

CULP INC
Form 10-Q
December 07, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended October 28, 2018
Commission File No. 1-12597

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

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

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

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

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

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

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

Large accelerated filer Accelerated filer Non-accelerated filer

Smaller Reporting Company Emerging Growth Company

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

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

Common shares outstanding at October 28, 2018: 12,491,956

Par Value: \$0.05 per share

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For the period ended October 28, 2018

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Item 1: Financial Statements

CULP, INC.
CONSOLIDATED
STATEMENTS OF NET
INCOME
FOR THE THREE AND SIX
MONTHS ENDED OCTOBER
28, 2018 AND OCTOBER 29,
2017
UNAUDITED
(Amounts in Thousands, Except
for Per Share Data)

	THREE MONTHS ENDED	
	October 28, 2018	October 29, 2017
Net sales	\$77,006	80,698
Cost of sales	63,680	64,894
Gross profit	13,326	15,804
Selling, general and administrative expenses	10,103	9,415
Restructuring credit	(1,061)) -
Income from operations	4,284	6,389
Interest expense	18	37
Interest income	(151)) (128)
Other expense	142	321
Income before income taxes	4,275	6,159
Income taxes	1,276	2,108
Loss from investment in unconsolidated joint venture	55	75
Net income	\$2,944	3,976
Less: Net income attributable to non-controlling interest	(11)) -
Net income attributable to Culp, Inc. common shareholders	\$2,933	3,976
Net income attributable to Culp Inc. common shareholders per share - basic	\$0.23	0.32
Net income attributable to Culp Inc. common shareholders per share - diluted	\$0.23	0.32
Average shares outstanding, basic	12,515	12,440
Average shares outstanding, diluted	12,551	12,580

SIX MONTHS ENDED

	October 28, 2018	October 29, 2017
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Net sales	\$ 148,479	160,230
Cost of sales	124,594	127,962
Gross profit	23,885	32,268
Selling, general and administrative expenses	18,136	18,916
Restructuring credit	(610) -
Income from operations	6,359	13,352
Interest expense	38	37
Interest income	(301) (259
Other expense	399	674
Income before income taxes	6,223	12,900
Income taxes	2,182	3,748
Loss from investment in unconsolidated joint venture	132	193
Net income	\$3,909	8,959
Less: Net income attributable to non-controlling interest	(19) -
Net income attributable to Culp, Inc. common shareholders	\$3,890	8,959
Net income attributable to Culp Inc. common shareholders per share - basic	\$0.31	0.72
Net income attributable to Culp Inc. common shareholders per share - diluted	\$0.31	0.71
Average shares outstanding, basic	12,512	12,420
Average shares outstanding, diluted	12,612	12,613

See accompanying notes to consolidated financial statements.

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CULP, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
FOR THE THREE AND SIX MONTHS ENDED OCTOBER 28, 2018 AND OCTOBER 29, 2017
(UNAUDITED)
(AMOUNTS IN THOUSANDS)

	THREE MONTHS ENDED	
	October 28, 2018	October 29, 2017
Net income	\$2,944	\$3,976
Other comprehensive (loss) income		
Unrealized (loss) gain on investments, net of tax		
Unrealized holding (losses) gains on investments	(43) 20
Reclassification adjustment for realized loss (gain) on investments	-	-
Total unrealized (loss) gain on investments	(43) 20
Unrealized gain on foreign currency cash flow hedge, net of tax		
Unrealized holding gain on foreign currency cash flow hedge	17	-
Reclassification adjustment for realized loss on foreign currency cash flow hedge	24	-
Total unrealized gain on foreign currency cash flow hedge	41	-
Total other comprehensive (loss) income	(2) 20
Comprehensive income	\$2,942	\$3,996
Less: Comprehensive income attributable to non-controlling interest	(11) -
Comprehensive income attributable to Culp, Inc. common shareholders	\$2,931	\$3,996
	SIX MONTHS ENDED	
	October 28, 2018	October 29, 2017
Net income	\$3,909	\$8,959
Other comprehensive income		
Unrealized gain on investments, net of tax		
Unrealized holding (losses) gains on investments	(3) 64

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Reclassification adjustment for realized loss on investments	94	-
Total unrealized gain on investments	91	64
Unrealized gain on foreign currency cash flow hedge, net of tax		
Unrealized holding loss on foreign currency cash flow hedge	(8) -
Reclassification adjustment for realized loss on foreign currency cash flow hedge	64	-
Total unrealized gain on foreign currency cash flow hedge	56	-
Total other comprehensive income	147	64
Comprehensive income	\$4,056	\$9,023
Less: Comprehensive income attributable to non-controlling interest	(19) -
Comprehensive income attributable to Culp, Inc. common shareholders	\$4,037	\$9,023

See accompanying notes to consolidated financial statements.

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CULP, INC.
CONSOLIDATED BALANCE SHEETS
OCTOBER 28, 2018, OCTOBER 29, 2017 AND APRIL 29, 2018
UNAUDITED
(Amounts in Thousands)

	October 28, 2018	October 29, 2017	April 29, 2018
Current assets:			
Cash and cash equivalents	\$ 14,768	15,739	21,228
Short-term investments - Available for Sale	-	2,478	2,451
Short-term investments - Held-To-Maturity	26,719	4,015	25,759
Accounts receivable, net	24,362	24,220	26,307
Inventories	50,601	50,209	53,454
Assets held for sale	237	-	-
Other current assets	2,461	2,263	2,870
Total current assets	119,148	98,924	132,069
Property, plant and equipment, net	51,325	52,530	51,794
Goodwill	27,222	11,462	13,569
Intangible assets	10,636	1,428	4,275
Deferred income taxes	3,614	491	1,458
Long-term investments - Held-To-Maturity	-	26,853	5,035
Long-term investments - Rabbi Trust	7,851	6,921	7,326
Investment in unconsolidated joint venture	1,470	1,522	1,501
Other assets	945	912	957
Total assets	\$222,211	201,043	217,984
Current liabilities:			
Accounts payable-trade	\$24,007	24,600	27,237
Accounts payable - capital expenditures	114	3,209	1,776
Deferred revenue	649	-	809
Accrued expenses	8,670	7,364	9,325
Accrued restructuring costs	260	-	-
Deferred compensation	714	-	-
Income taxes payable - current	2,044	692	1,437
Total current liabilities	36,458	35,865	40,584
Accrued expenses - long-term	-	-	763
Contingent consideration - earn-out obligation	5,706	-	-
Income taxes payable - long-term	3,233	487	3,758
Deferred income taxes	2,225	4,641	2,150
Deferred compensation	7,120	6,970	7,353
Total liabilities	54,742	47,963	54,608

Commitments and Contingencies (Notes 13 and 22)

Shareholders' equity
Preferred stock, \$0.05 par value, authorized

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10,000,000	-	-	-
Common stock, \$0.05 par value, authorized 40,000,000 shares, issued and outstanding 12,491,956 at October 28, 2018; 12,435,276 at October 29, 2017; and 12,450,276 at April 29, 2018	625	622	623
Capital contributed in excess of par value	45,959	47,441	48,203
Accumulated earnings	116,272	104,957	114,635
Accumulated other comprehensive income (loss)	62	60	(85)
Total shareholders' equity attributable to Culp Inc.	162,918	153,080	163,376
Non-controlling interest	4,551	-	-
Total equity	167,469	153,080	163,376
Total liabilities and shareholders' equity	\$222,211	201,043	217,984

* 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 SIX MONTHS ENDED OCTOBER 28, 2018 AND OCTOBER 29, 2017
UNAUDITED
(Amounts in Thousands)

	SIX MONTHS ENDED	
	October 28, 2018	October 29, 2017
Cash flows from operating activities:		
Net income	\$3,909	8,959
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	4,056	3,713
Amortization	391	166
Stock-based compensation	(106)	1,558
Deferred income taxes	(2,081)	976
Realized loss on sale of short-term investments (Available for Sale)	94	-
Gain on sale of equipment	(1,079)	-
Loss from investment in unconsolidated joint venture	132	193
Foreign currency exchange (gain) loss	(102)	42
Changes in assets and liabilities, net of effects of acquisition of businesses		
Accounts receivable	1,639	561
Inventories	3,767	1,597
Other current assets	379	723
Other assets	(10)	(35)
Accounts payable - trade	(3,264)	(5,074)
Deferred revenue	(160)	-
Accrued expenses and deferred compensation	(1,472)	(3,607)
Accrued restructuring costs	260	-
Income taxes	247	406
Net cash provided by operating activities	6,600	10,178
Cash flows from investing activities		
Net cash paid for acquisition of businesses	(12,096)	-
Capital expenditures	(2,096)	(4,978)
Proceeds from the sale of equipment	1,280	6
Investment in unconsolidated joint venture	(100)	(609)
Proceeds from the sale of short-term investments (Held to Maturity)	4,000	-
Proceeds from the sale of short-term investments (Available for Sale)	2,458	-
Purchase of short-term investments (Available for Sale)	(10)	(24)
Proceeds from the sale of long-term investments (Rabbi Trust)	-	54
Purchase of long-term investments (Rabbi Trust)	(526)	(1,457)
Net cash used in investing activities	(7,090)	(7,008)

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Cash flows from financing activities:		
Proceeds from line of credit	12,000	10,000
Payments on line of credit	(12,000)	(10,000)
Payments on vendor-financed capital expenditures	(1,412)	(2,500)
Dividends paid	(2,253)	(4,603)
Common stock surrendered for withholding taxes payable	(1,292)	(1,147)
Common stock repurchased	(844)	-
Proceeds from common stock issued	-	5
Net cash used in financing activities	(5,801)	(8,245)
Effect of exchange rate changes on cash and cash equivalents	(169)	19
Decrease in cash and cash equivalents	(6,460)	(5,056)
Cash and cash equivalents at beginning of period	21,228	20,795
Cash and cash equivalents at end of period	\$14,768	15,739

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)

Shareholders' equity attributable to Culp Inc.

	Common Stock		Capital Contributed in Excess of Par Value	Accumulated Earnings	Accumulated Other Comprehensive (Loss) Income	Total	Non- Controlling Interest	Total Equity
	Shares	Amount						
Balance, April 30, 2017								
*	12,356,631	\$618	47,415	100,601	(4)	\$148,630	\$ -	\$148,630
Net income	-	-	-	20,877	-	20,877	-	20,877
Stock-based compensation	-	-	2,212	-	-	2,212	-	2,212
Unrealized loss on foreign currency cash flow hedge	-	-	-	-	(55)	(55)	-	(55)
Unrealized loss on investments	-	-	-	-	(26)	(26)	-	(26)
Common stock issued in connection with vesting of performance based restricted stock units	118,845	6	(6)	-	-	-	-	-
Fully vested common stock award	4,800	-	-	-	-	-	-	-
Common stock issued in connection with vesting of time- based restricted stock units	1,200	-	-	-	-	-	-	-
Common stock issued in connection with exercise of stock options	15,600	1	110	-	-	111	-	111
Common stock surrendered for the cost of stock option exercises and withholding taxes payable	(46,800)	(2)	(1,528)	-	-	(1,530)	-	(1,530)
Dividends paid	-	-	-	(6,843)	-	(6,843)	-	(6,843)
Balance, April 29, 2018								
*	12,450,276	623	48,203	114,635	(85)	163,376	-	163,376
Net income	-	-	-	3,890	-	3,890	19	3,909
Acquisition of subsidiary with non-controlling interest	-	-	-	-	-	-	4,532	4,532

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Stock-based compensation	-	-	(106)	-	-	(106)	-	(106)
Unrealized gain on foreign currency cash flow hedge	-	-	-	-	56	56	-	56
Unrealized gain on investments	-	-	-	-	91	91	-	91
Common stock issued in connection with vesting of performance based restricted stock units	115,917	6	(6)	-	-	-	-	-
Common stock issued in connection with vesting of time- based restricted stock units	1,200	-	-	-	-	-	-	-
Fully vested common stock award	3,600	-	-	-	-	-	-	-
Common stock surrendered for withholding taxes payable	(42,157)	(2)	(1,290)	-	-	(1,292)	-	(1,292)
Common stock repurchased	(36,880)	(2)	(842)	-	-	(844)	-	(844)
Dividends paid	-	-	-	(2,253)	-	(2,253)	-	(2,253)
Balance, October 28, 2018	12,491,956	\$625	45,959	116,272	62	\$162,918	\$ 4,551	\$167,469

* Derived from audited financial statements.

See accompanying notes to consolidated financial statements.

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

1. Basis of Presentation

The accompanying unaudited consolidated financial statements of Culp, Inc. and its majority-owned subsidiaries (the “company”) include all adjustments, which are, in the opinion of management, necessary for fair presentation of the results of operations and financial position. All of these adjustments are of a normal recurring nature. Results of operations for interim periods may not be indicative of future results. The unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements, which are included in the company’s annual report on Form 10-K filed with the Securities and Exchange Commission on July 13, 2018, for the fiscal year ended April 29, 2018.

The company’s six-months ended October 28, 2018, and October 29, 2017, represent 26-week periods, respectively.

2. Significant Accounting Policies

As of October 28, 2018, there were no changes in the nature of our significant accounting policies or the application of those policies from those reported in our annual report on Form 10-K for the year then ended April 29, 2018.

Recently Adopted Accounting Pronouncements

In May 2014, the FASB issued ASU No. 2014-09, which subsequently amended ASC Topic 606, Revenue from Contracts with Customers. The amendments in this ASU are intended to enhance the comparability of revenue recognition practices and will be applied to all contracts with customers. Improved disclosures related to the nature, amount, timing, and uncertainty of revenue that is recognized are requirements under the amended guidance. The new revenue standard became effective at the beginning of our fiscal 2019, and therefore, we applied the new revenue guidance in our first quarter of fiscal 2019 interim financial statements. This guidance did not have a material impact on our results of operations and financial position but did have a material impact on the disclosures required in our notes to the consolidated financial statements, which are disclosed in Note 5.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments, to address the diversity in how certain cash receipts and cash payments are presented in the statement of cash flows. This new guidance provides clarity around the cash flow classification for eight specific issues in an effort to reduce the current and potential future diversity in practice. This new standard, which is to be applied retrospectively, became effective at the beginning of our fiscal 2019, and therefore, we applied this new guidance in our first quarter of fiscal 2019 interim financial statements. During the first quarter of fiscal 2019, this new guidance did not impact our results of operations, balance sheet, or statement of cash flows. Currently, we do expect that this guidance will be applicable in determining how we classify our contingent consideration payments associated with our business combinations (see note 3) as either investing or financing activities. This guidance requires cash payments not made soon after the acquisition date of a business combination by an acquirer to settle a contingent consideration liability should be separated and classified as cash outflows from financing activities. In comparison, cash payments made soon after the acquisition date should be separated and classified as cash outflows from investing activities.

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

In October 2016, the FASB issued ASU No. 2016-16, Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory, to reduce the diversity in practice and complexity associated with accounting for the income tax consequences of intra-entity transfers of assets other than inventory. Prior GAAP prohibited recognition of deferred income taxes for an intra-entity transfer until the asset had been sold to an outside party. The new pronouncement stipulates that an entity should recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. This new standard, which is required to be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings, became effective at the beginning of our fiscal 2019. Therefore, we were required to apply this new guidance in our first quarter fiscal 2019 interim financial statements. This guidance did not impact our results of operations and financial position.

Recently Issued Accounting Pronouncements

Leases

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

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

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

3. Business Combinations

Read Window Products, LLC (Read)

Overview

Effective April 1, 2018, we entered into an Asset Purchase Agreement (Asset Agreement) to acquire certain assets and assume certain liabilities of Read, a source of custom window treatments for the hospitality and commercial

industries. Based in Knoxville, Tennessee, Read is a turn-key provider of window treatments that offer sourcing of upholstery fabrics and other products, measuring, and installation services of their own products. Read's custom product line includes motorization, shades, upholstered drapery, upholstered headboards and shower curtains. In addition, Read supplies soft goods such as decorative top sheets, coverlets, duvet covers, bed skirts, bolsters and pillows, for leading hospitality brands worldwide. The addition of window treatments and other soft goods to our product line will allow us to be a more complete source of fabrics for the hospitality market, in which we believe there are significant growth opportunities.

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

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

Assets Acquired and Liabilities Assumed

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

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

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

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

The Asset Agreement contains a contingent consideration arrangement that requires us to pay a former shareholder of Read, an earn-out payment based on adjusted EBITDA as defined in the agreement for calendar year 2018 in excess of fifty percent of a pre-established adjusted EBITDA target. As of October 28, 2018, based on historical and projected financial results in relation to the pre-established adjusted EBITDA target, we currently believe a contingent payment will not be made, and therefore, no contingent liability has been recorded.

Other

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

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

eLuxury, LLC (eLuxury)

Overview

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

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

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

Assets Acquired and Liabilities Assumed

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

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

The estimated fair values of goodwill and tradename are provisional and are based on the information that was currently available to estimate their fair values. We believe that information provides a reasonable basis for estimating the fair values of goodwill and tradename, but we are waiting for additional information necessary to finalize those fair values. Therefore, the provisional measurements of fair value reflected are subject to change and such changes

could be significant. The Company expects to finalize the valuation and complete the purchase price allocation as soon as practicable but no later than one year from the acquisition date.

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

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

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

As mentioned above, the Equity Agreement contains a contingent consideration arrangement that requires us to pay the seller, who is also the shareholder of the noncontrolling interest, an earn-out payment based on a multiple of adjusted EBITDA for the twelve-month period ending August 31, 2021, less \$12.0 million, as defined in the Equity Agreement. We recorded a contingent liability at the acquisition date for this earn-out obligation at its fair value totaling \$5.6 million based on the Black Scholes pricing model.

Consolidation and Non-Controlling Interest

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

As result of the acquisition of our 80% controlling interest, we included all the accounts of eLuxury in our consolidated financial statements and have eliminated all significant intercompany balances and transactions. Net income (loss) attributable to the minority interest in eLuxury is excluded from total consolidated net income (loss) attributable to Culp, Inc. common shareholders.

Based on the terms of the Equity Agreement, we believe the related risks associated with the ownership interests are aligned and therefore, the total consideration of \$18.1 million for the 80% controlling interest provides information for the equity value of eLuxury as a whole, and therefore, is useful in estimating fair value of the 20% noncontrolling interest. In order to determine the carrying value of our noncontrolling interest in eLuxury, we applied the Hypothetical-Liquidation-At-Book-Value method (HLBV). HLBV is an approach that is used in practice to determine the carrying value of a noncontrolling interest if it is consistent with an existing profit-sharing arrangement such as the Equity Agreement. Therefore, the carrying amount of the noncontrolling interest of \$4.5 million represents the \$4.5 million fair value determined at the acquisition date plus its allocation of net income totaling \$19,000 subsequent to the acquisition date and through the end of our second quarter of fiscal 2019.

Other

Acquisitions costs totaling \$270,000 were included in selling, general, and administrative expenses in our Consolidated Statement of Net Income for the six-month period ending October 28, 2018.

Actual revenue and net income for the period June 22, 2018 through October 28, 2018 were included in our Consolidated Statement of Net Income for the six-months ended October 28, 2018, and totaled \$7.4 million and \$64,000, respectively.

Culp, Inc.
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Pro Forma Financial Information

The following unaudited pro forma consolidated results of operations for the three-month and six-month periods ending October 28, 2018, and October 29, 2017, have been prepared as if the acquisitions of Read had occurred on May 2, 2016 and eLuxury had occurred on May 1, 2017.

	Three Months Ended	
	October 28, 2018	October 29, 2017
(dollars in thousands, except per share data)		
Net Sales	\$77,006	\$88,760
Income from operations	4,284	6,675
Net income	2,944	4,100
Net income - noncontrolling interest	(11)	(57)
Net income – Culp Inc. common shareholders	2,933	4,043
Net income per share (basic) –		
Culp Inc. common shareholders	0.23	0.33
Net income per share (diluted) –		
Culp Inc. common shareholders	0.23	0.32

	Six Months Ended	
	October 28, 2018	October 29, 2017
(dollars in thousands, except per share data)		
Net Sales	\$151,604	\$177,498
Income from operations	6,357	13,540
Net income	3,883	8,973
Net (income) loss - noncontrolling interest	(11)	28
Net income – Culp Inc. common shareholders	3,872	9,001
Net income per share (basic) –		
Culp Inc. common shareholders	0.31	0.72
Net income per share (diluted) –		
Culp Inc. common shareholders	0.31	0.71

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

Culp, Inc.
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 (Unaudited)

4. Accounts Receivable

A summary of accounts receivable follows:

	October 28, 2018	October 29, 2017	April 29, 2018
(dollars in thousands)			
Customers	\$24,956	\$25,593	\$28,097
Allowance - doubtful accounts	(388)	(374)	(357)
Allowance - cash discounts	(164)	(188)	(245)
Allowance - sales returns & allowances (1)	(42)	(811)	(1,188)
	\$24,362	\$24,220	\$26,307

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

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

	Six months ended	
	October 28, 2018	October 29, 2017
(dollars in thousands)		
Beginning balance	\$(357)	\$(414)
Provision for bad debts	(28)	40
Net write-offs, net of recoveries	(3)	-
Ending balance	\$(388)	\$(374)

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

	Six months ended	
	October 28, 2018	October 29, 2017
(dollars in thousands)		
Beginning balance	\$(1,433)	\$(1,220)
Adoption of ASC Topic 606 (1)	1,145	-
Provision for returns, allowances and discounts	(1,080)	(1,330)
Credits issued	1,162	1,551
Ending balance	\$(206)	\$(999)

5. Revenue

Revenue from Contracts with Customers

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

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

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

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

Currently, we expect the adoption of this new standard to be immaterial to our net income on an ongoing basis. The effect of adopting ASC 606 on our Consolidated Statements of Net Income for the three-month and six-month periods ended October 28, 2018, are as follows:

	Three Months Ended October 28, 2018	Adjustments Due to ASC 606 Adoption (1)	Balances Without ASC 606 Adoption
(dollars in thousands) Statements of Net Income			
Net Sales	\$77,006	\$ 10	\$77,016
Cost of Sales	63,680	10	63,690

	Six Months Ended	Adjustments Due to	Balances Without
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	October	ASC 606	ASC 606
(dollars in thousands)	28, 2018	Adoption	Adoption
		(1)	
Statements of Net Income			
Net Sales	\$ 148,479	\$ (30)	\$ 148,449
Cost of Sales	124,594	(30)	124,564

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Culp, Inc.
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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The effect of adopting ASC 606 on our Consolidated Balance Sheets for the period ended October 28, 2018, is as follows:

	October	Adjustments Due to ASC 606 Adoption	Balances Without ASC 606 Adoption
(dollars in thousands)	28, 2018	(1)	
Balance Sheet			
Assets:			
Accounts Receivable	\$24,362	\$ (1,094)	\$ 23,268
Other Current Assets	2,461	(30)	2,431
Liabilities:			
Accrued Expenses	\$8,670	(1,124)	\$ 7,546

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

Nature of Performance Obligations

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

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

Significant Judgments

Revenue is recognized upon the transfer of control of promised products or services to customers in an amount that reflects the consideration we expect to receive in exchange for those products or services. We determined that our customer purchase orders represent contracts as defined in the new standard. In addition to purchase orders, we also have supply contracts with certain customers that define standard terms and conditions. Our contracts generally include promises to sell either upholstery fabric or mattress fabric products or promises to provide fabrication and

installation services associated with customized window treatments. The transaction price is typically allocated to performance obligations based upon stand-alone selling prices. We did not disclose the value of unsatisfied performance obligations as substantially all of any unsatisfied performance obligations as of October 28, 2018, will be satisfied within one year or less. Revenue associated with sales of our products are recognized at the point-in-time when control of the promised goods has been transferred to the customer. The point-in-time when control transfers to the customer depends on the contractually agreed upon shipping terms, but typically occurs once the product has been shipped or once it has been delivered to a location specified by the customer. For certain warehousing arrangements, transfer of control to the customer is deemed to have occurred when the customer pulls the inventory for use in their production. Revenue associated with our customized fabrication services, which are performed on various types of window treatments, is recognized over time once the customized products are deemed to have no alternative use but for which we have an enforceable right to payment for the services performed. Revenue for our customized fabrication services is recognized over time using the output method based on units produced. Revenue associated with our installation services is also recognized over time as the customer receives and consumes the benefits of the promised installation services. Revenue associated with our installation services is recognized over time using the output method based on units installed.

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

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

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

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 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Contract Assets & Liabilities

Certain contracts, primarily those for customized fabrication and installation services, require upfront customer deposits that result in a contract liability which is recorded on the Consolidated Balance Sheet as deferred revenue. If upfront deposits or prepayment are not required, customers may be granted credit terms which generally range from 15 – 45 days. Such terms are common within the industries in which we are associated and are not considered financing arrangements. There were no contract assets recognized as of October 28, 2018.

A summary of the activity of deferred revenue for the three-month and six-month periods ended October 28, 2018 follows:

	Three Months Ended October 28, 2018
(dollars in thousands)	
Balance as of July 29, 2018	\$634
Revenue recognized on contract liabilities during the period	(792)
Payments received for services not yet rendered during the period	807
Balance as of October 28, 2018	\$649

	Six Months Ended October 28, 2018
(dollars in thousands)	
Balance as of April 29, 2018	\$809
Revenue recognized on contract liabilities during the period	(1,534)
Payments received for services not yet rendered during the period	1,374
Balance as of October 28, 2018	\$649

Disaggregation of Revenue

The following table presents our disaggregated revenue by segment, timing of revenue recognition, and product sales versus services rendered for the three-month period ending October 28, 2018:

Net Sales

	Mattress Fabrics	Upholstery Fabrics	Total
(dollars in thousands)			
Products transferred at a point in time	\$41,989	\$ 31,877	\$73,866

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Services transferred over time	-	3,140	3,140
Total Net Sales	\$41,989	35,017	\$ 77,006

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Culp, Inc.
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The following table presents our disaggregated revenue by segment, timing of revenue recognition, and product sales versus services rendered for the six-month period ending October 28, 2018:

Net Sales

(dollars in thousands)	Mattress Fabrics	Upholstery Fabrics	Total
Products transferred at a point in time	\$ 78,972	\$ 63,878	142,850
Services transferred over time	-	5,629	5,629
Total Net Sales	\$ 78,972	\$ 69,507	148,479

6. Inventories

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

A summary of inventories follows:

(dollars in thousands)	October 28, 2018	October 29, 2017	April 29, 2018
Raw materials	\$5,397	\$6,617	\$6,024
Work-in-process	2,082	2,686	3,264
Finished goods	43,122	40,906	44,166
	\$50,601	\$50,209	\$53,454

7. Intangible Assets

A summary of intangible assets follows:

(dollars in thousands)	October 28, 2018	October 29, 2017	April 29, 2018
Tradenames	\$7,232	\$-	\$683
Customer relationships, net	2,688	638	2,839
Non-compete agreement, net	716	790	753
	\$10,636	\$1,428	\$4,275

Tradename

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

(dollars in thousands)

	October 28, 2018	October 29, 2017	April 29, 2018
Read	\$683	\$ -	\$683
eLuxury	6,549	-	-
	\$7,232	\$ -	\$683

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

Customer Relationships

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

	Six months ended	
	October 28, 2018	October 29, 2017
(dollars in thousands)		
Beginning balance	\$2,839	664
Acquisition of assets	-	-
Amortization expense	(151)	(26)
Loss on impairment	-	-
Ending balance	\$2,688	\$ 638

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

Additionally, we have customer relationships from a prior acquisition with a carrying amount of \$587,000 at October 28, 2018. These customer relationships are being amortized on a straight-line basis over their seventeen-year useful life.

The gross carrying amount of our customer relationships were \$3.1 million, \$868,000 and \$3.1 million at October 28, 2018, October 29, 2017, and April 29, 2018, respectively. Accumulated amortization for these customer relationships were \$427,000, \$230,000 and \$276,000 at October 28, 2018, October 29, 2017, and April 29, 2018, respectively.

The remaining amortization expense for the next five fiscal years and thereafter follows: FY 2019 - \$150,000; FY 2020 - \$301,000; FY 2021 - \$301,000; FY 2022 - \$301,000; FY 2023 - \$301,000; and Thereafter - \$1,334,000.

The weighted average amortization period for our customer relationships is 9.1 years as of October 28, 2018.

Non-Compete Agreement

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

	Six months ended	
	October 28, 2018	October 29, 2017
(dollars in thousands)		
Beginning balance	\$753	\$828

Amortization expense	(37)	(38)
Loss on impairment	-		-	
Ending balance	\$716		\$790	

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

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The gross carrying amount of this non-compete agreement was \$2.0 million at October 28, 2018, October 29, 2017, and April 29, 2018, respectively. Accumulated amortization for this non-compete agreement was \$1.3 million at October 28, 2018 and April 29, 2018, and \$1.2 million at October 29, 2017.

The remaining amortization expense for the next five years and thereafter follows: FY 2019 - \$38,000; FY 2020 - \$75,000; FY 2021 - \$75,000; FY 2022 - \$75,000; FY 2023 - \$75,000, and Thereafter - \$378,000.

The weighted average amortization period for the non-compete agreement is 9.5 years as of October 28, 2018.

8. Goodwill

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

	Six months ended	
	October 28, 2018	October 29, 2017
(dollars in thousands)		
Beginning balance	\$13,569	\$11,462
Acquisition of business (see note 3)	13,653	-
Loss on impairment	-	-
Ending balance	\$27,222	\$11,462

9. Investment in Unconsolidated Joint Venture

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

CLIH incurred a net loss totaling \$263,000 and \$386,000 for the six-month periods ending October 28, 2018 and October 29, 2017, respectively. CLIH's net loss through the second quarter of fiscal 2018 pertained to initial start-up operating expenses incurred. Our equity interests in these net losses were \$132,000 and \$193,000 for the six-month periods ending October 28, 2018 and October 29, 2017, respectively.

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

	October 28, 2018	October 29, 2017	April 29, 2018
(dollars in thousands)			
Total assets	\$3,063	\$3,180	\$3,130
Total liabilities	\$124	\$136	\$128

Total members' equity	\$2,939	\$3,044	\$3,002
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At October 28, 2018, October 29, 2017, and April 29, 2018, our investment in CLIH totaled \$1.5 million, which represents the company's fifty percent ownership interest in CLIH.

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10. Accrued Expenses

A summary of accrued expenses follows:

	October 28, 2018	October 29, 2017	April 29, 2018
(dollars in thousands)			
Compensation, commissions and related benefits	\$ 3,353	\$ 5,399	\$ 6,918
Interest	-	18	20
Other accrued expenses	5,317	1,947	3,150
	\$ 8,670	\$ 7,364	\$ 10,088

At October 28, 2018 and October 29, 2017, we had accrued expenses totaling \$8.7 million and \$7.4 million, respectively, all of which were classified as current accrued expenses in the accompanying Consolidated Balance Sheets. At April 29, 2018, we had accrued expenses totaling \$10.1 million, of which \$9.3 million and \$763,000 were classified as current accrued expenses and long-term accrued expenses, respectively, in the accompanying Consolidated Balance Sheets.

11. Exit and Disposal Activity

On June 12, 2018, our board of directors announced the closure of our upholstery fabrics manufacturing facility in Anderson, South Carolina. This closure was completed during the second quarter of fiscal 2019 and was due to a continued decline in demand for the products manufactured at this facility, reflecting a change in consumer style preferences.

The following summarizes our restructuring credit and related charges totaling \$1.2 million that were associated with the above exit and disposal activity:

	Six months ended October 28, 2018
(dollars in thousands)	
Inventory markdowns	\$ 1,565
Employee termination benefits	513
Other operating costs associated with a closed facility	270
Gain on sale of equipment	(1,123)
	\$ 1,225

Of this total net charge, a charge of \$1.8 million and a credit of \$610,000 was recorded in cost of sales and restructuring credit, respectively, in the Consolidated Statement of Net Income for the six-month period ending October 28, 2018.

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The following summarizes the activity in the restructuring accrual:

	Six months ended October 28, 2018
(dollars in thousands)	
Accrual established in fiscal 2019	\$ 451
Paid in fiscal 2019	(253)
Adjustments in fiscal 2019	62
	\$ 260

The above restructuring accrual pertains to employee termination benefits that were associated with the above exit and disposal activity.

Note 12. Assets Held for Sale

During the second quarter of fiscal 2019, and in connection with our exit and disposal activity noted above, a building and equipment with a carrying value totaling \$393,000 was classified as held for sale. We determined that the fair value of the building and equipment exceeded its carrying value and therefore, no impairment was recorded.

Additionally, during the second quarter we received sales proceeds totaling \$1.3 million on all of the equipment that was classified as held for sale and recorded a corresponding gain on this sale totaling \$1.1 million.

As of October 28, 2018, our assets held for sale had a carrying value totaling \$237,000 and pertains to the building and land of the above closed facility. We expect that the final sale of the building and land will be completed within a year.

13. Lines of Credit

Revolving Credit Agreement – United States

At April 29, 2018, our Credit Agreement with Wells Fargo Bank, N.A. (“Wells Fargo”) provided for a revolving loan commitment of \$30 million. Effective August 13, 2018, we entered into a Fifth Amendment to our Credit Agreement which reduced the amount of our line of credit from \$30 million to \$25 million, reduced the amount of the Unencumbered Liquid Assets maintenance covenant from \$20 million to \$15 million, and set the expiration date to August 15, 2020. Additionally, this amendment reduced the limit of outstanding letters to \$1.0 million, which includes the \$250,000 workers compensation letter of credit noted below.

Interest was charged at a rate (applicable interest rate of (3.75%, 2.69%, and 3.36% at October 28, 2018, October 29, 2017, and April 29, 2018) as a variable spread over LIBOR based on our ratio of debt to EBITDA.

Outstanding borrowings are secured by a pledge of 65% of the common stock of Culp International Holdings Ltd. (our subsidiary located in the Cayman Islands), as required by the Credit Agreement. There were no borrowings

outstanding under the Credit Agreement at October 28, 2018, October 29, 2017, and April 29, 2018, respectively.

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At October 28, 2018, October 29, 2017, and April 29, 2018, there were \$250,000 in outstanding letters of credit (all of which related to workers compensation) provided by the Credit Agreement.

Effective August 1, 2016, we entered into a Third Amendment to our Credit Agreement which allowed us to issue letters of credit not to exceed \$7.5 million. On August 3, 2016, we issued a \$5.0 million letter of credit, in addition to the \$250,000 letter of credit noted above, for the construction of a new building associated with our mattress fabrics segment (see Note 22 for further details). The terms of this \$5.0 million letter credit expired on May 15, 2018.

Revolving Credit Agreement – China

We have an unsecured credit agreement associated with our operations in China that provides for a line of credit up to 40 million RMB (\$5.7 million USD at October 28, 2018) and is set to expire on March 2, 2019. This agreement has an interest rate determined by the Chinese government and there were no outstanding borrowings as of October 28, 2018, October 29, 2017, and April 29, 2018.

Overall

Our loan agreements require, among other things, that we maintain compliance with certain financial covenants. As of October 28, 2018, we were in compliance with these financial covenants.

14. Fair Value of Financial Instruments

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

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

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

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

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Recurring Basis

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

(amounts in thousands)	Fair value measurements at October 28, 2018 using:				Total
	Quoted prices in active markets for identical assets	Significant other observable inputs	Significant unobservable inputs	Level 3	
	Level 1	Level 2	Level 3		
Assets:					
Premier Money Market Fund	\$6,943	N/A	N/A		\$6,943
Large Blend Fund	422	N/A	N/A		422
Growth Allocation Fund	175	N/A	N/A		175
Moderate Allocation Fund	114	N/A	N/A		114
Other	197	N/A	N/A		197

(amounts in thousands)	Fair value measurements at October 29, 2017 using:				Total
	Quoted prices in active markets for identical assets	Significant other observable inputs	Significant unobservable inputs	Level 3	
	Level 1	Level 2	Level 3		
Assets:					
Premier Money Market Fund	\$6,153	N/A	N/A		\$6,153
Low Duration Bond Fund	1,087	N/A	N/A		1,087
Intermediate Term Bond Fund	765	N/A	N/A		765
Strategic Income Fund	626	N/A	N/A		626
Large Blend Fund	393	N/A	N/A		393
Growth Allocation Fund	153	N/A	N/A		153

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Moderate Allocation Fund	107	N/A	N/A	107
Other	115	N/A	N/A	115

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Fair value measurements at April 29, 2018
using:

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

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

The determination of where an asset or liability falls in the hierarchy requires significant judgment. We evaluate our hierarchy disclosures each quarter based on various factors and it is possible that an asset or liability may be classified differently from quarter to quarter. However, we expect that changes in classifications between different levels will be rare.

Short-Term Investments – Available for Sale

There were no short-term investments classified as available for sale held at October 28, 2018. At October 29, 2017 and April 29, 2018, our short-term investments classified as available for sale totaled \$2.5 million and consisted of short-term bond funds. Since these short-term bond funds were classified as available for sale, these investments were

recorded at their fair market value and their unrealized gains or losses are included in other comprehensive income (loss). Our short-term bond investments had an accumulated unrealized loss totaling \$36,000 and \$91,000 at October 29, 2017, and April 29, 2018, respectively. At October 29, 2017, and April 29, 2018, the fair value of our short-term bond funds approximated its cost basis.

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Culp, Inc.
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Short-Term and Long-Term Investments - Held-To-Maturity

Our investments classified as held-to-maturity consist of investment grade U.S. Corporate bonds with maturities that ranged from 2 to 2.5 years. The purpose of these investments was to earn a higher rate of return on our excess cash located in the Cayman Islands. These investments are classified as held-to-maturity as we have the positive intent and ability to hold these investments until maturity. Our held-to-maturity investments are recorded as either current or noncurrent on our Consolidated Balance Sheets, based on contractual maturity date in relation to the respective reporting period and recorded at amortized cost.

At October 28, 2018, October 29, 2017 and April 29, 2018, our held-to-maturity investments recorded at amortized cost totaled \$26.7 million, \$30.9 million, and \$30.8 million, respectively. The fair value of our held-to-maturity investments at October 28, 2018, October 29, 2017, and April 29, 2018 totaled \$26.6 million, \$30.8 million, and \$30.6 million, respectively.

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

Long-Term Investments - Rabbi Trust

We have a Rabbi Trust to set aside funds for participants of our deferred compensation plan (the "Plan") which enables the participants to credit their contributions to various investment options of the Plan. The investments associated with the Rabbi Trust consist of a money market fund and various mutual funds that are classified as available for sale.

These long-term investments are recorded at their fair values of \$7.9 million, \$6.9 million, and \$7.3 million at October 28, 2018, October 29, 2017 and April 29, 2018, respectively. Our long-term investments had an accumulated unrealized gain of \$62,000, \$96,000, and \$61,000 at October 28, 2018, October 29, 2017, and April 29, 2018, respectively. The fair value of our long-term investments associated with our Rabbi Trust approximates its cost basis.

Other

The carrying amount of our cash and cash equivalents, accounts receivable, other current assets, accounts payable, and accrued expenses approximates fair value because of the short maturity of these financial instruments.

Culp, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Nonrecurring Basis

At October 28, 2018, we had no assets that were required to be measured at fair value on a nonrecurring basis other than the assets acquired from eLuxury (see note 3) that were acquired at fair value:

(amounts in thousands)	Fair value measurements at October 28, 2018 using:			Total
	Quoted prices in active market for identical assets	Significant other observable inputs	Significant unobservable inputs	
	Level 1	Level 2	Level 3	
Assets:				
Goodwill	N/A	N/A	\$ 13,653	\$13,653
Tradename	N/A	N/A	6,549	6,549
Equipment	N/A	N/A	2,179	2,179
Inventory	N/A	N/A	1,804	1,804
Liabilities:				
Contingent Consideration – Earn-Out Obligation	N/A	N/A	\$ 5,706	\$5,706

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

Additionally, we acquired certain current assets such as accounts receivable and prepaid expenses and assumed certain liabilities such as accounts payable and accrued expenses. Based on the nature of these items and their short maturity, the carrying amount of these items approximated their fair values. See note 3 for the preliminary allocation of the acquisition cost to the assets acquired and liabilities assumed based on their fair values.

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

Fair value measurements at April 29, 2018
using:

Quoted
prices
in
active
market
for identical
assets

Significant
other
observable
inputs

Significant
unobservable
inputs

(amounts in thousands)	Level 1	Level 2	Level 3	Total
Assets:				
Customer Relationships	N/A	N/A	\$ 2,247	\$2,247
Goodwill	N/A	N/A	2,107	2,107
Inventory	N/A	N/A	1,128	1,128
Tradename	N/A	N/A	683	683
Equipment	N/A	N/A	379	379

Liabilities:

None	N/A	N/A	N/A	N/A
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These customer relationships were recorded at fair market value using a multi-period excess earnings valuation model that used significant unobservable inputs and were classified as level 3. The tradename was recorded at fair market value using the royalty from relief method that used significant unobservable inputs and were classified as level 3.

Additionally, we acquired certain current assets such as accounts receivable and other assets and assumed certain liabilities such as deferred revenue, accounts payable and accrued expenses. Based on the nature of these items and their short maturity, the carrying amount of these items approximated their fair values. See note 3 for the allocation of the acquisition cost to the assets acquired and liabilities assumed based on their fair values.

15. Derivatives

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

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

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Culp, Inc.
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(Amounts in Thousands)
 Fair Values of Derivative Instruments
 October 28, 2018 April 29, 2018

Derivatives designated as hedging instruments under ASC Topic 815	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Euro Foreign Exchange Contract	Accrued Expenses	\$-	Accrued Expenses	\$55

At October 29, 2017, we did not have any derivatives designated as hedging instruments under ASC Topic 815.

Derivatives in ASC Topic 815 Net Investment Hedging Relationships	Amt of Gain (Loss) (net of tax) Recognized in OCI on Derivative (Effective Portion) and recorded in Accrued Expenses at Fair Value	Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective and Amount Excluded from Effectiveness Testing)	Amount of Gain (loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)
EURO Foreign Exchange Contract	Six Months Ended October 28, 2018	Six Months Ended October 29, 2017	Six Months Ended October 28, 2018	Six Months Ended October 29, 2017	Six Months Ended October 28, 2018
	\$ 56	\$ -	\$ (64)	\$ -	\$ -
		Other Expense		Other Expense	

16. Cash Flow Information

Interest and income taxes paid are as follows:

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	Six months ended	
(dollars in thousands)	October 28, 2018	October 29, 2017
Interest	\$54	\$146
Income taxes	3,994	2,599

Interest costs charged to operations were \$38,000 and \$137,000 for the six months ended October 28, 2018 and October 29, 2017, respectively.

No interest costs for the construction of qualifying fixed assets were capitalized for the six-months ended October 28, 2018. Interest costs totaling \$100,000 for the construction of qualifying fixed assets were capitalized for the six-months ended October 29, 2017. As a result, these interest costs will be amortized over the related assets' useful lives.

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Culp, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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17. 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	
	October 28, 2018	October 29, 2017
Weighted average common shares outstanding, basic	12,515	12,440
Dilutive effect of stock-based compensation	36	140
Weighted average common shares outstanding, diluted	12,551	12,580

At October 28, 2018 and April 29, 2018, there were no options to purchase shares of our common stock outstanding. Therefore, options to purchase shares of our common stock were not included in the computation of diluted net income for the three-months ending October 28, 2018. All options to purchase shares of common stock were included in the computation of diluted net income for the three-months ending October 29, 2017, as the exercise price of the options was less than the average market price of the common shares.

(amounts in thousands)	Six months ended	
	October 28, 2018	October 29, 2017
Weighted average common shares outstanding, basic	12,512	12,420
Dilutive effect of stock-based compensation	100	193
Weighted average common shares outstanding, diluted	12,612	12,613

At October 28, 2018 and April 29, 2018, there were no options to purchase shares of our common stock outstanding. Therefore, options to purchase shares of our common stock were not included in the computation of diluted net income for the six-months ending October 28, 2018. All options to purchase shares of common stock were included in the computation of diluted net income for the six-months ending October 29, 2017, as the exercise price of the options was less than the average market price of the common shares.

18. Segment Information

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

Effective April 1, 2018, we acquired Read (see Note 3 for further details), a turn key provider of window treatments that offer the sourcing of upholstery fabrics and other products, measuring, and installation services of their own products for the hospitality and commercial industries. Read's financial information is aggregated with our upholstery fabrics segment.

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

Effective June 22, 2018, we acquired eLuxury (see Note 3 for further details), a company that offers bedding accessories and home goods directly to consumers. eLuxury's primary products include a line of mattress pads, and also offer handmade platform beds, cotton bed sheets, and other bedding items. Currently, eLuxury's financial information is aggregated with our mattress fabrics segment.

We evaluate the operating performance of our segments based upon income from operations before certain unallocated corporate expenses, restructuring expense (credit) and related charges, and other non-recurring items. Cost of sales in both segments include costs to manufacture, develop, or source our products, including costs such as raw material and finished goods purchases, direct and indirect labor, overhead and incoming freight charges. Unallocated corporate expenses primarily represent compensation and benefits for certain executive officers, all costs associated with being a public company, and other miscellaneous expenses. Segment assets include assets used in the operations of each segment and primarily consist of accounts receivable, inventories, and property, plant and equipment. The mattress fabrics segment also includes in segment assets their investment in an unconsolidated joint venture. During fiscal 2019, we elected to no longer include goodwill and intangible assets in segment assets, as these assets are not used by the CODM to evaluate the respective segment's operating performance, to allocate resources to the individual segments, or to determine executive compensation.

Financial information for the company's operating segments follows:

	Three months ended	
	October 28, 2018	October 29, 2017
Net sales:		
Mattress Fabrics	\$41,989	\$48,601
Upholstery Fabrics	35,017	32,097
	\$77,006	\$80,698
Gross profit:		
Mattress Fabrics	\$7,498	\$9,730
Upholstery Fabrics	6,257	6,074
Total segment gross profit	\$13,755	\$15,804
Other non-recurring charges (1)	(159)	-
Restructuring related charges (2)	(270)	-
	\$13,326	\$15,804
Selling, general, and administrative expenses		
Mattress Fabrics	\$4,566	\$3,168
Upholstery Fabrics	3,535	3,700
Total segment selling, general, and administrative expenses	8,101	6,868
Other non-recurring charges (1)	89	-
Unallocated corporate expenses	1,913	2,547
	\$10,103	\$9,415
Income from operations:		
Mattress Fabrics	\$2,932	\$ 6,562
Upholstery Fabrics	2,722	2,374

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Total segment income from operations	5,654	8,936
Unallocated corporate expenses	(1,913)	(2,547)
Other non-recurring charges (1)	(248)	-
Restructuring credit and related charges (3)	791	-
Total income from operations	4,284	6,389
Interest expense	(18)	(37)
Interest income	151	128
Other expense	(142)	(321)
Income before income taxes	\$4,275	\$6,159

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

(1) During the three-month and six-month periods ending October 28, 2018, our mattress fabrics segment incurred non-recurring charges totaling \$248 that pertained to employee termination benefits and other operational reorganization costs. Of the \$248 total non-recurring charge, \$159 and \$89 were recorded in cost of sales and selling, general, and administrative expenses, respectively.

(2) The \$270 represents a restructuring related charge for other operating costs associated with our closed upholstery fabrics plant facility located in Anderson, SC.

(3) The \$791 pertains to a \$1.1 million restructuring credit that represents a \$1.1 million gain on the sale of equipment, partially offset by a restructuring charge of \$63 for employee termination benefits and a restructuring related charge of \$270 for other operating costs associated with our closed upholstery fabrics plant facility located in Anderson, SC.

	Six months ended	
	October 28,2018	October 29, 2017
Net sales:		
Mattress Fabrics	\$78,972	\$97,030
Upholstery Fabrics	69,507	63,200
	\$148,479	\$160,230
Gross profit:		
Mattress Fabrics	\$ 13,470	\$ 19,495
Upholstery Fabrics	12,410	12,773
Total segment gross profit	\$25,880	\$32,268
Other non-recurring charges (1)	(159)	-
Restructuring related charges (4)	(1,836)	-
	\$23,885	\$32,268
Selling, general, and administrative expenses		
Mattress Fabrics	\$7,714	\$6,559
Upholstery Fabrics	7,161	7,511
Total segment selling, general, and administrative expenses	14,875	14,070
Other non-recurring charges (1)	89	-
Unallocated corporate expenses	3,172	4,846
	\$18,136	\$18,916
Income from operations:		
Mattress Fabrics	\$5,755	\$12,936
Upholstery Fabrics	5,249	5,262
Total segment income from operations	11,004	18,198
Unallocated corporate expenses	(3,172)	(4,846)
Other non-recurring charges (1)	(248)	-
Restructuring credit and related charges (5)	(1,225)	-
Total income from operations	6,359	13,352
Interest expense	(38)	(37)
Interest income	301	259

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Other expense	(399)	(674)
Income before income taxes	\$6,223	\$12,900

(4) The \$1.8 million represents restructuring related charges, of which \$1.6 million pertains to inventory markdowns and \$270 for other operating costs associated with our closed upholstery fabrics plant facility located in Anderson, SC.

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Culp, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(5) The \$1.2 million pertains to restructuring related charges totaling \$1.8 million, partially offset by a restructuring credit of \$610 associated with our closed upholstery fabrics plant facility located in Anderson, SC. The \$1.8 million restructuring related charge represents \$1.6 million for inventory markdowns and \$270 for other operating costs. The \$610 restructuring credit represents a \$1.1 million gain on sale of equipment, partially offset by a charge for employee termination benefits totaling \$513.

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

(dollars in thousands)	October 28, 2018	October 29, 2017	April 29, 2018
Segment assets:			
Mattress Fabrics			
Accounts receivable	\$ 10,740	\$ 13,645	\$ 15,195
Inventory	29,836	29,083	28,740
Property, plant and equipment (1)	48,825	49,965	48,797
Investment in unconsolidated joint venture	1,470	1,522	1,501
Total mattress fabrics assets	90,871	94,215	94,233
Upholstery Fabrics			
Accounts receivable	13,622	10,575	11,112
Inventory	20,765	21,126	24,714
Property, plant and equipment (2)	2,048	2,063	2,445
Total upholstery fabrics assets	36,435	33,764	38,271
Total segment assets	127,306	127,979	132,504
Non-segment assets:			
Cash and cash equivalents	14,768	15,739	21,228
Short-term investments (Available for Sale)	-	2,478	2,451
Short-term investments (Held-to-Maturity)	26,719	4,015	25,759
Assets held for sale	237	-	-
Other current assets	2,461	2,263	2,870
Deferred income taxes	3,614	491	1,458
Property, plant and equipment (3)	452	502	552
Goodwill	27,222	11,462	13,569
Intangible assets	10,636	1,428	4,275
Long-term investments (Held-to-Maturity)	-	26,853	5,035
Long-term investments (Rabbi Trust)	7,851	6,921	7,326
Other assets	945	912	957
Total assets	\$ 222,211	\$ 201,043	\$ 217,984

(dollars in thousands)	Six months ended	
	October 28, 2018	October 29, 2017
Capital expenditures (4):		
Mattress Fabrics	\$ 1,578	\$ 4,364

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Upholstery Fabrics	267	203
Unallocated Corporate	-	30
Total capital expenditures	\$1,845	\$4,597
Depreciation expense:		
Mattress Fabrics	\$3,644	\$3,310
Upholstery Fabrics	412	403
Total depreciation expense	\$4,056	\$3,713

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Culp, Inc.

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The \$48.8 million at October 28, 2018, represents property, plant, and equipment of \$36.1 million and \$12.7 million located in the U.S. and Canada, respectively. The \$50.0 million at October 29, 2017, represents property, (1) plant, and equipment of \$35.8 million and \$14.2 million located in the U.S. and Canada, respectively. The \$48.8 million at April 29, 2018, represents property, plant, and equipment of \$35.4 million and \$13.4 million located in the U.S. and Canada, respectively.

The \$2.0 million at October 28, 2018, represents property, plant, and equipment of \$1.4 million and \$636 located (2) in the U.S. and China, respectively. The \$2.1 million at October 29, 2017, represents property, plant, and equipment of \$1.4 million and \$722 located in the U.S. and China, respectively. The \$2.4 million at April 29, 2018, represents property, plant, and equipment of \$1.8 million and \$661 located in the U.S. and China, respectively.

The \$452, \$502, and \$552 at October 28, 2018, October 29, 2017 and April 29, 2018, respectively, represent (3) 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.

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

19. Income Taxes

Effective Income Tax Rate

We recorded income tax expense of \$2.2 million, or 35.1% of income before income taxes, for the six-month period ended October 28, 2018, compared to income tax expense of \$3.7 million or 29.1% of income before income taxes, for the six-month period ended October 29, 2017. Our effective income tax rates for the six-month periods ended October 28, 2018, and October 29, 2017, were based upon the estimated effective income tax rate applicable for the full year after giving effect to any significant items related specifically to interim periods. The effective income tax rate can be affected over the fiscal year by the mix and timing of actual earnings from our U.S. operations and foreign subsidiaries located in China and Canada versus annual projections and changes in foreign currency exchange rates in relation to the U.S. dollar.

The following schedule summarizes the factors that contribute to the difference between income tax expense at the federal income tax rate and the effective income tax rate reflected in the consolidated financial statements:

	2019	2018
Federal income tax rate	21.0%	34.0%
Foreign income tax rate differential	7.8	1.1
Tax effects of Chinese foreign exchange (losses) gains	2.8	(1.5)
Global Intangible Low Taxed Income Tax (GILTI)	2.1	-
Change in estimate of valuation allowance	1.2	0.7
Excess income tax deficiency (benefits) related to stock-based compensation	0.5	(4.3)
Other	(0.3)	(0.9)
	35.1%	29.1%

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2017 Tax Cuts and Jobs Act

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

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

Deferred Income Taxes

Valuation Allowance

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

Based on our assessments at October 28, 2018, October 29, 2017, and April 29, 2018, valuation allowances against our deferred income taxes pertain to the following jurisdictions:

	October 28, 2018	October 29, 2017	April 29, 2018
(dollars in thousands)			
U.S. foreign income tax credits	\$4,550	-	4,550
U.S. state loss carryforwards and credits	756	554	578
Polish loss carryforwards	-	78	76
	\$5,306	632	5,204

Undistributed Earnings

In accordance with ASC Topic 740, we assess whether the undistributed earnings from our foreign subsidiaries will be reinvested indefinitely or eventually distributed to our U.S. parent company. ASC Topic 740 requires that a deferred tax liability should be recorded for undistributed earnings from foreign subsidiaries that will not be reinvested indefinitely. Based on our assessment as of October 28, 2018, it is our intention not to permanently invest our undistributed earnings from our foreign subsidiaries. Also, we assess the recognition of U.S. foreign income tax credits associated with foreign withholding and income tax payments and whether it is more-likely-than-not that our foreign income tax credits will not be realized. If it is determined that any foreign income tax credits need to be recognized or it is more-likely-than-not our foreign income tax credits will not be realized, an adjustment to our provision for income taxes will be recognized at that time.

For fiscal 2019 and beyond, the Tax Act allows a U.S. corporation a 100% dividend received deduction for earnings and profits received from a 10% owned foreign corporation. Therefore, a deferred tax liability will be required for withholding taxes that are incurred by our foreign subsidiaries at the time earnings and profits are distributed. As a result, at October 28, 2018 and April 29, 2018, we recorded a deferred income tax liability of \$3.1 million and \$4.3 million for withholding taxes on undistributed earnings and profits from our foreign subsidiaries.

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At October 29, 2017, which was prior to the Tax Act being signed into law, we recorded a deferred income tax liability of \$322,000, which included U.S. and foreign withholding taxes totaling \$42.4 million, offset by U.S. foreign income tax credits of \$42.1 million.

Uncertainty In Income Taxes

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

At October 28, 2018, we had a \$820,000 total gross unrecognized income tax benefit, of which \$440,000 and \$380,000 were classified as income taxes payable- long-term and non-current deferred income taxes, respectively, in the accompanying Consolidated Balance Sheets. At October 29, 2017, we had a \$12.6 million total gross unrecognized income tax benefit, of which \$12.1 million and \$487,000 were classified as non-current deferred income taxes and income taxes payable – long-term, respectively, in the accompanying Consolidated Balance Sheets. At April 29, 2018, we had a \$844,000 total gross unrecognized income tax benefit, of which \$464,000 and \$380,000 were classified as income taxes payable – long-term and non-current deferred income taxes respectively, in the accompanying Consolidated Balance Sheets.

At October 28, 2018, our \$820,000 total gross unrecognized income tax benefit included \$440,000 that, if recognized, would favorably affect the income tax rate in future periods. At October 29, 2017, our \$12.6 million total gross unrecognized income tax benefit, included \$487,000 that, if recognized, would favorably affect the income tax rate in future periods. At April 29, 2018, our \$844,000 total gross unrecognized income tax benefit included \$464,000 that, if recognized, would favorably affect the income tax rate in future periods.

Our gross unrecognized income tax benefit of \$820,000, relates to income tax positions for which significant change is currently not expected within the next year. This amount primarily relates to double taxation under applicable income tax treaties with foreign tax jurisdictions.

20. Stock-Based Compensation

Equity Incentive Plan Description

On September 16, 2015, our shareholders approved an equity incentive plan entitled the Culp, Inc. 2015 Equity Incentive Plan (the “2015 Plan”). The 2015 Plan updated and replaced our 2007 Equity Incentive Plan (the “2007 Plan”) as the vehicle for granting new equity-based awards substantially similar to those authorized under the 2007 Plan. In general, the 2015 Plan authorizes the grant of stock options intended to qualify as incentive stock options, nonqualified stock options, stock appreciation rights, restricted stock, restricted stock units, performance units, and other equity and cash related awards as determined by our Compensation Committee. An aggregate of 1,200,000 shares of common stock were authorized for issuance under the 2015 Plan, with certain sub-limits that would apply with respect to specific types of awards that may be issued as defined in the 2015 Plan. In connection with the

approval of the 2015 Plan, no further awards will be granted under the 2007 Plan, but outstanding awards under the 2007 Plan will be settled in accordance with their terms.

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

At October 28, 2018, there were 941,528 shares available for future equity-based grants under our 2015 plan.

Performance Based Restricted Stock Units

Executive Management (NEOs)

Fiscal 2019 and 2018

On August 2, 2018 (Fiscal 2019), and July 13, 2017 (Fiscal 2018), we granted performance-based restricted stock units to NEOs which could earn up to a certain number of shares of common stock if certain performance targets are met over a three-fiscal year performance period as defined in the related restricted stock unit agreements. The number of shares of common stock that are earned based on the performance targets that have been achieved will be adjusted based on a market-based total shareholder return component as defined in the related restricted stock unit agreements.

Compensation cost was measured based at the fair market value on the date of grant (August 2, 2018 and July 13, 2017). The fair market value per share was determined using the Monte Carlo simulation model for the market-based total shareholder return component and the closing price of our common stock for the performance-based component.

The following table provides assumptions used to determine the fair market value of the market-based shareholder return component using the Monte Carlo simulation model on the date of grants noted above:

	Fiscal 2019	Fiscal 2018
Closing price of our common stock	\$24.35	\$32.50
Expected volatility of our common stock	33.5 %	31.0 %
Expected volatility of peer companies	16.0 %	16.5 %
Risk-free interest rate	2.74 %	1.56 %
Dividend yield	1.35 %	1.66 %
Correlation coefficient of peer companies	0.47	0.46

Fiscal 2017

On July 14, 2016 we granted performance-based restricted stock units to NEOs which could earn up to a certain number of shares of common stock if certain performance targets were met over a three-fiscal year performance period as defined in the related restricted stock unit agreements. These awards were measured based on the fair market value (closing price of our common stock) on the date of grant. No market-based total shareholder return component was included in this award.

Key Employees and a Non-Employee

Fiscal 2019, 2018, and 2017

We granted performance-based restricted stock units which could earn up to a certain number of shares of common stock if certain performance targets are met over a three-fiscal year performance period as defined in the related

restricted stock unit agreements. Our performance based restricted stock units granted to key employees were measured based on the fair market value (the closing price of our common stock) on the date of grant. Our performance based restricted stock units granted to a non-employee (fiscal 2017 only) were measured based on the fair market value (the closing price of our common stock) at the earlier date of when the performance criteria are met or the end of the reporting period. No market-based total shareholder return component was included in these awards.

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

The following table summarizes information related to our grants of performance based restricted stock units associated with NEOs and key employees that are currently unvested:

Date of Grant	(3) Restricted Stock Units Awarded	Price Per Share	Vesting Period
August 2, 2018 (1)	86,599	\$18.51(4)	3 years
August 2, 2018 (2)	47,800	\$24.35(6)	3 years
July 13, 2017 (1)	78,195	\$31.85(5)	3 years
July 13, 2017 (2)	44,000	\$32.50(6)	3 years
July 14, 2016 (1) (2)	107,880	\$28.00(6)	3 years

(1) Performance-based restricted stock units awarded to NEOs.

(2) Performance-based restricted stock units awarded to key employees.

(3) Amounts represent the maximum number of common stock shares that could be earned if certain performance targets are met as defined in the related restricted stock unit agreements.

(4) Price per share represents the fair market value per share (\$0.76 per \$1 or a reduction of \$5.84 to the closing price of the our common stock) determined using the Monte Carlo simulation model for the market-based total shareholder return component and the closing price of our common stock (\$24.35) for the performance-based components of the performance-based restricted stock units granted to our NEOs on August 2, 2018.

(5) Price per share represents the fair market value per share (\$0.98 per \$1 or a reduction of \$0.65 to the closing price of the our common stock) determined using the Monte Carlo simulation model for the market-based total shareholder return component and the closing price of our common stock (\$32.50) for the performance-based components of the performance-based restricted stock units granted to our NEOs on July 13, 2017.

(6) Price per share represents the closing price of our common stock on the date of grant.

The following table summarizes information related to our grants of performance-based restricted stock units associated with a non-employee that are currently unvested:

Date of Grant	(1) Restricted Stock Units Awarded	Price Per Share	Vesting Period
July 14, 2016	11,549	\$22.31(2)	3 years

(1) Amounts represent the maximum number of common stock shares that could be earned if certain performance targets are met as defined in the related restricted stock unit agreements.

(2) The respective grant was unvested at the end of our reporting period. Accordingly, the price per share represents the closing price of our common stock on October 28, 2018, the end of our reporting period.

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

The following table summarizes information related to our performance based restricted stock units that vested during the six-month periods ending October 28, 2018 and October 29, 2017:

Fiscal Year	Common Stock Shares Vested	(3) Weighted Average Fair Value	Price Per Share
Fiscal 2019 (1)	107,553	\$ 3,466	\$32.23(4)
Fiscal 2019 (2)	10,364	\$ 320	\$30.90(5)
Fiscal 2018 (1)	102,845	\$ 1,820	\$17.70(4)
Fiscal 2018 (2)	16,000	\$ 520	\$32.50(5)

(1) NEOs and key employees.

(2) Non-employee

(3) Dollar amounts are in thousands.

(4) Price per share represents closing price of our common stock on the date of grant.

(5) The respective grant vested during the first quarter of fiscal 2019 or 2018, respectively. Accordingly, the price per share represents the closing price of our common stock on the date the award vested.

The performance based restricted stock units that vested during the six-months ending October 28, 2018, and October 29, 2017, had a fair value totaling \$3.6 million and \$3.9 million, respectively.

Overall

We recorded a credit to compensation expense of \$216,000 and a charge to compensation expense totaling \$1.4 million within selling, general, and administrative expenses for the six-month periods ending October 28, 2018 and October 29, 2017, respectively. Compensation cost is recorded based on an assessment each reporting period of the probability that certain performance goals will be met during the vesting period. If performance goals are not probable of occurrence, compensation cost will not be recognized and any recognized compensation cost would be reversed.

At October 28, 2018, the remaining unrecognized compensation cost related to our performance based restricted stock units was \$1.6 million, which is expected to be recognized over a weighted average vesting period of 2.3 years. At October 28, 2018, the performance based restricted stock units that were expected to vest had a fair value totaling \$2.4 million.

Time Vested Restricted Stock Units

Fiscal 2019

On August 2, 2018, we granted 11,200 shares of restricted stock units to certain key employees. Of the 11,200 shares of restricted stock units granted, 10,000 had a vesting period of 59 months and 1,200 had a vesting period 11 months, respectively. These awards were measured at their fair market value, which was \$24.35 per share, and represents the closing price of our common stock at the date of grant.

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Culp, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Fiscal 2018 Grant

On July 13, 2017, an employee was granted 1,200 shares of time vested restricted stock units which vested over the requisite service period of 11 months. This award was measured at its fair market value, which was \$32.50 per share, and represented the closing price of our common stock on the date of grant.

During the first quarter of fiscal 2019, 1,200 shares of common stock associated with this grant vested and had a weighted average grant date fair value of \$39,000 or \$32.50 per share.

Fiscal 2017 Grant

On July 14, 2016, an employee was granted 1,200 shares of time vested restricted stock units which vested over the requisite service period of 11 months. This award was measured at its fair market value, which was \$28 per share, and represented the closing price of our common stock on the date of grant.

During the first quarter of fiscal 2018, 1,200 shares of common stock associated with this grant vested and had a weighted average grant date fair value of \$34,000 or \$28 per share.

Overall

We recorded compensation expense of \$26,000 and \$17,000 within selling, general, and administrative expense associated with our time vested restricted stock unit awards for the six-month periods ending October 28, 2018 and October 29, 2017, respectively.

At October 28, 2018, the remaining unrecognized compensation cost related to our time vested restricted stock units was \$252,000, which is expected to be recognized over a weighted average vesting period of 4.3 years. At October 28, 2018, the time vested restricted stock awards that were expected to vest had a fair value totaling \$250,000.

Common Stock Awards

We granted a total of 3,600 and 4,800 shares of common stock to our outside directors on October 1, 2018, and October 2, 2017, respectively. These shares of common stock vested immediately and were valued based on the fair market value on the date of grant. The fair value of these awards were \$23.45 and \$33.20 per share, on October 1, 2018, and October 2, 2017, which represents the closing price of our common stock on the date of grant.

We recorded \$84,000 and \$159,000 of compensation expense within selling, general, and administrative expense for these common stock awards for the six-month periods ending October 28, 2018 and October 29, 2017, respectively.

21. Statutory Reserves

Our subsidiaries located in China are required to transfer 10% of their net income, as determined in accordance with the People's Republic of China (PRC) accounting rules and regulations, to a statutory surplus reserve fund until such reserve balance reaches 50% of the company's registered capital.

The transfer to this reserve must be made before distributions of any dividend to shareholders. As of October 28, 2018, the company's statutory surplus reserve was \$4.2 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.

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

Our subsidiaries located in China can transfer funds to the parent company with the exception of the statutory surplus reserve of \$4.2 million to assist with debt repayment, capital expenditures, and other expenses of the company's business.

22. 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.

Accounts Payable – Capital Expenditures

At October 28, 2018, we had total amounts due regarding capital expenditures totaling \$114,000, which pertained to outstanding vendor invoices, none of which were financed. The total amount outstanding of \$114,000 is required to be paid based on normal credit terms.

At October 29, 2017, and April 29, 2018, we had total amounts due regarding capital expenditures totaling \$3.2 million and \$1.8 million, respectively, of which \$2.7 million and \$1.4 million was financed and pertained to completed work for the construction of a new building (see below).

Purchase Commitments – Capital Expenditures

At October 28, 2018, we had open purchase commitments to acquire equipment for our mattress fabrics segment totaling \$826,000.

Mattress Fabric Building

Effective May 16, 2016, we entered into an agreement with a contractor to construct a new building located in North Carolina to expand our distribution capabilities and office space at a cost of \$11.3 million. This agreement required an installment payment of \$1.9 million that was made in April 2016, with additional installment payments of \$4.3 million that were made in fiscal 2017, \$3.7 million that were made in fiscal 2018, and a final installment payment of \$1.4 million made in May 2018 (first quarter of fiscal 2019). Interest was charged on the required outstanding installment payments for services that were previously rendered at a rate of \$2.25% plus the current 30-day LIBOR rate.

Also, we were required to issue a letter of a credit totaling \$5.0 million with the contractor's bank being the beneficiary. In addition to the interest charged on the outstanding installment payments noted above, there was a 0.1% unused fee calculated on the balance of the \$5.0 million letter of credit less the amount outstanding per month (see Note 13 for further details).

This new building was placed into service in July 2017 (first quarter of fiscal 2018).

Culp, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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23. Common Stock Repurchase Program

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

During the six-month period ended October 28, 2018, we purchased 36,880 shares of our common stock at a cost of \$844,000. During the six-month period ended October 29, 2017, we did not purchase any shares of our common stock.

At October 28, 2018, we had \$4.2 million available for repurchases of our common stock.

24. Dividend Program

On November 29, 2018, we announced that our board of directors approved an increase in the quarterly cash dividend from \$0.09 to \$0.10 per share. This payment will be made on or about January 16, 2019, to shareholders of record as of January 2, 2019.

During the six-months ended October 28, 2018, dividend payments totaled \$2.3 million, which represented quarterly dividend payments of \$0.09 per share. During the six-months ended October 29, 2017, dividend payments totaled \$4.6 million, of which \$2.6 million represented a special cash dividend payment of \$0.21 per share, and \$2.0 million represented quarterly dividend payments of \$0.08 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.

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CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING INFORMATION

This report and the exhibits attached hereto contain “forward-looking statements” within the meaning of the federal securities laws, including the Private Securities Litigation Reform Act of 1995 (Section 27A of the Securities Act of 1933 and Section 21E of the Securities and Exchange Act of 1934). Such statements are inherently subject to risks and uncertainties. Further, forward looking statements are intended to speak only as of the date on which they are made, and we disclaim any duty to update or alter such statements due to new information, future events, or otherwise. Forward-looking statements are statements that include projections, expectations or beliefs about future events or results or otherwise are not statements of historical fact. Such statements are often but not always characterized by qualifying words such as “expect,” “believe,” “estimate,” “plan,” 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, working capital levels, 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 potential acquisitions, 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, as well as our success in finalizing acquisition negotiations and integrating acquired business into our existing operations. 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 tariffs or trade policy, or changes in the value of the U.S. dollar versus other currencies could affect our financial results because a significant portion of our operations are located outside the United States. Strengthening of the U.S. dollar against other currencies could make our products less competitive on the basis of price in markets outside the United States, and strengthening of currencies in Canada and China can have a negative impact on our sales of products produced in those places. Also, economic and political instability in international areas could affect our operations or sources of goods in those areas, as well as demand for our products in international markets. Finally, increases in market prices for petrochemical products can significantly affect the prices we pay for raw materials, and in turn, increase our operating costs and decrease our profitability. Further information about these factors, as well as other factors that could affect our future operations or financial results and the matters discussed in forward-looking statements, are included in Item 1A “Risk Factors” section in our Form 10-K filed with the Securities and Exchange Commission on July 13, 2018, for the fiscal year ended April 29, 2018.

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

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

General

Our fiscal year is the 52 or 53-week period ending on the Sunday closest to April 30. The six-months ended October 28, 2018, and October 29, 2017, each represent 26-week periods. Our operations are classified into two business segments: mattress fabrics and upholstery fabrics. The mattress fabrics segment manufactures, sources and sells fabrics and mattress covers to bedding manufacturers. We have wholly owned mattress fabric operations located in Stokesdale, NC, High Point, NC, and Quebec, Canada, and a fifty percent owned cut and sew mattress cover operation located in Haiti. Additionally, with the recent acquisition of eLuxury, LLC (eLuxury), we now have a majority owned company located in Evansville, IN, that offers bedding accessories and home goods directly to consumers. The upholstery fabrics segment develops, manufactures, and sells fabrics primarily to residential and commercial furniture manufacturers. We have wholly owned upholstery fabric operations located in Shanghai, China and Burlington, NC. With the recent acquisition of Read, we now have a wholly owned company located in Knoxville, TN, that provides window treatments that Read offers sourcing of upholstery fabrics and other products, measuring, as well as installation services of their own products to customers in the hospitality and commercial industries. The company operated an upholstery fabrics plant facility in Anderson, SC during the first quarter of fiscal 2019, which has since been closed during the second quarter of fiscal 2019.

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

Executive Summary

Results of Operations

	Three Months Ended		
	October 28, 2018	October 29, 2017	Change
(dollars in thousands)			
Net sales	\$77,006	\$80,698	(4.6)%
Gross profit	13,326	15,804	(15.7)%
Gross profit margin	17.3 %	19.6 %	(230)bp
SG&A expenses	10,103	9,415	7.3 %
Income from operations	4,284	6,389	(32.9)%
Operating margin	5.6 %	7.9 %	(230)bp
Income before income taxes	4,275	6,159	(30.6)%
Income taxes	1,276	2,108	(39.5)%
Net income	2,944	3,976	(26.0)%
Net income attributable to Culp Inc common shareholders	2,933	3,976	(26.2)%

	Six Months Ended		
	October 28, 2018	October 29, 2017	Change
(dollars in thousands)			
Net sales	\$148,479	\$160,230	(7.3)%
Gross profit	23,885	32,268	(26.0)%
Gross profit margin	16.1 %	20.1 %	(400)bp
SG&A expenses	18,136	18,916	(4.1)%
Income from operations	6,359	13,352	(52.4)%
Operating margin	4.3 %	8.3 %	(400)bp
Income before income taxes	6,223	12,900	(51.8)%
Income taxes	2,182	3,748	(41.8)%
Net income	3,909	8,959	(56.4)%
Net income attributable to Culp Inc common shareholders	3,890	8,959	(56.6)%

Net Sales

Overall, our net sales for the second quarter of fiscal 2019 decreased by 4.6% compared with the same period a year ago, with mattress fabric sales declining 13.6% and upholstery fabrics increasing 9.1%. Our net sales for the first half of fiscal 2019 decreased by 7.3% compared with the same period a year ago, with mattress fabrics decreasing 18.6% and upholstery fabrics increasing 10.0%.

The decrease in mattress fabrics sales reflects the ongoing challenges facing the bedding industry, related to the significant increase of low-priced imported mattresses from China. In anticipation of both increased tariffs on mattresses and the anti-dumping petition that was approved by the United States International Trade Commission (ITC) on November 1, 2018, we believe that a number of companies and retailers accelerated orders and promotions of low-priced imported mattresses. As a result, we experienced reduced demand for mattress fabric and sewn covers from our customers.

The increase in upholstery fabric net sales for fiscal 2019 primarily relates to the net sales contribution from Read, acquired on April 1, 2018, partially offset by a decrease in sales associated with our closed facility located in Anderson, SC.

See the Segment Analysis section below for further details.

Income Before Income Taxes

Overall, income before income taxes decreased for the second quarter and first half of fiscal 2019, due primarily to the decrease in sales of mattress fabrics noted above.

Additionally, income before income taxes was affected by a non-recurring credit of \$543,000 in the second quarter and a charge of \$1.5 million in the first half of fiscal 2019, both of which related to the closure of our upholstery fabrics operation located in Anderson, SC, and other non-recurring charges associated with the mattress fabrics segment.

See the Segment Analysis section below for further details.

Income Taxes

We recorded income tax expense of \$2.2 million, or 35.1% of income before income taxes, for the first half of fiscal 2019 compared with income tax expense of \$3.7 million, or 29.1% of income before income taxes, for the same period a year ago. The increase in our effective income tax rate was primarily due to the mix of pre-tax earnings favoring our foreign jurisdictions that are taxed at higher income and withholding tax rates compared to the U.S. federal statutory rate of 21%.

Refer to Note 19 located in the notes to the consolidated financial statements for further details regarding our provision for income taxes.

Liquidity

At October 28, 2018, our cash and investments (which comprise cash and cash equivalents, short-term investments (available for sale)), and short-term and long-term investments (held-to-maturity), totaled \$41.5 million at October 28, 2018, compared with \$54.5 million at April 29, 2018. Additionally, we did not have any outstanding borrowings on our lines of credit as of October 28, 2018.

The decrease in our cash and investments from the end of fiscal 2018 was primarily due to cash payments of \$12.1 million for acquisitions, capital expenditures totaling \$3.5 million (of which \$1.4 million was vendor-financed) that were mostly associated with our mattress fabrics segment, \$3.1 million returned to our shareholders primarily in the form of our regular quarterly cash dividend payments and common stock share repurchases, and \$1.3 million in employee withholding tax payments associated with the vesting of certain stock-based compensation awards, partially offset by net cash provided by operating activities totaling \$6.6 million.

Our net cash provided by operating activities of \$6.6 million during the first half of fiscal 2019 decreased from \$10.2 million during the same period a year ago. This decrease is primarily due to the decrease in earnings, partially offset by a decrease in working capital requirements as of result of the decreased business volume noted above.

See the Liquidity section below for further details.

Dividend and Common Stock Repurchase Programs

On November 29, 2018, we announced that our board of directors approved an increase in the quarterly cash dividend from \$0.09 to \$0.10 per share. This payment will be made on or about January 16, 2019, to shareholders of record as of January 2, 2019.

During the six-months ended October 28, 2018, dividend payments totaled \$2.3 million, which represented quarterly dividend payments of \$0.09 per share. During the six months ended October 29, 2017, dividend payments totaled \$4.6 million, of which \$2.6 million represented a special cash dividend payment of \$0.21 per share, and \$2.0 million represented quarterly dividend payments of \$0.08 per share.

During the six month period ended October 28, 2018, we purchased 36,880 shares of our common stock at a cost of \$844,000. During the six month period ended October 29, 2017, we did not purchase any shares of our common stock. At October 28, 2018, we had \$4.2 million available for repurchases of our common stock.

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Segment Analysis

Mattress Fabrics Segment

	Three Months Ended		Change	
	October 28, 2018	October 29, 2017		
(dollars in thousands)				
Net sales	\$41,989	\$48,601	(13.6)%	
Gross profit	7,498	9,730	(22.9)%	
Gross profit margin	17.9 %	20.0 %	(210)bp	
SG&A expenses	4,566	3,168	44.1 %	
Non-recurring charges	248	-	100.0 %	
Income from operations	2,932	6,562	(55.3)%	
Operating margin	7.0 %	13.5 %	(650)bp	

	Six Months Ended		Change	
	October 28, 2018	October 29, 2017		
(dollars in thousands)				
Net sales	\$78,972	\$97,030	(18.6)%	
Gross profit	13,470	19,495	(30.9)%	
Gross profit margin	17.1 %	20.1 %	(300)bp	
SG&A expenses	7,714	6,559	17.6 %	
Non-recurring charges	248	-	100.0 %	
Income from operations	5,755	12,936	(55.5)%	
Operating margin	7.3 %	13.3 %	(600)bp	

Net Sales

The decreases in mattress fabrics sales for the second quarter and first half of fiscal 2019 reflect the ongoing challenges facing the bedding industry related to the significant increase of low-priced imported mattresses from China. In anticipation of both increased tariffs on mattresses and the anti-dumping petition that was approved by the United States International Trade Commission (ITC) on November 1, 2018, we believe that a number of companies and retailers accelerated orders and promotions of low-priced imported mattresses. As a result, we experienced reduced demand for mattress fabric and sewn covers from our customers.

Currently, we expect the ongoing challenges in the mattress industry continue to affect short-term demand trends and operating performance. While we are pleased to see the anti-dumping petition approved, and we are beginning to see some positive developments, it is uncertain when demand trends will return to normal levels. We believe expected punitive measures against Chinese importers will ultimately benefit our customers and our business.

Gross Profit and Operating Income

Our operating profits declined in the second quarter and first half of fiscal 2019 compared with the same periods a year ago, due primarily to the decrease in net sales noted above. In addition, we had a non-recurring charge of \$248,000 relating to employee termination benefits and other operational reorganization costs.

Over the past several years, we have invested substantially in creating a sustainable and efficient platform with enhanced capacity and distribution capabilities. We are focused on maximizing the efficiency of our operations and aligning our costs with current and expected demand trends. We have reduced our capital expenditure budget and deferred certain capital projects that were originally expected to be completed in fiscal 2019.

eLuxury, LLC (eLuxury)

Overview

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

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

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

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Assets Acquired and Liabilities Assumed

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

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

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

As mentioned above, the Equity Agreement contains a contingent consideration arrangement that requires us to pay the seller, who is also the shareholder of the noncontrolling interest, an earn-out payment based on a multiple of adjusted EBITDA for the twelve-month period ending August 31, 2021, less \$12.0 million, as defined in the Equity Agreement. We recorded a contingent liability at the acquisition date for this earn-out obligation at its fair value totaling \$5.6 million based on the Black Scholes pricing model.

Consolidation and Non-Controlling Interest

As result of the acquisition of our 80% controlling interest, we included all the accounts of eLuxury in our consolidated financial statements and have eliminated all significant intercompany balances and transactions. Net income (loss) attributable to the minority interest in eLuxury is excluded from total consolidated net income (loss) to arrive at net income (loss) attributable to Culp Inc. common shareholders.

Other

Acquisitions costs totaling \$270,000 were included in selling, general, and administrative expenses in our Consolidated Statement of Net Income for the six-month period ending October 28, 2018.

Segment assets

Segment assets consist of accounts receivable, inventory, property, plant and equipment, and our investment in an unconsolidated joint venture.

	October 28, 2018	October 29, 2017	April 29, 2018
(dollars in thousands)			
Accounts receivable	\$ 10,740	\$ 13,645	\$ 15,195
Inventory	29,836	29,083	28,740
Property, plant & equipment	48,825	49,965	48,797
Investment in unconsolidated joint venture	1,470	1,522	1,501

Refer to Note 18 located in the notes to the consolidated financial statements for disclosures regarding determination of our segment assets.

Accounts Receivable

As of October 28, 2018, accounts receivable decreased by \$2.9 million, or 21.3%, compared with October 29, 2017. As of October 28, 2018, accounts receivable decreased by \$4.5 million, or 29.3%, compared with April 29, 2018. The decrease for the respective periods is due mostly to the decline in net sales noted above.

Inventory

Despite the decrease in net sales in the second quarter and first half of fiscal 2019, inventory remained flat as of October 28, 2018, compared with October 29, 2017, and April 29, 2018. This is primarily due to the inventory associated with eLuxury, acquired on June 22, 2018, which offset the decrease in inventory due to the decreased business volume noted above.

Property, Plant & Equipment

The \$48.8 million at October 28, 2018, represents property, plant, and equipment of \$36.1 million and \$12.7 million located in the U.S. and Canada, respectively. The \$50.0 million at October 29, 2017, represents property, plant, and equipment of \$35.8 million and \$14.2 million located in the U.S. and Canada, respectively. The \$48.8 million at April 29, 2018, represents property, plant, and equipment of \$35.4 million and \$13.4 million located in the U.S. and Canada, respectively.

Investment in Unconsolidated Joint Venture

Our investment in unconsolidated joint venture represents our fifty percent ownership of Class International Holdings Ltd. (See Note 9 to the consolidated financial statements for further details).

Upholstery Fabrics Segment

Net Sales

	Three Months Ended			% Change
	October 28, 2018	October 29, 2017	October 29, 2017	
(dollars in thousands)				
Non U.S. Produced	\$30,542	87 %	\$30,138	94 % 1.3 %
U.S. Produced	4,475	13 %	1,959	6 % 128.4 %
Total	\$35,017	100 %	\$32,097	100 % 9.1 %

	Six Months Ended			% Change
	October 28, 2018	October 29, 2017	October 29, 2017	
(dollars in thousands)				
Non U.S. Produced	\$60,911	88 %	\$59,522	94 % 2.3 %
U.S. Produced	8,596	12 %	3,678	6 % 133.7 %
Total	\$69,507	100 %	\$63,200	100 % 10.0 %

Our increases in upholstery fabric sales for the second quarter and first half of fiscal 2019 include the contribution from Read, acquired on April 1, 2018, partially offset by the decline in net sales associated with the closure of our Anderson, SC facility during the second quarter.

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

	Three Months Ended			% Change
	October 28, 2018	October 29, 2017	October 29, 2017	
(dollars in thousands)				
Gross profit	\$6,257	\$6,074	3.0 %	
Gross profit margin	17.9 %	18.9 %	(100)bp	
SG&A expenses	3,535	3,700	(4.5)%	
Income from operations	2,722	2,374	14.7 %	
Operating margin	7.8 %	7.4 %	40 bp	
Restructuring related charges	270	-	100 %	

Our operating results for the second quarter reflect lower operating costs associated with more favorable foreign currency exchange rates in China, leading to higher gross profit and operating margins. However, the lower operating costs associated with our China operations were partially offset by the effects of U.S. tariffs implemented during the second quarter.

(dollars in thousands)	Six Months Ended		Change
	October 28, 2018	October 29, 2017	
Gross profit	\$12,410	\$12,773	(2.8)%
Gross profit margin	17.9 %	20.2 %	(230)bp
SG&A expenses	7,161	7,511	(4.7)%
Income from operations	5,249	5,262	(0.2)%
Operating margin	7.6 %	8.3 %	(70)bp
Restructuring related charges	1,836	-	100 %

Exit and Disposal Activity

On June 12, 2018, our board of directors announced the closure of our upholstery fabrics manufacturing facility in Anderson, South Carolina. This closure was completed during the second quarter of fiscal 2018 and was due to a continued decline in demand for the products manufactured at this facility, reflecting a change in consumer style preferences.

The following summarizes our restructuring credit and related charges totaling \$(791) million that were associated with the above exit and disposal activity:

(dollars in thousands)	Three months ended October 28, 2018
Gain on sale of equipment	\$(1,124)
Employee termination benefits	63
Other operating costs associated with a closed facility	270
	\$(791)

Of this total net credit, a credit of \$1.1 million and a charge of \$270,000 were recorded in restructuring credit and cost of sales, respectively, in the Consolidated Statement of Net Income for the three-month period ending October 28, 2018.

The following summarizes our restructuring credit and related charges totaling \$1.2 million that were associated with the above exit and disposal activity:

	Six months ended October 28, 2018
(dollars in thousands)	
Inventory markdowns	\$ 1,566
Employee termination benefits	513
Other operating costs associated with a closed facility	270
Gain on sale of equipment	(1,124)
	\$ 1,225

Of this total net charge, a charge of \$1.8 million and a credit of \$610,000 were recorded in cost of sales and restructuring credit, respectively, in the Consolidated Statement of Net Income for the six-month period ending October 28, 2018.

Segment Assets

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

	October 28, 2018	October 29, 2017	April 29, 2018
(dollars in thousands)			
Accounts receivable	\$ 13,622	\$ 10,575	\$ 11,112
Inventory	20,765	21,126	24,714
Property, plant & equipment	2,048	2,063	2,445

Refer to Note 18 located in the notes to the consolidated financial statements for disclosures regarding determination of our segment assets.

Accounts Receivable

As of October 28, 2018, accounts receivable increased by \$3.0 million or 28.8%, compared with October 29, 2017. As of October 28, 2018, accounts receivable increased by \$2.5 million or 22.6%, compared with April 29, 2018. The increase for the respective periods is due mostly to the increase in net sales noted above.

Inventory

Despite the increase in net sales in the second quarter and first half of fiscal 2019, inventory declined as of October 28, 2018, compared with October 29, 2017 and April 29, 2018. This is primarily due to the reduction in inventory associated with the closure of our upholstery fabrics operation located Anderson, SC in the second quarter of fiscal 2019.

Property, Plant & Equipment

The \$2.0 million at October 28, 2018, represents property, plant, and equipment of \$1.4 million and \$636 located in the U.S. and China, respectively. The \$2.1 million at October 29, 2017, represents property, plant, and equipment of

\$1.4 million and \$722 located in the U.S. and China, respectively. The \$2.4 million at April 29, 2018, represents property, plant, and equipment of \$1.8 million and \$661 located in the U.S. and China, respectively.

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Other Income Statement Categories

	Three Months Ended			% Change
	October 28, 2018	October 29, 2017		
(dollars in thousands)				
SG&A expenses	\$10,103	\$9,415	7.3	%
Interest expense	18	37	(51.4)	%
Interest income	151	128	18.0	%
Other expense	142	321	(55.8)	%

	Six Months Ended			% Change
	October 28, 2018	October 29, 2017		
(dollars in thousands)				
SG&A expenses	\$18,136	\$18,916	(4.1)	%
Interest expense	38	37	2.7	%
Interest income	301	259	16.2	%
Other expense	399	674	(40.8)	%

Selling, General and Administrative Expenses

SG&A expenses increased during the second quarter of fiscal 2019 compared with the same period a year ago. This increase is primarily due to selling expenses associated with eLuxury, as this was their first full quarter of operations, partially offset by lower incentive compensation reflecting weaker financial results for the company in relation to pre-established targets.

SG&A expenses decreased during first half of fiscal 2019 compared with the same period a year ago due primarily to lower incentive compensation expense reflecting weaker financial results for the company in relation to pre-established financial targets, partially offset by selling expenses associated with eLuxury.

Interest Expense

Interest costs charged to operations were \$38,000 and \$137,000 for the six months ended October 28, 2018, and October 29, 2017, respectively.

No interest costs for the construction of qualifying fixed assets were capitalized for the six months ended October 28, 2018. Interest costs totaling \$100,000 for the construction of qualifying fixed assets were capitalized for the six months ended October 29, 2017. These interest costs will be amortized over the related assets' useful lives.

Interest Income

Interest income for the second quarter and first half of fiscal 2019 was comparable with the same respective periods of fiscal 2018. Our interest income is mostly associated with our investment grade U.S. corporate bonds located in the Cayman Islands.

Other Expense

Other expense decreased for the second quarter and first half of fiscal 2019 compared with the same respective periods of fiscal 2018. This decrease was mostly due to more favorable foreign currency exchange rates associated with our operations located in China.

Income Taxes

Effective Income Tax Rate

We recorded income tax expense of \$2.2 million, or 35.1% of income before income taxes, for the six-month period ended October 28, 2018, compared to income tax expense of \$3.7 million, or 29.1% of income before income taxes, for the six-month period ended October 29, 2017. Our effective income tax rates for the six-month periods ended October 28, 2018, and October 29, 2017, were based upon the estimated effective income tax rate applicable for the full year after giving effect to any significant items related specifically to interim periods. The effective income tax rate can be affected over the fiscal year by the mix and timing of actual earnings from our U.S. operations and foreign subsidiaries located in China and Canada versus annual projections and changes in foreign currency exchange rates in relation to the U.S. dollar.

The following schedule summarizes the factors that contribute to the difference between income tax expense at the federal income tax rate and the effective income tax rate reflected in the consolidated financial statements:

	2019	2018
Federal income tax rate	21.0 %	34.0 %
Foreign income tax rate differential	7.8	1.1
Tax effects of Chinese foreign exchange (losses) gains	2.8	(1.5)
Global Intangible Low Taxed Income Tax (GILTI)	2.1	-
Change in estimate of valuation allowance	1.2	0.7
Excess income tax deficiency (benefits) related to stock-based compensation	0.5	(4.3)
Other	(0.3)	(0.9)
	35.1 %	29.1 %

2017 Tax Cuts and Jobs Act

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

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

Valuation Allowance

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

Refer to Note 19 located in the notes to the consolidated financial statements for disclosures regarding our assessments of our recorded valuation allowance as of October 28, 2018, October 29, 2017, and April 29, 2018, respectively.

Undistributed Earnings

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

Refer to Note 19 located in the Notes to the Consolidated Financial Statements for disclosures regarding our assessments of our recorded deferred income tax liability balances associated with undistributed earnings from our foreign subsidiaries as of October 28, 2018, October 29, 2017, and April 29, 2018, respectively.

Uncertain Income Tax Positions

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

Refer to Note 19 located in the Notes to the Consolidated Financial Statements for disclosures regarding our assessments of our uncertain income tax positions as of October 28, 2018, October 29, 2017, and April 29, 2018, respectively.

Income Taxes Paid

We reported income tax expense of \$2.2 million and \$3.7 million for the six-month periods ending October 28, 2018 and October 29, 2017, respectively. In addition, our income tax payments totaled \$4.0 million and \$2.6 million for the same respective periods. Our income tax payments were associated with our foreign subsidiaries located in Canada and China. These payments increased during the first half of fiscal 2019 as compared with the same period a year ago, mostly due to a withholding tax payment of \$862,000 associated with an earnings and profit distribution from our Canadian subsidiary and the first installment of our mandatory repatriation tax payment of \$500,000 made in our second quarter.

As a result of the Tax Act noted above, we were required to calculate a one-time mandatory repatriation tax (the Transition Tax) for fiscal 2018 related to the transition of U.S. international tax from a worldwide tax system to a territorial tax system. Consequently, we started making income tax payments associated with the Transition Tax in the second quarter fiscal 2019, which we elected to pay over a period of eight years. Additionally, as part of the Tax Act, we currently expect to elect out of using our U.S. Federal net loss operating carryforwards on our fiscal 2018 income tax returns, to offset the Transition Tax by fully utilizing our foreign tax credits. As a result, we expect to have approximately \$7.0 million of U.S. Federal net loss operating carryforwards to apply against fiscal 2019 U.S. taxable income. This fact, coupled with the lower U.S. corporate income tax rate and the immediate expensing of U.S. capital expenditures next year, is currently expected to result in minimal U.S. cash income taxes paid in fiscal 2019 (excluding the Transition Tax).

Liquidity and Capital Resources

Liquidity

Overall

Currently, our sources of liquidity include cash and cash equivalents, 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 of \$14.8 million as of October 28, 2018, cash flow from operations, and the current availability (\$30.7 million) under our revolving credit lines will be sufficient to fund our foreseeable business needs, contractual obligations, and potential acquisitions.

At October 28, 2018, our cash and investments (which comprise cash and cash equivalents, short-term investments (available for sale)), and short-term and long-term investments (held-to-maturity), totaled \$41.5 million compared with \$54.5 million at April 29, 2018. Additionally, we did not have any outstanding borrowings on our lines of credit as of October 28, 2018.

The decrease in our cash and investments from the end of fiscal 2018 was primarily due to cash payments of \$12.1 million for acquisitions, capital expenditures totaling \$3.5 million (of which \$1.4 million was vendor-financed) that were mostly associated with our mattress fabrics segment, \$3.1 million returned to our shareholders primarily in the form of our regular quarterly cash dividend payments and common stock share repurchases, and \$1.3 million in employee withholding tax payments associated with the vesting of certain stock-based compensation awards, partially offset by net cash provided by operating activities totaling \$6.6 million.

Our net cash provided by operating activities of \$6.6 million during the first half of fiscal 2019 decreased from \$10.2 million during the same period a year ago. This decrease is primarily due to the decrease in earnings, partially offset by a decrease in working capital requirements as a result of the decreased business volume noted above.

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

By Geographic Area

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

	October 28, 2018	October 29, 2017	April 29, 2018
(dollars in thousands)			
Cayman Islands	\$27,812	\$39,004	\$31,000
China	9,898	6,153	10,537
United States	2,302	3,275	9,221
Canada	1,475	653	3,715
	\$41,487	\$49,085	\$54,473

Currently, we are holding a significant amount of our cash and investments with our international holding company located in the Cayman Islands. Our cash and investments located in this jurisdiction stemmed from accumulated earnings and profits (totaling \$57.5 million as of October 28, 2018) that were distributed from our subsidiary located in China. Of the \$27.8 million held in the Cayman Islands, \$26.7 million represents investment grade U.S. corporate bonds with maturities with less than one year (as of October 28, 2018), ranging from November 2018 through May 2019. These investments are classified as held-to-maturity as we have the positive intent and ability to hold these investments until maturity.

For fiscal 2019 and beyond, the Tax Act allows a U.S. corporation a 100% dividend received income tax deduction on earnings and profits repatriated to the U.S. from 10% owned foreign corporations. As a result, and as our U.S. corporate bonds mature, we plan to repatriate most or all of our earnings and profits residing in the Cayman Islands to the U.S. parent company.

Common Stock Repurchase Program

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

During the six month period ended October 28, 2018, we purchased 36,880 shares of our common stock at a cost of \$844,000. During the six month period ended October 29, 2017, we did not purchase any shares of our common stock.

At October 28, 2018, we had \$4.2 million available for repurchases of our common stock.

Dividend Program

On November 29, 2018, we announced that our board of directors approved an increase in the quarterly cash dividend from \$0.09 to \$0.10 per share. This payment will be made on or about January 16, 2019, to shareholders of record as of January 2, 2019.

During the six-months ended October 28, 2018, dividend payments totaled \$2.3 million, which represented quarterly dividend payments of \$0.09 per share. During the six-months ended October 29, 2017, dividend payments totaled \$4.6 million, of which \$2.6 million represented a special cash dividend payment of \$0.21 per share, and \$2.0 million represented quarterly dividend payments of \$0.08 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.

Working Capital

Accounts receivable at October 28, 2018, totaling \$24.4 million, were comparable with \$24.2 million at October 29, 2017. Days' sales outstanding were 28 days for the second quarter of fiscal 2019, compared with 27 days for the second quarter of fiscal 2018.

Inventories as of October 28, 2018, totaling \$50.6 million, were comparable with \$50.2 million at October 29, 2017. Inventory turns were 5.0 for the second quarter of fiscal 2019 compared with 5.2 for the second quarter of fiscal 2018.

Accounts payable-trade as of October 28, 2018, totaling \$24.0 million, were comparable with \$24.6 million at October 29, 2017.

Operating working capital (accounts receivable and inventories, less accounts payable-trade, accounts payable-capital expenditures, and deferred revenue) was \$50.2 million at October 28, 2018, compared with \$46.6 million at October 29, 2017. Operating working capital turnover was 6.3 during the second quarter of fiscal 2019 compared with 7.4 during the second quarter of fiscal 2018.

Financing Arrangements

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

At October 28, 2018, we were in compliance with all our financial covenants.

Refer to Note 13 located in the notes to the consolidated financial statements for further details of our revolving credit agreements.

Capital Expenditures and Depreciation

Overall

Capital expenditures on a cash basis were \$3.5 million (of which \$1.4 million were vendor- financed) for the six-months ending October 28, 2018, compared with \$7.5 million (of which \$2.5 million were vendor-financed) for the same period a year ago. Capital expenditures mostly related to our mattress fabrics segment for both periods.

Depreciation expense was \$4.1 million for the six-month period ending October 28, 2018 compared with \$3.7 million for the six-month period ending October 29, 2017 and mostly related to the mattress fabrics segment.

For fiscal 2019, we are projecting capital expenditures to be in the range of \$6.0 million to \$6.5 million. Depreciation expense is projected to be approximately \$8.0 million in fiscal 2019. The estimated capital expenditures and depreciation expense for fiscal 2019 mostly relates to the mattress fabrics segment. These are management's current expectations only, and changes in our business could cause changes in plans for capital expenditures and expectations related to depreciation expense.

Accounts Payable – Capital Expenditures

At October 28, 2018, we had total amounts due regarding capital expenditures totaling \$114,000, pertaining to outstanding vendor invoices, none of which were financed. The total amount outstanding of \$114,000 is required to be paid based on normal credit terms.

Purchase Commitments – Capital Expenditures

At October 28, 2018, we had open purchase commitments to acquire equipment for our mattress fabrics segment totaling \$826,000.

Mattress Fabric Building

Effective May 16, 2016, we entered into an agreement with a contractor to construct a new building located in North Carolina to expand our distribution capabilities and office space at a cost of \$11.3 million. This agreement required an installment payment of \$1.9 million that was made in April 2016, with additional installment payments of \$4.3 million that were made in fiscal 2017, \$3.7 million that were made in fiscal 2018, and a final installment payment of \$1.4 million made in May 2018 (first quarter of fiscal 2019). Interest was charged on the required outstanding installment payments for services that were previously rendered at a rate of \$2.25% plus the current 30-day LIBOR rate.

Also, we were required to issue a letter of a credit totaling \$5.0 million with the contractor's bank being the beneficiary. In addition to the interest charged on the outstanding installment payments noted above, there was a 0.1% unused fee calculated on the balance of the \$5.0 million letter of credit less the amount outstanding per month (see Note 13 for further details).

This new building was placed into service in July 2017 (first quarter of fiscal 2018).

Critical Accounting Policies and Recent Accounting Developments

At October 28, 2018, there were no changes in the nature of our significant accounting policies or the application of those policies from those reported in our annual report on Form 10-K for the year ended April 29, 2018.

Refer to Notes 2 and 5 located in the notes to the consolidated financial statements for recently adopted and issued accounting pronouncements since the filing of our Form 10-K for the year ended April 29, 2018.

Contractual Obligations

As of October 28, 2018, there were no significant or new contractual obligations from those reported in our annual report on Form 10-K for the year ended April 29, 2018.

Inflation

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

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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 October 28, 2018 our U.S. revolving credit agreement requires interest to be charged at a rate (applicable interest rate of 3.75% at October 28, 2018) as a variable spread over LIBOR based on our ratio of debt to EBITDA as defined in the agreement. Our revolving credit line associated with our China subsidiaries bears interest at a rate determined by the Chinese government. There were no borrowings outstanding under our revolving credit lines associated at October 28, 2018.

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 October 28, 2018, 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 October 28, 2018, 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 October 28, 2018, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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Part II – Other Information

Item 1. Legal Proceedings

There have not been any material changes to our legal proceedings during the three months ended October 28, 2018. Our legal proceedings are disclosed in the company's annual report on Form 10-K filed with the Securities and Exchange Commission on July 13, 2018 for the fiscal year ended April 29, 2018.

Item 1A. Risk Factors

A detailed discussion of our risk factors is included in Item 1A "Risk Factors" of our Annual Report on Form 10-K filed July 13, 2018 for the year ended April 29, 2018. The information presented below updates and should be read in conjunction with the risk factors and information disclosed in that Form 10-K.

Our business may be adversely affected by increased tariffs or other changes in U.S. policy related to imported products.

Many of our products are manufactured or sourced outside of the United States. The U.S. government has recently compiled a list of products under consideration for potential tariffs on imports from many countries, including China, where a significant amount of our products is produced. Any tariffs that result in increased costs of imported products and materials could require us to increase prices to our domestic customers or, if we are unable to do so, result in lowering our gross margins on products sold. As a result, the tariffs could have a material adverse effect on our results of operations. In addition to recent announcements about tariffs, the U.S. government is considering other proposals for substantial changes to its trade and tax policies, which could include import restrictions, increased import tariffs, changes to or withdrawal from existing trade agreements, and border-adjustment taxes, among other possible measures. Material changes in these policies could increase our tax obligations or require us to increase prices to customers, which could adversely affect sales. Any significant change in U.S. policy related to imported products could have a material adverse effect on our business and financial results.

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)
July 30, 2018 to September 2, 2018	2,603	24.03	2,603	\$ 4,865,640
September 3, 2018 to September 30, 2018	8,000	23.55	8,000	\$ 4,677,221
October 1, 2018 to October 28, 2018	23,287	22.45	23,287	\$ 4,154,528
Total	33,890	22.83	33,890	\$ 4,154,528

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

Item 6. Exhibits

The following exhibits are submitted as part of this report.

31.1 Certification of Chief Executive Officer Pursuant to Section 302 of Sarbanes-Oxley Act of 2002.

31.2 Certification of Chief Financial Officer Pursuant to Section 302 of Sarbanes-Oxley Act of 2002.

32.1 Certification of Chief Executive Officer Pursuant to Section 906 of Sarbanes-Oxley Act of 2002.

32.2 Certification of Chief Financial Officer Pursuant to Section 906 of Sarbanes-Oxley Act of 2002.

101.INS XBRL Instance Document

101.SCH XBRL Taxonomy Extension Schema Document

101.CAL XBRL Taxonomy Extension Calculation Linkbase Document

101.LAB XBRL Taxonomy Extension Label Linkbase Document

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

101.DEF XBRL Taxonomy Extension Definition Linkbase Document

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SIGNATURES

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

CULP, INC.
(Registrant)

Date: December 7, 2018 By: /s/ Kenneth R. Bowling
Kenneth R. Bowling
Senior Vice President and Chief Financial Officer
(Authorized to sign on behalf of the registrant
and also signing as principal financial officer)

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

EXHIBIT INDEX

Exhibit Number

Exhibit

31.1 Certification of Chief Executive Officer Pursuant to Section 302 of Sarbanes-Oxley Act of 2002.

31.2 Certification of Chief Financial Officer Pursuant to Section 302 of Sarbanes-Oxley Act of 2002.

32.1 Certification of Chief Executive Officer Pursuant to Section 906 of Sarbanes-Oxley Act of 2002.

32.2 Certification of Chief Financial Officer Pursuant to Section 906 of Sarbanes-Oxley Act of 2002.

101.INSXBRL Instance Document

101.SCHXBRL Taxonomy Extension Schema Document

101.CALXBRL Taxonomy Extension Calculation Linkbase Document

101.LABXBRL Taxonomy Extension Label Linkbase Document

101.PREXBRL Taxonomy Extension Presentation Linkbase Document

101.DEF XBRL Taxonomy Extension Definition Linkbase Document