation allowance and corresponding income tax charge of \$207,000 against Culp Europe’s net deferred tax assets. Of this \$207,000 income tax charge, \$115,000 was treated as a discrete event in which the full tax effects of this adjustment were recorded in the nine month period ended January 27, 2013, as it pertained to a change in judgment about future years. The remaining income tax charge of \$92,000 was included in the computation of the annual effective rate for fiscal 2013 as the pre-tax net loss associated with this income tax charge originated during the current fiscal year.

Overall

At January 27, 2013, the current deferred tax asset of \$4.1 million represents \$3.8 million and \$329,000 from our operations located in the U.S. and China, respectively. At April 29, 2012, the current deferred tax asset of \$2.5 million represents \$2.1 million and \$405,000 from our operations located in the U.S. and China, respectively. At January 27, 2013, the non-current deferred tax asset of \$4.2 million represents \$3.4 million and \$793,000 from our operations located in the U.S. and China, respectively. At April 29, 2012, the non-current deferred tax asset of \$3.2 million represents \$2.1 million, \$1.0 million, and \$115,000 from our operations located in the U.S., China, and Poland, respectively. At January 27, 2013 and April 29, 2012, the non-current deferred tax liability of \$856,000 and \$705,000, respectively, pertains to our operation located in Canada.

Uncertainty In Income Taxes

At January 27, 2013, we had \$13.1 million of total gross unrecognized tax benefits, of which \$4.2 million represents the amount of gross unrecognized tax benefits that, if recognized, would favorably affect the income tax rate in future periods. Of the \$13.1 million in gross unrecognized tax benefits as of January 27, 2013, \$8.9 million were classified as net non-current deferred income taxes and \$4.2 million were classified as income taxes payable –long-term in the accompanying consolidated balance sheets.

We estimate that the amount of gross unrecognized tax benefits will increase by approximately \$821,000 for fiscal 2013. This increase primarily relates to double taxation under applicable tax treaties with foreign tax jurisdictions.

Although we reported an income tax benefit of \$188,000 and \$1.2 million for the nine months ended January 27, 2013 and January 29, 2012, respectively, we pay income taxes associated with our subsidiaries located in China and Canada. We had income tax payments totaling \$2.3 million and \$1.9 million for the nine months ended January 27, 2013 and January 29, 2012, respectively.

Liquidity and Capital Resources

Liquidity

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 \$24.7 million at January 27, 2013, cash flow from operations, and current availability under our unsecured revolving credit lines will be sufficient to fund our business needs and contractual obligations.

At January 27, 2013, our cash and cash equivalents and short-term investments totaled \$24.7 million, exceeded our total debt (current maturities of long-term debt, long-term debt, and line of credit) of \$7.3 million. On August 11, 2012, we paid our required annual principal payment of \$2.2 million associated with our unsecured senior term notes.

Our cash and cash equivalents and short-term investments of \$24.7 million at January 27, 2013, decreased from \$31.0 million at April 29, 2012, after spending \$7.2 million for dividend payments, \$5.0 million for common stock repurchases, \$2.8 million for capital expenditures, and \$2.4 million on long-term debt principal payments. This spending was significantly offset by net cash provided by operating activities of \$10.8 million as compared to \$2.7 million for the nine months ended January 29, 2012.

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.

Common Stock Repurchases

On June 13, 2012, we announced that our board of directors approved authorization for us to acquire up to \$5.0 million of our common stock. This action replaced prior authorizations to acquire up to \$7.0 million of our common stock in fiscal 2012, of which \$5.4 million had been used during fiscal 2012.

On August 29, 2012, we announced that our board of directors approved a new authorization for us to acquire up to \$2.0 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.

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During the nine months ended January 27, 2013, we purchased 502,595 shares of our common stock at a cost of \$5.0 million and, as a result, we reached the \$5.0 million limit authorized on June 13, 2012. As of January 27, 2013, there have been no repurchases of common stock on the \$2.0 million limit that was authorized on August 29, 2012.

Since our common stock repurchase program was implemented in fiscal 2012, we have repurchased 1.1 million shares of common stock at a cost of \$10.4 million.

Dividend Payments

On June 13, 2012, we announced that our board of directors approved the payment of a cash dividend of \$0.03 per share in the first quarter of fiscal 2013. These \$0.03 per share quarterly cash dividend payments continued into the second and third quarters of fiscal 2013. On November 27, 2012, we announced that our board of directors approved the payment of a special cash dividend of \$0.50 per share, which was paid on December 28, 2012.

During the nine month period ending January 27, 2013, dividend payments totaled \$7.2 million, of which \$6.1 million represented the special cash dividend payment of \$0.50 per share, and \$1.1 million represented the quarterly dividend payments of \$0.03 per share, respectively.

On February 27, 2013, we announced that our board of directors approved the payment of a quarterly cash dividend of \$0.03 per share, to be paid on or about April 15, 2013, to shareholders of record as of the close of business on April 1, 2013.

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

Working Capital

Accounts receivable at January 27, 2013, were \$24.3 million, an increase of \$2.2 million or 10% compared with \$22.0 million at January 29, 2012. This increase in accounts receivable is due to our net sales increase of 5% in the third quarter of fiscal 2013 compared with the third quarter of 2012, and the increase in our days' sales outstanding from 31 days during the third quarter of fiscal 2012 to 32 days in the third quarter of fiscal 2013. This increase in days' sales outstanding is primarily due to certain customers associated with our mattress fabric segment not taking advantage of sales discounts in the third quarter of fiscal 2013 compared with the third quarter of fiscal 2012.

Inventories as of January 27, 2013, were \$42.2 million, an increase of \$9.3 million, or 28%, compared with \$32.9 million at January 29, 2012. This increase primarily reflects increased business volume in both our business segments in fiscal 2013 compared with fiscal 2012. Inventory turns for the third quarter of fiscal 2013 were 5.3 compared with 6.2 for the third quarter of fiscal 2012.

Accounts payable-trade as of January 27, 2013, were \$26.2 million, an increase of \$2.7 million, or 12% compared with \$23.5 million at January 29, 2012. This increase primarily reflects increased business volume and inventory purchases in both our business segments in fiscal 2013 compared with fiscal 2012.

Operating working capital (comprised of accounts receivable and inventories, less accounts payable-trade and capital expenditures) was \$40.2 million at January 27, 2013 compared with \$31.4 million at January 29, 2012. Working capital turnover was 7.9 and 8.7 during the quarters ended January 27, 2013, and January 29, 2012, respectively.

Financing Arrangements

Unsecured Term Notes

In connection with the 2008 Bodet & Horst acquisition, we entered into a note agreement dated August 11, 2008. This agreement 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 principal payments are payable over an average term of 2.5 years through August 11, 2015. This agreement contains customary financial and other covenants as defined in the agreement.

We have paid the required principal payment total of \$4.4 million associated with this note agreement, of which \$2.2 million was paid on August 11, 2012 and August 11, 2011, respectively.

Government of Quebec Loan

We have an agreement with the Government of Quebec for a term loan that is non-interest bearing and is payable in 48 equal monthly installments (denominated in Canadian dollars) commencing December 1, 2009. The proceeds were used to partially finance capital expenditures at our Rayonese facility located in Quebec, Canada.

Revolving Credit Agreement – United States

We have an unsecured Amended and Restated Credit Agreement that provides for a revolving loan commitment of \$7.6 million and is set to expire on August 25, 2013. This agreement provides for a pricing matrix to determine the interest rate payable on loans made under the agreement (applicable interest rate of 1.8% at January 27, 2013). At January 27, 2013, there was a \$195,000 outstanding letter of credit (all of which related to workers compensation). As of April 29, 2012, there were no outstanding letters of credit. At January 27, 2013 and April 29, 2012, 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 \$6.4 million USD at January 27, 2013), expiring on September 2, 2013. This agreement has an interest rate determined by the Chinese government. There were no borrowings outstanding under the agreement as of January 27, 2013 and April 29, 2012.

Revolving Credit Agreement – Europe

On January 17, 2012, we entered into an unsecured credit agreement associated with our operations in Poland that provides for a line of credit of up to 6.8 million Polish Zloty (approximately \$2.2 million USD at January 27, 2013). This agreement bears interest at WIBOR (Warsaw Interbank Offered Rate) plus 2% (applicable interest rate of 6.0% at January 27, 2013). On January 8, 2013, this agreement was amended to extend the expiration date from January 15, 2013 to August 25, 2013.

At January 27, 2013, \$576,000 (1.8 million Polish Zloty) in borrowings were outstanding under this agreement. At April 29, 2012, \$889,000 (2.8 million Polish Zloty) in borrowings were outstanding under this agreement.

Overall

Our loan agreements require, among other things, that we maintain compliance with certain financial covenants. At January 27, 2013, the company was in compliance with these financial covenants.

At January 27, 2013, the principal payment requirements of long-term debt during the next three years are: Year 1 – \$2.4 million; Year 2 - \$2.2 million; and Year 3 - \$2.2 million.

Capital Expenditures and Depreciation

Capital expenditures on an accrual basis for the nine months ended January 27, 2013 and January 29, 2012, were \$2.6 million and \$3.6 million, respectively. Capital expenditures for the nine months ended January 27, 2013 and January 29, 2012, mostly related to the mattress fabrics segment. Depreciation expense for the nine months ended January 27, 2013 and January 29, 2012, was \$3.8 million and \$3.6 million, respectively. Depreciation expense for the nine months ended January 27, 2013 and January 29, 2012, primarily related to the mattress fabrics segment.

For fiscal 2013, we currently expect capital expenditures on an accrual basis to be approximately \$4.5 million compared with \$5.9 million in fiscal 2012 and \$6.3 million in fiscal 2011. Planned capital expenditures for fiscal 2013 primarily relate to the mattress fabrics segment. For fiscal 2013, depreciation expense is projected to be \$5.1 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.

We currently expect capital expenditures and depreciation expense in fiscal 2014 to be comparable to fiscal 2013.

Critical Accounting Policies and Recent Accounting Developments

As of January 27, 2013, 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 29, 2012.

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 29, 2012.

Contractual Obligations

Cash Surrender Value – Life Insurance

On December 27, 2012, we entered into an agreement (the "Agreement") with our Chairman of the Board and his irrevocable trust (the "Trust") dated December 11, 2012. As a result of this agreement, a previous split dollar life insurance agreement in which we purchased a policy on the life of our Chairman of the Board and his spouse, in which we retained ownership of the policy, paid premiums to support the policy, had the right to receive the cash surrender value of the policy upon the second to die of our Chairman of the Board and his spouse, with the Trust receiving the remainder of the policy's death benefit (\$8.0 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 of the policy totaling \$626,000. Also, the Agreement required us to pay our Chairman of the Board during the period of his continued employment, but in an event no longer than twelve years, additional compensation totaling \$60,000 annually.

Purchase Commitments

At January 27, 2013 and April 29, 2012, we had open purchase commitments to acquire equipment for our mattress fabrics segment totaling \$1.1 million and \$1.2 million, respectively.

Inflation

Any significant increase in our raw material costs, utility/energy costs and general economic inflation could have a material adverse impact on the company, because competitive conditions have limited our ability to pass significant operating cost increases on to customers. As discussed in our Form 10-K for the year ended April 29, 2012 (see “Segment Analysis”), significant increases in raw material costs led to lower profit margins for both of our business segments during fiscal 2012 and 2011.

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 January 27, 2013, our U.S. revolving credit agreement provides for a pricing matrix to determine the interest rate payable on loans made under this agreement. Our revolving credit line associated with our China subsidiaries bears interest at a rate determined by the Chinese government. At January 27, 2013, there were no borrowings outstanding under our U.S. or China revolving credit lines. On January 27, 2013, our revolving credit line associated with our operation in Europe bears interest at a rate of WIBOR plus 2% and had borrowings outstanding of \$576,000.

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%, and the loan associated with the Government of Quebec is non-interest bearing.

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 January 27, 2013, 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 January 27, 2013, 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 were 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 have been designed 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 January 27, 2013, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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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 nine months ended January 27, 2013. Our legal proceedings are disclosed in the company's annual report on Form 10-K filed with the Securities and Exchange Commission on July 12, 2012 for the fiscal year ended April 29, 2012.

Item 1A. Risk Factors

There have not been any material changes to our risk factors during the nine months ended January 27, 2013. Our risk factors are disclosed in the company's annual report on Form 10-K filed with the Securities and Exchange Commission on July 12, 2012 for the fiscal year ended April 29, 2012.

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

ISSUER PURCHASES OF EQUITY SECURITIES

| Period | (a) Total Number of Shares Purchased | (b) Average Price Paid per Share | (c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | (d) Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (1) |
|--|--|---|---|--|
| October 29, 2012 to December 2, 2012 | - | - | - | \$ 2,000,000 |
| December 3, 2012 to December 30, 2012 | - | - | - | \$ 2,000,000 |
| December 31, 2012 to January 27, 2013 | - | - | - | \$ 2,000,000 |
| Total | - | - | - | \$ 2,000,000 |

(1) On June 13, 2012, we announced that our board of directors approved a new authorization for us to acquire up to \$5.0 million of our common stock, and this authorization was reached through common stock repurchases through September 2, 2012. On August 29, 2012, we announced that our board of directors approved a new authorization for us to acquire up to \$2.0 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.
- 10.1 Agreement dated December 27, 2012 between Culp Inc., Robert G. Culp III, and Robert G. Culp III Irrevocable Trust dated December 11, 2012, filed as Exhibit 10.1 to the company's Form 8-K filed December 28, 2012, and is 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

** In accordance with Rule 406T of Regulation S-T, this interactive data file is deemed not filed or part of the registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CULP, INC.
(Registrant)

Date: March 8, 2013

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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