

CULP INC
Form 10-Q
March 11, 2016

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 31, 2016
Commission File No. 1-12597

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

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

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to the filing requirements for at least the past 90 days. x
YES NO o

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

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

Large accelerated filer o Accelerated filer x Non-accelerated filer o
Smaller Reporting Company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange

Act). YES NO x

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 31, 2016: 12,250,489
Par Value: \$0.05 per share

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For the period ended January 31, 2016

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Item 1: Financial Statements

CULP, INC.
 CONSOLIDATED STATEMENTS OF NET INCOME
 FOR THE THREE AND NINE MONTHS ENDED JANUARY 31, 2016 AND FEBRUARY 1, 2015
 UNAUDITED
 (Amounts in Thousands, Except for Per Share Data)

| | THREE MONTHS ENDED | |
|---|---------------------|---------------------|
| | January 31, 2016 | February 1, 2015 |
| Net sales | \$ 78,466 | 81,269 |
| Cost of sales | 61,903 | 66,867 |
| Gross profit | 16,563 | 14,402 |
| Selling, general and administrative expenses | 9,337 | 8,375 |
| Income from operations | 7,226 | 6,027 |
| Interest income | (38) | (202) |
| Other expense | 85 | 307 |
| Income before income taxes | 7,179 | 5,922 |
| Income taxes | 2,317 | 2,110 |
| Net income | \$ 4,862 | 3,812 |
| Net income per share, basic | \$ 0.39 | 0.31 |
| Net income per share, diluted | 0.39 | 0.31 |
| Average shares outstanding, basic | 12,331 | 12,219 |
| Average shares outstanding, diluted | 12,486 | 12,417 |
| | NINE MONTHS ENDED | |
| | January 31, 2016 | February 1, 2015 |
| Net sales | \$ 235,607 | 231,320 |
| Cost of sales | 187,109 | 191,925 |
| Gross profit | 48,498 | 39,395 |
| Selling, general and administrative expenses | 27,512 | 23,173 |
| Income from operations | 20,986 | 16,222 |
| Interest expense | - | 50 |
| Interest income | (150) | (478) |
| Other expense | 405 | 380 |

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| | | |
|-------------------------------------|-----------|--------|
| Income before income taxes | 20,731 | 16,270 |
| Income taxes | 7,398 | 6,113 |
| Net income | \$ 13,333 | 10,157 |
| Net income per share, basic | \$ 1.08 | 0.83 |
| Net income per share, diluted | 1.07 | 0.82 |
| Average shares outstanding, basic | 12,317 | 12,216 |
| Average shares outstanding, diluted | 12,488 | 12,410 |

See accompanying notes to consolidated financial statements.

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CULP, INC.
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
 FOR THE THREE AND NINE MONTHS ENDED JANUARY 31, 2016 AND FEBRUARY 1, 2015
 (UNAUDITED)
 (Amounts in Thousands)

| | THREE MONTHS ENDED | |
|--|---------------------|---------------------|
| | January 31, 2016 | February 1, 2015 |
| Net income | \$ 4,862 | \$ 3,812 |
| Other comprehensive (loss) income | | |
| Unrealized (losses) gains on investments | | |
| Unrealized holding (losses) gains on investments | (194) | 22 |
| Reclassification adjustment for realized loss included in net income | 71 | - |
| Total other comprehensive (loss) income | (123) | 22 |
| Comprehensive income | \$ 4,739 | \$ 3,834 |

| | NINE MONTHS ENDED | |
|--|---------------------|---------------------|
| | January 31, 2016 | February 1, 2015 |
| Net income | \$ 13,333 | \$ 10,157 |
| Other comprehensive loss | | |
| Unrealized (losses) gains on investments | | |
| Unrealized holding losses on investments | (312) | (6) |
| Reclassification adjustment for realized loss included in net income | 127 | - |
| Total other comprehensive loss | (185) | (6) |
| Comprehensive income | \$ 13,148 | \$ 10,151 |

See accompanying notes to consolidated financial statements.

CULP, INC.
CONSOLIDATED BALANCE SHEETS
JANUARY 31, 2016, FEBRUARY 1, 2015, AND MAY 3, 2015
UNAUDITED
(Amounts in Thousands)

| | January 31, 2016 | February 1, 2015 | * May 3, 2015 |
|--|---------------------|---------------------|------------------|
| Current assets: | | | |
| Cash and cash equivalents | \$ 31,713 | 28,772 | 29,725 |
| Short-term investments | 4,259 | 8,384 | 10,004 |
| Accounts receivable, net | 26,784 | 30,774 | 28,749 |
| Inventories | 48,485 | 38,013 | 42,484 |
| Income taxes receivable | 23 | 104 | 229 |
| Other current assets | 2,331 | 2,992 | 2,440 |
| Total current assets | 113,595 | 109,039 | 113,631 |
| | | | |
| Property, plant and equipment, net | 38,157 | 35,269 | 36,078 |
| Goodwill | 11,462 | 11,462 | 11,462 |
| Deferred income taxes | 4,312 | 5,020 | 5,169 |
| Long-term investments | 3,590 | 2,063 | 2,415 |
| Other assets | 2,435 | 2,505 | 2,545 |
| | | | |
| Total assets | \$ 173,551 | 165,358 | 171,300 |
| | | | |
| Current liabilities: | | | |
| Current maturities of long-term debt | \$ - | 2,200 | 2,200 |
| Accounts payable-trade | 25,601 | 28,644 | 28,414 |
| Accounts payable - capital expenditures | 380 | 772 | 990 |
| Accrued expenses | 12,690 | 9,954 | 11,129 |
| Income taxes payable - current | 622 | 325 | 325 |
| Total current liabilities | 39,293 | 41,895 | 43,058 |
| | | | |
| Income taxes payable - long-term | 3,480 | 3,630 | 3,792 |
| Deferred income taxes | 1,209 | 927 | 982 |
| Deferred compensation | 4,495 | 3,934 | 4,041 |
| | | | |
| Total liabilities | 48,477 | 50,386 | 51,873 |
| | | | |
| Commitments and Contingencies (Note 15) | | | |
| | | | |
| 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 | | | |

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| | | | |
|--|----------------|-------------|-------------|
| 12,250,489 at January 31, 2016; 12,219,121 at February 1, 2015; and 12,219,121 at May 3, 2015 | 613 | 611 | 611 |
| Capital contributed in excess of par value | 42,937 | 42,856 | 43,159 |
| Accumulated earnings | 81,804 | 71,571 | 75,752 |
| Accumulated other comprehensive loss | (280) | (66) | (95) |
| Total shareholders' equity | 125,074 | 114,972 | 119,427 |
| Total liabilities and shareholders' equity | \$ 173,551 | 165,358 | 171,300 |

* Derived from audited financial statements.

See accompanying notes to consolidated financial statements.

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CULP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED JANUARY 31, 2016 AND FEBRUARY 1, 2015
UNAUDITED
(Amounts in Thousands)

| | NINE MONTHS ENDED | |
|---|---------------------|---------------------|
| | January 31, 2016 | February 1, 2015 |
| Cash flows from operating activities: | | |
| Net income | \$ 13,333 | 10,157 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 4,888 | 4,244 |
| Amortization of other assets | 123 | 140 |
| Stock-based compensation | 1,964 | 482 |
| Excess tax benefit related to stock-based compensation | (822) | (110) |
| Deferred income taxes | 1,906 | 3,274 |
| Gain on sale of equipment | (66) | (74) |
| Realized loss on sale of short-term investments | 127 | - |
| Foreign currency gains | (85) | (6) |
| Changes in assets and liabilities: | | |
| Accounts receivable | 1,091 | (3,455) |
| Inventories | (6,485) | 2,536 |
| Other current assets | (108) | (739) |
| Other assets | 48 | (30) |
| Accounts payable - trade | (1,979) | 2,267 |
| Accrued expenses and deferred compensation | 1,406 | 2,121 |
| Income taxes | 535 | (108) |
| Net cash provided by operating activities | 15,876 | 20,699 |
| Cash flows from investing activities: | | |
| Capital expenditures | (7,686) | (8,185) |
| Proceeds from the sale of equipment | 230 | 625 |
| Proceeds from the sale of life insurance policies | - | 320 |
| Payments on life insurance policies | (18) | (18) |
| Proceeds from the sale of short-term investments | 5,612 | 1,628 |
| Purchase of short-term investments | (86) | (3,719) |
| Purchase of long-term investments | (1,268) | (1,298) |
| Net cash used in investing activities | (3,216) | (10,647) |
| Cash flows from financing activities: | | |
| Proceeds from line of credit | 7,000 | - |
| Payments on line of credit | (7,000) | (538) |
| Payments on long-term debt | (2,200) | (2,200) |
| Repurchase of common stock | (2,397) | (745) |
| Dividends paid | (7,281) | (6,846) |
| Payments on debt issuance costs | (43) | - |

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| | | |
|--|-----------|-----------|
| Proceeds from common stock issued | 138 | 94 |
| Excess tax benefit related to stock-based compensation | 822 | 110 |
| Net cash used in financing activities | (10,961) | (10,125) |
| Effect of exchange rate changes on cash and cash equivalents | 289 | (458) |
| Increase (decrease) in cash and cash equivalents | 1,988 | (531) |
| Cash and cash equivalents at beginning of period | 29,725 | 29,303 |
| Cash and cash equivalents at end of period | \$31,713 | 28,772 |

See accompanying notes to consolidated financial statements.

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CULP, INC.
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
UNAUDITED

(Dollars in thousands, except share data)

| | Common Stock | | Capital Contributed | Accumulated | Accumulated Other | Total |
|--|--------------|--------|------------------------------|-------------|----------------------|-------------------------|
| | Shares | Amount | in Excess of Par Value | Earnings | Loss | Shareholders' Equity |
| Balance, April 27, 2014 | 12,250,030 | \$612 | 42,932 | 68,260 | (60) | \$ 111,744 |
| Net income | - | - | - | 15,071 | - | 15,071 |
| Stock-based compensation | - | - | 786 | - | - | 786 |
| Unrealized loss on investments | - | - | - | - | (35) | (35) |
| Excess tax benefit related to stock based compensation | - | - | 109 | - | - | 109 |
| Common stock repurchased | (43,014) | (2) | (743) | - | - | (745) |
| Fully vested common stock award | 3,000 | - | - | - | - | - |
| Common stock issued in connection with exercise of stock options | 10,100 | 1 | 93 | - | - | 94 |
| Common stock surrendered for withholding taxes payable | (995) | - | (18) | - | - | (18) |
| Dividends paid | - | - | - | (7,579) | - | (7,579) |
| Balance, May 3, 2015 * | 12,219,121 | 611 | 43,159 | 75,752 | (95) | 119,427 |
| Net income | - | - | - | 13,333 | - | 13,333 |
| Stock-based compensation | - | - | 1,964 | - | - | 1,964 |
| Unrealized loss on investments | - | - | - | - | (185) | (185) |
| Excess tax benefit related to stock based compensation | - | - | 822 | - | - | 822 |
| 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 | 39,500 | 2 | 136 | - | - | 138 |
| Common stock surrendered for withholding taxes payable | (26,211) | (1) | (746) | - | - | (747) |
| Dividends paid | - | - | - | (7,281) | - | (7,281) |

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| | | | | | | | |
|---------------------------|------------|-------|--------|--------|------|---|------------|
| Balance, January 31, 2016 | 12,250,489 | \$613 | 42,937 | 81,804 | (280 |) | \$ 125,074 |
|---------------------------|------------|-------|--------|--------|------|---|------------|

* Derived from audited financial statements.

See accompanying notes to consolidated financial statements.

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

1. Basis of Presentation

The accompanying unaudited consolidated financial statements of Culp, Inc. and subsidiaries (the “company”) include all adjustments, which are, in the opinion of management, necessary for fair presentation of the results of operations and financial position. All of these adjustments are of a normal recurring nature. 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 17, 2015 for the fiscal year ended May 3, 2015.

The company’s nine months ended January 31, 2016 and February 1, 2015, represent 39 and 40 week periods, respectively.

2. Significant Accounting Policies

As of January 31, 2016, 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 3, 2015.

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. Accordingly, we reclassified our current deferred income taxes to noncurrent on our February 1, 2015 Consolidated Balance Sheet, which increased noncurrent deferred income taxes \$4.5 million and decreased noncurrent deferred tax liabilities \$2.5 million. We reclassified our current deferred income taxes to noncurrent on our May 3, 2015 Consolidated Balance Sheet, which increased noncurrent deferred income taxes \$4.7 million and decreased noncurrent deferred tax liabilities \$68,000.

Recently Issued Accounting Pronouncements

In June 2014, the Financial Accounting Standards Board (“FASB”) amended its authoritative guidance on accounting for certain share-based payment awards. The amended guidance requires that share-based compensation awards with terms of a performance target that affects vesting, and that could be achieved after the requisite service period, be treated as a performance condition. As such, the performance target should not be reflected in estimating the grant-date fair value of the award and compensation cost should be recognized in the period in which it becomes

probable that the performance target will be achieved.

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

The guidance will be effective in our fiscal 2017 first quarter. The guidance will permit an entity to apply the amendments in the update either (a) prospectively to all awards granted or modified after the effective date or (b) retrospectively to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented in the consolidated financial statements and to all new or modified awards thereafter. Currently, we do not have any share-based payment awards with terms of a performance target that affects vesting and could be achieved after the requisite service period. We are currently assessing the impact that this guidance will have on our consolidated financial statements.

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 18, 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.

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 is intended to update and replace 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.

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

Incentive Stock Option Awards

We did not grant any incentive stock option awards through the third quarter of fiscal 2016.

At January 31, 2016, options to purchase 98,600 shares of common stock were outstanding and exercisable, had a weighted average exercise price of \$7.73 per share, and a weighted average contractual term of 1.7 years. At January 31, 2016, the aggregate intrinsic value for options outstanding and exercisable was \$1.7 million.

The aggregate intrinsic value for options exercised for the nine months ending January 31, 2016 and February 1, 2015, was \$1.0 million and \$87,000, respectively.

At January 31, 2016, there were no unvested incentive stock option awards. Therefore, there was no unrecognized compensation cost related to incentive stock option awards at January 31, 2016.

No compensation expense was recorded on incentive stock options for the nine months ended January 31, 2016 and February 1, 2015, respectively.

Common Stock Awards

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.

On October 1, 2014, 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 \$17.95 per share, which represents the closing price of our common stock at the date of grant.

We recorded \$95,000 and \$54,000 of compensation expense within selling, general, and administrative expense for these common stock awards for the nine months ending January 31, 2016, and February 1, 2015, respectively.

Time Vested Restricted Stock Awards

We did not grant any time vested restricted stock awards through the third quarter of fiscal 2016.

At January 31, 2016, there were no outstanding and unvested shares of time vested restricted stock. Therefore, there was no unrecognized compensation cost related to time vested restricted stock awards at January 31, 2016.

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

No compensation expense was recorded on time vested restricted stock awards for the nine months ended January 31, 2016. We recorded \$4,000 within selling, general, and administrative expense for time vested restricted stock awards for the nine months ended February 1, 2015.

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

Performance Based Restricted Stock Units

Fiscal 2016 Grant

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 31, 2016, this grant was unvested and was measured at \$25.32 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 Grant

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 31, 2016, this grant was unvested and was measured at \$25.32 per share, which represents the closing price of the company's common stock at the end of the reporting period. The vesting of these awards is over the requisite service periods of 16 months and 28 months for performance based restricted stock units which could earn up to 12,000 and 16,000 shares of common stock, respectively.

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

Fiscal 2014 Grant

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

Fiscal 2013 Grant

On July 11, 2012, certain key members of management were granted performance based restricted 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 nine month period ending January 31, 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. As of January 31, 2016, our fiscal 2013 grant was fully vested.

Overall

We recorded compensation expense of \$1.9 million and \$424,000 within selling, general, and administrative expense for performance based restricted stock units for the nine month periods ending January 31, 2016 and February 1, 2015, 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 31, 2016, the remaining unrecognized compensation cost related to the performance based restricted stock units was \$4.2 million, which is expected to be recognized over a weighted average vesting period of 2.1 years.

4. Accounts Receivable

A summary of accounts receivable follows:

| (dollars in thousands) | January 31, 2016 | February 1, 2015 | May 3, 2015 |
|--|------------------|------------------|-------------|
| Customers | \$ 28,684 | \$ 31,952 | \$ 30,338 |
| Allowance for doubtful accounts | (814) | (449) | (851) |
| Reserve for returns and allowances and discounts | (1,086) | (729) | (738) |
| | \$ 26,784 | \$ 30,774 | \$ 28,749 |

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

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

| (dollars in thousands) | Nine months ended | |
|-----------------------------------|-------------------|------------------|
| | January 31, 2016 | February 1, 2015 |
| Beginning balance | \$ (851) | \$ (573) |
| Provision for bad debts | (93) | (20) |
| Net write-offs, net of recoveries | 130 | 144 |
| Ending balance | \$ (814) | \$ (449) |

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

| (dollars in thousands) | Nine months ended | |
|---|-------------------|------------------|
| | January 31, 2016 | February 1, 2015 |
| Beginning balance | \$ (738) | \$ (479) |
| Provision for returns, allowances and discounts | (2,389) | (2,065) |
| Credits issued | 2,041 | 1,815 |
| Ending balance | \$ (1,086) | \$ (729) |

5. Inventories

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

A summary of inventories follows:

| (dollars in thousands) | January 31, 2016 | February 1, 2015 | May 3, 2015 |
|------------------------|------------------|------------------|-------------|
| Raw materials | \$ 6,831 | \$ 5,787 | \$ 5,374 |
| Work-in-process | 3,365 | 2,227 | 2,766 |
| Finished goods | 38,289 | 29,999 | 34,344 |
| | \$ 48,485 | \$ 38,013 | \$ 42,484 |

6. Other Assets

A summary of other assets follows:

| (dollars in thousands) | January 31, 2016 | February 1, 2015 | May 3, 2015 |
|---------------------------------------|---------------------|---------------------|-------------|
| Cash surrender value – life insurance | \$357 | \$338 | \$339 |
| Non-compete agreement, net | 922 | 998 | 979 |
| Customer relationships, net | 728 | 779 | 766 |
| Other | 428 | 390 | 461 |

\$2,435

\$2,505

\$2,545

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.

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The gross carrying amount of our non-compete agreement was \$2.0 million at January 31, 2016, February 1, 2015 and May 3, 2015, respectively. At January 31, 2016 and May 3, 2015, accumulated amortization for our non-compete agreement was \$1.1 million. At February 1, 2015 accumulated amortization for our non-compete agreement was \$1.0 million.

Amortization expense for our non-compete agreement was \$56,000 for the nine month periods ended January 31, 2016 and February 1, 2015. The remaining amortization expense for the next five fiscal years and thereafter follows: FY 2016 - \$18,000; FY 2017 - \$75,000; FY 2018- \$75,000; FY 2019 - \$75,000; FY 2020 - \$75,000 and Thereafter - \$604,000.

The weighted average amortization period for our non-compete agreement is 12.3 years as of January 31, 2016.

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 31, 2016, February 1, 2015, and May 3, 2015, respectively. Accumulated amortization for our customer relationships was \$140,000, \$89,000, and \$102,000 at January 31, 2016, February 1, 2015, and May 3, 2015, respectively.

Amortization expense for our customer relationships was \$38,000 for the nine months ending January 31, 2016 and February 1, 2015. The remaining amortization expense for the next five fiscal years and thereafter follows: FY 2016 - \$13,000; FY 2017 - \$51,000; FY 2018 - \$51,000; FY 2019 - \$51,000; FY 2020 - \$51,000; and Thereafter - \$511,000.

The weighted average amortization period for our customer relationships is 14.3 years as of January 31, 2016.

Cash Surrender Value – Life Insurance

At January 31, 2016, February 1, 2015, and May 3, 2015 we had one life insurance contract with a death benefit of \$1.4 million.

Our cash surrender value – life insurance balances totaling \$357,000, \$338,000 and \$339,000 at January 31, 2016, February 1, 2015, and May 3, 2015, respectively, are collectible upon death of the respective insured.

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

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7. Accrued Expenses

A summary of accrued expenses follows:

| (dollars in thousands) | January 31, 2016 | February 1, 2015 | May 3, 2015 |
|--|---------------------|---------------------|-------------|
| Compensation, commissions and related benefits | \$8,678 | \$6,399 | \$9,081 |
| Advertising rebates | 2,876 | 2,522 | 1,002 |
| Interest | - | 81 | 37 |
| Other accrued expenses | 1,136 | 952 | 1,009 |
| | \$12,690 | \$9,954 | \$11,129 |

8. Long-Term Debt and Lines of Credit

A summary of long-term debt follows:

| (dollars in thousands) | January 31, 2016 | February 1, 2015 | May 3, 2015 |
|---|---------------------|---------------------|-------------|
| Unsecured senior term notes | \$- | \$2,200 | \$2,200 |
| Current maturities of long-term debt | - | (2,200) | (2,200) |
| Long-term debt, less current maturities of long-term debt | \$- | \$- | \$- |

Unsecured Senior Term Notes

We entered into a note agreement dated August 11, 2008 that provided for the issuance of \$11.0 million of unsecured senior term notes with a fixed interest rate of 8.01% and a term of seven years. Principal payments of \$2.2 million per year were due on the notes beginning August 11, 2011. Any principal pre-payments would have been assessed a penalty as defined in the agreement. The agreement contained customary financial and other covenants as defined in the agreement.

On August 11, 2015, we paid our last annual payment of \$2.2 million and this agreement has been paid in full.

Revolving Credit Agreement – United States

As of May 3, 2015, we had an unsecured credit agreement with Wells Fargo Bank, N.A. (“Wells Fargo”) that provided for an unsecured revolving loan commitment of \$10 million to be used to finance working capital and general corporate purposes. Interest is charged at a rate (applicable interest rate of 1.93%, 1.77%, and 1.78% at January 31, 2016, February 1, 2015, and May 3, 2015, respectively) equal to the one-month LIBOR rate plus a spread based on our ratio of debt to EBITDA as defined in the agreement. The Credit Agreement contained customary financial and other covenants as defined in the agreement and was set to expire on August 31, 2015.

Effective July 10, 2015, we amended our Credit Agreement to extend the expiration date to August 31, 2017, and maintain an annual capital expenditure limit of \$12 million.

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We entered into a Second Amendment to our Credit Agreement dated March 10, 2016, which amends our Credit Agreement with Wells Fargo Bank, National Association. The terms of the Second Amendment include, among other things, provisions that (i) increase our line of credit under the Credit Agreement to \$30 million, (ii) increase the annual limit on capital expenditures by the company to \$15 million, (iii) add a new financial covenant to establish a minimum level of unencumbered liquid assets, (iv) eliminate certain financial covenants, (v) amend the pricing matrix that provides for interest payable on obligations under the agreement as a variable spread over LIBOR, based upon the company's ratio of debt to EBITDA, and (vi) provide that the obligations under the Credit Agreement are to be secured by a pledge of 65% of the common stock of Culp International Holdings Ltd, our Cayman subsidiary.

The purpose of the increase in our revolving credit line with Wells Fargo 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 repatriate earnings and profits from our foreign subsidiaries to the U.S. for various strategic purposes.

At January 31, 2016, February 1, 2015 and May 3, 2015 there was a \$250,000 outstanding letter of credit (all of which related to workers compensation). At January 31, 2016, February 1, 2015, and May 3, 2015, there were no borrowings outstanding under the Credit Agreement.

Revolving Credit Agreement – China

We had an unsecured credit agreement associated with our operations in China that provided for a line of credit of up to 40 million RMB (approximately \$6.1 million USD at January 31, 2016), that was set to expire on February 9, 2016. This agreement had an interest rate determined by the Chinese government. There were no borrowings outstanding under the agreement as of January 31, 2016, February 1, 2015, and May 3, 2015.

On March 8, 2016, we renewed our unsecured credit agreement associated with our operations located in China. The renewal extended the agreement to March 8, 2017 and maintained the line of credit up to 40 million RMB (approximately \$6.1 million USD).

Overall

Our loan agreements require, among other things, that we maintain compliance with certain financial covenants. At January 31, 2016, the company was in compliance with these financial covenants.

The fair value of the company's long-term debt is estimated by discounting the future cash flows at rates currently offered to the company for similar debt instruments of comparable maturities. At February 1, 2015, the carrying value of the company's long-term debt was \$2.2 million and the fair value was \$2.3 million. At May 3, 2015, the carrying value of the company's long-term debt was \$2.2 million and the fair value was \$2.3 million.

9. Fair Value of Financial Instruments

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

that effectively falls in a lower level in the hierarchy. The hierarchy consists of three broad levels as follows:

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

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

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

Recurring Basis

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

Fair value measurements at January 31, 2016 using:

| (amounts in thousands) | Q u o t e d prices in a c t i v e 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 |

Fair value measurements at February 1, 2015 using:

| (amounts in thousands) | Q u o t e d prices in a c t i v e markets for identical assets Level 1 | Significant other observable inputs Level 2 | Significant unobservable inputs Level 3 | Total |
|------------------------|--|---|--|-------|
| Assets: | | | | |

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| | | | | |
|-----------------------------|----------|-----|-----|----------|
| Limited Term Bond Fund | \$ 3,112 | N/A | N/A | \$ 3,112 |
| Intermediate Term Bond Fund | 2,188 | N/A | N/A | 2,188 |
| Low Duration Bond Fund | 2,084 | N/A | N/A | 2,084 |
| Premier Money Market Fund | 1,951 | N/A | N/A | 1,951 |
| Strategic Income Fund | 1,000 | N/A | N/A | 1,000 |
| Growth Allocation Fund | 63 | N/A | N/A | 63 |
| Other | 49 | N/A | N/A | 49 |

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Fair value measurements at May 3, 2015 using:

| (amounts in thousands) | Q u o t e d prices in a c t i v e markets for identical assets | | | Significant other observable inputs | Significant unobservable inputs | Total |
|-----------------------------|---|---------|---------|--|---------------------------------------|-------|
| | Level 1 | Level 2 | Level 3 | | | |
| Assets: | | | | | | |
| Limited Term Bond Fund | \$ 3,107 | N/A | N/A | | \$ 3,107 | |
| Premier Money Market Fund | 2,285 | N/A | N/A | | 2,285 | |
| Intermediate Term Bond Fund | 2,181 | N/A | N/A | | 2,181 | |
| Low Duration Bond Fund | 2,096 | N/A | N/A | | 2,096 | |
| Strategic Income Fund | 1,008 | N/A | N/A | | 1,008 | |
| Growth Allocation Fund | 85 | N/A | N/A | | 85 | |
| Other | 45 | N/A | N/A | | 45 | |

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 31, 2016 and February 1, 2015, our short-term investments totaled \$4.3 million and \$8.4 million, respectively, and consisted of short-term bond funds. At May 3, 2015, our short-term investments totaled \$10.0 million and consisted of short-term bonds of \$8.4 million and a deposit account that had a maturity of more than three months of \$1.6 million.

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 \$181,000, \$66,000, and \$95,000 at January 31, 2016, February 1, 2015, and May 3, 2015, respectively. At January 31, 2016, February 1, 2015, and May 3, 2015, the fair value of our short-term bond funds approximated its cost basis.

Long-Term Investments

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 \$3.6 million, \$2.1 million, and \$2.4 million at January 31, 2016, February 1, 2015, and May 3, 2015, respectively. Our long-term investments had an accumulated unrealized loss of \$99,000 at January 31, 2016. At February 1, 2015 and May 3, 2015, our accumulated gains or losses regarding our long-term investments were immaterial. The fair value of our long-term investments approximates its cost basis.

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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:

| (dollars in thousands) | Nine months ended | |
|------------------------|---------------------|---------------------|
| | January 31, 2016 | February 1, 2015 |
| Interest | \$95 | \$180 |
| Income Taxes | 4,921 | 3,005 |

Interest costs charged to operations and incurred on our long-term debt and lines of credit were \$58,000 and \$191,000 for the nine months ended January 31, 2016 and February 1, 2015, respectively.

Interest costs of \$58,000 and \$141,000 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 31, 2016 and February 1, 2015, 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 31, 2016 | February 1, 2015 |
| Weighted average common shares outstanding, basic | 12,331 | 12,219 |
| Dilutive effect of stock-based compensation | 155 | 198 |
| Weighted average common shares outstanding, diluted | 12,486 | 12,417 |

All options to purchase shares of common stock were included in the computation of diluted net income for the three months ended January 31, 2016 and February 1, 2015, 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 31, 2016 | February 1, 2015 |

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| | | |
|---|--------|--------|
| Weighted average common shares outstanding, basic | 12,317 | 12,216 |
| Dilutive effect of stock-based compensation | 171 | 194 |
| Weighted average common shares outstanding, diluted | 12,488 | 12,410 |

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All options to purchase shares of common stock were included in the computation of diluted net income for the nine months ended January 31, 2016 and February 1, 2015, 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.

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, goodwill, a non-compete agreement, and customer relationships associated with an acquisition.

Financial information for the company's operating segments follows:

| (dollars in thousands) | Three months ended | |
|---|---------------------|---------------------|
| | January 31, 2016 | February 1, 2015 |
| Net sales: | | |
| Mattress Fabrics | \$44,277 | \$45,683 |
| Upholstery Fabrics | 34,189 | 35,586 |
| | \$78,466 | \$81,269 |
| Gross profit: | | |
| Mattress Fabrics | \$8,751 | \$8,076 |
| Upholstery Fabrics | 7,812 | 6,326 |
| | \$16,563 | \$14,402 |
| Selling, general, and administrative expenses: | | |
| Mattress Fabrics | \$2,953 | \$2,853 |
| Upholstery Fabrics | 3,963 | 3,781 |
| Total segment selling, general, and administrative expenses | 6,916 | 6,634 |
| Unallocated corporate expenses | 2,421 | 1,741 |
| | \$9,337 | \$8,375 |
| Income from operations: | | |
| Mattress Fabrics | \$5,798 | \$5,223 |
| Upholstery Fabrics | 3,849 | 2,545 |
| Total segment income from operations | 9,647 | 7,768 |

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| | | | | |
|--------------------------------|---------|---|---------|---|
| Unallocated corporate expenses | (2,421 |) | (1,741 |) |
| Total income from operations | 7,226 | | 6,027 | |
| Interest income | 38 | | 202 | |
| Other expense | (85 |) | (307 |) |
| Income before income taxes | \$7,179 | | \$5,922 | |

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Financial information for the company's operating segments follows:

| (dollars in thousands) | Nine months ended | |
|---|---------------------|---------------------|
| | January 31, 2016 | February 1, 2015 |
| Net sales: | | |
| Mattress Fabrics | \$137,522 | \$131,543 |
| Upholstery Fabrics | 98,085 | 99,777 |
| | \$235,607 | \$231,320 |
| Gross profit: | | |
| Mattress Fabrics | \$28,133 | \$22,603 |
| Upholstery Fabrics | 20,365 | 16,792 |
| | \$48,498 | \$39,395 |
| Selling, general, and administrative expenses: | | |
| Mattress Fabrics | \$8,865 | \$8,019 |
| Upholstery Fabrics | 11,372 | 10,518 |
| Total segment selling, general, and administrative expenses | 20,237 | 18,537 |
| Unallocated corporate expenses | 7,275 | 4,636 |
| | \$27,512 | \$23,173 |
| Income from operations: | | |
| Mattress Fabrics | \$19,267 | \$14,584 |
| Upholstery Fabrics | 8,994 | 6,274 |
| Total segment income from operations | 28,261 | 20,858 |
| Unallocated corporate expenses | (7,275) | (4,636) |
| Total income from operations | 20,986 | 16,222 |
| Interest expense | - | (50) |
| Interest income | 150 | 478 |
| Other expense | (405) | (380) |
| Income before income taxes | \$20,731 | \$16,270 |

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

| (dollars in thousands) | January 31, 2016 | February 1, 2015 | May 3, 2015 |
|-----------------------------------|------------------|------------------|-------------|
| Segment assets: | | | |
| Mattress Fabrics | | | |
| Current assets (1) | \$ 44,309 | \$ 36,658 | \$ 41,328 |
| Non-compete agreement | 922 | 998 | 979 |
| Customer relationships | 728 | 779 | 766 |
| Goodwill | 11,462 | 11,462 | 11,462 |
| Property, plant and equipment (2) | 35,637 | 33,046 | 33,773 |
| Total mattress fabrics assets | 93,058 | 82,943 | 88,308 |
| Upholstery Fabrics | | | |
| Current assets (1) | 30,960 | 32,129 | 29,905 |
| Property, plant and equipment (3) | 1,590 | 1,522 | 1,467 |
| Total upholstery fabrics assets | 32,550 | 33,651 | 31,372 |
| Total segment assets | 125,608 | 116,594 | 119,680 |
| Non-segment assets: | | | |
| Cash and cash equivalents | 31,713 | 28,772 | 29,725 |
| Short-term investments | 4,259 | 8,384 | 10,004 |
| Deferred income taxes | 4,312 | 5,020 | 5,169 |
| Income taxes receivable | 23 | 104 | 229 |
| Other current assets | 2,331 | 2,992 | 2,440 |
| Property, plant and equipment (4) | 930 | 701 | 838 |
| Long-term investments | 3,590 | 2,063 | 2,415 |
| Other assets | 785 | 728 | 800 |
| Total assets | \$ 173,551 | \$ 165,358 | \$ 171,300 |

| (dollars in thousands) | Nine months ended | |
|----------------------------|---------------------|---------------------|
| | January 31, 2016 | February 1, 2015 |
| Capital expenditures (5): | | |
| Mattress Fabrics | \$6,215 | \$8,232 |
| Upholstery Fabrics | 481 | 390 |
| Unallocated Corporate | 381 | 62 |
| Total capital expenditures | \$7,077 | \$8,684 |
| Depreciation expense: | | |
| Mattress Fabrics | \$4,273 | \$3,692 |
| Upholstery Fabrics | 615 | 552 |
| Total depreciation expense | \$4,888 | \$4,244 |

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- (1) Current assets represent accounts receivable and inventory for the respective segment.
- (2) 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 \$33.0 million at February 1, 2015, represents property, plant, and equipment of \$23.5 million and \$9.5 million located in the U.S. and Canada, respectively. The \$33.8 million at May 3, 2015, represents property, plant, and equipment of \$23.8 million and \$10.0 million located in the U.S. and Canada, respectively.
- (3) 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 \$1.5 million at February 1, 2015, represents property, plant, and equipment of \$877 and \$645 located in the U.S. and China, respectively. The \$1.5 million at May 3, 2015, represents property, plant, and equipment of \$848 and \$619 located in the U.S. and China, respectively.
- (4) The \$930, \$701, and \$838 at January 31, 2016, February 1, 2015 and May 3, 2015, 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.

13. Income Taxes

Effective Income Tax Rate

We recorded income tax expense of \$7.4 million, or 35.7% of income before income tax expense, for the nine month period ended January 31, 2016, compared to income tax expense of \$6.1 million or 37.6% of income before income tax expense, for the nine month period ended February 1, 2015. Our effective income tax rates for the nine month periods ended January 31, 2016 and February 1, 2015, were based upon the estimated effective income tax rate applicable for the full year after giving effect to any significant items related specifically to interim periods. The effective income tax rate can be affected over the fiscal year by the mix and timing of actual earnings from our U.S. operations and foreign sources versus annual projections and changes in foreign currencies in relation to the U.S. dollar.

The 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:

| | | |
|---|-------|-------|
| | 2016 | 2015 |
| federal income tax rate | 34.0% | 34.0% |
| foreign tax rate differential | (6.6) | (6.0) |
| undistributed earnings from foreign subsidiaries | 1.4 | 4.1 |
| increase in liability for uncertain tax positions | 2.9 | 3.5 |
| tax effects of Chinese foreign exchange gains | 3.5 | 0.2 |
| other | 0.5 | 1.8 |
| | 35.7% | 37.6% |

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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 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 February 1, 2015, we recorded a partial valuation allowance of \$1.0 million, of which \$596,000 pertained to certain U.S. state net operating loss carryforwards and credits and \$400,000 pertained to loss carryforwards associated with our Culp Europe operation located in Poland. Based on our assessment at May 3, 2015, we recorded a partial valuation allowance of \$922,000, of which \$561,000 pertained to certain U.S. state net operating loss carryforwards and credits and \$361,000 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 31, 2016, February 1, 2015, and May 3, 2015, respectively.

The recorded valuation allowance of \$874,000 at January 31, 2016, 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 31, 2016, 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 31, 2016, the net 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 February 1, 2015, the net deferred tax liability associated with our undistributed earnings from our foreign subsidiaries totaled \$2.4 million, which included U.S. income and foreign withholding taxes totaling \$32.1 million, offset by U.S. foreign income tax credits of \$29.7 million. At May 3, 2015, the net deferred tax liability associated with our undistributed earnings from our foreign

subsidiaries totaled \$1.7 million, which included U.S. income and foreign withholding taxes totaling \$32.4 million, offset by U.S. foreign income tax credits of \$30.7 million.

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We had accumulated earnings from our foreign subsidiaries totaling \$100.9 million, \$82.4 million, and \$85.2 million at January 31, 2016, February 1, 2015, and May 3, 2015, respectively.

Overall

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 February 1, 2015, our non-current deferred tax asset of \$5.0 million represents \$4.2 million and \$776,000 from our operations located in the U.S. and China, respectively. At May 3, 2015, our non-current deferred tax asset of \$5.2 million represents \$4.3 million and \$868,000 from our operations located in the U.S. and China, respectively.

Our non-current deferred tax liability balances of \$1.2 million, \$927,000, and \$982,000 at January 31, 2016, February 1, 2015, and May 3, 2015, respectively, pertain to our operations located in Canada.

Uncertainty In Income Taxes

At January 31, 2016, we had a \$13.2 million total gross unrecognized tax benefit, of which \$3.5 million represents the amount of gross unrecognized tax benefit that, if recognized, would favorably affect the income tax rate in future periods. At February 1, 2015, we had a \$13.9 million total gross unrecognized tax benefit, of which \$3.6 million represents the amount of gross unrecognized tax benefit that, if recognized, would favorably affect the income tax rate in future periods. At May 3, 2015, we had a \$14.1 million total gross unrecognized tax benefit, of which \$3.8 million represents the amount of gross unrecognized tax benefit that, if recognized, would favorably affect the income tax rate in future periods.

At January 31, 2016, we had a \$13.2 million total gross unrecognized 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 February 1, 2015, we had a \$13.9 million total gross unrecognized tax benefit, of which \$10.3 million and \$3.6 million were classified as non-current deferred income taxes and income taxes payable – long-term, respectively, in the accompanying consolidated balance sheets. At May 3, 2015, we had \$14.1 million of total gross unrecognized tax benefit, of which \$10.3 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.

We estimate that the amount of gross unrecognized tax benefit will decrease by approximately \$120,000 for fiscal 2016. This decrease primarily relates to double taxation under applicable tax treaties with foreign tax jurisdictions.

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.

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The transfer to this reserve must be made before distributions of any dividend to shareholders. As of January 31, 2016, the company's statutory surplus reserve was \$4.7 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 \$4.7 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.

Purchase Commitments

At January 31, 2016, February 1, 2015, and May 3, 2015, we had open purchase commitments to acquire equipment for our mattress fabrics segment totaling \$977,000, \$3.8 million, and \$2.3 million, respectively.

16. Common Stock Repurchase Program

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

During the nine months ended January 31, 2016, we purchased 100,776 shares of our common stock at a cost of \$2.4 million, all of which was purchased during the third quarter. During fiscal 2015, we purchased 43,014 shares of our common stock at a cost of \$745,000, all of which were purchased in the first and second quarters.

At January 31, 2016, we had \$1.9 million available for additional repurchases of our common stock.

17. Dividend Program

On March 1, 2016, we announced that our board of directors approved a quarterly cash dividend of \$0.07 per share. This payment will be made on or about April 15, 2016, to shareholders of record as of April 1, 2016.

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

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

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

CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING INFORMATION

This report and the exhibits attached hereto contain “forward-looking statements” within the meaning of the federal securities laws, including the Private Securities Litigation Reform Act of 1995 (Section 27A of the Securities Act of 1933 and Section 21E of the Securities and Exchange Act of 1934). Such statements are inherently subject to risks and uncertainties. Further, forward looking statements are intended to speak only as of the date on which they are made, and we disclaim any duty to update such statements. Forward-looking statements are statements that include projections, expectations or beliefs about future events or results or otherwise are not statements of historical fact. Such statements are often but not always characterized by qualifying words such as “expect,” “believe,” “estimate,” “plan” and “project” and their derivatives, and include but are not limited to statements about expectations for our future operations, production levels, sales, profit margins, profitability, operating income, 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. Further information about these factors, as well as other factors that could affect our future operations or financial results and the matters discussed in forward-looking statements, is included in Item 1A “Risk Factors” section in our Form 10-K filed with the Securities and Exchange Commission on July 17, 2015, for the fiscal year ended May 3, 2015.

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 31, 2016, and February 1, 2015, represent 39 and 40 week periods, respectively. Our operations are classified into two business segments: mattress fabrics and upholstery fabrics. The mattress fabrics segment manufactures, sources and sells fabrics and mattress covers to bedding manufacturers. The upholstery fabrics segment sources, manufactures, and sells fabrics primarily to residential furniture manufacturers.

We evaluate the operating performance of our segments based upon income from operations before certain unallocated corporate expenses and other non-recurring items. Cost of sales in both segments include costs to manufacture or source our products, including 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

| (dollars in thousands) | Three Months Ended | | |
|----------------------------|--------------------|------------------|----------|
| | January 31, 2016 | February 1, 2015 | % Change |
| Net sales | \$ 78,466 | \$ 81,269 | (3.4)% |
| Gross profit | 16,563 | 14,402 | 15.0 % |
| Gross profit margin | 21.1 % | 17.7 % | 340 bp |
| SG&A expenses | 9,337 | 8,375 | 11.5 % |
| Income from operations | 7,226 | 6,027 | 19.9 % |
| Operating margin | 9.2 % | 7.4 % | 180 bp |
| Income before income taxes | 7,179 | 5,922 | 21.2 % |
| Income taxes | 2,317 | 2,110 | 9.8 % |
| Net income | 4,862 | 3,812 | 27.5 % |

| (dollars in thousands) | Nine Months Ended | | |
|----------------------------|-------------------|------------------|----------|
| | January 31, 2016 | February 1, 2015 | % Change |
| Net sales | \$ 235,607 | \$ 231,320 | 1.9 % |
| Gross profit | 48,498 | 39,395 | 23.1 % |
| Gross profit margin | 20.6 % | 17.0 % | 360 bp |
| SG&A expenses | 27,512 | 23,173 | 18.7 % |
| Income from operations | 20,986 | 16,222 | 29.4 % |
| Operating margin | 8.9 % | 7.0 % | 190 bp |
| Income before income taxes | 20,731 | 16,270 | 27.4 % |
| Income taxes | 7,398 | 6,113 | 21.0 % |
| Net income | 13,333 | 10,157 | 31.3 % |

Net Sales

Overall, our net sales were slightly higher for the nine month year-to-date period of fiscal 2016 compared with the same period a year ago. However, we experienced a slight decrease in our net sales for the third quarter of fiscal 2016 compared with the prior year third quarter, which was an exceptionally strong sales performance for both our business segments. We have remained focused on our top strategic priorities of product innovation and creativity in order to provide a product mix that meets the demands of our customers. Our scalable and flexible manufacturing platform supports this strategy and we have made significant capital investments to improve our operating efficiencies and overall capacity.

Income Before Income Taxes

The increase in income before income taxes primarily reflects the significant improvement in our operating results for both business segments. We continued to realize the benefits of our recent capital investments in our mattress fabrics business, with increased capacity via newer and more efficient equipment, enhanced finishing capabilities and better overall throughput. We also incurred lower raw material costs and operating expenses (primarily more favorable currency exchange rates) in both our business segments during fiscal 2016 compared with fiscal 2015. Partially offsetting the improvement in income before income taxes was the increase in SG&A expenses due primarily to higher incentive compensation expense reflecting stronger financial results in relation to pre-established performance targets.

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

Liquidity

At January 31, 2016, our cash and cash equivalents and short-term investments totaled \$36.0 million compared with \$39.7 million at May 3, 2015. This decrease was primarily due to capital expenditures mostly associated with our mattress fabric segment of \$7.7 million, dividend payments of \$7.3 million, repurchases of our common stock of \$2.4 million, a long-term debt payment of \$2.2 million, and long-term investment purchases of \$1.3 million associated with our Rabbi Trust. This spending was partially offset by net cash provided by operating activities of \$15.9 million.

Net cash provided by operating activities was \$15.9 million for the nine months ending January 31, 2016, a decrease of \$4.8 million compared with \$20.7 million for the nine months ending February 1, 2015. This decrease reflects an increase in inventory purchases, as well as higher annual bonus payments made in fiscal 2016 compared with those made in fiscal 2015. This spending was partially offset by cash flow from earnings and improved cash collections from customers in fiscal 2016 compared with fiscal 2015.

On August 11, 2015, we paid our last annual payment of \$2.2 million on our unsecured term notes, and we currently do not have any long-term debt or balances due on our revolving credit lines.

On March 10, 2016, we amended our Credit Agreement with Wells Fargo to increase our borrowing capacity from \$10 million to \$30 million. The purpose of the increase in our revolving credit line with Wells Fargo 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 repatriate earnings and profits from our foreign subsidiaries to the U.S. for various strategic purposes.

Dividend Program

On March 1, 2016, we announced that our board of directors approved a quarterly cash dividend of \$0.07 per share. This payment will be made on or about April 15, 2016, to shareholders of record as of April 1, 2016.

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

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

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

Common Stock Repurchase Program

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

During the nine months ended January 31, 2016, we purchased 100,776 shares of our common stock at a cost of \$2.4 million, all of which were purchased during the third quarter. During fiscal 2015, we purchased 43,014 shares of our common stock at a cost of \$745,000, all of which were purchased in the first and second quarters.

At January 31, 2016, we had \$1.9 million available for additional repurchases of our common stock.

Segment Analysis

Mattress Fabrics Segment

| (dollars in thousands) | Three Months Ended | | |
|------------------------|--------------------|------------------|----------|
| | January 31, 2016 | February 1, 2015 | % Change |
| Net sales | \$ 44,277 | \$ 45,683 | (3.1)% |
| Gross profit | 8,751 | 8,076 | 8.4 % |
| Gross profit margin | 19.8 % | 17.7 % | 210 bp |
| SG&A expenses | 2,953 | 2,853 | 3.5 % |
| Income from operations | 5,798 | 5,223 | 11.0 % |
| Operating margin | 13.1 % | 11.4 % | 170 bp |

| (dollars in thousands) | Nine Months Ended | | |
|------------------------|-------------------|------------------|----------|
| | January 31, 2016 | February 1, 2015 | % Change |
| Net sales | \$ 137,522 | \$ 131,543 | 4.5 % |
| Gross profit | 28,133 | 22,603 | 24.5 % |
| Gross profit margin | 20.5 % | 17.2 % | 330 bp |
| SG&A expenses | 8,865 | 8,019 | 10.5 % |
| Income from operations | 19,267 | 14,584 | 32.1 % |
| Operating margin | 14.0 % | 11.1 % | 290 bp |

Net Sales

Our net sales for mattress fabrics were slightly higher for the nine month year-to-date period of fiscal 2016 compared with the same period a year ago. However, we experienced a slight decrease in our net sales for the third quarter of fiscal 2016 compared with the prior year third quarter. Our net sales for the third quarter were affected by several factors, including a significant weather event at the end of the quarter, which affected our production and shipment schedules. In addition, we experienced a timing difference related to customer roll-outs of new product lines that typically occur in our third quarter as they did the previous year. We expect to recognize this business in our fourth quarter of fiscal 2016 following the Presidents Day holiday mattress promotional events.

Design and innovation remain our top strategic priorities to meet customer style preferences and demand trends. As such, we are in the process of enhancing our design services and facilities. In addition, our mirrored manufacturing platform, technical expertise, and expanded reactive capacity support our strategic priorities that focus on customer demand trends and style preferences.

Our mattress fabric net sales also were affected by increased customer pricing pressures and the fact that the nine month year-to-date period of fiscal 2016 contained one less week compared with the same period a year ago.

Gross Profit and Operating Income

Our mattress fabric gross profit and operating income increased in the third quarter and the nine month year-to-date period of fiscal 2016 compared with the same periods a year ago. These results reflect the benefits of our recent capital investments, which include increased production capacity via newer and more efficient equipment, enhanced finishing capabilities, and improved overall efficiency and throughput. As planned, we completed the initial phase of our expansion project at our facility located in Canada during the third quarter, and we plan to install additional new equipment and make other technological improvements to our manufacturing platform during the fourth quarter. This project is expected to improve our production capacity and operating efficiency at this location. We also experienced lower raw material costs and operating expenses due to more favorable exchange rates in Canada for fiscal 2016 compared with fiscal 2015.

Partially offsetting the improvement in operating income was an increase in SG&A expenses, due primarily to higher incentive compensation expense reflecting stronger financial results in relation to pre-established performance targets and increased customer pricing pressures as noted above.

Segment assets

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

| (dollars in thousands) | January 31, 2016 | February 1, 2015 | May 3, 2015 |
|-----------------------------------|---------------------|---------------------|-------------|
| Accounts receivable and inventory | \$44,309 | \$36,658 | \$41,328 |
| Property, plant & equipment | 35,637 | 33,046 | 33,773 |
| Goodwill | 11,462 | 11,462 | 11,462 |
| Non-compete agreement | 922 | 998 | 979 |
| Customer Relationships | 728 | 779 | 766 |

Accounts Receivable & Inventory

As of January 31, 2016, accounts receivable and inventory increased \$7.7 million or 21%, compared with February 1, 2015. This increase is due to an increase in inventory of \$9.8 million, as a result of customers requiring us to hold higher inventory levels of key products. This increase in inventory was partially offset by a decrease in accounts receivable of \$2.1 million, due to lower net sales and improved cash collections in the third quarter of fiscal 2016 compared to the third quarter of fiscal 2015.

As of January 31, 2016, accounts receivable and inventory increased \$3.0 million or 7%, compared with May 3, 2015. This increase is due to an increase in inventory of \$4.4 million, as a result of customers requiring us to hold higher inventory levels of key products. This was partially offset by a decrease in accounts receivable of \$1.4 million due to improved cash collections in the third quarter of fiscal 2016 compared with the fourth quarter of fiscal 2015.

Property, Plant & Equipment

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 \$33.0 million at February 1, 2015, represents property, plant, and equipment of \$23.5 million and \$9.5 million located in the U.S. and Canada, respectively. The \$33.8 million at May 3, 2015, represents property, plant, and equipment of \$23.8 million and \$10.0 million located in the U.S. and Canada, respectively.

As of January 31, 2016, property, plant, and equipment increased \$2.6 million, or 8% compared with February 1, 2015. This increase is primarily due to the capital investments noted above, partially offset by depreciation expense.

As of January 31, 2016, property, plant, and equipment increased \$1.9 million, or 6%, compared with May 3, 2015. This increase is due to capital expenditures of \$6.2 million that primarily relate to the purchases and installation of machinery and equipment associated with our operation located in Canada, partially offset by depreciation expense of \$4.3 million for the nine month year-to-date period of fiscal 2016.

Upholstery Fabrics Segment

Net Sales

| (dollars in thousands) | Three Months Ended | | | February 1, | | | % Change |
|------------------------|---------------------|--------|-------|-------------|--------|-------|----------|
| | January 31, 2016 | | | 2015 | | | |
| Non U.S. Produced | \$ | 31,515 | 92 % | \$ | 32,584 | 92 % | (3.3)% |
| U.S. Produced | | 2,674 | 8 % | | 3,002 | 8 % | (10.9)% |
| Total | \$ | 34,189 | 100 % | \$ | 35,586 | 100 % | (3.9)% |

| (dollars in thousands) | Nine Months Ended | | | | | | % Change |
|------------------------|---------------------|-----|---|---------------------|-----|---|----------|
| | January 31, 2016 | | | February 1, 2015 | | | |
| Non U.S. Produced | \$ 90,037 | 92 | % | \$ 91,603 | 92 | % | (1.7)% |
| U.S. Produced | 8,048 | 8 | % | 8,174 | 8 | % | (1.5)% |
| Total | \$ 98,085 | 100 | % | \$ 99,777 | 100 | % | (1.7)% |

Our net sales for upholstery fabrics were lower for the third quarter and nearly flat for the nine month year-to-date period of fiscal 2016 compared with the same periods a year ago. The third quarter of fiscal 2015 was an exceptionally strong quarterly performance for upholstery fabric sales.

Our upholstery fabric net sales also were affected by the fact that the nine month year-to-date period of fiscal 2016 contained one less week compared with the same period a year ago, the closure of our finished goods warehouse and distribution facility located in Poznan, Poland, in the third quarter of fiscal 2015, and some pricing pressures from key customers.

Design and product innovation remain our top strategic priorities. This strategy has allowed us to offer a diverse range of products that meet changing market trends and style preferences. As a result, we have extended our market reach to a more diverse customer base, enhanced our product mix with profitable results, and increased our net sales with the hospitality and lifestyle retail markets. Our 100% owned China platform supports our marketing efforts with the manufacturing flexibility to adapt to changing furniture market trends and consumer style preferences. This platform has allowed us to more effectively reach new customers, with the ability to offer a diverse product mix of fabric styles and price points.

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

| (dollars in thousands) | Three Months Ended | | | | |
|------------------------|--------------------|--------|------------------|--------|----------|
| | January 31, 2016 | | February 1, 2015 | | % Change |
| Gross profit | \$ | 7,812 | \$ | 6,326 | 23.5 % |
| Gross profit margin | | 22.8 % | | 17.8 % | 500 bp |
| SG&A expenses | | 3,963 | | 3,781 | 4.8 % |
| Income from operations | | 3,849 | | 2,545 | 51.2 % |
| Operating margin | | 11.3 % | | 7.2 % | 410 bp |

| (dollars in thousands) | Nine Months Ended | | | % Change |
|------------------------|-------------------|------------------|-------|----------|
| | January 31, 2016 | February 1, 2015 | | |
| Gross profit | \$ 20,365 | \$ 16,792 | 21.3 | % |
| Gross profit margin | 20.8 | 16.8 | % 400 | bp |
| SG&A expenses | 11,372 | 10,518 | 8.1 | % |
| Income from operations | 8,994 | 6,274 | 43.4 | % |
| Operating margin | 9.2 | 6.3 | % 290 | bp |

Our upholstery fabric gross profit and operating income increased in the third quarter and the nine month year-to-date period of fiscal 2016 compared with the same periods a year ago. These results reflect the benefits from our strategic focus on product innovation and sales diversification. The benefits include an enhanced product mix that has resulted in greater operating efficiency and capacity utilization in our cut and sew operation located in China. We also experienced lower raw material costs and operating expenses due to more favorable exchange rates in China for fiscal 2016 compared with fiscal 2015. Partially offsetting the improvement in income from operations was an increase in SG&A expenses due primarily to higher incentive compensation expense reflecting stronger financial results in relation to pre-established performance targets, and some pricing pressures from key customers as noted above.

Also, our profitability for the nine month year-to-date period of fiscal 2015 was affected by non-recurring charges of approximately \$200,000 during the second quarter that related to the closure of our Culp Europe operation. No corresponding charge was recorded during the nine month year-to-date period of fiscal 2016.

Culp Europe

As previously announced 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 very interested in developing business in Europe, and we are assessing the best strategy for selling upholstery fabric into this market as business conditions improve.

Segment Assets

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

| (dollars in thousands) | January 31, 2016 | February 1, 2015 | May 3, 2015 |
|-----------------------------------|---------------------|---------------------|-------------|
| Accounts receivable and inventory | \$30,960 | \$32,129 | \$29,905 |
| Property, plant & equipment | 1,590 | 1,522 | 1,467 |

Accounts Receivable & Inventory

As of January 31, 2016, accounts receivable and inventory for this segment decreased \$1.2 million or 4% compared with February 1, 2015. This decrease was primarily due to a decrease in accounts receivable as a result of lower net sales and improved cash collections in the third quarter of fiscal 2016 compared with the third quarter of fiscal 2015.

As of January 31, 2016, accounts receivable and inventory increased \$1.0 million, or 4%, compared with May 3, 2015. This increase was primarily due to an increase in inventory as a result of holding higher inventory levels to better service our customers.

Property, Plant & Equipment

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 \$1.5 million at February 1, 2015, represents property, plant, and equipment of \$877,000 and \$645,000 located in the U.S. and China, respectively. The \$1.5 million at May 3, 2015, represents property, plant, and equipment of \$848,000 and \$619,000 located in the U.S. and China, respectively.

Other Income Statement Categories

| (dollars in thousands) | Three Months Ended | | |
|------------------------|--------------------|------------------|----------|
| | January 31, 2016 | February 1, 2015 | % Change |
| SG&A expenses | \$ 9,337 | \$ 8,375 | 11.5 % |
| Interest income | 38 | 202 | (81.2)% |
| Other expense | 85 | 307 | (72.3)% |

| (dollars in thousands) | Nine Months Ended | | |
|------------------------|-------------------|------------------|-----------|
| | January 31, 2016 | February 1, 2015 | % Change |
| SG&A expenses | \$ 27,512 | \$ 23,173 | 18.7 % |
| Interest expense | - | 50 | (100.0)% |
| Interest income | 150 | 478 | (68.6)% |
| Other expense | 405 | 380 | 6.6 % |

Selling, General and Administrative Expenses

SG&A expenses have increased in the third quarter and the nine month year-to-date period of fiscal 2016 compared with the same periods a year ago. This trend is primarily due to higher incentive compensation expense reflecting stronger financial results in relation to pre-established performance targets.

Interest Expense

Interest expense decreased for the nine month year-to-date period of fiscal 2016 compared with the same period a year ago. This trend primarily reflects lower outstanding balances of long-term debt, and interest costs that were capitalized in connection with our capital investments associated with our mattress fabrics segment. Interest costs charged to operations and incurred on our long-term debt and lines of credit were \$58,000 and \$191,000 for the nine month year-to-date periods of fiscal 2016 and 2015, respectively. Interest costs charged to operations were reduced by of \$58,000 and \$141,000 for capitalized interest costs for the nine month year-to-date periods of fiscal 2016 and 2015, respectively. These capitalized interest costs will be amortized over the related assets' useful lives.

Interest Income

Interest income decreased in the third quarter and the nine month year-to-date period of fiscal 2016 compared with the same periods a year ago. This trend reflects higher cash and cash equivalent and short-term investment balances held in U.S. dollar denominated account balances during fiscal 2016 compared with fiscal 2015. Cash and cash equivalents and short-term investment balances held in U.S. dollar denominated account balances earn lower interest rates as compared to our cash and cash equivalents and short-term investment balances denominated in the local currency of our foreign subsidiaries. During fiscal 2016, we implemented a strategy of substantially reducing the amount of cash we hold in Chinese Yuan Renminbi. Although this action has resulted in lower interest income as compared to last year, the strategy has mitigated our foreign currency exchange rate exposure in China. See discussion in “Other Expense” below.

Other Expense

The decrease in other expense for the third quarter of fiscal 2016 compared with the third quarter of fiscal 2015 resulted from our ability to better mitigate the effects of foreign currency exchange rate fluctuations associated with our operations located in China. This was achieved by transferring the amount of cash held in Chinese Yuan Renminbi to U.S. dollars as noted above. As a result, we were able to mitigate the effects of foreign currency exchange rate fluctuations associated with our China operations by achieving a balance of assets and liabilities denominated in Chinese Yuan Renminbi. Our operations located in China reported a foreign exchange gain of \$48,000 for the third quarter of fiscal 2016 compared with a foreign exchange loss of \$136,000 for the same period a year ago.

Other expenses remained flat for the nine month year-to-date period of fiscal 2016 compared with the same period a year ago. This result reflects our ability to mitigate the effects of foreign currency exchange rate fluctuations associated with our subsidiaries domiciled in Canada and China through maintenance of a natural hedge by keeping a balance of assets and liabilities denominated in foreign currencies other than the U.S. dollar. Although we will continue to try and maintain this natural hedge, there is no assurance that we will be able to continue to do so in future reporting periods.

Income Taxes

Effective Income Tax Rate

We recorded income tax expense of \$7.4 million, or 35.7% of income before income tax expense, for the nine month period ended January 31, 2016, compared to income tax expense of \$6.1 million or 37.6% of income before income tax expense, for the nine month period ended February 1, 2015. Our effective income tax rates for the nine month periods ended January 31, 2016 and February 1, 2015, were based upon the estimated effective income tax rate applicable for the full year after giving effect to any significant items related specifically to interim periods. The effective income tax rate can be affected over the fiscal year by the mix and timing of actual earnings from our U.S. operations and foreign sources versus annual projections and changes in foreign currencies in relation to the U.S. dollar.

The 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:

| | 2016 | 2015 |
|---|-------|-------|
| federal income tax rate | 34.0% | 34.0% |
| foreign tax rate differential | (6.6) | (6.0) |
| undistributed earnings from foreign subsidiaries | 1.4 | 4.1 |
| increase in liability for uncertain tax positions | 2.9 | 3.5 |
| tax effects of Chinese foreign exchange gains | 3.5 | 0.2 |
| other | 0.5 | 1.8 |
| | 35.7% | 37.6% |

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 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 February 1, 2015, we recorded a partial valuation allowance of \$1.0 million, of which \$596,000 pertained to certain U.S. state net operating loss carryforwards and credits and \$400,000 pertained to loss carryforwards associated with our Culp Europe operation located in Poland. Based on our assessment at May 3, 2015, we recorded a partial valuation allowance of \$922,000, of which \$561,000 pertained to certain U.S. state net operating loss carryforwards and credits and \$361,000 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 31, 2016, February 1, 2015, and May 3, 2015, respectively.

The recorded valuation allowance of \$874,000 at January 31, 2016, 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 31, 2016, 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 31, 2016, the net 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 February 1, 2015, the net deferred tax liability associated with our undistributed earnings from our foreign subsidiaries totaled \$2.4 million, which included U.S. income and foreign withholding taxes totaling \$32.1 million, offset by U.S. foreign income tax credits of \$29.7 million. At May 3, 2015, the net deferred tax liability associated with our undistributed earnings from our foreign subsidiaries totaled \$1.7 million, which included U.S. income and foreign withholding taxes totaling \$32.4 million, offset by U.S. foreign income tax credits of \$30.7 million.

We had accumulated earnings from our foreign subsidiaries totaling \$100.9 million, \$82.4 million, and \$85.2 million at January 31, 2016, February 1, 2015, and May 3, 2015, respectively.

Overall

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 February 1, 2015, our non-current deferred tax asset of \$5.0 million represents \$4.2 million and \$776,000 from our operations located in the U.S. and China, respectively. At May 3, 2015, our non-current deferred tax asset of \$5.2 million represents \$4.3 million and \$868,000 from our operations located in the U.S. and China, respectively.

Our non-current deferred tax liability balances of \$1.2 million, \$927,000, and \$982,000 at January 31, 2016, February 1, 2015, and May 3, 2015, respectively, pertain to our operations located in Canada.

Uncertainty In Income Taxes

At January 31, 2016, we had a \$13.2 million total gross unrecognized tax benefit, of which \$3.5 million represents the amount of gross unrecognized tax benefit that, if recognized, would favorably affect the income tax rate in future periods. At February 1, 2015, we had a \$13.9 million total gross unrecognized tax benefit, of which \$3.6 million represents the amount of gross unrecognized tax benefit that, if recognized, would favorably affect the income tax rate in future periods. At May 3, 2015, we had a \$14.1 million total gross unrecognized tax benefit, of which \$3.8 million represents the amount of gross unrecognized tax benefit that, if recognized, would favorably affect the income tax rate in future period.

At January 31, 2016, we had a \$13.2 million total gross unrecognized 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 February 1, 2015, we had a \$13.9 million total gross unrecognized tax benefit, of which \$10.3 million and \$3.6 million were classified as non-current deferred income taxes and income taxes payable – long-term, respectively, in the accompanying consolidated balance sheets. At May 3, 2015, we had \$14.1 million of total gross unrecognized tax benefit, of which \$10.3 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.

We estimate that the amount of gross unrecognized tax benefits will decrease by approximately \$120,000 for fiscal 2016. This decrease primarily relates to double taxation under applicable tax treaties with foreign tax jurisdictions.

Income Taxes Paid

We reported income tax expense of \$7.4 million and \$6.1 million for the nine month periods ending January 31, 2016, and February 1, 2015, respectively. Currently, we are not paying income taxes in the United States, nor do we expect to for a few more years, due to our loss carryforwards that totaled \$33.3 million as of May 3, 2015. As a result, we had income tax payments of \$4.9 million and \$3.0 million for the nine month periods ending January 31, 2016 and February 1, 2015, respectively. Our income tax payments are associated with our subsidiaries located in China and Canada.

Liquidity and Capital Resources

Liquidity

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 \$36.0 million at January 31, 2016, cash flow from operations, and the current availability under our revolving credit lines will be sufficient to fund our foreseeable business needs and contractual obligations.

On August 11, 2015, we paid our last annual payment of \$2.2 million on our unsecured senior term notes, and we currently do not have any long-term debt or balances due on our revolving credit lines.

On March 10, 2016, we amended our Credit Agreement with Wells Fargo to increase our borrowing capacity from \$10 million to \$30 million. The purpose of the increase in our revolving credit line with Wells Fargo 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 repatriate earnings and profits from our foreign subsidiaries to the U.S. for various strategic purposes.

We currently hold cash and cash equivalents and short-term investments in foreign jurisdictions to support the operational requirements of our foreign operations and for U.S. and foreign income tax planning purposes.

A summary of our cash and cash equivalents and short-term investments by geographic area follows:

| (dollars in thousands) | January 31, 2016 | May 3, 2015 |
|------------------------|---------------------|----------------|
| Cayman Islands | \$20,077 | \$8,591 |
| Canada | 6,570 | 12,511 |
| China | 6,479 | 14,630 |
| United States | 2,846 | 3,977 |
| Poland | - | 20 |
| | \$35,972 | \$39,729 |

At January 31, 2016, our cash and cash equivalents and short-term investments totaled \$36.0 million compared with \$39.7 million at May 3, 2015. This decrease was primarily due to capital expenditures mostly associated with our mattress fabric segment of \$7.7 million, dividend payments of \$7.3 million, repurchases of our common stock of \$2.4 million, a long-term debt payment of \$2.2 million, and long-term investment purchases of \$1.3 million associated with our Rabbi Trust. This spending was partially offset by net cash provided by operating activities of \$15.9 million.

Our net cash provided by operating activities was \$15.9 million for the nine months ending January 31, 2016, a decrease of \$4.8 million compared with \$20.7 million for the nine months ending February 1, 2015. This decrease reflects an increase in inventory purchases, as well as higher annual bonus payments made in fiscal 2016 compared with those made in fiscal 2015. This spending was partially offset by cash flow from earnings and improved cash collections in fiscal 2016 compared with fiscal 2015.

We have had a significant shift in cash and cash equivalents and short-term investments held in China and the Cayman Islands. During the third quarter of fiscal 2016, we distributed earnings and profits totaling \$13.6 million from our subsidiaries located in China to our international holding company located in the Cayman Islands. This shift is primarily due to our strategy of ultimately repatriating earnings and profits from our subsidiaries located in China to the U.S. and mitigating our risk to foreign exchange rate fluctuations for assets and liabilities denominated in Chinese Yuan Renminbi. By reducing 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 against 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 repatriate these earnings and profits to the U.S. for various strategic purposes.

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.

Dividend Program

On March 1, 2016, we announced that our board of directors approved a quarterly cash dividend of \$0.07 per share. This payment will be made on or about April 15, 2016, to shareholders of record as of April 1, 2016.

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

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

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

Common Stock Repurchase Program

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

During the nine months ended January 31, 2016, we purchased 100,776 shares of our common stock at a cost of \$2.4 million, all of which were purchased during the third quarter. During fiscal 2015, we purchased 43,014 shares of our common stock at a cost of \$745,000, all of which were purchased in the first and second quarters.

At January 31, 2016, we had \$1.9 million available for additional repurchases of our common stock.

Working Capital

Accounts receivable at January 31, 2016, were \$26.8 million, a decrease of \$4.0 million, or 13%, compared with \$30.8 million at February 1, 2015. This decrease is primarily due to lower net sales and improved cash collections with customers associated with both our business segments in the third quarter of fiscal 2016 compared to the third quarter of fiscal 2015. Days' sales outstanding were 31 days for the third quarter of fiscal 2016 compared with 34 days for the third quarter of fiscal 2015.

Inventories as of January 31, 2016, were \$48.5 million, an increase of \$10.5 million, or 28%, compared with \$38.0 million at February 1, 2015. This increase is primarily due to customers requiring us to hold higher inventory levels of key products. Inventory turns were 5.1 for the third quarter of fiscal 2016 compared with 7.0 for the third quarter of fiscal 2015.

Accounts payable-trade as of January 31, 2016, were \$25.6 million, a decrease of \$3.0 million, or 11%, compared with \$28.6 million at February 1, 2015. This decrease is primarily due to the timing of payments to suppliers associated with operations located in China as a result of the Chinese New Year holiday.

Operating working capital (accounts receivable and inventories, less accounts payable-trade and accounts payable-capital expenditures) was \$49.3 million at January 31, 2016, compared with \$39.4 million at February 1, 2015. Operating working capital turnover was 7.2 during the third quarter of fiscal 2016, compared with 7.5 during the third quarter of fiscal 2015.

Financing Arrangements

Unsecured Senior Term Notes

We entered into a note agreement dated August 11, 2008 that provided for the issuance of \$11.0 million of unsecured senior term notes with a fixed interest rate of 8.01% and a term of seven years. Principal payments of \$2.2 million per year were due on the notes beginning August 11, 2011. Any principal pre-payments would have been assessed a penalty as defined in the agreement. The agreement contained customary financial and other covenants as defined in the agreement.

On August 11, 2015, we paid our last annual payment of \$2.2 million and this agreement has been paid in full.

Revolving Credit Agreement – United States

As of May 3, 2015, we had an unsecured credit agreement with Wells Fargo Bank, N.A. (“Wells Fargo”) that provided for an unsecured revolving loan commitment of \$10 million to be used to finance working capital and general corporate purposes. Interest is charged at a rate (applicable interest rate of 1.93%, 1.77%, and 1.78% at January 31, 2016, February 1, 2015, and May 3, 2015, respectively) equal to the one-month LIBOR rate plus a spread based on our ratio of debt to EBITDA as defined in the agreement. The Credit Agreement contained customary financial and other covenants as defined in the agreement and was set to expire on August 31, 2015.

Effective July 10, 2015, we amended our Credit Agreement to extend the expiration date to August 31, 2017, and maintain an annual capital expenditure limit of \$12 million.

We entered into a Second Amendment to our Credit Agreement dated March 10, 2016, which amends our Credit Agreement with Wells Fargo Bank, National Association. The terms of the Second Amendment include, among other things, provisions that (i) increase our line of credit under the Credit Agreement to \$30 million, (ii) increase the annual limit on capital expenditures by the company to \$15 million, (iii) add a new financial covenant to establish a minimum level of unencumbered liquid assets, (iv) eliminate certain financial covenants, (v) amend the pricing matrix that provides for interest payable on obligations under the agreement as a variable spread over LIBOR, based upon the company's ratio of debt to EBITDA, and (vi) provide that the obligations under the Credit Agreement are to be secured by a pledge of 65% of the common stock of Culp International Holdings Ltd, our Cayman subsidiary.

The purpose of the increase in our revolving credit line with Wells Fargo 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 repatriate earnings and profits from our foreign subsidiaries to the U.S. for various strategic purposes.

At January 31, 2016, February 1, 2015 and May 3, 2015 there was a \$250,000 outstanding letter of credit (all of which related to workers compensation). At January 31, 2016, February 1, 2015, and May 3, 2015, there were no borrowings outstanding under the Credit Agreement.

Revolving Credit Agreement – China

We had an unsecured credit agreement associated with our operations in China that provided for a line of credit of up to 40 million RMB (approximately \$6.1 million USD at January 31, 2016), that was set to expire on February 9, 2016. This agreement had an interest rate determined by the Chinese government. There were no borrowings outstanding under the agreement as of January 31, 2016, February 1, 2015, and May 3, 2015.

On March 8, 2016, we renewed our unsecured credit agreement associated with our operations located in China. The renewal extended the agreement to March 8, 2017 and maintained the line of credit up to 40 million RMB (approximately \$6.1 million USD).

Overall

Our loan agreements require, among other things, that we maintain compliance with certain financial covenants. At January 31, 2016, the company was in compliance with these financial covenants.

Capital Expenditures and Depreciation

Capital expenditures on a cash basis were \$7.7 million for the nine month year-to-date period for fiscal 2016 compared with \$8.2 million for the same period a year ago. Capital expenditures for the nine month year-to-date periods of fiscal 2016 and 2015 were primarily related to our mattress fabrics segment.

Depreciation expense was \$4.9 million for the nine month year-to-date period of fiscal 2016 compared with \$4.2 million for the same period a year ago. Depreciation expense for the nine month year-to-date periods of fiscal 2016 and 2015 primarily related to the mattress fabrics segment.

For fiscal 2016, we are projecting capital expenditures for the company as a whole to be approximately \$12.0 million. Depreciation expense for the company as a whole is projected to be approximately \$7.0 million in fiscal 2016. The estimated capital expenditures and depreciation expense primarily relate to the mattress fabrics segment. For fiscal 2017, our preliminary estimate for capital expenditures is in the range of \$11 million to \$12 million, as we continue to invest in our mattress fabrics business. These are management's current expectations only, and changes in our business needs could cause changes in plans for capital expenditures and expectations for related depreciation expense.

Critical Accounting Policies and Recent Accounting Developments

At January 31, 2016, 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 3, 2015.

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 3, 2015.

Contractual Obligations

As of January 31, 2016, there were no significant or new contractual obligations from those reported in our annual report on Form 10-K for the year ended May 3, 2015.

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 31, 2016, our U.S. revolving credit agreement had an interest rate equal to the one-month LIBOR rate plus a spread based on our ratio of debt to EBITDA as defined in the agreement. Our revolving credit line associated with our China subsidiaries bears interest at a rate determined by the Chinese government. At January 31, 2016, 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 31, 2016, 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 31, 2016, 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 31, 2016, 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 31, 2016. Our legal proceedings are disclosed in the company's annual report on Form 10-K filed with the Securities and Exchange Commission on July 17, 2015 for the fiscal year ended May 3, 2015.

Item 1A. Risk Factors

There have not been any material changes to our risk factors during the nine months ended January 31, 2016. Our risk factors are disclosed in the company's annual report on Form 10-K filed with the Securities and Exchange Commission on July 17, 2015 for the fiscal year ended May 3, 2015.

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

ISSUER PURCHASES OF EQUITY SECURITIES

| Period | (a) Total Number of Shares Purchased | (b) Average Price Paid per Share | (c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | (d) Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (1) |
|--------------------------------------|--|---|---|--|
| November 2, 2015 to December 6, 2015 | - | - | - | \$ 4,256,235 |
| December 7, 2015 to January 3, 2016 | - | - | - | \$ 4,256,235 |
| January 4, 2016 to January 31, 2016 | 100,776 | \$ 23.79 | 100,776 | \$ 1,859,274 |
| Total | 100,776 | \$ 23.79 | 100,776 | \$ 1,859,274 |

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

Item 5. Other Information

We entered into a Second Amendment to our Credit Agreement dated March 10, 2016, which amends our Credit Agreement with Wells Fargo Bank, National Association. The terms of the Second Amendment include, among other things, provisions that (i) increase our line of credit under the Credit Agreement to \$30 million, (ii) increase the annual limit on capital expenditures by the company to \$15 million, (iii) add a new financial covenant to establish a minimum level of unencumbered liquid assets, (iv) eliminate certain financial covenants, (v) amend the pricing matrix that provides for interest payable on obligations under the agreement as a variable spread over LIBOR, based upon the company's ratio of debt to EBITDA, and (vi) provide that the obligations under the Credit Agreement are to be secured by a pledge of 65% of the common stock of Culp International Holdings Ltd, our Cayman subsidiary. This description of the Second Amendment is qualified in its entirety by reference to the terms of the Second Amendment, a copy of which is filed as Exhibit 10.1 hereto.

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 | Second Amendment to the Credit Agreement dated as of March 10, 2016, by and between Culp, Inc and Wells Fargo. N.A. |
| 31.1 | Certification of Chief Executive Officer Pursuant to Section 302 of Sarbanes-Oxley Act of 2002. |
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| 101.INS | XBRL Instance Document |
| 101.SCH | XBRL Taxonomy Extension Schema Document |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document |

SIGNATURES

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

CULP, INC.
(Registrant)

Date: March 11, 2016

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

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

EXHIBIT INDEX

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