

CULP INC
Form 10-Q
March 10, 2017

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 29, 2017
Commission File No. 1-12597

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

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

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

(336) 889-5161
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to the filing requirements for at least the past 90 days.

YES NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period after the registrant was required to submit and post such files).

YES NO

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

Large accelerated filer Accelerated filer Non-accelerated filer

Smaller Reporting Company

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

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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 29, 2017: 12,314,756

Par Value: \$0.05 per share

INDEX TO FORM 10-Q
For the period ended January 29, 2017

| | Page |
|--|------|
| <u>Part I - Financial Statements</u> | |
| <u>Item 1. Financial Statements: (Unaudited)</u> | |
| <u>Consolidated Statements of Net Income — Three and Nine Months Ended January 29, 2017 and January 31, 2016</u> | I-1 |
| <u>Consolidated Statements of Comprehensive Income – Three and Nine Months Ended January 29, 2017 and January 31, 2016</u> | I-2 |
| <u>Consolidated Balance Sheets — January 29, 2017, January 31, 2016, and May 1, 2016</u> | I-3 |
| <u>Consolidated Statements of Cash Flows — Nine Months Ended January 29, 2017 and January 31, 2016</u> | I-4 |
| <u>Consolidated Statements of Shareholders' Equity</u> | I-5 |
| <u>Notes to Consolidated Financial Statements</u> | I-6 |
| <u>Cautionary Statement Concerning Forward-Looking Information</u> | I-28 |
| <u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | I-29 |
| <u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u> | I-47 |
| <u>Item 4. Controls and Procedures</u> | I-47 |
| <u>Part II - Other Information</u> | |
| <u>Item 1. Legal Proceedings</u> | II-1 |
| <u>Item 1A. Risk Factors</u> | II-1 |
| <u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u> | II-1 |
| <u>Item 6. Exhibits</u> | II-2 |
| <u>Signatures</u> | II-3 |

Item 1: Financial Statements

CULP, INC.

CONSOLIDATED STATEMENTS OF NET INCOME

FOR THE THREE AND NINE MONTHS ENDED

JANUARY 29, 2017 AND JANUARY 31, 2016

UNAUDITED

(Amounts in Thousands, Except for Per Share Data)

| | THREE MONTHS ENDED | |
|---|------------------------|------------------------|
| | January 29, 2017 | January 31, 2016 |
| Net sales | \$76,169 | 78,466 |
| Cost of sales | 59,410 | 61,903 |
| Gross profit | 16,759 | 16,563 |
| Selling, general and administrative expenses | 9,824 | 9,337 |
| Income from operations | 6,935 | 7,226 |
| Interest income | (124) | (38) |
| Other expense | 69 | 85 |
| Income before income taxes | 6,990 | 7,179 |
| Income taxes | 643 | 2,317 |
| Net income | \$6,347 | 4,862 |
| Net income per share, basic | \$0.52 | 0.39 |
| Net income per share, diluted | 0.51 | 0.39 |
| Average shares outstanding, basic | 12,313 | 12,331 |
| Average shares outstanding, diluted | 12,544 | 12,486 |

| | NINE MONTHS ENDED | |
|---|------------------------|------------------------|
| | January 29, 2017 | January 31, 2016 |
| Net sales | \$232,194 | 235,607 |
| Cost of sales | 180,115 | 187,109 |
| Gross profit | 52,079 | 48,498 |
| Selling, general and administrative expenses | 29,171 | 27,512 |
| Income from operations | 22,908 | 20,986 |

| | | |
|-------------------------------------|----------|--------|
| Interest income | (164) | (150) |
| Other expense | 376 | 405 |
| Income before income taxes | 22,696 | 20,731 |
| Income taxes | 6,560 | 7,398 |
| Net income | \$16,136 | 13,333 |
| Net income per share, basic | \$1.31 | 1.08 |
| Net income per share, diluted | 1.29 | 1.07 |
| Average shares outstanding, basic | 12,302 | 12,317 |
| Average shares outstanding, diluted | 12,517 | 12,488 |

See accompanying notes to consolidated financial statements.

I-1

CULP, INC.
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
 FOR THE THREE AND NINE MONTHS ENDED JANUARY 29, 2017 AND
 JANUARY 31, 2016
 (UNAUDITED)
 (AMOUNTS IN THOUSANDS)

| | THREE MONTHS ENDED | |
|--|--------------------------|------------------------|
| | January 29, 2017 | January 31, 2016 |
| Net income | \$6,347 | \$4,862 |
| Other comprehensive loss | | |
| Unrealized losses on investments | | |
| Unrealized holding losses on investments | (13) | (194) |
| Reclassification adjustment for realized loss included in net income | - | 71 |
| Total other comprehensive loss | (13) | (123) |
| Comprehensive income | \$6,334 | \$4,739 |
| | | |
| | NINE MONTHS ENDED | |
| | January 29, 2017 | January 31, 2016 |
| Net income | \$16,136 | \$13,333 |
| Other comprehensive gain (loss) | | |
| Unrealized gains (losses) on investments | | |
| Unrealized holding gains (losses) on investments | 75 | (312) |
| Reclassification adjustment for realized loss included in net income | 12 | 127 |

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| | | |
|---------------------------------------|----|--------|
| Total other comprehensive gain (loss) | 87 | (185) |
|---------------------------------------|----|--------|

| | | |
|----------------------|----------|----------|
| Comprehensive income | \$16,223 | \$13,148 |
|----------------------|----------|----------|

See accompanying notes to consolidated financial statements.

I-2

CULP, INC.
CONSOLIDATED BALANCE SHEETS
JANUARY 29, 2017, JANUARY 31, 2016 AND MAY 1, 2016
UNAUDITED
(Amounts in Thousands)

| | January 29, 2017 | January 31, 2016 | * May 1, 2016 |
|--|------------------------|------------------------|------------------|
| Current assets: | | | |
| Cash and cash equivalents | \$15,659 | 31,713 | 37,787 |
| Short-term investments | 2,410 | 4,259 | 4,359 |
| Accounts receivable, net | 22,726 | 26,784 | 23,481 |
| Inventories | 46,193 | 48,485 | 46,531 |
| Income taxes receivable | - | 23 | 155 |
| Other current assets | 2,514 | 2,331 | 2,477 |
| Total current assets | 89,502 | 113,595 | 114,790 |
| Property, plant and equipment, net | 50,333 | 38,157 | 39,973 |
| Goodwill | 11,462 | 11,462 | 11,462 |
| Deferred income taxes | 422 | 4,312 | 2,319 |
| Long-term investments - Held-To-Maturity | 30,832 | - | - |
| Long-term investments - Rabbi Trust | 5,488 | 3,590 | 4,025 |
| Investment in unconsolidated joint venture | 600 | - | - |
| Other assets | 2,417 | 2,435 | 2,573 |
| Total assets | \$191,056 | 173,551 | 175,142 |
| Current liabilities: | | | |
| Accounts payable-trade | \$22,352 | 25,601 | 23,994 |
| Accounts payable - capital expenditures | 4,886 | 380 | 224 |
| Accrued expenses | 10,511 | 12,690 | 11,922 |
| Income taxes payable - current | 217 | 622 | 180 |
| Total current liabilities | 37,966 | 39,293 | 36,320 |
| Accounts payable - capital expenditures | 708 | - | - |
| Income taxes payable - long-term | 1,817 | 3,480 | 3,841 |
| Deferred income taxes | 2,924 | 1,209 | 1,483 |
| Deferred compensation | 5,327 | 4,495 | 4,686 |
| Total liabilities | 48,742 | 48,477 | 46,330 |

Commitments and Contingencies (Notes 15 and 16)

| | | | |
|--|---|---|---|
| Shareholders' equity | | | |
| Preferred stock, \$0.05 par value, authorized 10,000,000 | - | - | - |
| Common stock, \$0.05 par value, authorized 40,000,000 shares, issued and outstanding 12,314,756 at January 29, 2017; 12,250,489 at January 31, 2016; and 12,265,489 at | | | |

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| | | | |
|--|-----------|---------|---------|
| May 1, 2016 | 615 | 613 | 614 |
| Capital contributed in excess of par value | 46,365 | 42,937 | 43,795 |
| Accumulated earnings | 95,391 | 81,804 | 84,547 |
| Accumulated other comprehensive loss | (57) | (280) | (144) |
| Total shareholders' equity | 142,314 | 125,074 | 128,812 |
| | | | |
| Total liabilities and shareholders' equity | \$191,056 | 173,551 | 175,142 |

* Derived from audited financial statements.

See accompanying notes to consolidated financial statements.

I-3

CULP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED JANUARY 29, 2017 AND JANUARY 31,
2016
UNAUDITED
(Amounts in Thousands)

| | NINE MONTHS ENDED | |
|--|------------------------|------------------------|
| | January 29, 2017 | January 31, 2016 |
| Cash flows from operating activities: | | |
| Net income | \$ 16,136 | 13,333 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 5,304 | 4,888 |
| Amortization of assets | 162 | 123 |
| Stock-based compensation | 2,619 | 1,964 |
| Excess tax benefit related to stock-based compensation | (195) | (822) |
| Deferred income taxes | 3,533 | 1,906 |
| Realized loss on sale of short-term investments | 12 | 127 |
| Gain on sale of equipment | (71) | (66) |
| Foreign currency exchange gains | (18) | (85) |
| Changes in assets and liabilities: | | |
| Accounts receivable | 340 | 1,091 |
| Inventories | (137) | (6,485) |
| Other current assets | 90 | (108) |
| Other assets | 51 | 48 |
| Accounts payable - trade | (946) | (1,979) |
| Accrued expenses and deferred compensation | (948) | 1,406 |
| Income taxes | (1,695) | 535 |
| Net cash provided by operating activities | 24,237 | 15,876 |
| Cash flows from investing activities: | | |
| Capital expenditures | (9,253) | (7,686) |
| Investment in unconsolidated joint venture | (600) | - |
| Proceeds from the sale of equipment | 80 | 230 |
| Payment on life insurance policy | (18) | (18) |
| Proceeds from the sale of short-term investments | 2,000 | 5,612 |
| Purchase of short-term investments | (8) | (86) |
| Purchase of long-term investments (Held-To-Maturity) | (31,050) | - |
| Purchase of long-term investments (Rabbi Trust) | (1,431) | (1,268) |
| Net cash used in investing activities | (40,280) | (3,216) |
| Cash flows from financing activities: | | |
| Proceeds from line of credit | 7,000 | 7,000 |
| Payments on line of credit | (7,000) | (7,000) |

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| | | |
|--|----------|----------|
| Payments on vendor-financed capital expenditures | (1,050) | - |
| Payments on long-term debt | - | (2,200) |
| Excess tax benefit related to stock-based compensation | 195 | 822 |
| Repurchase of common stock | - | (2,397) |
| Dividends paid | (5,292) | (7,281) |
| Payments on debt issuance costs | (2) | (43) |
| Proceeds from common stock issued | 37 | 138 |
| Net cash used in financing activities | (6,112) | (10,961) |
| Effect of exchange rate changes on cash and cash equivalents | 27 | 289 |
| (Decrease) increase in cash and cash equivalents | (22,128) | 1,988 |
| Cash and cash equivalents at beginning of period | 37,787 | 29,725 |
| Cash and cash equivalents at end of period | \$15,659 | 31,713 |

See accompanying notes to consolidated financial statements.

I-4

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

| | Common Stock | | Capital Contributed in Excess of Par Value | Accumulated Earnings | Accumulated Other Comprehensive Loss | Total Shareholders' Equity |
|---|--------------|--------|--|-------------------------|---|----------------------------------|
| | Shares | Amount | | | | |
| Balance, May 3, 2015 | 12,219,121 | \$ 611 | 43,159 | 75,752 | (95) |) \$ 119,427 |
| Net income | - | - | - | 16,935 | - | 16,935 |
| Stock-based compensation | - | - | 2,742 | - | - | 2,742 |
| Unrealized loss on investments | - | - | - | - | (49) |) (49) |
| Excess tax benefit related to stock based compensation | - | - | 841 | - | - | 841 |
| Common stock repurchased | (100,776) | (5) | (2,392) | - | - | (2,397) |
| Common stock issued in connection | | | | | | |
| with performance based units | 115,855 | 6 | (6) | - | - | - |
| Fully vested common stock award | 3,000 | - | - | - | - | - |
| Common stock issued in connection | | | | | | |
| with exercise of stock options | 54,500 | 3 | 197 | - | - | 200 |
| Common stock surrendered for withholding taxes payable | (26,211) | (1) | (746) | - | - | (747) |
| Dividends paid | - | - | - | (8,140) | - | (8,140) |
| Balance, May 1, 2016 * | 12,265,489 | 614 | 43,795 | 84,547 | (144) |) 128,812 |
| Net income | - | - | - | 16,136 | - | 16,136 |
| Stock-based compensation | - | - | 2,619 | - | - | 2,619 |
| Unrealized gain on investments | - | - | - | - | 87 | 87 |
| Excess tax benefit related to stock based compensation | - | - | 195 | - | - | 195 |
| Common stock issued in connection | | | | | | |
| with performance based units | 49,192 | 2 | (2) | - | - | - |
| Fully vested common stock award | 4,800 | - | - | - | - | - |
| Common stock issued in connection | | | | | | |
| with exercise of stock options | 5,000 | - | 37 | - | - | 37 |
| Common stock surrendered for withholding taxes payable | (9,725) | (1) | (279) | - | - | (280) |
| Dividends paid | - | - | - | (5,292) | - | (5,292) |
| Balance, January 29, 2017 | 12,314,756 | \$ 615 | 46,365 | 95,391 | (57) |) \$ 142,314 |

* Derived from audited financial statements.

See accompanying notes to consolidated financial statements.

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

1. Basis of Presentation

The accompanying unaudited consolidated financial statements of Culp, Inc. and subsidiaries (the “company”) include all adjustments, which are, in the opinion of management, necessary for fair presentation of the results of operations and financial position. All of these adjustments are of a normal recurring nature. Results of operations for interim periods may not be indicative of future results. The unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements, which are included in the company’s annual report on Form 10-K filed with the Securities and Exchange Commission on July 15, 2016, for the fiscal year ended May 1, 2016.

The company’s nine months ended January 29, 2017, and January 31, 2016, represent 39 week periods, respectively.

2. Significant Accounting Policies

As of January 29, 2017, 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 May 1, 2016.

Recently Adopted Accounting Pronouncements

In November 2015, the FASB issued ASU No. 2015-17, Balance Sheet Classification of Deferred Taxes, an amendment to FASB ASC Topic 740, which simplifies the presentation of deferred income taxes on an entity’s classified balance sheet. Currently, entities that are required to issue a classified balance sheet present a net current and net noncurrent deferred income tax asset or liability for each tax jurisdiction. The amendments in this ASU require entities to offset all deferred income tax assets and liabilities for each tax jurisdiction and present a net deferred income tax asset or liability as a single noncurrent amount. The recognition and measurement guidance for deferred income tax assets and liabilities are not affected by this amendment. This amended guidance is effective for fiscal years and interim periods within those fiscal years, beginning after December 15, 2016. Early adoption is permitted and the standard may be applied either retrospectively or on a prospective basis to all deferred income tax assets and liabilities. We early adopted this amendment during the third quarter of fiscal 2016 on a retrospective basis.

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

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

Recently Issued Accounting Pronouncements

In May 2014, the FASB issued ASU No. 2014-09, which amends ASC Topic 606, Revenue from Contracts with Customers. The amendments in this ASU are intended to enhance the comparability of revenue recognition practices and will be applied to all contracts with customers. Improved disclosures related to the nature, amount, timing, and uncertainty of revenue that is recognized are requirements under the amended guidance. In April 2015, the FASB issued ASU 2015-24, Revenue from Contracts with Customers: Deferral of the Effective Date which proposed a deferral of the effective date by one year, and on July 7, 2015, the FASB decided to delay the effective date by one year. The deferral results in the new revenue standard being effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. We are therefore required to apply the new revenue guidance in our fiscal 2019 interim and annual financial statements. This ASU can be adopted either retrospectively or as a cumulative-effect adjustment as of the date of adoption. We are currently assessing the impact that this guidance will have on our consolidated financial statements.

In July 2015, the FASB issued ASU No. 2015-11, Simplifying the Measurement of Inventory, which changed the measurement principle for inventory from the lower of cost or market to lower of cost and net realizable value. This ASU is effective for fiscal years and interim periods within those fiscal years, beginning after December 15, 2016. We are therefore required to apply this guidance in our fiscal 2018 interim and annual financial statements. We are currently assessing the impact that this guidance will have on our consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), which increases transparency and comparability among companies accounting for lease transactions. The most significant change of this update will require the recognition of lease assets and liabilities on the balance sheet for operating lease arrangements with lease terms greater than twelve months for lessees. This update will require a modified retrospective application which includes a number of optional practical expedients related to the identification and classification of leases commenced before the effective date. This ASU is effective for fiscal years and interim periods within those fiscal years, beginning after December 15, 2018. We are therefore required to apply this guidance in our fiscal 2020 interim and annual financial statements. We are currently assessing the impact that this guidance will have on our consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-09, "Compensation - Stock Compensation (Topic 718): Improvements to Employee Shares-Based Payment Accounting." ASU 2016-09 is intended to improve the accounting for share-based payment transactions as part of the FASB's simplification initiative. ASU 2016-09 changes several aspects of the accounting for share-based payment award transactions, including: (1) accounting for income taxes; (2) classification of excess tax benefits on the statement of cash flows; (3) forfeitures; (4) minimum statutory tax withholding requirements; and (5) classification of employee taxes paid on the statement of cash flows when an employer withholds shares for tax-withholding purposes. ASU 2016-09 is effective for fiscal years beginning after December 15, 2016, and interim periods within those years for public companies. We are therefore required to apply this guidance in our fiscal 2018 interim and annual financial statements. We are currently assessing the impact that ASU 2016-09 will have on its consolidated financial statements.

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

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments, to address the diversity in how certain cash receipts and cash payments are presented in the statement of cash flows. This new guidance provides clarity around the cash flow classification for eight specific issues in an effort to reduce the current and potential future diversity in practice. This standard, which is to be applied retrospectively, will be effective for the first interim period within annual reporting periods beginning after December 15, 2017, and early adoption is permitted. We are therefore required to apply this new guidance in our fiscal 2019 interim and annual financial statements. We are currently assessing the impact that this guidance will have on our consolidated financial statements.

In October 2016, the FASB issued ASU No. 2016-16, Income Taxes (Topic 740): Intra-Entity Transfers of Assets Than Inventory, to reduce the diversity in practice and complexity associated with accounting for the income tax consequences of intra-entity transfers of assets other than inventory. Current GAAP prohibits recognition of deferred income taxes for an intra-entity transfer until the asset has been sold to an outside party. The new pronouncement stipulates that an entity should recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. This new guidance will be effective for annual reporting periods beginning after December 15, 2017, including interim periods within those annual reporting periods, with early adoption permitted in the first interim period only. We are therefore required to apply this new guidance in our fiscal 2019 interim and annual financial statements. The amendments are to applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. We are currently assessing the impact that this guidance will have on our consolidated financial statements.

There are no other new accounting pronouncements that are expected to have a significant impact on our consolidated financial statements.

3. Stock-Based Compensation

Equity Incentive Plan Description

On September 16, 2015, our shareholders approved an equity incentive plan entitled the Culp, Inc. 2015 Equity Incentive Plan (the "2015 Plan"). The 2015 Plan updated and replaced our 2007 Equity Incentive Plan (the "2007 Plan") as the vehicle for granting new equity based awards substantially similar to those authorized under the 2007 Plan. In general, the 2015 Plan authorizes the grant of stock options intended to qualify as incentive stock options, nonqualified stock options, stock appreciation rights, restricted stock, restricted stock units, performance units, and other equity and cash related awards as determined by our Compensation Committee. An aggregate of 1,200,000 shares of common stock were authorized for issuance under the 2015 Plan, with certain sub-limits that would apply with respect to specific types of awards that may be issued as defined in the 2015 Plan. In connection with the approval of the 2015 Plan, no further awards will be granted under the 2007 Plan, but outstanding awards under the 2007 Plan will be settled in accordance with their terms.

At January 29, 2017, there were 959,942 shares available for future equity based grants under our 2015 plan.

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

Incentive Stock Option Awards

We did not grant any incentive stock option awards through the through the third quarter of fiscal 2017.

At January 29, 2017, options to purchase 78,600 shares of common stock were outstanding and exercisable, had a weighted average exercise price of \$8.43 per share, and a weighted average contractual term of 0.6 years. At January 29, 2017, the aggregate intrinsic value for options outstanding and exercisable was \$2.0 million.

The aggregate intrinsic value for options exercised for the nine months ending January 29, 2017 and January 31, 2016, was \$128,000 and \$1.0 million, respectively.

At January 29, 2017, there were no unvested incentive stock option awards. Therefore, there was no unrecognized compensation cost related to incentive stock option awards at January 29, 2017.

No compensation expense was recorded for incentive stock options for the nine months ended January 29, 2017 and January 31, 2016, respectively.

Common Stock Awards

On October 3, 2016, we granted a total of 4,800 shares of common stock to our outside directors. These shares of common stock vest immediately and were measured at \$29.80 per share, which represents the closing price of our common stock at the date of grant.

On October 1, 2015, we granted a total of 3,000 shares of common stock to our outside directors. These shares of common stock vest immediately and were measured at \$31.77 per share, which represents the closing price of our common stock at the date of grant.

We recorded \$143,000 and \$95,000 within selling, general, and administrative expense for these common stock awards for the nine months ending January 29, 2017, and January 31, 2016, respectively.

Performance Based Restricted Stock Units Fiscal 2017 Grants

On July 14, 2016, certain key members of management were granted performance-based restricted stock units which could earn up to 107,880 shares of common stock if certain performance targets are met as defined in the related restricted stock unit agreements. These awards were valued based on the fair market value on the date of grant. The fair value of these awards was \$28 per share, which represents the closing price of our common stock on the date of grant. The vesting of these awards is over the requisite service period of three years.

On July 14, 2016, a non-employee was granted performance-based restricted stock units which could earn up to 11,549 shares of common stock if certain performance targets are met as defined in the related restricted stock unit agreement. The fair value of this award is measured at the earlier date of when the performance criteria are met or the end of the reporting period. At January 29, 2017, this grant was unvested and was measured at \$33.80 per share, which represents the closing price of our common stock at the end of the reporting period. The vesting of this award is over the requisite service period of three years.

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

Fiscal 2016 Grants

On July 15, 2015, certain key members of management were granted performance-based restricted stock units which could earn up to 107,554 shares of common stock if certain performance targets are met as defined in the related restricted stock unit agreements. These awards were valued based on the fair market value on the date of grant. The fair value of these awards was \$32.23 per share, which represents the closing price of our common stock on the date of grant. The vesting of these awards is over the requisite service period of three years.

On July 15, 2015, a non-employee was granted performance-based restricted stock units which could earn up to 10,364 shares of common stock if certain performance targets are met as defined in the related restricted stock unit agreement. The fair value of this award is measured at the earlier date of when the performance criteria are met or the end of the reporting period. At January 29, 2017, this grant was unvested and was measured at \$33.80 per share, which represents the closing price of our common stock at the end of the reporting period. The vesting of this award is over the requisite service period of three years.

Fiscal 2015 Grants

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

On March 3, 2015, a non-employee was granted performance-based restricted stock units which could earn up to 28,000 shares of common stock if certain performance targets are met as defined in the related restricted stock unit agreements. The fair value of this award is measured at the earlier date of when the performance criteria are met or the end of the reporting period. At January 29, 2017, 16,000 restricted stock units associated with this grant were unvested and were measured at \$33.80 per share, which represents the closing price of the company's common stock at the end of the reporting period. The vesting of these 16,000 restricted stock units vest over their requisite service period of 28 months. During the first quarter of fiscal 2017, 12,000 shares of common stock associated with the grant vested and had a weighted average fair value of \$345,000 or \$28.77 per share.

2014 Grant

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

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

During the first quarter of fiscal 2017, 37,192 shares of common stock associated with this grant vested and had a weighted average fair value of \$637,000 or \$17.12 per share. Our fiscal 2014 grant is fully vested.

Fiscal 2013 Grant

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

During the first quarter of fiscal 2016, 115,855 shares of common stock associated with our fiscal 2013 grant vested and had a weighted average fair value of \$1.2 million or \$10.21 per share. Our fiscal 2013 grant is fully vested.

Overall

We recorded compensation expense of \$2.5 million and \$1.9 million within selling, general, and administrative expense for our performance based restricted stock unit awards for the nine month periods ending January 29, 2017 and January 31, 2016, respectively. Compensation cost is recorded based on an assessment each reporting period of the probability if certain performance goals will be met during the vesting period. If performance goals are not probable of occurrence, no compensation cost will be recognized and any recognized compensation cost would be reversed.

As of January 29, 2017, the remaining unrecognized compensation cost related to our performance based restricted stock unit awards was \$4.8 million, which is expected to be recognized over a weighted average vesting period of 1.9 years.

Time Vested Restricted Stock Units

On July 14, 2016, an employee was granted 1,200 shares of time vested restricted stock units. This award was valued based on the fair market value on the date of grant. The fair value of this award was \$28 per share, which represents the closing price of our common stock on the date of grant. The vesting of this award is over the requisite service period of 11 months.

We recorded compensation expense of \$20,000 within selling, general, and administrative expense for our time vested restricted stock unit awards for the nine months ending January 29, 2017. There were not any time vested restricted stock unit awards granted or unvested during the nine months ending January 31, 2016 and, therefore, no compensation expense was recorded.

At January 29, 2017, the remaining unrecognized compensation cost related to unvested time vested restricted stock awards was \$14,000, which is expected to be recognized over the next 4.5 months.

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

4. Accounts Receivable

A summary of accounts receivable follows:

| | January 29, 2017 | January 31, 2016 | May 1, 2016 |
|--|------------------------|------------------------|----------------|
| (dollars in thousands) | | | |
| Customers | \$24,339 | \$28,684 | \$25,531 |
| Allowance for doubtful accounts | (397) | (814) | (1,088) |
| Reserve for returns and allowances and discounts | (1,216) | (1,086) | (962) |
| | \$22,726 | \$26,784 | \$23,481 |

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

| | Nine months ended | |
|-----------------------------------|------------------------|------------------------|
| | January 29, 2017 | January 31, 2016 |
| (dollars in thousands) | | |
| Beginning balance | \$(1,088) | \$(851) |
| Provision for bad debts | 239 | (93) |
| Net write-offs, net of recoveries | 452 | 130 |
| Ending balance | \$(397) | \$(814) |

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

| | Nine months ended | |
|--|------------------------|------------------------|
| | January 29, 2017 | January 31, 2016 |
| (dollars in thousands) | | |
| Beginning balance | \$(962) | \$(738) |
| Provision for returns, allowances and discounts | (2,357) | (2,389) |
| Credits issued | 2,103 | 2,041 |
| Ending balance | \$(1,216) | \$(1,086) |

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:

| | January 29, 2017 | January 31, 2016 | May 1, 2016 |
|------------------------|------------------------|------------------------|----------------|
| (dollars in thousands) | | | |

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| | | | |
|-----------------|----------|----------|----------|
| Raw materials | \$6,977 | \$6,831 | \$5,462 |
| Work-in-process | 3,161 | 3,365 | 2,972 |
| Finished goods | 36,055 | 38,289 | 38,097 |
| | \$46,193 | \$48,485 | \$46,531 |

I-12

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

6. Other Assets

A summary of other assets follows:

| | January 29, 2017 | January 31, 2016 | May 1, 2016 |
|---------------------------------------|------------------------|------------------------|----------------|
| (dollars in thousands) | | | |
| Cash surrender value – life insurance | \$ 376 | \$ 357 | \$ 357 |
| Non-compete agreement, net | 847 | 922 | 903 |
| Customer relationships, net | 677 | 728 | 715 |
| Other | 517 | 428 | 598 |
| | \$2,417 | \$2,435 | \$2,573 |

Non-Compete Agreement

We recorded our non-compete agreement at its fair value based on a discounted cash flow valuation model. Our non-compete agreement is amortized on a straight-line basis over the fifteen year life of the respective agreement.

The gross carrying amount of our non-compete agreement was \$2.0 million at January 29, 2017, January 31, 2016 and May 1, 2016, respectively. At January 29, 2017, January 31, 2016, and May 1, 2016, accumulated amortization for our non-compete agreement was \$1.2 million, \$1.1 million, and \$1.1 million, respectively.

Amortization expense for our non-compete agreement was \$56,000 for the nine month periods ended January 29, 2017 and January 31, 2016. The remaining amortization expense for the next five fiscal years and thereafter follows: FY 2017 - \$18,000; FY 2018 - \$75,000; FY 2019- \$75,000; FY 2020 - \$75,000; FY 2021 - \$75,000 and Thereafter - \$529,000.

The weighted average amortization period for our non-compete agreement is 11.3 years as of January 29, 2017.

Customer Relationships

We recorded our customer relationships at their fair value based on a multi-period excess earnings valuation model. Our customer relationships are amortized on a straight-line basis over its seventeen year useful life.

The gross carrying amount of our customer relationships was \$868,000 at January 29, 2017, January 31, 2016, and May 1, 2016, respectively. Accumulated amortization for our customer relationships was \$191,000, \$140,000, and \$153,000 at January 29, 2017, January 31, 2016, and May 1, 2016, respectively.

Amortization expense for our customer relationships was \$38,000 for the nine months ending January 29, 2017 and January 31, 2016. The remaining amortization expense for the next five fiscal years and thereafter follows: FY 2017 - \$13,000; FY 2018 - \$51,000; FY 2019 - \$51,000; FY 2020 - \$51,000; FY 2021 - \$51,000; and Thereafter - \$460,000.

The weighted average amortization period for our customer relationships is 13.3 years as of January 29, 2017.

Cash Surrender Value – Life Insurance

At January 29, 2017, January 31, 2016, and May 1, 2016 we had one life insurance contract with a death benefit of \$1.4 million.

I-13

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

Our cash surrender value – life insurance balances totaling \$376,000, \$357,000 and \$357,000 at January 29, 2017, January 31, 2016, and May 1, 2016, respectively, are collectible upon death of the respective insured.

7. Accrued Expenses

A summary of accrued expenses follows:

| | January 29, 2017 | January 31, 2016 | May 1, 2016 |
|--|------------------------|------------------------|----------------|
| (dollars in thousands) | | | |
| Compensation, commissions and related benefits | \$9,205 | \$8,678 | \$10,011 |
| Advertising rebates | 118 | 2,876 | 870 |
| Interest | 11 | - | - |
| Other accrued expenses | 1,177 | 1,136 | 1,041 |
| | \$10,511 | \$12,690 | \$11,922 |

8. Lines of Credit

Revolving Credit Agreement – United States

Our Credit Agreement with Wells Fargo Bank, N.A. (“Wells Fargo”) provides a revolving loan commitment of \$30 million. Interest was charged at a rate (applicable interest rate of 2.23% at January 29, 2017) as a variable spread over LIBOR based on our ratio of debt to EBITDA. The Credit Agreement contains certain financial and other covenants as defined in the agreement and is set to expire on August 15, 2018.

The purposes of our revolving credit line is to support potential short term cash needs in different jurisdictions within our global operations, mitigate our risk associated with foreign currency exchange rate fluctuations, and ultimately repatriate earnings and profits from our foreign subsidiaries to the U.S. for various strategic purposes.

Outstanding borrowings are secured by a pledge of 65% of the common stock of Culp International Holdings Ltd. (our subsidiary located in the Cayman Islands), as required by the Credit Agreement. There were no borrowings outstanding under the Credit Agreement at January 29, 2017, January 31, 2016, and May 1, 2016, respectively.

At January 29, 2017, January 31, 2016, and May 1, 2016, there were \$250,000 in outstanding letters of credit (all of which related to workers compensation) provided by the Credit Agreement.

Effective August 1, 2016, we entered into a Third Amendment to our Credit Agreement that will allow us to issue letters of credit not to exceed \$7.5 million. On August 3, 2016, we issued a \$5.0 million letter of credit (all of which is currently outstanding and in addition to the \$250,000 letter of credit noted above) for the construction of a new building associated with our mattress fabrics segment (see Note 15 for further details). This \$5.0 million letter of credit will be automatically reduced in increments of \$1.25 million on August 1, 2017, November 1, 2017, February 1, 2018, and May 15, 2018, respectively.

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 Chinese Yuan Renminbi (approximately \$5.8 million USD at January 29, 2017), that expires February 15, 2018. This agreement has an interest rate determined by the Chinese government and there were no borrowings outstanding as of January 29, 2017, January 31, 2016, and May 1, 2016.

I-14

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

Overall

Our loan agreements require, among other things, that we maintain compliance with certain financial covenants. At January 29, 2017, the company was in compliance with these financial covenants.

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.

Recurring Basis

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

| (amounts in thousands) | Fair value measurements at January 29, 2017 using: | | | Total |
|-----------------------------|--|---|--|----------|
| | Quoted prices in active markets for identical assets Level 1 | Significant other observable inputs Level 2 | Significant unobservable inputs Level 3 | |
| Assets: | | | | |
| U.S. Corporate Bonds | \$ - | \$ 30,682 | N/A | \$30,682 |
| Premier Money Market Fund | 4,888 | N/A | N/A | 4,888 |
| Low Duration Bond Fund | 1,073 | N/A | N/A | 1,073 |
| Intermediate Term Bond Fund | 739 | N/A | N/A | 739 |
| Strategic Income Fund | 598 | N/A | N/A | 598 |
| Large Blend Fund | 343 | N/A | N/A | 343 |
| Growth Allocation Fund | 113 | N/A | N/A | 113 |
| Moderate Allocation Fund | 83 | N/A | N/A | 83 |

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| | | | | |
|-------|----|-----|-----|----|
| Other | 61 | N/A | N/A | 61 |
|-------|----|-----|-----|----|

I-15

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

| (amounts in thousands) | Fair value measurements at January 31, 2016 using: | | | |
|-----------------------------|--|---|---|---------|
| | Quoted prices in active markets for identical assets Level 1 | Significant other observable inputs Level 2 | Significant unobservable inputs Level 3 | Total |
| Assets: | | | | |
| Premier Money Market Fund | \$3,071 | N/A | N/A | \$3,071 |
| Low Duration Bond Fund | 1,592 | N/A | N/A | 1,592 |
| Intermediate Term Bond Fund | 1,116 | N/A | N/A | 1,116 |
| Strategic Income Fund | 957 | N/A | N/A | 957 |
| Limited Term Bond Fund | 594 | N/A | N/A | 594 |
| Large Blend Fund | 254 | N/A | N/A | 254 |
| Growth Allocation Fund | 128 | N/A | N/A | 128 |
| Mid Cap Value Fund | 90 | N/A | N/A | 90 |
| Other | 47 | N/A | N/A | 47 |

| (amounts in thousands) | Fair value measurements at May 1, 2016 using: | | | |
|-----------------------------|--|---|---|---------|
| | Quoted prices in active markets for identical assets Level 1 | Significant other observable inputs Level 2 | Significant unobservable inputs Level 3 | Total |
| Assets: | | | | |
| Premier Money Market Fund | \$3,404 | N/A | N/A | \$3,404 |
| Low Duration Bond Fund | 1,604 | N/A | N/A | 1,604 |
| Intermediate Term Bond Fund | 1,154 | N/A | N/A | 1,154 |
| Strategic Income Fund | 999 | N/A | N/A | 999 |
| Limited Term Bond Fund | 602 | N/A | N/A | 602 |
| Large Blend Fund | 289 | N/A | N/A | 289 |
| Growth Allocation Fund | 148 | N/A | N/A | 148 |
| Mid Cap Value Fund | 102 | N/A | N/A | 102 |

| | | | | |
|-------|----|-----|-----|----|
| Other | 82 | N/A | N/A | 82 |
|-------|----|-----|-----|----|

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

At January 29, 2017, January 31, 2016, and May 1, 2016, our short-term investments totaled \$2.4 million, \$4.3 million, and \$4.4 million, respectively, and consisted of short-term bond funds. Our short-term bond funds are recorded at their fair value, are classified as available-for-sale, and their unrealized gains or losses are included in other comprehensive income (loss). Our short-term bond investments had an accumulated unrealized loss totaling \$68,000, \$181,000, and \$100,000 at January 29, 2017, January 31, 2016, and May 1, 2016, respectively. At January 29, 2017, January 31, 2016, and May 1, 2016, the fair value of our short-term bond funds approximated its cost basis.

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

Long- Term Investments - Held-To-Maturity

During the second quarter of fiscal 2017, management decided to invest approximately \$31.0 million in investment grade U.S. Corporate bonds with maturities primarily ranging from 2 to 2.5 years. The purpose of this investment was to earn a higher rate of return on our excess cash located in the Cayman Islands. These investments are classified as held-to-maturity as we have the positive intent and ability to hold these investments until maturity. Our held-to-maturity investments will be recorded as either current or noncurrent on our Consolidated Balance Sheets, based on contractual maturity date and stated at amortized cost.

At January 29, 2017, our held-to-maturity investments totaled \$30.8 million and consisted of U.S. Corporate bonds. The fair value of our held-to-maturity investments totaled \$30.7 million.

Long-Term Investments - Rabbi Trust

Effective January 1, 2014, we established a Rabbi Trust to set aside funds for participants of our deferred compensation plan (the "Plan") and enable the participants to credit their contributions to various investment options of the Plan. The investments associated with the Rabbi Trust consist of a money market fund and various mutual funds that are classified as available for sale.

Our long-term investments are recorded at their fair value of \$5.5 million, \$3.6 million, and \$4.0 million at January 29, 2017, January 30, 2016, and May 1, 2016, respectively. Our long-term investments had an accumulated unrealized gain of \$11,000 at January 29, 2017 and an accumulated unrealized loss of \$99,000 and \$44,000 at January 31, 2016 and May 1, 2016, respectively. The fair value of our long-term investments associated with our Rabbi Trust approximates its cost basis.

Other

The carrying amount of cash and cash equivalents, 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

Interest and income taxes paid are as follows:

| | Nine months ended | |
|------------------------|------------------------|------------------------|
| | January 29, 2017 | January 31, 2016 |
| (dollars in thousands) | | |
| Interest | \$ 110 | \$ 95 |
| Income taxes | 4,704 | 4,921 |

Interest costs charged to operations were \$97,000 and \$58,000 for the nine months ended January 29, 2017 and January 31, 2016, respectively.

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

Interest costs of \$97,000 and \$58,000 for the construction of qualifying fixed assets were capitalized and will be amortized over the related assets' useful lives for the nine months ended January 29, 2017 and January 31, 2016, respectively.

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:

| (amounts in thousands) | Three months ended | |
|---|--------------------|------------------|
| | January 29, 2017 | January 31, 2016 |
| Weighted average common shares outstanding, basic | 12,313 | 12,331 |
| Dilutive effect of stock-based compensation | 231 | 155 |
| Weighted average common shares outstanding, diluted | 12,544 | 12,486 |

All options to purchase shares of common stock were included in the computation of diluted net income for the three months ended January 29, 2017 and January 31, 2016, as the exercise price of the options was less than the average market price of the common shares.

| (amounts in thousands) | Nine months ended | |
|---|-------------------|------------------|
| | January 29, 2017 | January 31, 2016 |
| Weighted average common shares outstanding, basic | 12,302 | 12,317 |
| Dilutive effect of stock-based compensation | 215 | 171 |
| Weighted average common shares outstanding, diluted | 12,517 | 12,488 |

All options to purchase shares of common stock were included in the computation of diluted net income for the nine months ended January 29, 2017 and January 31, 2016, as the exercise price of the options was less than the average market price of the common shares.

12. Segment Information

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

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

We evaluate the operating performance of our segments based upon income from operations before certain unallocated corporate expenses and other non-recurring items. Cost of sales in both segments include costs to manufacture or source our products, including costs such as raw material and finished goods purchases, direct and indirect labor, overhead and incoming freight charges. Unallocated corporate expenses primarily represent compensation and benefits for certain executive officers, all costs related to being a public company, and other miscellaneous expenses. 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, investment in an unconsolidated joint venture, goodwill, a non-compete agreement, and customer relationships associated with an acquisition.

Financial information for the company's operating segments follows:

| | Three months ended | |
|--|------------------------|------------------------|
| | January 29, 2017 | January 31, 2016 |
| (dollars in thousands) | | |
| Net sales: | | |
| Mattress Fabrics | \$45,920 | \$44,277 |
| Upholstery Fabrics | 30,249 | 34,189 |
| | \$76,169 | \$78,466 |
| Gross profit: | | |
| Mattress Fabrics | \$9,758 | \$8,751 |
| Upholstery Fabrics | 7,001 | 7,812 |
| | \$16,759 | \$16,563 |
| Selling, general, and administrative expenses: | | |
| Mattress Fabrics | \$3,391 | \$2,953 |
| Upholstery Fabrics | 3,901 | 3,963 |
| Total segment selling, general, and administrative expenses | 7,292 | 6,916 |
| Unallocated corporate expenses | 2,532 | 2,421 |
| | \$9,824 | \$9,337 |
| Income from operations: | | |
| Mattress Fabrics | \$6,367 | \$5,798 |
| Upholstery Fabrics | 3,100 | 3,849 |
| Total segment income from operations | 9,467 | 9,647 |
| Unallocated corporate expenses | (2,532) | (2,421) |
| Total income from operations | 6,935 | 7,226 |
| Interest income | 124 | 38 |
| Other expense | (69) | (85) |
| Income before income taxes | \$6,990 | \$7,179 |

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

| (dollars in thousands) | Nine months ended | |
|--|---------------------|---------------------|
| | January 29, 2017 | January 31, 2016 |
| Net sales: | | |
| Mattress Fabrics | \$141,977 | \$137,522 |
| Upholstery Fabrics | 90,217 | 98,085 |
| | \$232,914 | \$235,607 |
| Gross profit: | | |
| Mattress Fabrics | \$32,414 | \$28,133 |
| Upholstery Fabrics | 19,665 | 20,365 |
| | \$52,079 | \$48,498 |
| Selling, general, and administrative expenses: | | |
| Mattress Fabrics | \$10,185 | \$8,865 |
| Upholstery Fabrics | 11,086 | 11,372 |
| Total segment selling, general, and administrative expenses | 21,271 | 20,237 |
| Unallocated corporate expenses | 7,900 | 7,275 |
| | \$29,171 | \$27,512 |
| Income from operations: | | |
| Mattress Fabrics | \$22,229 | \$19,267 |
| Upholstery Fabrics | 8,579 | 8,994 |
| Total segment income from operations | 30,808 | 28,261 |
| Unallocated corporate expenses | (7,900) | (7,275) |
| Total income from operations | 22,908 | 20,986 |
| Interest income | 164 | 150 |
| Other expense | (376) | (405) |
| Income before income taxes | \$22,696 | \$20,731 |

I-20

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

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

| (dollars in thousands) | January 29, 2017 | January 31, 2016 | May 1, 2016 |
|--|---------------------|---------------------|----------------|
| Segment assets: | | | |
| Mattress Fabrics | | | |
| Current assets (1) | \$41,498 | \$44,309 | \$43,472 |
| Non-compete agreement | 847 | 922 | 903 |
| Customer relationships | 677 | 728 | 715 |
| Investment in unconsolidated joint venture | 600 | - | - |
| Goodwill | 11,462 | 11,462 | 11,462 |
| Property, plant and equipment (2) | 47,755 | 35,637 | 37,480 |
| Total mattress fabrics assets | 102,839 | 93,058 | 94,032 |
| Upholstery Fabrics | | | |
| Current assets (1) | 27,421 | 30,960 | 26,540 |
| Property, plant and equipment (3) | 1,826 | 1,590 | 1,564 |
| Total upholstery fabrics assets | 29,247 | 32,550 | 28,104 |
| Total segment assets | 132,086 | 125,608 | 122,136 |
| Non-segment assets: | | | |
| Cash and cash equivalents | 15,659 | 31,713 | 37,787 |
| Short-term investments | 2,410 | 4,259 | 4,359 |
| Deferred income taxes | 422 | 4,312 | 2,319 |
| Income taxes receivable | - | 23 | 155 |
| Other current assets | 2,514 | 2,331 | 2,477 |
| Property, plant and equipment (4) | 752 | 930 | 929 |
| Long-term investments (Held-to-Maturity) | 30,832 | - | - |
| Long-term investments (Rabbi Trust) | 5,488 | 3,590 | 4,025 |
| Other assets | 893 | 785 | 955 |
| Total assets | \$191,056 | \$173,551 | \$175,142 |

| (dollars in thousands) | Nine months ended | |
|----------------------------|------------------------|------------------------|
| | January 29, 2017 | January 31, 2016 |
| Capital expenditures (5): | | |
| Mattress Fabrics | \$14,957 | \$6,215 |
| Upholstery Fabrics | 645 | 481 |
| Unallocated Corporate | 72 | 381 |
| Total capital expenditures | \$15,674 | \$7,077 |
| Depreciation expense: | | |
| Mattress Fabrics | \$4,673 | \$4,273 |
| Upholstery Fabrics | 631 | 615 |
| Total depreciation expense | \$5,304 | \$4,888 |

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

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

The \$47.8 million at January 29, 2017, represents property, plant, and equipment of \$32.6 million and \$15.2 million located in the U.S. and Canada, respectively. The \$35.6 million at January 31, 2016, represents property, (2) plant, and equipment of \$23.0 million and \$12.6 million located in the U.S. and Canada, respectively. The \$37.5 million at May 1, 2016, represents property, plant, and equipment of \$24.8 million and \$12.7 million located in the U.S. and Canada, respectively.

The \$1.8 million at January 29, 2017, represents property, plant, and equipment of \$1.1 million and \$711 located in (3) the U.S. and China, respectively. The \$1.6 million at January 31, 2016, represents property, plant, and equipment of \$860 and \$730 located in the U.S. and China, respectively. The \$1.6 million at May 1, 2016, represents property, plant, and equipment of \$893 and \$671 located in the U.S. and China, respectively.

The \$752, \$930, and \$929 at January 29, 2017, January 31, 2016 and May 1, 2016, respectively, represent (4) property, plant, and equipment associated with unallocated corporate departments and corporate departments shared by both the mattress and upholstery fabric segments. Property, plant, and equipment associated with corporate are located in the U.S.

(5) Capital expenditure amounts are stated on the accrual basis. See Consolidated Statements of Cash Flows for capital expenditure amounts on a cash basis.

13. Income Taxes

Effective Income Tax Rate

We recorded income tax expense of \$6.6 million, or 28.9% of income before income taxes, for the nine month period ended January 29, 2017, compared to income tax expense of \$7.4 million, or 35.7% of income before income taxes, for the nine month period ended January 31, 2016. Our effective income tax rates for the nine month periods ended January 29, 2017, and January 31, 2016, 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 currency exchange rates in relation to the U.S. dollar. The following schedule summarizes the factors that are attributable to the difference between income tax expense at the federal income tax rate and the effective income tax rate reflected in the consolidated financial statements:

| | 2017 | 2016 |
|---|-------|-------|
| Federal income tax rate | 34.0% | 34.0% |
| Tax effects of Chinese foreign exchange gains | 1.9 | 3.5 |
| Reversal of foreign uncertain tax position | (9.1) | - |
| U.S state income tax expense | 0.6 | 0.7 |
| Other | 1.5 | (2.5) |
| | 28.9% | 35.7% |

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

Deferred Income Taxes

Valuation Allowance

In accordance with ASC Topic 740, we evaluate our deferred income taxes to determine if a valuation allowance is required. ASC Topic 740 requires that companies assess whether a valuation allowance should be established based on the consideration of all available evidence using a “more-likely-than-not” standard, with significant weight being given to evidence that can be objectively verified. Since the company operates in multiple jurisdictions, we assess the need for a valuation allowance on a jurisdiction-by-jurisdiction basis, taking into account the effects of local tax law. Based on our assessment at January 29, 2017, we recorded a partial valuation allowance of \$557,000, of which \$473,000 pertained to certain U.S. state net operating loss carryforwards and credits and \$84,000 pertained to loss carryforwards associated with our Culp Europe operation located in Poland. Based on our assessment at January 31, 2016, we recorded a partial valuation allowance of \$874,000, of which \$498,000 pertained to certain U.S. state net operating loss carryforwards and credits and \$376,000 pertained to loss carryforwards associated with our Culp Europe operation located in Poland. Based on our assessment at May 1, 2016, we recorded a partial valuation allowance of \$590,000, of which \$518,000 pertained to certain U.S. state net operating loss carryforwards and credits and \$72,000 pertained to loss carryforwards associated with our Culp Europe operation located in Poland.

No valuation allowance was recorded against our net deferred tax assets associated with our operations located in China and Canada at January 29, 2017, January 31, 2016, and May 1, 2016, respectively.

The recorded valuation allowance of \$557,000 at January 29, 2017, has no effect on our operations, loan covenant compliance, or the possible realization of certain U.S. state net operating loss carryforwards and credits and our loss carryforwards associated with our Culp Europe operation located in Poland. If it is determined that it is more-likely-than-not that we will realize any of these deferred tax assets, an income tax benefit will be recognized at that time.

Undistributed Earnings

In accordance with ASC Topic 740, we assess whether the undistributed earnings from our foreign subsidiaries will be reinvested indefinitely or eventually distributed to our U.S. parent company. ASC Topic 740 requires that a deferred tax liability should be recorded for undistributed earnings from foreign subsidiaries that will not be reinvested indefinitely. Based on our assessment as of January 29, 2017, it is our intention not to permanently invest our undistributed earnings from our foreign subsidiaries. Also, we assess the recognition of U.S. foreign income tax credits associated with foreign withholding and income tax payments and whether it is more-likely-than-not that our foreign income tax credits will not be realized. If it is determined that any foreign income tax credits need to be recognized or it is more-likely-than-not our foreign income tax credits will not be realized, an adjustment to our provision for income taxes will be recognized at that time.

At January 29, 2017, we had accumulated earnings and profits from our foreign subsidiaries totaling \$143.2 million. At the same date, the deferred tax liability associated with our undistributed earnings from our foreign subsidiaries totaled \$405,000, which included U.S. income and foreign withholding taxes totaling \$42.5 million, offset by U.S. foreign income tax credits of \$42.1 million.

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

At January 31, 2016, we had accumulated earnings and profits from our foreign subsidiaries totaling \$100.9 million. At the same date, the deferred tax liability associated with our undistributed earnings from our foreign subsidiaries totaled \$3.3 million, which included U.S. income and foreign withholding taxes totaling \$37.3 million, offset by U.S. foreign income tax credits of \$34.0 million.

At May 1, 2016, we had accumulated earnings and profits from our foreign subsidiaries totaling \$129.6 million. At the same date, the deferred tax liability associated with our undistributed earnings from our foreign subsidiaries totaled \$604,000, which included U.S. income and foreign withholding taxes totaling \$38.5 million, offset by U.S. foreign income tax credits of \$37.9 million.

Overall

At January 29, 2017, our non-current deferred tax asset of \$422,000 pertains to our operations located in China. At January 31, 2016, our non-current deferred tax asset of \$4.3 million represents \$3.5 million and \$773,000 from our operations located in the U.S. and China, respectively. At May 1, 2016, our non-current deferred tax asset of \$2.3 million represents \$1.7 million and \$572,000 from our operations located in the U.S. and China, respectively.

At January 29, 2017, our non-current deferred tax liability of \$2.9 million represents \$1.7 million and \$1.2 million from our operations located in Canada and the U.S., respectively. Our non-current deferred tax liability balances of \$1.2 million and \$1.5 million at January 31, 2016 and May 1, 2016, respectively, pertain to our operations located in Canada.

Uncertainty In Income Taxes

At January 29, 2017, we had a \$13.4 million total gross unrecognized income tax benefit, of which \$11.6 million and \$1.8 million were classified as non-current deferred income taxes and income taxes payable – long-term, respectively, in the accompanying consolidated balance sheets. At January 31, 2016, we had a \$13.2 million total gross unrecognized income tax benefit, of which \$9.7 million and \$3.5 million were classified as non-current deferred income taxes and income taxes payable – long-term, respectively, in the accompanying consolidated balance sheets. At May 1, 2016, we had \$14.9 million of total gross unrecognized income tax benefit, of which \$11.1 million and \$3.8 million were classified as non-current deferred income taxes and income taxes payable – long-term, respectively, in the accompanying consolidated balance sheets.

At January 29, 2017, our \$13.4 million total gross unrecognized income tax benefit included \$1.8 million that, if recognized, would favorably affect the income tax rate in future periods. At January 31, 2016, our \$13.2 million total gross unrecognized income tax benefit, included \$3.5 million that, if recognized, would favorably affect the income tax rate in future periods. At May 1, 2016, our \$14.9 million total gross unrecognized income tax benefit included \$3.8 million that, if recognized, would favorably affect the income tax rate in future periods.

Our gross unrecognized income tax benefit of \$13.4 million at January 29, 2017, relates to tax positions for which significant change is reasonably possible within the next year. This amount primarily relates to double taxation under applicable income tax treaties with foreign tax jurisdictions. United States federal and state income tax returns filed by us remain subject to examination for income tax years 2005 and subsequent due to loss carryforwards. Canadian federal returns filed by us remain subject to examination for income tax years 2010 and subsequent. Canadian provincial (Quebec) returns filed by us remain subject to examination for income tax years 2009 and subsequent, with the statute of limitations for the 2009 income tax year expiring in April 2017. Income tax returns associated with our operations located in China are subject to examination for income tax year 2011 and subsequent.

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

Currently, the Internal Revenue Service is examining our U.S. Federal income tax returns for fiscal 2014, and no adjustments have been proposed at this time. We currently expect this examination to be completed during fiscal 2018. During the third quarter of fiscal 2017, Revenue Quebec commenced an examination of our Canadian provincial (Quebec) income tax returns for fiscal years 2013 through 2015, and no adjustments have been proposed at this time. We currently expect this examination to be completed during fiscal 2018.

In accordance with ASC Topic 740, an unrecognized income tax benefit for an uncertain income tax position can be recognized in the first interim period if the more-likely-than-not recognition threshold is met by the reporting period, or is effectively settled through examination, negotiation, or litigation, or the statute of limitations for the relevant taxing authority to examine and challenge the tax position has expired. If it is determined that any of the above conditions occur regarding our uncertain income tax positions, an adjustment to our unrecognized income tax benefit will be recorded at that time.

During the third quarter of fiscal 2017, we recognized an income tax benefit of \$2.1 million for the reversal of an uncertain income tax position associated with a foreign jurisdiction in which the statute of limitations expired. This income tax benefit was treated as a discrete event in which the full income tax effects of the adjustment were recorded in the three and nine month periods ending January 29, 2017.

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 29, 2017, the company's statutory surplus reserve was \$4.5 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 \$4.5 million to assist with debt repayment, capital expenditures, and other expenses of the company's business.

15. Commitments and Contingencies

Litigation

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

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

Purchase Commitments

Overall

At January 29, 2017, January 31, 2016, and May 1, 2016, we had open purchase commitments to acquire a building and equipment for our mattress fabrics segment totaling \$8.2 million, \$977,000, and \$10.6 million, respectively. The \$8.2 million and \$10.6 million open purchase commitments as of January 29, 2017 and May 1, 2016, include \$4.9 million (of which \$4.5 million represents completed work) and \$9.3 million associated with the construction of a new building noted below.

Construction of New Building

Effective May 16, 2016, we entered into an agreement with a contractor to construct a new building located in North Carolina that will expand our distribution capabilities and office space at an current estimated cost of \$11.1 million. This agreement required an installment payment of \$1.9 million in April 2016 and requires additional installment payments to be made in the following fiscal years: Fiscal 2017- \$4.3 million; Fiscal 2018- \$3.8 million; and Fiscal 2019 - \$1.1 million. Interest will be charged on the required outstanding installment payments in excess of services that have been rendered at a rate of \$2.25% plus the current 30 day LIBOR rate.

Also, we were required to issue a letter of a credit totaling \$5.0 million with the contractor's bank being the beneficiary. In addition to the interest that will be charged on the outstanding installment payments noted above, there will be a 0.1% unused fee calculated on the balance of the \$5.0 million letter of credit less the amount outstanding per month (see Note 8 for further details).

The remaining \$4.9 million on this commitment is required to be paid on an installment basis over the next two fiscal years as follows: Fiscal 2018 - \$3.8 million; and Fiscal 2019 - \$1.1 million.

This new building is currently expected to be completed and placed in service in our fourth quarter of fiscal 2017.

16. Investment in Unconsolidated Joint Venture

Effective January 1, 2017, Culp International Holdings, Ltd. (Culp), a wholly-owned subsidiary of Culp, Inc., entered into a joint venture agreement, pursuant to which Culp owns fifty percent of CLASS International Holdings, Ltd (CLIH). CLIH will produce cut and sewn mattress covers, and its operations will be located in a modern industrial park on the northeast border of Haiti, which borders the Dominican Republic. CLIH is currently expected to commence production in the second quarter of fiscal 2018 and will complement our existing mattress fabric operations with a mirrored platform that will enhance our ability to meet customer demand while adding a lower cost operation to our platform.

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

Culp's investment in CLIH will be accounted for under the equity method of accounting in accordance with ASC Topic 823 – Investments – Equity Method and Joint Ventures. The equity method of accounting is required for an investee entity (i.e. CLIH) that is not consolidated but over which the reporting entity (i.e. Culp Inc.) exercises significant influence. Whether or not a reporting entity exercises significant influence with respect to an investee depends on an evaluation of several factors, including representation on the investee's board of directors, voting rights, and ownership level. Under the equity method of accounting, CLIH's accounts are not reflected within our Consolidated Balance Sheets and Statements of Net Income. Our share of earnings and losses from CLIH will be reflected in the caption "Equity in net income (loss) of unconsolidated joint venture" in the Consolidated Statements of Net Income. Our carrying value in CLIH is reflected in the caption "Investment in unconsolidated joint venture" in our Consolidated Balance Sheets.

If our carrying value in CLIH is reduced to zero, no further losses will be recorded in our consolidated financial statements. However, if CLIH subsequently reports income, we will not record our share of such income until it equals the amount of its share of losses previously recognized.

17. Common Stock Repurchase Program

On June 15, 2016, we announced that our board of directors approved an authorization for us to acquire up to \$5.0 million of our common stock. Under the common stock repurchase program, shares may be purchased from time to time in open market transactions, block trades, through plans established under the Securities Exchange Act Rule 10b5-1, or otherwise. The amount of shares purchased and the timing of such purchases will be based on working capital requirements, market and general business conditions, and other factors including alternative investment opportunities.

During the nine months ended January 29, 2017, and January 31, 2016, we did not purchase any shares of our common stock.

At January 29, 2017, we had \$5.0 million available for additional repurchases of our common stock.

18. Dividend Program

On February 28, 2017, we announced that our board of directors approved a quarterly cash dividend of \$0.08 per share. This payment will be made on or about April 17, 2017, to shareholders of record as of April 3, 2017.

During the nine months ended January 29, 2017, dividend payments totaled \$5.3 million, of which \$2.6 million represented a special cash dividend payment of \$0.21 per share, and \$2.7 million represented quarterly dividend payments ranging from \$0.07 to \$0.08 per share.

During the nine months ended January 31, 2016, dividend payments totaled \$7.3 million, of which \$5.0 million represented a special cash dividend of \$0.40 per share, and \$2.3 million represented quarterly dividend payments ranging from \$0.06 to \$0.07 per share.

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

CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING INFORMATION

This report and the exhibits attached hereto contain “forward-looking statements” within the meaning of the federal securities laws, including the Private Securities Litigation Reform Act of 1995 (Section 27A of the Securities Act of 1933 and Section 21E of the Securities and Exchange Act of 1934). Such statements are inherently subject to risks and uncertainties. Further, forward looking statements are intended to speak only as of the date on which they are made, and we disclaim any duty to update or alter such statements, whether as a result of new information, future events or otherwise. 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,” “project,” “anticipate,” “depend” and their derivatives, and include but are not limited to statements about expectations for our future operations, production levels, sales, profit margins, operating income, capital expenditures, income taxes, SG&A or other expenses, pre-tax income, earnings, cash flow, and other performance or liquidity measures, as well as any statements regarding future economic or industry trends or future developments. Factors that could influence the matters discussed in such statements include the level of housing starts and sales of existing homes, consumer confidence, trends in disposable income, and general economic conditions. Decreases in these economic indicators could have a negative effect on our business and prospects. Likewise, increases in interest rates, particularly home mortgage rates, and increases in consumer debt or the general rate of inflation, could affect us adversely. Changes in consumer tastes or preferences toward products not produced by us could erode demand for our products. Changes in the value of the U.S. dollar versus other currencies can affect our financial results because a significant portion of our operations are located outside the United States. Strengthening of the U.S. dollar against other currencies could make our products less competitive on the basis of price in markets outside the United States, and strengthening of currencies in Canada and China can have a negative impact on our sales of products produced in those places. Also, economic and political instability in international areas could affect our operations or sources of goods in those areas, as well as demand for our products in international markets. Finally, increases in market prices for petrochemical products can significantly affect the prices we pay for raw materials, and in turn, increase our operating costs and decrease our profitability. 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 15, 2016, for the fiscal year ended May 1, 2016.

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

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

General

Our fiscal year is the 52 or 53 week period ending on the Sunday closest to April 30. The nine months ended January 29, 2017, and January 31, 2016, each represent 39-week periods. Our operations are classified into two business segments: mattress fabrics and upholstery fabrics. The mattress fabrics segment manufactures, sources and sells fabrics and mattress covers to bedding manufacturers. The upholstery fabrics segment sources, manufactures, and sells fabrics primarily to residential furniture manufacturers. Our mattress fabric operations are located in Stokesdale, NC, High Point, NC and Quebec, Canada. Our upholstery fabric operations are located in Shanghai, China, Burlington, North Carolina, and Anderson, South Carolina.

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

Executive Summary

Results of Operations

| | Three Months | | | Change |
|----------------------------|------------------------|------------------------|--------|--------|
| | Ended | | | |
| (dollars in thousands) | January 29, 2017 | January 31, 2016 | | |
| Net sales | \$76,169 | \$78,466 | (2.9) |)% |
| Gross profit | 16,759 | 16,563 | 1.2 | % |
| Gross profit margin | 22.0 % | 21.1 % | 90 | bp |
| SG&A expenses | 9,824 | 9,337 | 5.2 | % |
| Income from operations | 6,935 | 7,226 | (4.0) |)% |
| Operating margin | 9.1 % | 9.2 % | (10) |)bp |
| Income before income taxes | 6,990 | 7,179 | (2.6) |)% |
| Income taxes | 643 | 2,317 | (72.2) |)% |
| Net income | 6,347 | 4,862 | 30.5 | % |

| | Nine Months Ended | | |
|----------------------------|-------------------|-----------|----------|
| | January | January | Change |
| (dollars in thousands) | 29, 2017 | 31, 2016 | |
| Net sales | \$232,194 | \$235,607 | (1.4)% |
| Gross profit | 52,079 | 48,498 | 7.4 % |
| Gross profit margin | 22.4 % | 20.6 % | 180 bp |
| SG&A expenses | 29,171 | 27,512 | 6.0 % |
| Income from operations | 22,908 | 20,986 | 9.2 % |
| Operating margin | 9.9 % | 8.9 % | 100 bp |
| Income before income taxes | 22,696 | 20,731 | 9.5 % |
| Income taxes | 6,560 | 7,398 | (11.3)% |
| Net income | 16,136 | 13,333 | 21.0 % |

Net Sales

Overall, net sales were slightly lower in the third quarter and the year-to-date period of fiscal 2017 as compared with the same periods a year ago, as both business segments were affected by an uncertain economic environment and soft consumer demand trends for home furnishings. Our mattress fabrics segment reported year-over-year improvement in both the third quarter and the first nine months of fiscal 2017 in spite of a more challenging marketplace. However, in addition to the uncertain economic environment and soft consumer demand trends, our upholstery fabrics net sales were also affected by the timing of the Chinese New Year holiday that started in January for fiscal 2017 compared with February in fiscal 2016.

See the Segment Analysis section below for further details.

Income Before Income Taxes

Income before income taxes decreased slightly for the third quarter of fiscal 2017 as compared with the third quarter of fiscal 2016. Our upholstery fabrics segment reported a decrease in operating income that was primarily due to the decrease in net sales noted above. However, partially offsetting the decrease in our upholstery fabrics operating income was an increase in the mattress fabrics operating income due to lower raw material costs and the operational benefits of recent capital investments. Operating income for the mattress fabrics segment was also negatively affected by non-recurring plant facility consolidation charges associated with our expansion projects located in North Carolina. Despite the decrease in net sales for the first nine months of fiscal 2017, income before income taxes increased by 9.5% compared to the same period a year ago. This increase primarily reflects the improvement in profitability from our mattress fabrics segment, as discussed above, partially offset by lower operating income associated with our upholstery fabrics segment, and higher SG&A expenses.

See the Segment Analysis section below for further details.

Income Taxes

Income tax expense decreased for the third quarter and nine month year-to-date period of fiscal 2017 compared with the same periods a year ago. During the third quarter of fiscal 2017, we recognized an income tax benefit of \$2.1 million for the reversal of an uncertain income tax position associated with a foreign jurisdiction in which the statute of limitations expired. This income tax benefit was treated as a discrete event in which the full income tax effects of the adjustment were recorded in the three and nine month periods ending January 29, 2017.

Refer to Note 13 located in the notes to the consolidated financial statements for further details regarding our income tax provision.

Liquidity

At January 29, 2017, our cash and cash equivalents, short-term investments, and long-term investments (held-to-maturity) totaled \$48.9 million compared with \$42.1 million at May 1, 2016. This increase from the end of fiscal 2016 was primarily due to net cash provided by operating activities of \$24.2 million, partially offset by \$10.3 million in capital expenditures (of which \$1.0 million was vendor financed) that were mostly associated with our mattress fabric segment, \$5.3 million in dividend payments, and \$1.4 million in long-term investment purchases associated with our Rabbi Trust that fund our deferred compensation plan. Our net cash provided by operating activities of \$24.2 million increased \$8.3 million compared with \$15.9 million for the nine months ending January 31, 2016. This increase is primarily due to increased earnings and improved inventory management during fiscal 2017 compared with fiscal 2016.

During the second quarter of fiscal 2017, management decided to invest approximately \$31.0 million in investment grade U.S. Corporate bonds with maturities primarily ranging from 2 to 2.5 years. The purpose of this investment was to earn a higher rate of return on our excess cash located in the Cayman Islands. These investments are classified as held-to-maturity as we have the positive intent and ability to hold these investments until maturity.

Currently, we do not have any borrowings outstanding under our credit agreements. At the end of our first quarter of fiscal 2017, we had an outstanding balance of \$7.0 million on our U.S. revolving line of credit. This outstanding balance was repaid during our second quarter of fiscal 2017.

See the Liquidity section below for further details.

Dividend and Common Stock Repurchase Programs

On February 28, 2017, we announced that our board of directors approved a quarterly cash dividend of \$0.08 per share. This payment will be made on or about April 17, 2017, to shareholders of record as of April 3, 2017.

During the nine months ended January 29, 2017, dividend payments totaled \$5.3 million, of which \$2.6 million represented a special cash dividend payment of \$0.21 per share, and \$2.7 million represented quarterly dividend payments ranging from \$0.07 to \$0.08 per share.

During the nine months ended January 29, 2017, and January 31, 2016, we did not purchase any shares of our common stock.

At January 29, 2017, we had \$5.0 million available for additional repurchases of our common stock.

I-32

Segment Analysis

Mattress Fabrics Segment

| | Three Months Ended | | | Change |
|------------------------|--------------------|------------------|--------|--------|
| | January 29, 2017 | January 31, 2016 | | |
| (dollars in thousands) | | | | |
| Net sales | \$45,920 | \$44,277 | 3.7 % | |
| Gross profit | 9,758 | 8,751 | 11.5 % | |
| Gross profit margin | 21.3 % | 19.8 % | 150 bp | |
| SG&A expenses | 3,391 | 2,953 | 14.8 % | |
| Income from operations | 6,367 | 5,798 | 9.8 % | |
| Operating margin | 13.9 % | 13.1 % | 80 bp | |

| | Nine Months Ended | | | Change |
|------------------------|-------------------|------------------|--------|--------|
| | January 29, 2017 | January 31, 2016 | | |
| (dollars in thousands) | | | | |
| Net sales | \$141,977 | \$137,522 | 3.2 % | |
| Gross profit | 32,414 | 28,133 | 15.2 % | |
| Gross profit margin | 22.8 % | 20.5 % | 230 bp | |
| SG&A expenses | 10,185 | 8,865 | 14.9 % | |
| Income from operations | 22,229 | 19,267 | 15.4 % | |
| Operating margin | 15.7 % | 14.0 % | 170 bp | |

Net Sales

Overall

Our mattress fabrics segment reported year-over-year improvement in net sales for both the third quarter and the first nine months of fiscal 2017 in spite of a more challenging marketplace. Our strategic focus on design and innovation remain our top priorities and has allowed us to meet customer style preferences and changing demand trends by offering a full complement of mattress fabrics and sewn covers across all price points. Our mattress cover business, known as CLASS, has continued to perform well in fiscal 2017. The growth in CLASS allows us to design product offerings from fabric to finished covers. We also have an opportunity to expand our business with our traditional customers and also reach new market segments, especially the fast growing Internet bedding space. Our scalable and flexible manufacturing platform supports our focus on design and innovation, and we have made significant capital investments to improve our operating efficiencies and overall capacity.

Industry disruptions and demand trends have caused some short-term uncertainty in the mattress fabrics industry. Some of these disruptions involve major customers of our mattress fabrics business, including changes to the distribution channels of at least one significant customer. As a result, we have indications from a customer that there will be reductions in orders from them, but at the same time we have indications from other large customers that our levels of business with them is expected to increase. The structure of our supply arrangements and contracts with major customers are such that it is difficult to make predictions with certainty, and this is further complicated by the just in time (JIT) order and delivery model. Nonetheless, we are cautiously optimistic that we will not experience a significant negative impact on our mattress fabrics business related to these issues. While industry disruptions and demand issues in the bedding industry may affect sales trends in the short term, we believe that challenges with certain customers will at least be partially offset by increased sales and opportunities with others.

Gross Profit and Operating Income

Overall

Our mattress fabric gross profit and operating income increased in the third quarter and the first nine months of fiscal 2017 compared with the same periods a year ago. The increase in our operating income reflects lower raw material costs and the benefits of our capital investments. However, operating income for mattress fabrics was also negatively affected by increased SG&A expenses relating to higher inventory warehousing costs, design and sales expenses, and non-recurring plant facility consolidation charges (approximately \$200,000 in the third quarter) associated with the expansion projects located in North Carolina noted below.

In addition to the industry disruptions and demand trends noted above, this segment's operating income will continue to be affected by non-recurring plant consolidation expenses associated with the expansion projects located in North Carolina during the fourth quarter of fiscal 2017.

Capital Projects

During fiscal 2017, we continued to make capital investments to enhance our operations and improve product delivery performance. Our expansion projects in North Carolina, including our new distribution center, are expected to be completed in the fourth quarter of fiscal 2017. We are underway with our planned knitted fabric plant consolidation project in North Carolina to streamline our production platform and more effectively support our continuous improvement initiatives and long-term growth strategy. Currently, we expect an annual cost savings of \$1 million to \$1.5 million related to our North Carolina expansion projects.

Additionally, we have made excellent progress with an expansion project at our facility located in Canada. This project includes the installation of new finishing equipment and a new distribution center, which will allow us to ship directly to customers located in Canada. The new distribution platform is expected to commence operations in the fourth quarter of fiscal 2017.

Joint Venture

Effective January 1, 2017, Culp International Holdings, Ltd. (Culp), a wholly-owned subsidiary of Culp, Inc., entered into a joint venture agreement, pursuant to which Culp owns fifty percent of CLASS International Holdings, Ltd (CLIH). CLIH will produce cut and sewn mattress covers, and its operations will be located in a modern industrial park on the northeast border of Haiti, which borders the Dominican Republic. CLIH is currently expected to commence production in the second quarter of fiscal 2018 and will complement our existing mattress fabric operations with a mirrored platform that will enhance our ability to meet customer demand while adding a lower cost operation to our platform.

Culp's investment in CLIH will be accounted for under the equity method of accounting in accordance with ASC Topic 823 – Investments – Equity Method and Joint Ventures. The equity method of accounting is required for an investee entity (i.e. CLIH) that is not consolidated but over which the reporting entity (i.e. Culp Inc.) exercises significant influence. Whether or not a reporting entity exercises significant influence with respect to an investee depends on an evaluation of several factors, including representation on the investee's board of directors, voting rights, and ownership level. Under the equity method of accounting, CLIH's accounts are not reflected within our Consolidated Balance Sheets and Statements of Net Income. Our share of earnings and losses from CLIH will be reflected in the caption "Equity in net income (loss) of unconsolidated joint venture" in the Consolidated Statements of Net Income. Our carrying value in CLIH is reflected in the caption "Investment in unconsolidated joint venture" in our Consolidated Balance Sheets.

If our carrying value in CLIH is reduced to zero, no further losses will be recorded in our consolidated financial statements. However, if CLIH subsequently reports income, we will not record our share of such income until it equals the amount of its share of losses previously recognized.

Segment assets

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

| | January 29, 2017 | January 31, 2016 | May 1, 2016 |
|--|------------------------|------------------------|----------------|
| (dollars in thousands) | | | |
| Accounts receivable and inventory | \$41,498 | \$44,309 | \$43,472 |
| Property, plant & equipment | 47,755 | 35,637 | 37,480 |
| Goodwill | 11,462 | 11,462 | 11,462 |
| Investment in unconsolidated joint venture | 600 | - | - |
| Non-compete agreement | 847 | 922 | 903 |
| Customer Relationships | 677 | 728 | 715 |

Accounts Receivable & Inventory

As of January 29, 2017, accounts receivable and inventory decreased \$2.8 million, or 6%, compared with January 31, 2016. This decrease is due to improved inventory management and more timely cash collections on accounts receivable as customers were taking more advantage of sales discounts in the third quarter of fiscal 2017 compared with the third quarter of fiscal 2016.

As of January 29, 2017, accounts receivable and inventory decreased \$2.0 million, or 5%, compared with May 1, 2016. This decrease is due to improved inventory management in fiscal 2017 compared to fiscal 2016.

Property, Plant & Equipment

The \$47.8 million at January 29, 2017, represents property, plant and equipment of \$32.6 million and \$15.2 million located in the U.S. and Canada, respectively. The \$35.6 million at January 31, 2016, represents property, plant, and equipment of \$23.0 million and \$12.6 million located in the U.S. and Canada, respectively. The \$37.5 million at May 1, 2016, represents property, plant, and equipment of \$24.8 million and \$12.7 million located in the U.S. and Canada, respectively.

As of January 29, 2017, property, plant, and equipment increased \$12.1 million, or 34%, compared with January 31, 2016. This increase is primarily due to the capital investments noted above, partially offset by depreciation expense.

As of January 29, 2017, property, plant, and equipment increased \$10.3 million, or 27%, compared with May 1, 2016. This increase is due to capital expenditures of \$15.0 million that primarily relate to the construction of a new building (see Note 15 to the Consolidated Financial Statements for further details) and purchases and installation of machinery and equipment, partially offset by depreciation expense of \$4.7 million for the nine months of fiscal 2017.

Upholstery Fabrics Segment

Net Sales

| | Three Months Ended | | | % Change |
|------------------------|--------------------|------------------|-------|----------|
| | January 29, 2017 | January 31, 2016 | | |
| (dollars in thousands) | | | | |
| Non U.S. Produced | \$27,696 | \$31,515 | 92 % | (12.1)% |
| U.S. Produced | 2,553 | 2,674 | 8 % | (4.5)% |
| Total | \$30,249 | \$34,189 | 100 % | (11.5)% |

| | Nine Months Ended | | | % Change |
|------------------------|-------------------|------------------|-------|----------|
| | January 29, 2017 | January 31, 2016 | | |
| (dollars in thousands) | | | | |
| Non U.S. Produced | \$83,279 | \$90,037 | 92 % | (7.5)% |
| U.S. Produced | 6,938 | 8,048 | 8 % | (13.8)% |
| Total | \$90,217 | \$98,085 | 100 % | (8.0)% |

The decrease in upholstery fabric net sales reflects continued soft demand trends for home furnishings and the uncertain economic environment. In addition, upholstery fabric sales were affected by the timing of the Chinese New Year holiday that started in January for fiscal 2017 as opposed to February in fiscal 2016.

In spite of the challenging demand trends, we have remained focus on our product-driven strategy. For example, we have seen positive demand trends for our latest performance line of highly durable and stain-resistant fabrics. We have also experienced meaningful sales growth for this fiscal year in the hospitality segment, which is a key area of focus in our product diversification strategy.

Our 100% owned China platform supports our marketing efforts with the manufacturing flexibility to adapt to changing furniture market trends and consumer style preferences.

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

| | Three Months Ended | | | Change |
|------------------------|--------------------|------------------|--|----------|
| | January 29, 2017 | January 31, 2016 | | |
| (dollars in thousands) | | | | |
| Gross profit | \$7,001 | \$7,812 | | (10.4)% |
| Gross profit margin | 23.1 % | 22.8 % | | 30 bp |
| SG&A expenses | 3,901 | 3,963 | | (1.6)% |
| Income from operations | 3,100 | 3,849 | | (19.5)% |
| Operating margin | 10.2 % | 11.3 % | | (110)bp |

| | Nine Months Ended | | |
|------------------------|------------------------|------------------------|---------|
| | January 29, 2017 | January 31, 2016 | Change |
| (dollars in thousands) | | | |
| Gross profit | \$19,665 | \$20,365 | (3.4)% |
| Gross profit margin | 21.8 % | 20.8 % | 100 bp |
| SG&A expenses | 11,086 | 11,372 | (2.5)% |
| Income from operations | 8,579 | 8,994 | (4.6)% |
| Operating margin | 9.5 % | 9.2 % | 30 bp |

Our gross profit and operating income for the third quarter and first nine months of fiscal 2017 decreased in comparison to the same periods a year ago. This trend reflects the decline in net sales noted above, partially offset by lower raw material costs and operating expenses due to more favorable currency exchange rates in China.

Culp Europe

At the end of the third quarter of fiscal 2015, we closed our finished goods warehouse and distribution facility located in Poznan, Poland, primarily as a result of ongoing economic weakness in Europe. We remain interested in developing business in Europe, and we are pursuing alternatives for selling upholstery fabric into this market.

Segment Assets

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

| (dollars in thousands) | January 29, 2017 | January 31, 2016 | May 1, 2016 |
|-----------------------------------|------------------------|------------------------|----------------|
| Accounts receivable and inventory | \$27,421 | \$30,960 | \$26,540 |
| Property, plant & equipment | 1,826 | 1,590 | 1,564 |

Accounts Receivable & Inventory

As of January 29, 2017, accounts receivable and inventory decreased \$3.5 million, or 11%, compared with January 31, 2016. This decrease is primarily due to a decrease in accounts receivable. Accounts receivable decreased as a result of lower business volume in the third quarter of fiscal 2017 due to the timing of the Chinese New Year holiday that started in January for fiscal 2017 as opposed to February in fiscal 2016.

As of January 29, 2017, accounts receivable and inventory modestly increased 3% compared with May 1, 2016.

Property, Plant & Equipment

The \$1.8 million at January 29, 2017, represents property, plant, and equipment of \$1.1 million and \$711,000 located in the U.S. and China, respectively. The \$1.6 million at January 31, 2016, represents property, plant, and equipment of \$860,000 and \$730,000 located in the U.S. and China, respectively. The \$1.6 million at May 1, 2016, represents property, plant, and equipment of \$893,000 and \$671,000 located in the U.S. and China, respectively.

Other Income Statement Categories

| | Three Months Ended | | | | |
|------------------------|------------------------|------------------------|-------------|----|--|
| | January 29, 2017 | January 31, 2016 | % Change | | |
| (dollars in thousands) | | | | | |
| SG&A expenses | \$9,824 | \$9,337 | 5.2 | % | |
| Interest expense | - | - | - | | |
| Interest income | 124 | 38 | 226.3 | % | |
| Other expense | 69 | 85 | (18.8) |)% | |

| | Nine Months Ended | | | | |
|------------------------|------------------------|------------------------|-------------|----|--|
| | January 29, 2017 | January 31, 2016 | % Change | | |
| (dollars in thousands) | | | | | |
| SG&A expenses | \$29,171 | \$27,512 | 6.0 | % | |
| Interest expense | - | - | - | | |
| Interest income | 164 | 150 | 9.3 | % | |
| Other expense | 376 | 405 | (7.2) |)% | |

Selling, General and Administrative Expenses

The increases in SG&A expenses for third quarter and the first nine months of fiscal 2017 compared with the same periods a year ago, were due primarily to higher incentive compensation expense reflecting stronger financial results in relation to pre-established performance targets. The increases in SG&A expenses were also due to higher inventory warehousing costs, design and sales expenses, and non-recurring plant facility consolidation charges (approximately \$200,000 in the third quarter) associated with our mattress fabrics segment.

Interest Expense

Interest costs charged to operations were \$52,000 and \$9,000 for the third quarter of fiscal 2017 and 2016, respectively. Interest costs charged to operations were \$97,000 and \$58,000 for the nine months ended January 29, 2017 and January 31, 2016, respectively. The interest costs charged to operations were fully offset by interest costs for the construction of qualifying fixed assets that were capitalized and will be amortized over the related assets' useful lives.

Interest Income

Interest income increased in the third quarter and the nine month year-to-date period of fiscal 2017 compared with the same periods a year ago. The increases in interest income were due to management's decision at the end of the second quarter of fiscal 2017 to invest approximately \$31.0 million in investment grade U.S. Corporate bonds with maturities primarily ranging from 2 to 2.5 years. The purpose of this investment was to earn a higher rate of return on our excess cash located in the Cayman Islands. These investments are classified as held-to-maturity as we have the positive intent and ability to hold these investments until maturity.

Other Expense

Other expenses in the third quarter and the year-to-date period of fiscal 2017 were comparable to the same periods a year ago.

Income Taxes

Effective Income Tax Rate

We recorded income tax expense of \$6.6 million, or 28.9% of income before income taxes, for the nine month period ended January 29, 2017, compared to income tax expense of \$7.4 million, or 35.7% of income before income taxes, for the nine month period ended January 31, 2016. Our effective income tax rates for the nine month periods ended January 29, 2017, and January 31, 2016, 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 currency exchange rates in relation to the U.S. dollar. The following schedule summarizes the factors that are attributable to the difference between income tax expense at the federal income tax rate and the effective income tax rate reflected in the consolidated financial statements:

| | 2017 | 2016 |
|---|--------|--------|
| Federal income tax rate | 34.0% | 34.0% |
| Tax effects of Chinese foreign exchange gains | 1.9 | 3.5 |
| Reversal of foreign uncertain tax position | (9.1) | - |
| U.S state income tax expense | 0.6 | 0.7 |
| Other | 1.5 | (2.5) |
| | 28.9% | 35.7% |

Deferred Income Taxes

Valuation Allowance

In accordance with ASC Topic 740, we evaluate our deferred income taxes to determine if a valuation allowance is required. ASC Topic 740 requires that companies assess whether a valuation allowance should be established based on the consideration of all available evidence using a “more-likely-than-not” standard, with significant weight being given to evidence that can be objectively verified. Since the company operates in multiple jurisdictions, we assess the need for a valuation allowance on a jurisdiction-by-jurisdiction basis, taking into account the effects of local tax law.

Refer to Note 13 located in the notes to the consolidated financial statements for disclosures regarding our assessments of our recorded valuation allowance as of January 29, 2017, January 31, 2016, and May 1, 2016, respectively.

Undistributed Earnings

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

Refer to Note 13 located in the notes to the consolidated financial statements for disclosures regarding our assessments of our recorded deferred income tax liability balances associated with undistributed earnings from our foreign subsidiaries as of January 29, 2017, January 31, 2016, and May 1, 2016, respectively.

Uncertainty In Income Taxes

Our gross unrecognized income tax benefit of \$13.4 million at January 29, 2017, relates to tax positions for which significant change is reasonably possible within the next year. This amount primarily relates to double taxation under applicable income tax treaties with foreign tax jurisdictions. United States federal and state income tax returns filed by us remain subject to examination for income tax years 2005 and subsequent due to loss carryforwards. Canadian federal returns filed by us remain subject to examination for income tax years 2010 and subsequent. Canadian provincial (Quebec) returns filed by us remain subject to examination for income tax years 2009 and subsequent, with the statute of limitations for the 2009 income tax year expiring in April 2017. Income tax returns associated with our operations located in China are subject to examination for income tax year 2011 and subsequent.

Currently, the Internal Revenue Service is examining our U.S. Federal income tax returns for fiscal 2014, and no adjustments have been proposed at this time. We currently expect this examination to be completed during fiscal 2018. During the third quarter of fiscal 2017, Revenue Quebec commenced an examination of our Canadian provincial (Quebec) income tax returns for fiscal years 2013 through 2015 and no adjustments have been proposed at this time. We currently expect this examination to be completed during fiscal 2018.

In accordance with ASC Topic 740, an unrecognized income tax benefit for an uncertain income tax position can be recognized in the first interim period if the more-likely-than-not recognition threshold is met by the reporting period, or is effectively settled through examination, negotiation, or litigation, or the statute of limitations for the relevant taxing authority to examine and challenge the tax position has expired. If it is determined that any of the above conditions occur regarding our uncertain income tax positions, an adjustment to our unrecognized income tax benefit will be recorded at that time.

During the third quarter of fiscal 2017, we recognized an income tax benefit of \$2.1 million for the reversal of an uncertain income tax position associated with a foreign jurisdiction in which the statute of limitations expired. This income tax benefit was treated as a discrete event in which the full income tax effects of the adjustment were recorded in the three and nine month periods ending January 29, 2017.

Income Taxes Paid

We reported income tax expense of \$6.6 million and \$7.4 million for the nine month periods ending January 29, 2017 and January 31, 2016, respectively. Currently, we are not paying income taxes in the United States as we have \$19.2 million in operating loss carryforwards as of May 1, 2016. However, we did have income tax payments of \$4.7 million and \$4.9 million for the nine month periods ending January 29, 2017 and January 31, 2016, respectively. These income tax payments are associated with our subsidiaries located in China and Canada.

Liquidity and Capital Resources

Liquidity

Overall

Currently, our sources of liquidity include cash and cash equivalents, short-term investments, cash flow from operations, and amounts available under our 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 \$18.1 million at January 29, 2017, cash flow from operations, and the current availability (\$35.8 million as of January 29, 2017) under our revolving credit lines will be sufficient to fund our foreseeable business needs and contractual obligations.

At January 29, 2017, our cash and cash equivalents, short-term investments, and long-term investments (held-to-maturity) totaled \$48.9 million compared with \$42.1 million at May 1, 2016. This increase from the end of fiscal 2016 was primarily due to net cash provided by operating activities of \$24.2 million, partially offset by \$10.3 million in capital expenditures (of which \$1.0 million was vendor financed) that were mostly associated with our mattress fabric segment, \$5.3 million in dividend payments, and \$1.4 million in long-term investment purchases associated with our Rabbi Trust that fund our deferred compensation plan. Our net cash provided by operating activities of \$24.2 million increased \$8.3 million compared with \$15.9 million for the nine months ending January 31, 2016. This increase is primarily due to increased earnings and improved inventory management during fiscal 2017 compared to fiscal 2016.

Currently, we do not have any borrowings outstanding under our credit agreements. At the end of our first quarter of fiscal 2017, we had an outstanding balance of \$7.0 million on our U.S. revolving line of credit. This outstanding balance was repaid during our second quarter of fiscal 2017.

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

By Geographic Area

We currently hold cash and cash equivalents, short-term investments, and long-term investments (held-to-maturity) in the U.S. and our foreign jurisdictions to support our operational requirements, mitigate our risk to foreign exchange rate fluctuations, and U.S. and foreign income tax planning purposes.

A summary of our cash and cash equivalents, short-term investments, and long-term investments (held-to-maturity) by geographic area follows:

| | January 29, 2017 | January 31, 2016 | May 1, 2016 |
|------------------------|------------------------|------------------------|----------------|
| (dollars in thousands) | | | |
| Cayman Islands | \$35,416 | \$20,077 | \$25,762 |
| China | 8,624 | 6,479 | 8,454 |
| Canada | 4,560 | 6,570 | 6,844 |
| United States | 301 | 2,846 | 1,086 |
| | \$48,901 | \$35,972 | \$42,146 |

We have had a significant shift from cash and cash equivalents and investments held in China to the Cayman Islands. Since April 2016 through the end of our third quarter of fiscal 2017, we distributed earnings and profits totaling \$39.2 million from our subsidiaries located in China to our international holding company located in the Cayman Islands. This shift was primarily due to our strategy of mitigating our risk to foreign exchange rate fluctuations for assets and liabilities denominated in Chinese Yuan Renminbi. By limiting the amount of cash and cash equivalents held in Chinese Yuan Renminbi, we are able to obtain a better balance of assets and liabilities denominated in Chinese Yuan Renminbi, and therefore mitigate the risk of foreign currency exchange rate fluctuations in China. In addition, by transferring earnings and profits from China to the Cayman Islands, it provides increased flexibility to ultimately repatriate these earnings and profits to the U.S. for various strategic purposes. Currently, we do not intend to repatriate any earnings and profits to the U.S. until after our U.S. loss carryforwards are fully utilized, which we currently expect to be approximately two years.

During the second quarter of fiscal 2017, management decided to invest approximately \$31.0 million in investment grade U.S. Corporate bonds with maturities primarily ranging from 2 to 2.5 years. The purpose of this investment was to earn a higher rate of return on our excess cash located in the Cayman Islands. These investments are classified as held-to-maturity as we have the positive intent and ability to hold these investments until maturity.

Dividend Program

On February 28, 2017, we announced that our board of directors approved a quarterly cash dividend of \$0.08 per share. This payment will be made on or about April 17, 2017, to shareholders of record as of April 3, 2017.

During the nine months ended January 29, 2017, dividend payments totaled \$5.3 million, of which \$2.6 million represented a special cash dividend payment of \$0.21 per share, and \$2.7 million represented quarterly dividend payments ranging from \$0.07 to \$0.08 per share.

During the nine months ended January 31, 2016, dividend payments totaled \$7.3 million, of which \$5.0 million represented a special cash dividend of \$0.40 per share, and \$2.3 million represented quarterly dividend payments ranging from \$0.06 to \$0.07 per share.

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

Common Stock Repurchase Program

On June 15, 2016, we announced that our board of directors approved an authorization for us to acquire up to \$5.0 million of our common stock. Under the common stock repurchase program, shares may be purchased from time to time in open market transactions, block trades, through plans established under the Securities Exchange Act Rule 10b5-1, or otherwise. The amount of shares purchased and the timing of such purchases will be based on working capital requirements, market and general business conditions, and other factors including alternative investment opportunities.

During the nine months ended January 29, 2017, and January 31, 2016, we did not purchase any shares of our common stock.

At January 29, 2017, we had \$5.0 million available for additional repurchases of our common stock.

Working Capital

Accounts receivable at January 29, 2017, were \$22.7 million, a decrease of \$4.1 million, or 15%, compared with \$26.8 million at January 31, 2016. This decrease is primarily due to lower business volume associated with our upholstery fabrics segment as a result of the timing of the Chinese New Year holiday that started in January for fiscal 2017 as opposed to February for fiscal 2016. In addition, this decrease is also due to improved cash collections as customers associated with our mattress fabrics segment were taking more advantage of sales discounts in the third quarter of fiscal 2017 compared with the third quarter of fiscal 2016. Days' sales outstanding were 27 days for the third quarter of fiscal 2017 compared with 31 days for the third quarter of fiscal 2016.

Inventories as of January 29, 2017, were \$46.2 million, a decrease of \$2.3 million, or 5%, compared with \$48.5 million at January 31, 2016. The decrease in inventory is primarily due to improved inventory management. Inventory turns were 5.2 for the third quarter of fiscal 2017 compared with 5.1 for the third quarter of fiscal 2016.

Accounts payable-trade as of January 29, 2017, were \$22.4 million, a decrease of \$3.2 million, or 13%, compared with \$25.6 million at January 31, 2016. This decrease is primarily due to lower business volume associated with our upholstery fabrics segment as a result of the timing of the Chinese New Year holiday as noted above.

Operating working capital (accounts receivable and inventories, less accounts payable-trade and accounts payable-capital expenditures) was \$41.0 million at January 29, 2017, compared with \$49.3 million at January 31, 2016. Operating working capital turnover was 7.0 during the third quarter of fiscal 2017 compared with 7.2 during the third quarter of fiscal 2016.

Financing Arrangements

Currently, we have revolving credit agreements with banks for our U.S parent company and our operations located in China. The purposes of our revolving lines of credit are to support potential short term cash needs in different jurisdictions, mitigate our risk associated with foreign currency exchange rate fluctuations, and ultimately repatriate earnings and profits from our foreign subsidiaries to the U.S. for various strategic purposes. Our revolving credit agreements require us to maintain compliance with certain financial covenants as defined in the respective agreements.

At January 29, 2017, we were in compliance with all our financial covenants.

Refer to Note 8 located in the notes to the consolidated financial statements for further details of our revolving credit agreements.

Capital Expenditures and Depreciation

Overall

Capital expenditures on a cash basis were \$10.3 million (of which \$1.0 million was vendor financed) for the nine month period ending January 29, 2017, compared with \$7.7 million for the same period a year ago. Capital expenditures for fiscal 2017 and 2016 mostly related to our mattress fabrics segment.

Depreciation expense was \$5.3 million for the nine month period ending January 29, 2017 compared with \$4.9 million for the same period a year ago. Depreciation expense for fiscal 2017 and 2016 mostly related to the mattress fabrics segment.

For fiscal 2017, we are projecting capital expenditures for the company as a whole to be in the range of \$12.0 million to \$15.0 million. Depreciation expense for the company as a whole is projected to be approximately \$7.0 million in fiscal 2017. The estimated capital expenditures and depreciation expense mostly relate to the mattress fabrics segment.

We have incurred a higher than normal level of capital spending in fiscal 2017 on expansion projects to support our growth strategy and provide flexibility to meet expected demand trends. We expect capital spending to be somewhat lower in fiscal 2018 as compared to fiscal 2017.

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.

Accounts Payable – Capital Expenditures

At January 29, 2017, we had total amounts due regarding capital expenditures totaling \$5.6 million, of which \$4.5 million is financed and pertains to completed work for the construction of a new building (see below). Of the total amount due of \$5.6 million, \$4.9 million is required to be paid within one year from the end of our third quarter of fiscal 2017, with a remaining amount of \$708,000 due in May 2018.

Purchase Commitments – Capital Expenditures

At January 29, 2017 we had open purchase commitments to acquire a building and equipment for our mattress fabrics segment totaling \$8.2 million. The \$8.2 million includes \$4.9 million (of which \$4.5 million represents completed work) associated with the construction of a new building noted below.

Effective May 16, 2016, we entered into an agreement with a contractor to construct a new building located in North Carolina that will expand our distribution capabilities and office space at an current estimated cost of \$11.1 million. This agreement required an installment payment of \$1.9 million in April 2016 and requires additional installment payments to be made in the following fiscal years: Fiscal 2017- \$4.3 million; Fiscal 2018- \$3.8 million; and Fiscal 2019 - \$1.1 million. Interest will be charged on the required outstanding installment payments in excess of services that have been rendered at a rate of \$2.25% plus the current 30 day LIBOR rate.

Also, we were required to issue a letter of a credit totaling \$5.0 million with the contractor's bank being the beneficiary. In addition to the interest that will be charged on the outstanding installment payments noted above, there will be a 0.1% unused fee calculated on the balance of the \$5.0 million letter of credit less the amount outstanding per month (see Note 8 for further details).

The remaining \$4.9 million on this commitment is required to be paid on an installment basis over the next two fiscal years as follows: Fiscal 2018 - \$3.8 million; and Fiscal 2019 - \$1.1 million.

This new building is currently expected to be completed and placed in service in our fourth quarter of fiscal 2017.

Critical Accounting Policies and Recent Accounting Developments

At January 29, 2017, 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 May 1, 2016.

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 May 1, 2016.

Contractual Obligations

As of January 29, 2017, there were no significant or new contractual obligations from those reported in our annual report on Form 10-K for the year ended May 1, 2016, with the exception of the joint venture agreement disclosed in the mattress fabrics segment analysis section of the Results of Operations.

Inflation

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

At January 29, 2017, our U.S. revolving credit agreement requires interest to be charged at a rate (applicable interest rate of 2.23% at January 29, 2017) as a variable spread over LIBOR based on our ratio of debt to EBITDA as defined in the agreement. Our revolving credit line associated with our China subsidiaries bears interest at a rate determined by the Chinese government. At January 29, 2017, there were no borrowings outstanding under any of our revolving credit lines.

We are exposed to market risk from changes in the value of foreign currencies for our subsidiaries domiciled in Canada and China. 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 China, 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 29, 2017, 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 29, 2017, the end of the period covered by this report. This evaluation was conducted under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer. Based upon that evaluation, we have concluded that these disclosure controls and procedures are effective to ensure that information required to be disclosed in the reports filed by us and submitted under the Securities Exchange Act of 1934, as amended (the "Exchange Act") is recorded, processed, summarized, and reported as and when required. Further, we concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed in reports filed by us under the Exchange Act is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, in a manner to allow timely decisions regarding the required disclosures.

There has been no change in our internal control over financial reporting that occurred during the quarter ended January 29, 2017, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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 29, 2017. Our legal proceedings are disclosed in the company's annual report on Form 10-K filed with the Securities and Exchange Commission on July 15, 2016 for the fiscal year ended May 1, 2016.

Item 1A. Risk Factors

There have not been any material changes to our risk factors during the nine months ended January 29, 2017. Our risk factors are disclosed in the company's annual report on Form 10-K filed with the Securities and Exchange Commission on July 15, 2016 for the fiscal year ended May 1, 2016.

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

ISSUER PURCHASES OF EQUITY SECURITIES

| Period | (a) Total Number of Shares Purchased | (b) Average Price Paid per Share | (c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | (d) Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (1) |
|---|--|--|---|--|
| October 31, 2016 to December 4, 2016 | - | - | - | \$ 5,000,000 |
| December 5, 2016 to January 1, 2017 | - | - | - | \$ 5,000,000 |
| January 2, 2017 to January 29, 2017 | - | - | - | \$ 5,000,000 |
| Total | - | - | - | \$ 5,000,000 |

(1) On June 15, 2016, we announced that our board of directors increased the authorization for us to acquire up to \$5.0 million of our common stock.

Item 6. Exhibits

The following exhibits are submitted as part of this report.

- 3(i) Articles of Incorporation of the company, as amended, were filed as Exhibit 3(i) to the company's Form 10-Q for the quarter ended July 28, 2002, filed September 11, 2002 (Commission File No. 001-12597), and 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 (Commission File No. 001-12597), and incorporated herein by reference.
- 10.1 Written description of non-employee compensation was filed as Exhibit 10.1 to the company's Form 10-Q dated December 9, 2016 (Commission File No. 001-12597), and incorporated herein by reference.
- 31.1 Certification of Chief Executive Officer Pursuant to Section 302 of Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer Pursuant to Section 302 of Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer Pursuant to Section 906 of Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer Pursuant to Section 906 of Sarbanes-Oxley Act of 2002.
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema Document
- 101.CALXBRL Taxonomy Extension Calculation Linkbase Document
- 101.LABXBRL Taxonomy Extension Label Linkbase Document
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document

SIGNATURES

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

CULP, INC.
(Registrant)

Date: March 10, 2017 By: Kenneth R. Bowling
Kenneth R. Bowling
Vice President and Chief Financial Officer
(Authorized to sign on behalf of the registrant
and also signing as principal financial officer)

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

EXHIBIT INDEX

Exhibit Number Exhibit

| | |
|---------|---|
| 31.1 | Certification of Chief Executive Officer Pursuant to Section 302 of Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Chief Financial Officer Pursuant to Section 302 of Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of Chief Executive Officer Pursuant to Section 906 of Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification of Chief Financial Officer Pursuant to Section 906 of Sarbanes-Oxley Act of 2002. |
| 101.INS | XBRL Instance Document |
| 101.SCH | XBRL Taxonomy Extension Schema Document |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document |