CULP INC
Form 10-Q
September 07, 2018

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 July 29, 2018
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 incorporation or other organization)	(I.R.S. Employer Identification No.)
1823 Eastchester Drive	**27265-1402**
High Point, North Carolina	(zip code)
(Address of principal executive offices)	

(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, smaller reporting company, and emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer

Smaller Reporting Company Emerging Growth Company

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

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

Common shares outstanding at July 29, 2018: 12,522,246
Par Value: $0.05 per share

INDEX TO FORM 10-Q
For the period ended July 29, 2018

Item 1: Financial Statements

CULP, INC.
CONSOLIDATED STATEMENTS OF NET INCOME
FOR THE THREE MONTHS ENDED JULY 29, 2018 AND JULY 30, 2017
UNAUDITED
(Amounts in Thousands, Except for Per Share Data)

	THREE MONTHS ENDED	
	July 29, 2018	July 30, 2017
Net sales	$71,473	79,533
Cost of sales	60,914	63,068
Gross profit	10,559	16,465
Selling, general and administrative expenses	8,033	9,501
Restructuring expense	451	-
Income from operations	2,075	6,964
Interest expense	20	-
Interest income	(150)	(131)
Other expense	257	353
Income before income taxes	1,948	6,742
Income taxes	906	1,640
Loss from investment in unconsolidated joint venture	77	118
Net income	$965	4,984
Less: Net income attributable to non-controlling interest	(8)	-
Net income attributable to Culp, Inc. common shareholders	$957	4,984
Net income attributable to Culp Inc. common shareholders per share - basic	$0.08	0.40
Net income attributable to Culp Inc. common shareholders per share - diluted	$0.08	0.40
Average shares outstanding, basic	12,510	12,399
Average shares outstanding, diluted	12,600	12,590

See accompanying notes to consolidated financial statements.

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CULP, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
FOR THE THREE MONTHS ENDED JULY 29, 2018 AND JULY 30, 2017
(UNAUDITED)
(AMOUNTS IN THOUSANDS)

	THREE MONTHS ENDED			
	July 29, 2018		July 30, 2017	
Net income	$	965	$	4,984
Other comprehensive income				
Unrealized gain on investments, net of tax				
Unrealized holding gains on investments		40		44
Reclassification adjustment for realized loss on investments		94		-
Total unrealized gain on investments		134		44
Unrealized gain on foreign currency cash flow hedge, net of tax				
Unrealized holding loss on foreign currency cash flow hedge		(25)		-
Reclassification adjustment for realized loss on foreign currency cash flow hedge		40		-
Total unrealized gain on foreign currency cash flow hedge		15		-
Total other comprehensive income		149		44
Comprehensive income	$	1,114	$	5,028
		-		-

Less: Comprehensive income attributable to non-controlling interest				
Comprehensive income attributable to Culp, Inc. common shareholders	$	1,114	$	5,028

See accompanying notes to consolidated financial statements.

CULP, INC.
CONSOLIDATED BALANCE SHEETS
JULY 29, 2018, JULY 30, 2017 AND APRIL 29, 2018
UNAUDITED
(Amounts in Thousands)

	July 29, 2018	July 30, 2017	*April 29, 2018
Current assets:			
Cash and cash equivalents	$8,593	18,322	21,228
Short-term investments - Available for Sale	-	2,469	2,451
Short-term investments - Held-To-Maturity	30,756	-	25,759
Accounts receivable, net	23,225	22,140	26,307
Inventories	54,989	55,227	53,454
Other current assets	3,852	3,441	2,870
Total current assets	121,415	101,599	132,069
Property, plant and equipment, net	53,178	52,912	51,794
Goodwill	27,222	11,462	13,569
Deferred income taxes	3,721	436	1,458
Long-term investments - Held-To-Maturity	-	30,907	5,035
Long-term investments - Rabbi Trust	7,671	6,714	7,326
Investment in unconsolidated joint venture	1,525	1,477	1,501
Other assets	11,640	2,397	5,232
Total assets	$226,372	207,904	217,984
Current liabilities:			
Accounts payable-trade	$25,070	29,112	27,237
Accounts payable - capital expenditures	862	5,647	1,776
Deferred revenue	634	-	809
Accrued expenses	8,176	6,075	9,325
Accrued restructuring costs	445	-	-
Income taxes payable - current	1,244	884	1,437
Total current liabilities	36,431	41,718	40,584
Line of credit	4,000	5,000	-
Accrued expenses - long-term	749	-	763
Contingent consideration - earn-out obligation	5,600	-	-
Income taxes payable - long-term	3,733	487	3,758
Deferred income taxes	2,150	4,253	2,150
Deferred compensation	7,679	6,769	7,353
Total liabilities	60,342	58,227	54,608
Commitments and Contingencies (Notes 12 and 21)			
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 12,522,246 at July 29, 2018; 12,441,161 at July 30, 2017; and 12,450,276 at April 29, 2018	627	622	623
Capital contributed in excess of par value	46,334	47,038	48,203
Accumulated earnings	114,465	101,977	114,635
Accumulated other comprehensive income (loss)	64	40	(85)
Total shareholders' equity attributable to Culp Inc.	161,490	149,677	163,376
Non-controlling interest	4,540	-	-
Total equity	166,030	149,677	163,376
Total liabilities and shareholders' equity	$226,372	207,904	217,984

* Derived from audited financial statements.

See accompanying notes to consolidated financial statements.

CULP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED JULY 29, 2018 AND JULY 30, 2017
UNAUDITED
(Amounts in Thousands)

	THREE MONTHS ENDED	
	July 29, 2018	July 30, 2017
Cash flows from operating activities:		
Net income	$965	4,984
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation	2,015	1,807
Amortization of assets	145	82
Stock-based compensation	(501)	757
Deferred income taxes	(2,263)	643
Realized loss on sale of short-term investments (Available for Sale)	94	-
Loss on disposal of equipment	35	-
Loss from investment in unconsolidated joint venture	77	118
Foreign currency exchange (gain) loss	(91)	35
Changes in assets and liabilities:		
Accounts receivable	2,837	2,524
Inventories	(429)	(3,539)
Other current assets	(989)	(467)
Other assets	34	(47)
Accounts payable - trade	(2,494)	(397)
Deferred revenue	(175)	-
Accrued expenses and deferred compensation	(1,566)	(4,704)
Accrued restructuring costs	445	-
Income taxes	(75)	608
Net cash (used in) provided by operating activities	(1,936)	2,404
Cash flows from investing activities:		
Capital expenditures	(757)	(2,260)
Net cash paid for acquisition of businesses	(11,971)	-
Investment in unconsolidated joint venture	(100)	(489)
Proceeds from the sale of short-term investments (Available for Sale)	2,458	-
Purchase of short-term investments (Available for Sale)	(10)	(12)
Proceeds from the sale of long-term investments (Rabbi Trust)	-	49
Purchase of long-term investments (Rabbi Trust)	(302)	(1,267)
Net cash used in investing activities	(10,682)	(3,979)

Cash flows from financing activities:		
Proceeds from line of credit	11,000	5,000
Payments on line of credit	(7,000)	-
Payments on vendor-financed capital expenditures	(1,412)	(1,250)
Dividends paid	(1,127)	(3,608)
Common stock surrendered for withholding taxes payable	(1,292)	(1,135)
Common stock repurchased	(72)	-
Proceeds from common stock issued	-	5
Net cash provided by (used in) financing activities	97	(988)
Effect of exchange rate changes on cash and cash equivalents	(114)	90
Decrease in cash and cash equivalents	(12,635)	(2,473)
Cash and cash equivalents at beginning of period	21,228	20,795
Cash and cash equivalents at end of period	$8,593	18,322

See accompanying notes to consolidated financial statements.

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

	Shareholders' eqity attributable to Culp Inc.							
	Common Stock		Capital Contributed in Excess of Par	Accumulated	Accumulated Other Comprehensive (Loss)		Non-Controlling	Total
	Shares	Amount	Value	Earnings	Income	Total	Interest	Equity
Balance, April 30, 2017 *	12,356,631	$ 618	47,415	100,601	(4)	$ 148,630	$ -	$ 148,630
Net income	-	-	-	20,877	-	20,877	-	20,877
Stock-based compensation	-	-	2,212	-	-	2,212	-	2,212
Unrealized loss on foreign currency cash flow hedge	-	-	-	-	(55)	(55)	-	(55)
Unrealized loss on investments	-	-	-	-	(26)	(26)	-	(26)
Common stock issued in connection with vesting of performance based restricted stock units	118,845	6	(6)	-	-	-	-	-
Fully vested common stock award	4,800	-	-	-	-	-	-	-
Common stock issued in connection with vesting of time-based restricted stock units	1,200	-	-	-	-	-	-	-
Common stock issued in connection with exercise of stock options	15,600	1	110	-	. -	111	-	111
Common stock surrendered for the cost of stock option excercises and withholding taxes payable	(46,800)	(2)	(1,528)	-	-	(1,530)	-	(1,530)
Dividends paid	-	-	-	(6,843)	-	(6,843)	-	(6,843)
Balance, April 29, 2018 *	12,450,276	623	48,203	114,635	(85)	163,376	-	163,376

Net income	-	-	-	957	-	957	8	965
Acquisition of subsidiary with non-controlling interest	-	-	-	-	-	-	4,532	4,532
Stock-based compensation	-	-	(501)	-	-	(501)	-	(501)
Unrealized gain on foreign currency cash flow hedge	-	-	-	-	15	15	-	15
Unrealized gain on investments	-	-	-	-	134	134	-	134
Common stock issued in connection with vesting of performance based restricted stock units	115,917	6	(6)	-	-	-	-	-
Common stock issued in connection with vesting of time- based restricted stock units	1,200	-	-	-	-	-	-	-
Common stock surrendered for withholding taxes payable	(42,157)	(2)	(1,290)	-	-	(1,292)	-	(1,292)
Common stock repurcchased	(2,990)	-	(72)	-	-	(72)	-	(72)
Dividends paid	-	-	-	(1,127)	-	(1,127)	-	(1,127)
Balance, July 29, 2018	12,522,246	$ 627	46,334	114,465	64	$ 161,490	$ 4,540	$ 166,030

* Derived from audited financial statements.

See accompanying notes to consolidated financial statements.

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

1. Basis of Presentation

The accompanying unaudited consolidated financial statements of Culp, Inc. and its majority-owned 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 13, 2018, for the fiscal year ended April 29, 2018.

The company's three-months ended July 29, 2018, and July 30, 2017, represent 13 week periods, respectively.

2. Significant Accounting Policies

As of July 29, 2018, there were no changes in the nature of our significant accounting policies or the application of those policies from those reported in our annual report on Form 10-K for the year then ended April 29, 2018.

Recently Adopted Accounting Pronouncements

In May 2014, the FASB issued ASU No. 2014-09, which subsequently amended 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. The new revenue standard became effective at the beginning of our fiscal 2019, and therefore, we applied the new revenue guidance in our first quarter of fiscal 2019 interim financial statements. This guidance did not have a material impact on our results of operations and financial position but did have a material impact on the disclosures required in our notes to the consolidated financial statements, which are disclosed in Note 5.

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 new standard, which is to be applied retrospectively, became effective at the beginning of our fiscal 2019, and therefore, we applied this new guidance in our first quarter of fiscal 2019 interim financial statements. During the first quarter of fiscal 2019, this new guidance did not impact our results of operations, balance sheet, or statement of cash flows. Currently, we do expect that this guidance will be applicable in determining how we classify our contingent consideration payments associated with our business combinations (see note 2) as either investing or financing activities. This guidance requires cash payments not made soon after the acquisition date of a business combination by an acquirer to settle a contingent consideration liability should be separated and classified as cash outflows from financing activities. In comparison, cash payments made soon after the acquisition date should be separated and classified as cash outflows from investing activities.

In October 2016, the FASB issued ASU No. 2016-16, Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other 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 standard, which is required to be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings, became effective at the beginning of our fiscal 2019. Therefore, we were required to apply this new guidance in our first quarter fiscal 2019 interim financial statements. This guidance did not impact our results of operations and financial position.

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

Recently Issued Accounting Pronouncements

Leases

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.

The FASB recently issued ASU No. 2018-11, “Leases (Topic 842): Targeted Improvements”, which allows entities to apply the transition provisions of the new standard at its adoption date instead of the earliest comparative period presented in the consolidated financial statements. This ASU allows entities to continue to use Topic 840, Leases, including its disclosure requirements, in the comparative periods presented in the year the new leases standard is adopted. Entities that elect this option would still adopt the new leases standard using a modified retrospective transition method but would recognize a cumulative effect adjustment to the opening balance of retained earnings in the period of adoption rather than in the earliest period presented.

We are required to apply this guidance in our fiscal 2020 interim and annual financial statements and are currently assessing the impact the above guidance will have on our consolidated financial statements, but we expect this guidance to have a material impact on our financial position due to the requirement to recognize right-of-use assets and lease liabilities on our Consolidated Balance Sheets.

3. Business Combinations

Read Window Products, LLC (Read)

Overview

Effective April 1, 2018, we entered into an Asset Purchase Agreement (Asset Agreement) to acquire certain assets and assume certain liabilities of Read, a source of custom window treatments for the hospitality and commercial industries. Based in Knoxville, Tennessee, Read is a turn-key provider of window treatments offering measuring, sourcing, fabrication and installation services. Read’s custom product line includes motorization, shades, drapery, upholstered headboards and shower curtains. In addition, Read supplies soft goods such as decorative top sheets, coverlets, duvet covers, bed skirts, bolsters and pillows, for leading hospitality brands worldwide. The addition of window treatments and other soft goods to our product line will allow us to be a more complete source of fabrics for the hospitality market, in which we believe there are significant growth opportunities.

The purchase price for the net assets acquired was $5.7 million, of which $4.5 million was paid at closing on April 1, 2018, $375,000 was paid in May 2018, and $763,000 is to be paid in June in 2019, subject to certain conditions as defined in the Asset Agreement.

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

Assets Acquired and Liabilities Assumed

The following table presents the final allocation of the acquisition cost to the assets acquired and liabilities assumed based on their fair values.

(dollars in thousands)	Fair Value
Customer relationships	$2,247
Goodwill	2,107
Inventory	1,128
Accounts receivable	897
Tradename	683
Property, plant & equipment	379
Other assets	35
Deferred revenue	(903)
Accounts payable	(719)
Accrued expenses	(174)
	$5,680

We recorded customer relationships at fair market value based on a multi-period excess earnings valuation model. These customer relationships will be amortized on a straight-line basis over their nine-year useful life. We recorded the tradename at fair market based on the relief from royalty method. This tradename was determined to have an indefinite useful life and, therefore, is not being amortized. Equipment will be depreciated on a straight-line basis over useful lives ranging from three to ten years.

The goodwill related to this acquisition is attributable to Read's reputation with the products and services they provide and the collective experience of management with regards to its operations, customers, and industry. Goodwill was assigned to the upholstery fabrics segment and is deductible for income tax purposes over the statutory period of fifteen years.

The Asset Agreement contains a contingent consideration arrangement that requires us to pay a former shareholder of Read an earn-out payment based on adjusted EBITDA as defined in the agreement for calendar year 2018 in excess of fifty percent of a pre-established adjusted EBITDA target as defined in the agreement. As of July 29, 2018, based on historical and projected financial results in relation to the pre-established adjusted EBITDA target, we currently believe a contingent payment will not be made, and therefore, no contingent liability has been recorded.

Other

Acquisition costs totaling $339,000 were included in selling, general, and administrative expenses in our fiscal 2018 Consolidated Statement of Net Income.

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

eLuxury, LLC (eLuxury)

Overview

Effective June 22, 2018, we entered into an Equity Purchase Agreement (Equity Agreement) in which we acquired an initial 80% ownership interest in eLuxury, an e-commerce company offering bedding accessories and home goods directly to consumers. eLuxury's primary products include a line of mattress pads manufactured at eLuxury's facility located in Evansville, Indiana. eLuxury also offers handmade platform beds, cotton bed sheets, as well as other bedding items. Their products are available on eLuxury's own branded website, eLuxury.com, Amazon and other leading online retailers for specialty home goods.

We believe this acquisition will provide a new sales channel for bedding accessories and will expand our opportunity to participate in the e-commerce direct-to-consumer space. This business combination brings together eLuxury's experience in e-commerce, online brand building, and direct-to-consumer shopping and fulfillment expertise with our global production, sourcing, and distribution capabilities. We also have an opportunity to market our new line of bedding accessories, marketed under the brand name, "Comfort Supply Company by Culp," as well as other finished products that we may develop, through this e-commerce platform.

The estimated consideration given for the initial 80% ownership interest in eLuxury totaled $18.1 million, of which $12.5 million represents the estimated purchase price and $5.6 million represents the fair value for contingent consideration associated with an earn-out obligation (see below for further details). Of the $12.5 million estimated purchase price, $11.6 million was paid at closing on June 22, 2018, $185,000 was paid in August 2018, and $749,000 is to be paid in September 2019, subject to certain conditions as defined in the Equity Agreement.

Assets Acquired and Liabilities Assumed

The following table presents the preliminary allocation of the acquisition cost to the assets acquired and liabilities assumed based on their fair values.

(dollars in thousands)	Fair Value
Goodwill	$13,653
Tradename	6,549
Equipment	2,179
Inventory	1,804
Accounts receivable and other current assets	108
Accounts payable	(1,336)
Accrued expenses	(295)
Non-controlling interest in eLuxury	(4,532)
	$18,130

The estimated fair values of the assets acquired and liabilities assumed are provisional and are based on the information that was currently available to estimate the fair value of assets acquired and liabilities assumed. We believe that information provides a reasonable basis for estimating the fair values of assets acquired and liabilities assumed, but we are waiting for additional information necessary to finalize those fair values. Therefore, the provisional measurements of fair value reflected are subject to change and such changes could be significant. The Company expects to finalize the valuation and complete the purchase price allocation as soon as practicable but no later than one year from the acquisition date.

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

We recorded the tradename at fair market based on the relief from royalty method. This tradename was determined to have an indefinite useful life and, therefore, is not being amortized. Equipment will be depreciated on a straight-line basis over useful lives ranging from five to ten years.

The goodwill related to this acquisition is attributable to eLuxury's reputation with the products they offer and management's experience in e-commerce, online brand building, and direct-to-consumer shopping and fulfillment expertise. Goodwill was assigned to the mattress fabrics segment and is deductible for income tax purposes over the statutory period of fifteen years.

As mentioned above, the Equity Agreement contains a contingent consideration arrangement that requires us to pay the seller who is also the shareholder of the noncontrolling interest an earn-out payment based on eLuxury's adjusted EBITDA for the twelve month period ending August 31, 2021, as defined in the Equity Agreement. We recorded a contingent liability for this earn-out obligation at its fair value totaling $5.6 million based on the Black Scholes pricing model.

Consolidation and Non-Controlling Interest

The Equity Agreement contains substantive profit-sharing arrangement provisions in which it explicitly states the ownership interests at the effective date of this business combination and the allocation of net income or loss between the controlling interest (Culp) and the noncontrolling interest. The Equity Agreement states that at the effective date of this acquisition (June 22, 2018), Culp acquired an 80% ownership interest in eLuxury with the seller retaining a 20% noncontrolling interest. Additionally, the Equity Agreement states that eLuxury's net income or loss will be allocated at a percentage of 70% and 30% to Culp and the noncontrolling interest, respectively.

As result of the acquisition of our 80% controlling interest, we included all the accounts of eLuxury in our consolidated financial statements and have eliminated all significant intercompany balances and transactions.

Based on the terms of the Equity Agreement, we believe the related risks associated with the ownership interests are aligned and therefore, the total consideration of $18.1 million for the 80% controlling interest provides information for the equity value of eLuxury as a whole, and therefore, is useful in estimating the fair value of the 20% noncontrolling interest. In order to determine the carrying value of our noncontrolling interest in eLuxury, we applied the Hypothetical-Liquidation-At-Book-Value method (HLBV). HLBV is an approach that is used in practice to determine the carrying value of a noncontrolling interest if it is consistent with an existing profit-sharing arrangement such as the Equity Agreement. Therefore, the carrying amount of the noncontrolling interest of $4.5 million represents the $4.5 million fair value determined at the acquisition date plus its allocation of net income totaling $8,000 subsequent to the acquisition date and until the end of our first quarter of fiscal 2019.

Other

Acquisitions costs totaling $270,000 were in included in selling, general, and administrative expenses in our Consolidated Statement of Net Income for the three-month period ending July 29, 2018.

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

Actual revenue and net income for the period June 22, 2018 through July 29, 2018 were included in our Consolidated Statement of Net Income for the three-months ended July 29, 2018, and totaled $2.6 million and $27,000, respectively.

Pro Forma Financial Information

The following unaudited pro forma consolidated results of operations for the three-month periods ending July 29, 2018, and July 30, 2017, have been prepared as if the acquisitions of Read had occurred on May 2, 2016 and eLuxury had occurred on May 1, 2017.

	Three Months Ended	
(dollars in thousands, except per share data)	July 29, 2018	July 30, 2017
Net Sales	$74,598	$88,739
Income from operations	2,073	6,867
Net income	939	4,875
Net income (loss) - noncontrolling interest	-	(85)
Net income – Culp Inc. common shareholders	939	4,959
Net income per share (basic) – Culp Inc. common shareholders	0.08	0.40
Net income per share (diluted) – Culp Inc. common shareholders	0.07	0.39

The unaudited pro forma information is presented for informational purposes only and is not necessarily indicative of the results of operations that actually would have been achieved had the acquisition been consummated as of that time, nor is it intended to be a projection of future results.

4. Accounts Receivable

A summary of accounts receivable follows:

(dollars in thousands)	July 29, 2018	July 30, 2017	April 29, 2018
Customers	$23,793	$23,548	$28,097
Allowance - doubtful accounts	(366)	(325)	(357)
Allowance - cash discounts	(150)	(238)	(245)
Allowance - sales returns & allowances (1)	(52)	(845)	(1,188)
	$23,225	$22,140	$26,307

(1) Due to the adoption of ASC Topic 606, Revenue from Contracts with Customers, certain balance sheet reclassifications were required regarding our allowance for sales returns and allowances for the current year's presentation only. See Note 5 to the consolidated financial statements for required balance sheet disclosures associated

with the adoption of ASC Topic 606.

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

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

	Three months ended	
(dollars in thousands)	July 29, 2018	July 30, 2017
Beginning balance	$(357)	$(414)
Provision for bad debts	(9)	89
Net write-offs, net of recoveries	-	-
Ending balance	$(366)	$(325)

A summary of the activity in the allowances for sales returns and allowances and cash discounts follows:

	Three months ended	
(dollars in thousands)	July 29, 2018	July 30, 2017
Beginning balance	$(1,433)	$(1,220)
Adoption of ASC Topic 606 (1)	1,145	-
Provision for returns, allowances and discounts	(487)	(628)
Credits issued	573	765
Ending balance	$(202)	$(1,083)

5. Revenue

Revenue from Contracts with Customers

On April 30, 2018, we adopted ASU 2014-09 "Revenue from Contracts with Customers" (ASC Topic 606 or the "new standard") using the retrospective modified method. The retrospective modified method requires an adjustment to the opening balance of retained earnings for the cumulative effect of initially applying the new revenue standard. As permitted by the transition guidance, we elected to apply the new standard only to contracts that were not completed at the date of initial application, and therefore, we only evaluated those contracts that were in-process and not completed before April 30, 2018.

The application of the new standard did not result in a material impact to the opening balance of retained earnings, and therefore no adjustment to retained earnings was recorded. The largest impact of applying the new standard are the required qualitative and quantitative disclosures and the presentation and classification related to estimates of allowances for sales returns. The cumulative effect of the classification changes related to our allowances for sales returns on our April 30, 2018, balance sheet are as follows:

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(dollars in thousands)	Balance at April 29, 2018	Adjustments Due to ASC 606 Adoption (1)	Balance at April 30, 2018
Balance Sheet			
Assets:			
Accounts Receivable	$26,307	$ 1,145	$27,452
Other Current Assets	2,870	27	2,897
Liabilities:			
Accrued Expenses	9,325	1,172	10,497

(1) The adjustments associated with the adoption of the new standard are related to classifying allowances for estimated sales returns as a liability rather than as a contra account to accounts receivable on the consolidated balance sheet for the current year's presentation only. As required under the new standard, we also recorded the estimated allowance for sales returns on a gross basis rather than a net basis by separately reflecting a return goods asset within other current assets rather than netting it with the estimated sales returns liability.

Currently, we expect the adoption of this new standard to be immaterial to our net income on an ongoing basis. The effect of adopting ASC 606 on our Consolidated Statements of Net Income and Consolidated Balance Sheets for the three months ended July 29, 2018, are as follows:

(dollars in thousands)	Three months ended July 29, 2018	Adjustments Due to ASC 606 Adoption (1)	Balances Without ASC 606 Adoption
Statements of Net Income			
Net Sales	$71,473	$ (40)	$ 71,433
Cost of Sales	60,914	(40)	60,874
Balance Sheet			
Assets:			
Accounts Receivable	$23,225	$ 1,123	$ 24,348
Other Current Assets	3,852	(40)	3,812
Liabilities:			
Accrued Expenses	$8,176	1,163	$ 9,339

(1) The adjustments associated with the adoption of the new standard are related to classifying allowances for estimated sales returns as a liability rather than as a contra account to accounts receivable on the consolidated balance sheet for the current year's presentation only. As required under the new standard, we also recorded the estimated allowance for sales returns on a gross basis rather than a net basis by separately reflecting a return goods asset within other current assets rather than netting it with the estimated sales returns liability.

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Nature of Performance Obligations

Our operations are classified into two business segments: mattress fabrics and upholstery fabrics. The mattress fabrics segment manufactures, sources, and primarily sells fabrics and mattress covers to bedding manufacturers. The upholstery fabrics segment manufactures, sources, develops, and sells fabrics primarily to residential and commercial furniture manufacturers. Effective April 1, 2018, we acquired Read (see Note 3 for further details), a turn key provider of window treatments offering measuring, sourcing, fabrication, and installation services for the hospitality and commercial industries. In addition, Read supplies soft goods such as decorative top sheets, coverlets, duvet covers, bed skirts, bolsters and pillows. Effective June 22, 2018, we acquired a majority interest in eLuxury (see Note 3 for further details), an e-commerce company offering bedding accessories and home products directly to consumers.

Our primary performance obligations primarily include the sale of mattress and upholstery fabric products and the performance of customized fabrication and installation services associated window treatments.

Significant Judgments

Revenue is recognized upon the transfer of control of promised products or services to customers in an amount that reflects the consideration we expect to receive in exchange for those products or services. We determined that our customer purchase orders represent contracts as defined in the new standard. In addition to purchase orders, we also have supply contracts with certain customers that define standard terms and conditions. Our contracts generally include promises to sell either upholstery fabric or mattress fabric products or promises to provide fabrication and installation services associated with customized window treatments. The transaction price is typically allocated to performance obligations based upon stand-alone selling prices. We do not disclose the value of unsatisfied performance obligations as substantially all of any unsatisfied performance obligations as of July 29,2018, will be satisfied within one year or less. Revenue associated with sales of our products are recognized at the point-in-time when control of the promised goods has been transferred to the customer. The point-in-time when control transfers to the customer depends on the contractually agreed upon shipping terms, but typically occurs once the product has been shipped or once it has been delivered to a location specified by the customer. For certain warehousing arrangements, transfer of control to the customer is deemed to have occurred when the customer pulls the inventory for use in their production. Revenue associated with our customized fabrication services, which are performed on various types of window treatments, are recognized over time and determined when the products on which those services are performed have no alternative use but for which we have an enforceable right to payment for the services expended. Revenue for our customized fabrication services are recognized over time using the output method based on units produced. Revenue associated with our installation services of window treatments are also recognized over time as it is determined when the customer receives and consumes the benefits as we perform the promised installation services. Revenue associated with our installation services are recognized over time using the output method based on units installed.

We evaluated the nature of any guarantees or warranties related to our contracts with customers and determined that any such warranties are assurance-type warranties that cover only compliance with agreed upon specifications, and therefore are not considered separate performance obligations. We have elected to treat both shipping costs and handling costs as fulfillment costs which are classified in the Consolidated Statements of Net Income as cost of sales and selling, general and administrative expenses, respectively.

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Revenue is measured as the amount of consideration we expect to receive in exchange for the transfer of the promised products and services. The amount of consideration we expect to receive changes due to variable consideration associated with allowances for sales returns, early payment discounts, and volume rebates that we offer to customers. The amount of variable consideration which is included in the transaction price is only included in net sales to the extent that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur in a future period. We only allow product returns to the extent that the products or services did not meet the contractually agreed upon specifications at the time of the sale. Customers must receive authorization prior to returning products. Estimates of allowances for sales returns are based on historical data, current potential product return issues, and known sales returns for which customers have been granted return authorization. Known sales returns for which customers have been granted permission to return products for a refund or credit, continue to be recorded as a contra account receivable. Estimates for potential future sales returns and related customer accommodations are now recorded within accrued expenses as required by the new standard. Under the new standard we record estimates for sales returns on a gross basis rather than a net basis and an estimate of a right of return asset is recorded in other current assets and cost of goods sold. Variable consideration associated with early payment cash discounts are estimated using current payment trends and historical data on a customer-by-customer basis. The variable consideration associated with volume rebates are based on the portion of the rebate earned relative to the total amount of rebates the customer is expected to earn over the rebate period as determined using historical data and projections.

Revenue is recognized net of any taxes collected from customers which are subsequently remitted to governmental authorities. We generally recognize sales commission as expense when incurred because the amortization period is one year or less. Sales commissions are recorded within selling, general, and administrative expenses in the Consolidated Statements of Net Income.

Contract Assets & Liabilities

Certain contracts, primarily those for customized fabrication and installation services, require upfront customer deposits that result in a contract liability which is recorded on the Consolidated Balance Sheet as deferred revenue. If upfront deposits or prepayment are not required, customers may be granted credit terms which generally range from 15 – 45 days. Such terms are common within the industries we are associated and are not considered financing arrangements. There were no contract assets recognized as of July 29, 2018.

A summary of the activity for deferred revenue follows:

(dollars in thousands)	Three Months Ended July 29, 2018
Balance as of April 29, 2018	$ 809
Revenue recognized on contract liabilities during the period	(742)
Payments received for services not yet rendered during the period	567
Balance as of July 29, 2018	$ 634

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Disaggregation of Revenue

The following table presents our disaggregated revenue by segment, timing of revenue recognition, and product sales versus services rendered for the three-month period ending July 29, 2018
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Net Sales

(dollars in thousands)	Mattress Fabrics	Upholstery Fabrics	Total
Products transferred at a point in time	$36,983	$31,821	$68,804
Services transferred over time	-	2,669	2,669
Total Net Sales	$36,983	$34,490	$71,473

6. Inventories

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

A summary of inventories follows:

(dollars in thousands)	July 29, 2018	July 30, 2017	April 29, 2018
Raw materials	$5,291	$6,956	$6,024
Work-in-process	2,413	2,782	3,264
Finished goods	47,285	45,489	44,166
	$54,989	$55,227	$53,454

7. Other Noncurrent Assets

A summary of other noncurrent assets follows:

(dollars in thousands)	July 29, 2018	July 30, 2017	April 29, 2018
Tradenames	$7,232	$-	$683
Customer relationships, net	2,764	651	2,839
Non-compete agreement, net	734	809	753
Cash surrender value – life insurance	393	376	393
Other	517	561	564
	$11,640	$2,397	$5,232

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Tradename

A summary of the carrying amount of our tradenames from our recent acquisitions (see Note 3) follow:

(dollars in thousands)	July 29, 2018	July 30, 2017	April 29, 2018
Read	$683	$ -	$683
eLuxury	6,549	-	-
	$7,232	$ -	$683

Our tradenames were recorded at their fair market values at the effective date of their acquisitions (see Note 3) and were based on the relief from royalty method. These tradenames were determined to have an indefinite useful life and therefore, are not being amortized.

Customer Relationships

A summary of the change in the carrying amount of our customer relationships follows:

	Three months ended	
(dollars in thousands)	July 29, 2018	July 30, 2017
Beginning balance	$2,839	$664
Acquisition of assets	-	-
Amortization expense	(75)	(13)
Loss on impairment	-	-
Ending balance	$2,764	$651

In connection with our asset purchase agreement with Read (see note 3) on April 1, 2018, we purchased certain customer relationships. We recorded these customer relationships at fair market value totaling $2.2 million based on a multi-period excess earnings valuation model. These customer relationships will be amortized on a straight-line basis over their nine-year useful life.

Additionally, we have customer relationships from a prior acquisition with a carrying amount of $600,000 at July 29, 2018. These customer relationships are being amortized on a straight-line basis over their seventeen-year useful life.

The gross carrying amount of our customer relationships were $3.1 million, $868,000 and $3.1 million at July 29, 2018, July 30, 2017, and April 29, 2018, respectively. Accumulated amortization for these customer relationships were $351,000, $217,000 and $276,000 at July 29, 2018, July 30, 2017, and April 29, 2018, respectively.

The remaining amortization expense for the next five fiscal years and thereafter follows: FY 2019 - $226,000; FY 2020 - $301,000; FY 2021 - $301,000; FY 2022 - $301,000; FY 2023 - $301,000; and Thereafter - $1,334,000.

The weighted average amortization period for our customer relationships is 9.4 years as of July 29, 2018.

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Non-Compete Agreement

A summary of the change in the carrying amount of our non-compete agreement follows:

	Three months ended	
(dollars in thousands)	July 29, 2018	July 30, 2017
Beginning balance	$ 753	$ 828
Amortization expense	(19)	(19)
Loss on impairment	-	-
Ending balance	$ 734	$ 809

We have a non-compete agreement from a prior acquisition that is being amortized on a straight-line basis over the fifteen-year life of the agreement.

The gross carrying amount of this non-compete agreement was $2.0 million at July 29, 2018, July 30, 2017, and April 29, 2018, respectively. Accumulated amortization for this non-compete agreement was $1.3 million at July 29, 2018 and April 29, 2018, and $1.2 million at July 30, 2017.

The remaining amortization expense for the next five years and thereafter follows: FY 2019 - $56,000; FY 2020 - $75,000; FY 2021 - $75,000; FY 2022 - $75,000; FY 2023 - $75,000, and Thereafter - $378,000.

The weighted average amortization period for the non-compete agreement is 9.8 years as of July 29, 2018.

Cash Surrender Value – Life Insurance

We had one life insurance contract with a death benefit of $1.4 million at July 29, 2018, July 30, 2017, and April 29, 2018, respectively. Our cash surrender value – life insurance balances totaling $393,000, $376,000 and $393,000 at July 29, 2018, July 30, 2017, and April 29, 2018, respectively, are collectible upon death of the respective insured.

8. Goodwill

A summary of the change in the carrying amount of goodwill follows:

	Three months ended	
(dollars in thousands)	July 29, 2018	July 30, 2017
Beginning balance	$ 13,569	$ 11,462

Acquisition of business (see note 3)	13,653	-
Loss on impairment	-	-
Ending balance	$27,222	$11,462

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9. Investment in Unconsolidated Joint Venture

Culp International Holdings, Ltd. (Culp), a wholly-owned subsidiary of Culp, Inc. (collectively known as CULP), entered into a joint venture agreement, pursuant to which CULP owns fifty percent of CLASS International Holdings, Ltd. (CLIH). CLIH produces cut and sewn mattress covers, and its operations are located in a modern industrial park in northeastern Haiti, which borders the Dominican Republic. CLIH commenced production during the second quarter of fiscal 2018 (October 2017) and complements our mattress fabric operations with a mirrored platform that enhances our ability to meet customer demand while adding a lower cost operation to our platform.

CLIH incurred a net loss totaling $154,000 and $236,000 for the three-month periods ending July 29, 2018 and July 30, 2017, respectively. CLIH's net loss in the first quarter of fiscal 2018 pertained to initial start-up operating expenses incurred. Our equity interests in these net losses were $77,000 and $118,000 for the three-month periods ending July 29, 2018 and July 30, 2017, respectively.

The following table summarizes information on assets, liabilities and members' equity of our equity method investment in CLIH:

(dollars in thousands)	July 29, 2018	July 30, 2017	April 29, 2018
Total assets	$3,153	$3,003	$3,130
Total liabilities	$103	$48	$128
Total members' equity	$3,050	$2,955	$3,002

At July 29, 2018, July 30, 2017, and April 29, 2018, our investment in CLIH totaled $1.5 million, which represents the company's fifty percent ownership interest in CLIH.

10. Accrued Expenses

A summary of accrued expenses follows:

(dollars in thousands)	July 29, 2018	July 30, 2017	April 29, 2018
Compensation, commissions and related benefits	$3,719	$4,535	$6,918
Interest	12	19	20
Other accrued expenses	5,194	1,521	3,150
	$8,925	$6,075	$10,088

At July 29, 2018, we had accrued expenses totaling $8.9 million, of which $8.2 million and $749,000 were classified as current accrued expenses and long-term accrued expenses, respectively, in the accompanying Consolidated Balance Sheets. At July 30, 2017, we had accrued expenses totaling $6.1 million, all of which were classified as current accrued expenses, in the accompanying Consolidated Balance Sheets. At April 29, 2018, we had accrued expenses totaling $10.1 million, of which $9.3 million and $763,000 were classified as current accrued expenses and long-term accrued expenses, respectively, in the accompanying Consolidated Balance Sheets.

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11. Exit and Disposal Activity

On June 12, 2018, our board of directors decided to close our upholstery fabrics manufacturing facility in Anderson, South Carolina. This closure is due to a continued decline in demand for the products manufactured at this facility, reflecting a change in consumer style preferences. We expect to close this facility during the second quarter of fiscal 2019. Restructuring expense and related charges totaled $2.0 million of which $1.6 million represented inventory markdowns and $451,000 represented employee termination benefits. Of this total charge, $1.6 million and $451,000 were recorded in cost of sales and restructuring expense in the Consolidated Statement of Net Income for the three-month period July 29, 2018.

As of July 29, 2018, accrued restructuring costs represented $445,000 for employee termination benefits, of which a $451,000 accrual was established as noted above, less $6,000 in severance payments during the three-month period ending July 29, 2018.

Currently, management expects to offset most of the $2.0 million charge over the second and third quarters from sale of associated property, plant, and equipment.

12. Lines of Credit

Revolving Credit Agreement – United States

At July 29, 2018, our Credit Agreement with Wells Fargo Bank, N.A. ("Wells Fargo") provided for a revolving loan commitment of $30 million. Interest was charged at a rate (applicable interest rate of 3.53%, 2.68%, and 3.36% at July 29, 2018, July 30, 2017, and April 29, 2018) 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 was 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. At July 29, 2018 and July 30, 2017, we had outstanding borrowings associated with our Credit Agreement totaling $4.0 million and $5.0 million, respectively. There were no borrowings outstanding under the Credit Agreement at April 29, 2018.

At July 29, 2018, July 30, 2017, and April 29, 2018, 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 which allowed 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, 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 21 for further details). The terms of this $5.0 million letter credit expired on May 15, 2018.

Effective August 13, 2018, we entered into a Fifth Amendment to our Credit Agreement which reduced the amount of our line of credit from $30 million to $25 million, reduced the amount of the Unencumbered Liquid Assets maintenance covenant from $20 million to $15 million, and set and expiration date of August 15, 2020. Additionally, this amendment reduced the limit of outstanding letters to $1.0 million, which includes the $250,000 workers compensation letter of credit noted above.

Revolving Credit Agreement – China

We have an unsecured credit agreement associated with our operations in China that provides for a line of credit up to 40 million RMB ($5.9 million USD at July 29, 2018) and is set to expire on March 2, 2019. This agreement has an interest rate determined by the Chinese government and there were no outstanding borrowings as of July 29, 2018, July 30, 2017, and April 29, 2018.

Overalls

Our loan agreements require, among other things, that we maintain compliance with certain financial covenants. At July 29, 2018, the company was in compliance with these financial covenants.

13. 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.

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Recurring Basis

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

	Fair value measurements at July 29, 2018 using:			
(amounts in thousands)	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	$6,749	N/A	N/A	$ 6,749
Large Blend Fund	438	N/A	N/A	438
Growth Allocation Fund	180	N/A	N/A	180
Moderate Allocation Fund	117	N/A	N/A	117
Other	187	N/A	N/A	187
Liabilities:				
EURO Foreign Currency Cash Flow Hedge	N/A	$ 40	N/A	$ 40

Fair value measurements at July 30, 2017 using:		
Quoted prices in active markets for identical assets	Significant other observable inputs	Significant unobservable inputs

(amounts in thousands)	Level 1	Level 2	Level 3	Total
Assets:				
Premier Money Market Fund	$5,991	N/A	N/A	$5,991
Low Duration Bond Fund	1,085	N/A	N/A	1,085
Intermediate Term Bond Fund	762	N/A	N/A	762
Strategic Income Fund	622	N/A	N/A	622
Large Blend Fund	381	N/A	N/A	381
Growth Allocation Fund	140	N/A	N/A	140
Moderate Allocation Fund	102	N/A	N/A	102
Other	100	N/A	N/A	100

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	Fair value measurements at April 29, 2018 using:			
	Quoted prices in active markets for identical assets	Significant other observable inputs	Significant unobservable inputs	
(amounts in thousands)	Level 1	Level 2	Level 3	Total
Assets:				
Premier Money Market Fund	$6,492	N/A	N/A	$6,492
Low Duration Bond Fund	1,085	N/A	N/A	1,085
Intermediate Term Bond Fund	747	N/A	N/A	747
Strategic Income Fund	619	N/A	N/A	619
Large Blend Fund	402	N/A	N/A	402
Growth Allocation Fund	169	N/A	N/A	169
Moderate Allocation Fund	113	N/A	N/A	113
Other	150	N/A	N/A	150
Liabilities:				
EURO Foreign Currency Cash Flow Hedge	N/A	$ 55	N/A	$55

Our EURO foreign exchange contract was recorded at a fair value provided by our bank and is classified within level 2 of the fair value hierarchy. Most derivative contracts are not listed on an exchange and require the use of valuation models. In accordance with ASC Topic 820, we attempted to maximize the use of observable inputs used in the valuation models used to determine the fair value of this contract. Derivative contracts valued based on valuation models with significant unobservable inputs and that are not actively traded, are classified within level 3 of the fair value hierarchy.

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 – Available for Sale

There were no short-term investments classified as available for sale held at July 29, 2018. At July 30, 2017 and April 29, 2018, our short-term investments classified as available for sale totaled $2.5 million and consisted of short-term bond funds. Since these short-term bond funds were classified as available for sale, these investments were recorded at their fair market value and their unrealized gains or losses are included in other comprehensive income (loss). Our short-term bond investments had an accumulated unrealized loss totaling $33,000 and $91,000 at July 30, 2017, and April 29, 2018, respectively. At July 30, 2017, and April 29, 2018, the fair value of our short-term bond funds approximated its cost basis.

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Short-Term and Long-Term Investments - Held-To-Maturity

Our investments classified as held-to-maturity consist of investment grade U.S. Corporate bonds with maturities that ranged from 2 to 2.5 years. The purpose of these investments 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 as of a respective reporting period and recorded at amortized cost.

At July 29, 2018, July 30, 2017 and April 29, 2018, our held-to-maturity investments recorded at amortized cost totaled $30.8 million, $30.9 million, and $30.8 million, respectively. The fair value of our held-to-maturity investments at July 29, 2018, July 30, 2017, and April 29, 2018 totaled $30.6 million, $30.8 million, and $30.6 million, respectively.

Our U.S. corporate bonds were classified as level 2 as they are traded over the counter within a broker network and not on an active market. The fair value of our U.S. corporate bonds is determined based on a published source that provides an average bid price. The average bid price is based on various broker prices that are determined based on market conditions, interest rates, and the rating of the respective U.S. corporate bond.

Long-Term Investments - Rabbi Trust

We have 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.

These long-term investments are recorded at their fair values of $7.7 million, $6.7 million, and $7.3 million at July 29, 2018, July 30, 2017 and April 29, 2018, respectively. Our long-term investments had an accumulated unrealized gain of $104,000, $73,000, and $61,000 at July 29, 2018, July 30, 2017, and April 29, 2018, respectively. The fair value of our long-term investments associated with our Rabbi Trust approximates its cost basis.

Other

The carrying amount of our 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.

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Nonrecurring Basis

At July 29, 2018, we had no assets that were required to be measured at fair value on a nonrecurring basis other than the assets acquired from eLuxury (see note 3) that were acquired at fair value:

	Fair value measurements at July 29, 2018 using:			
	Quoted prices in active markets for identical assets	Significant other observable inputs	Significant unobservable inputs	
(amounts in thousands)	Level 1	Level 2	Level 3	Total
Assets:				
Goodwill	N/A	N/A	$ 13,653	$13,653
Tradename	N/A	N/A	6,549	6,549
Equipment	N/A	N/A	2,179	2,179
Inventory	N/A	N/A	1,804	1,804
Liabilities:				
Contingent Consideration – Earn-Out Obligation	N/A	N/A	$ 5,600	$5,600

The tradename was recorded at fair market value using the royalty from relief method that used significant unobservable inputs and were classified as level 3. The contingent consideration – earn-out obligation was recorded at fair market value using Black Sholes pricing model.

Additionally, we acquired certain current assets such as accounts receivable and prepaid expenses and assumed certain liabilities such as accounts payable and accrued expenses. Based on the nature of these items and their short maturity, the carrying amount of these items approximated their fair values. See note 2 for the preliminary allocation of the acquisition cost to the assets acquired and liabilities assumed based on their fair values.

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At April 29, 2018, we had no assets that were required to be measured at fair value on a nonrecurring basis other than the assets acquired from Read (see note 3) that were acquired at fair value:

	Fair value measurements at April 29, 2018 using:			
	Quoted prices in active markets for identical assets	Significant other observable inputs	Significant unobservable inputs	
(amounts in thousands)	Level 1	Level 2	Level 3	Total
Assets:				
Customer Relationships	N/A	N/A	$ 2,247	$2,247
Goodwill	N/A	N/A	2,107	2,107
Inventory	N/A	N/A	1,128	1,128
Tradename	N/A	N/A	683	683
Equipment	N/A	N/A	379	379
Liabilities:				
None	N/A	N/A	N/A	N/A

These customer relationships were recorded at fair market value using a multi-period excess earnings valuation model that used significant unobservable inputs and were classified as level 3. The tradename was recorded at fair market value using the royalty from relief method that used significant unobservable inputs and were classified as level 3.

Additionally, we acquired certain current assets such as accounts receivable and other assets and assumed certain liabilities such as deferred revenue, accounts payable and accrued expenses. Based on the nature of these items and their short maturity, the carrying amount of these items approximated their fair values. See note 2 for the allocation of the acquisition cost to the assets acquired and liabilities assumed based on their fair values.

14. Derivatives

During the fourth quarter of fiscal 2018, we entered into a EURO foreign exchange contract to mitigate the risk of foreign exchange rate fluctuations associated with certain capital expenditures. The contract effectively converts our EURO capital expenditures at a fixed EURO foreign exchange rate compared with the United States dollar of 1.263 and is due to expire in August 2018.

In accordance with the provisions of ASC Topic 815, Derivatives and Hedging, our EURO foreign exchange contract was designated as a cash flow hedge, with the fair value of these financial instruments recorded in accrued expenses and changes in fair value recorded in accumulated other comprehensive income (loss). ASC Topic 815 requires disclosure of gains and losses on derivative instruments in the following tabular format.

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	(Amounts in Thousands) Fair Values of Derivative Instruments			
	July 29, 2018		April 29, 2018	
Derivatives designated as hedging instruments under ASC Topic 815	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Euro Foreign Exchange Contract	Accrued Expenses	$ 40	Accrued Expenses	$ 55

At July 30, 2017, we did not have any derivatives designated as hedging instruments under ASC Topic 815.

Derivatives in ASC Topic 815 Net Investment Hedging Relationships	Amt of Gain (Loss) (net of tax) Recognized in OCI on Derivative (Effective Portion) and recorded in Accrued Expenses at Fair Value		Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)		Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)	Amount of Gain (loss) (net of tax) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)	
	Three Months Ended July 29, 2018	Three Months Ended July 30, 2017		Three Months Ended July 29, 2018	Three Months Ended July 30, 2017		Three Months Ended July 29, 2018	Three Months Ended July 30, 2017
EURO Foreign Exchange Contract	$ 15	$ -	Other Exp	$ (40)	$ -	Other Exp	$ -	$ -

15. Cash Flow Information

Interest and income taxes paid are as follows:

	Three months ended	
	July 29,	July 30,
(dollars in thousands)	2018	2017
Interest	$24	$83
Income taxes	3,223	536

Interest costs charged to operations were $20,000 and $64,000 for the three months ended July 29, 2018 and July 30, 2017, respectively.

No interest costs for the construction of qualifying fixed assets were capitalized for the three months ended July 29, 2018. Interest costs totaling $64,000 for the construction of qualifying fixed assets were capitalized for the three-months ended July 30, 2017. As a result, these interest costs will be amortized over the related assets' useful lives.

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16. 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:

	Three months ended	
(amounts in thousands)	July 29, 2018	July 30, 2017
Weighted average common shares outstanding, basic	12,510	12,399
Dilutive effect of stock-based compensation	90	191
Weighted average common shares outstanding, diluted	12,600	12,590

At July 29, 2018 and April 29, 2018, there were no options to purchase shares of our common stock outstanding. Therefore, options to purchase shares of our common stock were not included in the computation of diluted net income for the three-months ending July 29, 2018. All options to purchase shares of common stock were included in the computation of diluted net income for the three-months ending July 30, 2017, as the exercise price of the options was less than the average market price of the common shares.

17. Segment Information

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

Effective April 1, 2018, we acquired Read (see Note 3 for further details), a turn key provider of window treatments offering measuring, sourcing, fabrication, and installation services for the hospitality and commercial furniture industries. Currently, our Chief Executive Officer (CODM) evaluates Read’s performance within our upholstery fabrics segment as they provide products and services in similar industries in which our upholstery fabrics segment operates and uses upholstery fabric products to service their customers.

Effective June 22, 2018, we acquired eLuxury (see Note 3 for further details), an e-commerce company offering bedding accessories and other home goods directly to consumers. eLuxury’s primary products include a line of mattress pads, and also offer handmade platform beds, cotton bed sheets, and other bedding items. Currently, our CODM evaluates eLuxury's performance within our mattress fabrics segment as they primarily provide bedding products and service the same industry.

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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, develop, 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 associated with 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, goodwill and other intangible assets associated with prior acquisitions and the recent acquisition of eLuxury and our investment in an unconsolidated joint venture. The upholstery fabrics segment also includes in segment assets goodwill and other intangible assets associated with the acquisition of Read.

Financial information for the company’s operating segments follows:

	Three months ended	
	July 29, 2018	July 30, 2017
Net sales:		
Mattress Fabrics	$36,983	$48,429
Upholstery Fabrics	34,490	31,104
	$71,473	$79,533
Gross profit:		
Mattress Fabrics	$5,971	$9,760
Upholstery Fabrics	6,153	6,705
	$12,124	$16,465
Restructuring related charges (1)	(1,565)	-
	$10,559	$16,465
Selling, general, and administrative expenses		
Mattress Fabrics	$3,148	$3,391
Upholstery Fabrics	3,626	3,811
Total segment selling, general, and administrative expenses	6,774	7,202
Unallocated corporate expenses	1,259	2,299
	$8,033	$9,501
Income from operations:		
Mattress Fabrics	$2,823	$6,368
Upholstery Fabrics	2,527	2,895
Total segment income from operations	5,350	9,263
Unallocated corporate expenses	(1,259)	(2,299)
Restructuring expense and related charges (2)	(2,016)	-
Total income from operations	2,075	6,964
Interest expense	(20)	-
Interest income	150	131
Other expense	(257)	(353)
Income before income taxes	$1,948	$6,742

(1) The $1.6 million represents a restructuring related charge for inventory markdowns associated with the closing of our upholstery fabrics operation located in Anderson, SC.

(2) The $2.0 million represents the $1.6 million restructuring related charge noted above and a restructuring charge of $451 for employee termination benefits associated with the closing of our upholstery fabrics operation located in Anderson, SC.

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

(dollars in thousands)	July 29, 2018	July 30, 2017	April 29, 2018
Segment assets:			
Mattress Fabrics			
Current assets (1)	$45,085	$46,750	$43,935
Tradename	6,549	-	-
Non-compete agreement	734	809	753
Customer relationships	600	651	613
Investment in unconsolidated joint venture	1,525	1,477	1,501
Goodwill	25,115	11,462	11,462
Property, plant and equipment (2)	50,297	50,270	48,797
Total mattress fabrics assets	129,905	111,419	107,061
Upholstery Fabrics			
Current assets (1)	33,129	30,617	35,826
Goodwill	2,107	-	2,107
Customer relationships	2,164	-	2,226
Tradename	683	-	683
Property, plant and equipment (3)	2,370	1,857	2,445
Total upholstery fabrics assets	40,453	32,474	43,287
Total segment assets	170,358	143,893	150,348
Non-segment assets:			
Cash and cash equivalents	8,593	18,322	21,228
Short-term investments (Available for Sale)	-	2,469	2,451
Short-term investments (Held-to-Maturity)	30,756	-	25,759
Deferred income taxes	3,721	436	1,458
Other current assets	3,852	3,441	2,870
Property, plant and equipment (4)	511	785	552
Long-term investments (Held-to-Maturity)	-	30,907	5,035
Long-term investments (Rabbi Trust)	7,671	6,714	7,326
Other assets	910	937	957
Total assets	$226,372	$207,904	$$217,984

	Three months ended	
(dollars in thousands)	July 29, 2018	July 30, 2017
Capital expenditures (5):		
Mattress Fabrics	$1,198	$2,967
Upholstery Fabrics	57	85
Unallocated Corporate	-	16
Total capital expenditures	$1,255	$3,068
Depreciation expense:		
Mattress Fabrics	$1,800	$1,612

Upholstery Fabrics	215	195
Total depreciation expense	$2,015	$1,807

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

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(2) The $50.3 million at July 29, 2018, represents property, plant, and equipment of $37.2 million and $13.1 million located in the U.S. and Canada, respectively. The $50.3 million at July 30, 2017, represents property, plant, and equipment of $35.8 million and $14.5 million located in the U.S. and Canada, respectively. The $48.8 million at April 29, 2018, represents property, plant, and equipment of $35.4 million and $13.4 million located in the U.S. and Canada, respectively.

(3) The $2.4 million at July 29, 2018, represents property, plant, and equipment of $1.8 million and $616 located in the U.S. and China, respectively. The $1.9 million at July 30, 2017, represents property, plant, and equipment of $1.2 million and $684 located in the U.S. and China, respectively. The $2.4 million at April 29, 2018, represents property, plant, and equipment of $1.8 million and $661 located in the U.S. and China, respectively.

(4) The $511, $785, and $552 at July 29, 2018, July 30, 2017 and April 29, 2018, respectively, represent property, plant, and equipment associated with unallocated corporate departments and corporate departments shared by both the mattress and upholstery fabric segments. Property, plant, and equipment associated with corporate are located in the U.S.

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

18. Income Taxes

Effective Income Tax Rate

We recorded income tax expense of $906,000, or 46.5% of income before income taxes, for the three-month period ended July 29, 2018, compared to income tax expense of $1.6 million or 24.3% of income before income taxes, for the three-month period ended July 30, 2017. Our effective income tax rates for the three-month periods ended July 29, 2018, and July 30, 2017, 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 subsidiaries located in China and Canada versus annual projections and changes in foreign currency exchange rates in relation to the U.S. dollar.

The following schedule summarizes the factors that contribute 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:

	2019	2018
Federal income tax rate	21.0%	34.0%
Change in estimate of U.S. valuation allowance	8.6	1.4
Foreign income tax rate differential	8.3	(1.3)
Global Intangible Low Taxed Income Tax (GILTI)	2.5	-
Tax effects of Chinese foreign exchange (losses) gains	2.1	(0.9)
Excess income tax deficiency (benefits) related to stock-based compensation	1.7	(8.2)
Other	2.3	(0.7)
	46.5%	24.3%

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2017 Tax Cuts and Jobs Act

On December 22, 2017, the Tax Cuts and Jobs Act (H.R.1) (the “Tax Act”) was signed into law. The key impacts of the Tax Act on our financial statements during fiscal 2019 will be the reduction of our U.S federal statutory income tax rate to 21% compared with the blended statutory income tax rate of 30.4% during fiscal 2018 and the creation of the Global Intangible Low Taxed Income Tax (“GILTI”).

In order to calculate GILTI, provisional estimates were required based on (i) projection and estimates associated with U.S. and foreign pre-tax earnings and income tax expense for fiscal 2019, (ii) projections and estimates regarding certain assets that will be held in our domestic operations or foreign subsidiaries, and (iii) projections and estimates associated with our net sales with foreign jurisdictions. Our estimates may change based on actual versus projected results.

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 assessments at July 29, 2018, July 30, 2017, and April 29, 2018, valuation allowances against our deferred income taxes pertain to the following jurisdictions:

(dollars in thousands)	July 29, 2018	July 30, 2017	April 29, 2018
U.S. foreign income tax credits	$4,550	-	4,550
U.S. state loss carryforwards and credits	849	559	578
Polish loss carryforwards	-	78	76
	$5,399	637	5,204

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 July 29, 2018, 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.

For fiscal 2019 and beyond, the Tax Act allows a U.S. corporation a 100% dividend received deduction for earnings and profits received from a 10% owned foreign corporation. Therefore, a deferred tax liability will be required for withholding taxes that are incurred by our foreign subsidiaries at the time earnings and profits are distributed. As a result, at July 29, 2018 and April 29, 2018, we recorded a deferred income tax liability of $2.8 million and $4.3 million for withholding taxes on undistributed earnings and profits from our foreign subsidiaries.

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At July 30, 2017, which was prior to the Tax Act being signed into law, we recorded a deferred income tax liability of $810,000, which included U.S. and foreign withholding taxes totaling $45.4 million, offset by U.S. foreign income tax credits of $44.6 million.

Uncertainty In Income Taxes

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 benefits will be recorded at that time.