CULP INC
Form 10-Q
March 11, 2011

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

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

For the quarterly period ended January 30, 2011
Commission File No. 1-12597

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

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

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

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

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

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

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

Large accelerated filer o Accelerated filer o Non-accelerated filer x

Smaller Reporting Company o

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

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

Common shares outstanding at January 30, 2011: 13,213,939
Par Value: $0.05 per share

INDEX TO FORM 10-Q
For the period ended January 30, 2011

Item 1. Financial Statements

CULP, INC.
CONSOLIDATED STATEMENTS OF NET INCOME
FOR THE THREE MONTHS AND NINE MONTHS ENDED JANUARY 30, 2011 AND JANUARY 31, 2010
(UNAUDITED)
(Amounts in Thousands, Except for Per Share Data)

THREE MONTHS ENDED

| | Amounts | | | Percent of Sales | |
|---|---|---|---|---|---|
| | January 30, 2011 | January 31, 2010 | % Over (Under) | January 30, 2011 | January 31, 2010 |
| Net sales | $ 51,652 | 53,980 | (4.3 ) % | 100.0 % | 100.0 % |
| Cost of sales | 43,413 | 43,323 | 0.2 % | 84.0 % | 80.3 % |
| Gross profit | 8,239 | 10,657 | (22.7 ) % | 16.0 % | 19.7 % |
| Selling, general and administrative expenses | 5,129 | 6,435 | (20.3 ) % | 9.9 % | 11.9 % |
| Restructuring expense | 7 | 26 | (73.1 ) % | 0.0 % | 0.0 % |
| Income from operations | 3,103 | 4,196 | (26.0 ) % | 6.0 % | 7.8 % |
| Interest expense | 224 | 327 | (31.5 ) % | 0.4 % | 0.6 % |
| Interest income | (57 ) | (52 ) | 9.6 % | (0.1 ) % | (0.1 ) % |
| Other expense | 28 | 96 | (70.8 ) % | 0.1 % | 0.2 % |
| Income before income taxes | 2,908 | 3,825 | (24.0 ) % | 5.6 % | 7.1 % |
| Income taxes * | 483 | 825 | (41.5 ) % | 16.6 % | 21.6 % |
| Net income | $ 2,425 | 3,000 | (19.2 ) % | 4.7 % | 5.6 % |
| Net income per share, basic | $ 0.19 | 0.24 | (20.8 ) % | | |
| Net income per share, diluted | $ 0.18 | 0.23 | (21.7 ) % | | |
| Average shares outstanding, basic | 13,005 | 12,713 | 2.3 % | | |
| Average shares outstanding, diluted | 13,228 | 13,074 | 1.2 % | | |

NINE MONTHS ENDED

| | Amounts | | | Percent of Sales | |
|---|---|---|---|---|---|

| | January 30, 2011 | January 31, 2010 | % Over (Under) | January 30, 2011 | January 31, 2010 |
|---|---|---|---|---|---|
| Net sales | $ 156,443 | 149,173 | 4.9 % | 100.0 % | 100.0 % |
| Cost of sales | 130,886 | 121,795 | 7.5 % | 83.7 % | 81.6 % |
| Gross profit | 25,557 | 27,378 | (6.7 ) % | 16.3 % | 18.4 % |
| Selling, general and administrative expenses | 14,544 | 16,716 | (13.0 ) % | 9.3 % | 11.2 % |
| Restructuring credit | - | (317 ) | (100.0 ) % | 0.0 % | (0.2 ) % |
| Income from operations | 11,013 | 10,979 | 0.3 % | 7.0 % | 7.4 % |
| Interest expense | 659 | 1,026 | (35.8 ) % | 0.4 % | 0.7 % |
| Interest income | (144 ) | (81 ) | 77.8 % | (0.1 ) % | (0.1 ) % |
| Other expense | 111 | 714 | (84.5 ) % | 0.1 % | 0.5 % |
| Income before income taxes | 10,387 | 9,320 | 11.4 % | 6.6 % | 6.2 % |
| Income taxes * | 213 | 1,565 | (86.4 ) % | 2.1 % | 16.8 % |
| Net income | $ 10,174 | 7,755 | 31.2 % | 6.5 % | 5.2 % |
| Net income per share, basic | $ 0.79 | 0.61 | 29.5 % | | |
| Net income per share, diluted | $ 0.77 | 0.60 | 28.3 % | | |
| Average shares outstanding, basic | 12,936 | 12,679 | 2.0 % | | |
| Average shares outstanding, diluted | 13,218 | 12,960 | 2.0 % | | |

*Percent of sales column for income taxes is calculated as a % of income before income taxes.

See accompanying notes to consolidated financial statements.

CULP, INC.
CONSOLIDATED BALANCE SHEETS
JANUARY 30, 2011, JANUARY 31, 2010 AND MAY 2, 2010
(UNAUDITED)
(Amounts in Thousands)

| | Amounts | | Increase (Decrease) | | * May 2, |
|---|---|---|---|---|---|
| | January 30, 2011 | January 31, 2010 | Dollars | Percent | 2010 |
| Current assets: | | | | | |
| Cash and cash equivalents | $ 17,259 | 15,994 | 1,265 | 7.9 % | 18,295 |
| Short-term investments | 5,518 | 3,021 | 2,497 | 82.7 % | 3,023 |
| Accounts receivable | 16,909 | 20,871 | (3,962 ) | (19.0 ) % | 19,822 |
| Inventories | 26,407 | 24,366 | 2,041 | 8.4 % | 26,002 |
| Deferred income taxes | 296 | 57 | 239 | 419.3 % | 150 |
| Assets held for sale | 112 | 98 | 14 | 14.3 % | 123 |
| Income taxes receivable | 407 | 331 | 76 | 23.0 % | 728 |
| Other current assets | 1,521 | 1,217 | 304 | 25.0 % | 1,698 |
| Total current assets | 68,429 | 65,955 | 2,474 | 3.8 % | 69,841 |
| Property, plant and equipment, net | 30,571 | 26,431 | 4,140 | 15.7 % | 28,403 |
| Goodwill | 11,462 | 11,462 | - | 0.0 % | 11,462 |
| Deferred income taxes | 1,322 | - | 1,322 | 100.0 % | 324 |
| Other assets | 2,093 | 2,660 | (567 ) | (21.3 ) % | 2,568 |
| Total assets | $ 113,877 | 106,508 | 7,369 | 6.9 % | 112,598 |
| Current liabilities: | | | | | |
| Current maturities of long-term debt | $ 2,400 | 4,880 | (2,480 ) | (50.8 ) % | 196 |
| Current portion of obligation under a capital lease | - | 107 | (107 ) | (100.0 ) % | - |
| Accounts payable-trade | 17,121 | 18,649 | (1,528 ) | (8.2 ) % | 22,278 |
| Accounts payable - capital expenditures | 203 | 790 | (587 ) | (74.3 ) % | 567 |
| Accrued expenses | 5,971 | 8,144 | (2,173 ) | (26.7 ) % | 9,613 |
| Accrued restructuring costs | 71 | 362 | (291 ) | (80.4 ) % | 324 |
| Income taxes payable - current | 289 | 153 | 136 | 88.9 % | 224 |
| Total current liabilities | 26,055 | 33,085 | (7,030 ) | (21.2 ) % | 33,202 |
| | - | 188 | (188 ) | (100.0 ) % | - |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Accounts payable - capital expenditures | | | | | | | |
| Income taxes payable - long-term | | 3,934 | 3,690 | 244 | 6.6 | % | 3,876 |
| Deferred income taxes | | 622 | 1,092 | (470 ) | (43.0 | ) % | 982 |
| Long-term debt, less current maturities | | 9,166 | 11,529 | (2,363 ) | (20.5 | ) % | 11,491 |
| Total liabilities | | 39,777 | 49,584 | (9,807 ) | (19.8 | ) % | 49,551 |
| Commitments and Contingencies (Note 19) | | | | | | | |
| Shareholders' equity | | 74,100 | 56,924 | 17,176 | 30.2 | % | 63,047 |
| Total liabilities and shareholders' equity | $ | 113,877 | 106,508 | 7,369 | 6.9 | % | 112,598 |
| Shares outstanding | | 13,214 | 12,935 | 279 | 2.2 | % | 13,052 |

* Derived from audited financial statements.

See accompanying notes to consolidated financial statements.

CULP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED JANUARY 30, 2011 AND JANUARY 31, 2010
(UNAUDITED)
(Amounts in Thousands)

| | NINE MONTHS ENDED | |
|---|---|---|
| | Amounts | |
| | January 30, 2011 | January 31, 2010 |
| Cash flows from operating activities: | | |
| Net income | $10,174 | 7,755 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 3,205 | 3,042 |
| Amortization of other assets | 385 | 416 |
| Stock-based compensation | 280 | 695 |
| Deferred income taxes | (1,219) | 190 |
| Restructuring expenses, net of gain on sale of related assets | - | (127) |
| Loss (gain) on sale of equipment | 15 | (72) |
| Excess tax benefits related to stock-based compensation | (285) | (182) |
| Foreign currency exchange losses | 33 | 613 |
| Changes in assets and liabilities: | | |
| Accounts receivable | 3,053 | (2,742) |
| Inventories | (291) | (385) |
| Other current assets | 204 | 46 |
| Other assets | 13 | (48) |
| Accounts payable | (5,459) | 1,558 |
| Accrued expenses | (3,822) | 1,555 |
| Accrued restructuring | (253) | (491) |
| Income taxes | 379 | 109 |
| Net cash provided by operating activities | 6,412 | 11,932 |
| Cash flows from investing activities: | | |
| Capital expenditures | (5,580) | (4,209) |
| Purchase of short-term investments | (4,532) | (3,021) |
| Proceeds from the sale of short-term investments | 2,037 | - |
| Proceeds from the sale of equipment | 27 | 513 |
| Net cash used in investing activities | (8,048) | (6,717) |
| Cash flows from financing activities: | | |
| Payments on vendor-financed capital expenditures | (188) | (797) |
| Payments on capital lease obligation | - | (519) |
| Payments on long-term debt | (129) | (32) |
| Debt issuance costs | (27) | (15) |

| | | |
|---|---|---|
| Excess tax benefits related to stock-based compensation | 285 | 182 |
| Proceeds from common stock issued | 591 | 250 |
| Net cash provided by (used in) financing activities | 532 | (931) |
| Effect of exchange rate changes on cash and cash equivalents | 68 | (87) |
| (Decrease) increase in cash and cash equivalents | (1,036) | 4,197 |
| Cash and cash equivalents at beginning of period | 18,295 | 11,797 |
| Cash and cash equivalents at end of period | $17,259 | 15,994 |

See accompanying notes to consolidated financial statements.

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

| | Common Stock | | Capital Contributed in Excess of Par | Accumulated (Deficit) | Accumulated Other Comprehensive | Total Shareholders' |
|---|---|---|---|---|---|---|
| | Shares | Amount | Value | Earnings | Income | Equity |
| Balance, May 3, 2009 | 12,767,527 | $ 638 | 47,728 | (355) | 20 | $ 48,031 |
| Net income | - | - | - | 13,188 | - | 13,188 |
| Stock-based compensation | - | - | 834 | - | - | 834 |
| Gain on cash flow hedge, net of taxes | - | - | - | - | 83 | 83 |
| Restricted common stock award | 80,000 | 4 | (4) | - | - | - |
| Common stock issued in connection with performance based units | 80,000 | 4 | (4) | - | - | - |
| Common stock surrendered for withholding taxes payable | (20,658) | (1) | (190) | - | - | (191) |
| Excess tax benefit related to stock based compensation | - | - | 429 | - | - | 429 |
| Common stock issued in connection with stock option exercises | 144,916 | 7 | 666 | - | - | 673 |
| Balance, May 2, 2010 | 13,051,785 | 652 | 49,459 | 12,833 | 103 | 63,047 |
| Net income | - | - | - | 10,174 | - | 10,174 |
| Stock-based compensation | - | - | 280 | - | - | 280 |
| Loss on cash flow hedge, net of taxes | - | - | - | - | (103) | (103) |
| Excess tax benefit related to stock based compensation | - | - | 285 | - | - | 285 |
| Common stock issued in connection with performance based units | 40,000 | 2 | (2) | - | - | - |
| Common stock issued in connection with stock option exercises | 152,875 | 8 | 738 | - | - | 746 |
| Fully vested common stock award | 3,114 | - | - | | | - |
| Common stock surrendered for withholding | | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| taxes payable and cost of option exercises | (33,835) | (2) | (327) | - | - | (329) |
| Balance, January 30, 2011 | 13,213,939 | $ 660 | 50,433 | 23,007 | - | $ 74,100 |

See accompanying notes to consolidated financial statements.

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

1. Basis of Presentation

The accompanying unaudited consolidated financial statements of Culp, Inc. and subsidiaries (the "company") include all adjustments, which are, in the opinion of management, necessary for fair presentation of the results of operations and financial position. All of these adjustments are of a normal recurring nature except for the income tax benefit of $1.3 million to reduce the valuation allowance against our net deferred tax assets associated with our China operations disclosed in note 16. Results of operations for interim periods may not be indicative of future results. The unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements, which are included in the company's annual report on Form 10-K filed with the Securities and Exchange Commission on July 15, 2010 for the fiscal year ended May 2, 2010.

Certificates of deposit with maturities of six months totaling $3.0 million have been reclassified from cash and cash equivalents to short-term investments on the January 31, 2010 Consolidated Balance Sheet to conform to current year presentation. The purchases of these certificates of deposit totaling $3.0 million have been classified in investing activities on the Statement of Cash Flows for the nine-month period ending January 31, 2010 to conform to current year presentation.

The company's three months ended January 30, 2011 and January 31, 2010, represent 13 week periods, respectively. The company's nine months ended January 30, 2011, and January 31, 2010, represent 39 week periods, respectively.

2. Significant Accounting Policies

As of January 30, 2011, there were no changes in the nature of our significant accounting policies or the application of those policies from those reported in our annual report on Form 10-K for the year then ended May 2, 2010.

Recently Adopted Accounting Pronouncements

ASC Topic 860

In June 2009, the FASB amended certain provisions of ASC Topic 860, Transfers and Servicing (previously reported as SFAS No. 166, "Accounting for Transfers of Financial Assets, an amendment to SFAS No. 140"). The amended provisions of ASC Topic 860 eliminate the concept of a "qualifying special-purpose entity," changes the requirements for derecognizing financial assets, and requires additional disclosures in order to enhance information reported to users of financial statements by providing greater transparency about transfers of financial assets, including securitization transactions, and an entity's continuing involvement in and exposure to the risks related to transferred financial assets. The amended provisions of ASC Topic 860 are effective for the first annual reporting period beginning after November 15, 2009 and for interim periods within that first annual reporting period. We adopted the provisions of ASC Topic 860 in the first quarter of fiscal 2011. The adoption of this standard did not have a material impact on our consolidated results of operations or financial condition.

ASC Topic 810

In June 2009, the FASB amended certain provisions of ASC Topic 810, Consolidation (previously reported as SFAS No. 167, "Amendments to FASB Interpretation No. 46(R)") which revised the consolidation guidance for variable-interest entities. The amendments include: (1) the elimination of the exemption for qualifying special purpose entities, (2) a new approach for determining who should consolidate a variable-interest entity, and (3) changes to when it is necessary to reassess who should consolidate a variable-interest entity. The amended provisions of ASC Topic 810 are effective for the first annual reporting period beginning after November 15, 2009 and for interim periods within that first annual reporting period. We adopted the provisions of ASC Topic 860 in the first quarter of fiscal 2011. The adoption of this standard did not have a material impact on our consolidated results of operations or financial condition.

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

Recently Issued Accounting Pronouncements

ASC Topic 605

In October 2009, the FASB issued ASU 2009-13, which amends ASC Topic 605, "Revenue Recognition", to revise accounting guidance related to revenue arrangements with multiple deliverables. The guidance relates to the determination of when the individual deliverables included in a multiple-element arrangement may be treated as separate units of accounting and modifies the manner in which the transaction consideration is allocated across the individual deliverables. Also, the guidance expands the disclosure requirements for revenue arrangements with multiple deliverables. The guidance will be effective for our fiscal 2012. Because the Company historically does not have revenue arrangements with multiple deliverables, the adoption of this standard is not expected to have a material impact on its consolidated results of operations or financial condition.

3. Stock-Based Compensation

Common Stock Awards

On October 1, 2010, we granted a total of 3,114 shares of common stock to our board of directors. These shares of common stock vested immediately and were measured at $10.02 per share, which represents the closing price of the company's common stock at the date of grant.

We recorded $31,000 of compensation expense within selling, general, and administrative expense for these common stock awards for the nine-month period ended January 30, 2011. There were not any common stock awards for the nine-month period ended January 31, 2010 and, therefore no compensation expense was recorded on fully vested common stock awards.

Incentive Stock Option Awards

We did not grant any incentive stock option awards during the first three quarters of fiscal 2011.

At January 30, 2011, options to purchase 345,974 shares of common stock were outstanding, had a weighted average exercise price of $6.30 per share, and a weighted average contractual term of 4.4 years. At January 30, 2011, the aggregate intrinsic value for options outstanding was $1.2 million.

At January 30, 2011, outstanding options to purchase 256,574 shares of common stock were exercisable, had a weighted average exercise price of $6.19 per share, and a weighted average contractual term of 3.5 years. At January 30, 2011, the aggregate intrinsic value for options exercisable was $925,000.

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

The aggregate intrinsic value for options exercised for the nine-month periods ended January 30, 2011 and January 31, 2010 was $820,000 and $252,000, respectively.

The remaining unrecognized compensation cost related to incentive stock option awards at January 30, 2011, was $230,000 which is expected to be recognized over a weighted average period of 1.9 years.

We recorded $111,000 and $274,000 of compensation expense for incentive stock option grants within selling, general, and administrative expense for the nine-month periods ended January 30, 2011 and January 31, 2010, respectively.

Time Vested Restricted Stock Awards

We did not grant any time vested restricted stock awards during the first three quarters of fiscal 2011.

We recorded $126,000 and $132,000 of compensation expense within selling, general, and administrative expense for time vested restricted stock awards for the nine-month periods ending January 30, 2011 and January 31, 2010, respectively.

At January 30, 2011, there were 195,000 shares of time vested restricted stock outstanding and unvested. Of the 195,000 shares outstanding and unvested, 115,000 shares (granted on January 7, 2009) vest in equal one-third installments on May 1, 2012, 2013, and 2014, respectively. The remaining 80,000 shares (granted on July 1, 2009) vest in equal one-third installments on July 1, 2012, 2013, and 2014, respectively. At January 30, 2011 the weighted average fair value of these outstanding and unvested shares was $3.60 per share.

At January 30, 2011, the remaining unrecognized compensation cost related to the unvested restricted stock awards was $386,000, which is expected to be recognized over a weighted average vesting period of 2.5 years.

Performance Based Restricted Stock Units

We did not grant any performance based restricted stock units during the first three quarters of fiscal 2011.

On January 7, 2009, and under our 2007 Equity Incentive Plan, certain key management employees and a non-employee were granted 120,000 shares of performance based restricted stock units. This award contingently vested in one-third increments, if in any discreet period of two consecutive quarters from February 2, 2009 through April 30, 2012, certain performance goals were met. As of August 1, 2010, the performance goals as defined in the agreement were met and as a result, all of the performance based restricted stock units were vested.

The fair value (the closing price of the company's common stock) of the performance based restricted stock units granted to key management employees was measured at the date of grant (January 7, 2009) and was $1.88 per share. The fair value (the closing price of the company's common stock) of the performance based restricted stock units granted to a non-employee was measured at the earlier date of when the performance criteria was met or the end of each reporting period. The performance based restricted stock units granted to the non-employee vested in one-third increments on August 2, 2009, January 31, 2010, and August 1, 2010, respectively. The restricted stock awards that vested on August 2, 2009, January 31, 2010, and August 1, 2010, were measured at $6.59, $13.01, and $10.42 per share, respectively, which represents the closing price of the company’s common stock at the date in which the performance criteria were met.

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

We recorded $12,000 and $289,000 of compensation expense within selling, general, and administrative expense for performance based restricted stock units for the nine-month periods ended January 30, 2011 and January 31, 2010, respectively.

Of the 120,000 vested shares, 105,000 and 15,000 pertained to key management employees and a non-employee, respectively. The total fair value of the 120,000 performance based restricted stock units that vested was $348,000 with a weighted average fair value of $2.90 per share.

Other Share-Based Arrangements

We have a stock-based agreement with a non-employee that requires the company to settle in cash and is indexed by shares of the company's common stock as defined in the agreement. The cash settlement is based on a 30-day average closing price of the company's common stock at the time of payment. At January 30, 2011, this agreement was indexed by approximately 68,260 shares of the company's common stock. The fair value of this agreement is included in accrued expenses and was $701,000 and $821,000 at January 30, 2011 and May 2, 2010, respectively. We recorded a credit of $120,000 for the decrease in this accrual and to reflect the change in fair value for the nine-month period ending January 30, 2011. The company recorded a charge of $543,000 for the increase in this accrual and to reflect the change in fair value for the nine-month period ending January 31, 2010. We did not make any payments under this arrangement for the nine-month periods ending January 30, 2011 and January 31, 2010, respectively.

4. Accounts Receivable

A summary of accounts receivable follows:

| (dollars in thousands) | January 30, 2011 | | | May 2, 2010 | | |
|---|---|---|---|---|---|---|
| Customers | $ | 18,545 | | $ | 21,678 | |
| Allowance for doubtful accounts | | (1,046 | ) | | (1,322 | ) |
| Reserve for returns and allowances and discounts | | (590 | ) | | (534 | ) |
| | $ | 16,909 | | $ | 19,822 | |

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

| | Nine months ended | | | | | |
|---|---|---|---|---|---|---|
| (dollars in thousands) | January 30, 2011 | | | January 31, 2010 | | |
| Beginning balance | $ | (1,322 | ) | $ | (1,535 | ) |
| Provision for bad debts | | 295 | | | (96 | ) |
| Net write-offs, net of recoveries | | (19 | ) | | 500 | |
| Ending balance | $ | (1,046 | ) | $ | (1,131 | ) |

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

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

| | Nine months ended | |
|---|---|---|
| (dollars in thousands) | January 30, 2011 | January 31, 2010 |
| Beginning balance | $ (534) | $ (442) |
| Provision for returns, allowances and discounts | (1,606) | (2,307) |
| Credits issued | 1,550 | 2,275 |
| Ending balance | $ (590) | $ (474) |

5. Inventories

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

A summary of inventories follows:

| (dollars in thousands) | January 30, 2011 | May 2, 2010 |
|---|---|---|
| Raw materials | $ 5,867 | $ 5,639 |
| Work-in-process | 2,120 | 2,160 |
| Finished goods | 18,420 | 18,203 |
| | $ 26,407 | $ 26,002 |

6. Other Assets

A summary of other assets follows:

| (dollars in thousands) | January 30, 2011 | May 2, 2010 |
|---|---|---|
| Cash surrender value – life insurance | $ 1,321 | $ 1,312 |
| Non-compete agreements, net | 517 | 843 |
| Other | 255 | 413 |
| | $ 2,093 | $ 2,568 |

We recorded non-compete agreements in connection with our asset purchase agreements with International Textile Group, Inc. (ITG) and Bodet & Horst. These non-compete agreements pertain to our mattress fabrics segment. The non-compete agreement associated with ITG was amortized on a straight line basis over the four year life of the agreement that expired at the end of the third quarter of fiscal 2011. The non-compete agreement associated with Bodet & Horst is amortized on a straight line basis over the six year life of the agreement and requires quarterly payments of $12,500 over the life of the agreement. As of January 30, 2011, the total remaining non-compete payments were $175,000.

The gross carrying amount of these non-compete agreements was $1.0 million and $2.1 million at January 30, 2011 and May 2, 2010, respectively. At January 30, 2011 and May 2, 2010, accumulated amortization for these non-compete agreements were $495,000 and $1.3 million, respectively. Amortization expense for these non-compete agreements was $363,000 and $380,000 for the nine-month periods ended January 30, 2011 and January 31, 2010, respectively. The remaining amortization expense (which includes the total remaining Bodet & Horst non-compete payments of $175,000) for the next five fiscal years follows: FY 2011 - $49,000; FY 2012 - $198,000; FY 2013 - $198,000; FY 2014 - $198,000; and FY 2015 - $49,000. The weighted average amortization period for these non-compete agreements is 3.5 years as of January 30, 2011.

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

Our cash surrender value – life insurance balances at January 30, 2011 and May 2, 2010, are payable upon death of the respective insured.

7. Accounts Payable – Capital Expenditures

At January 30, 2011, we had amounts due regarding capital expenditures totaling $203,000, of which $188,000 was vendor-financed and $15,000 was non-vendor financed. Our vendor-financed arrangement bears interest at a fixed interest rate of 7.14%. The total outstanding amount of $203,000 is required to be paid in full during fiscal 2011.

At May 2, 2010, we had total amounts due regarding capital expenditures totaling $567,000, of which $377,000 was vendor-financed and $190,000 was non-vendor financed.

8. Accrued Expenses

A summary of accrued expenses follows:

| (dollars in thousands) | January 30, 2011 | May 2, 2010 |
|---|---|---|
| Compensation, commissions and related benefits | $ 4,028 | $ 7,460 |
| Interest | 409 | 187 |
| Other accrued expenses | 1,534 | 1,966 |
| | $ 5,971 | $ 9,613 |

9. Long-Term Debt and Lines of Credit

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

| (dollars in thousands) | January 30, 2011 | May 2, 2010 |
|---|---|---|
| Unsecured senior term notes | $ 11,000 | $ 11,000 |
| Canadian government loan | 566 | 687 |
| | 11,566 | 11,687 |
| Current maturities of long-term debt | (2,400) | (196) |
| Long-term debt, current maturities of long-term debt | $ 9,166 | $ 11,491 |

Unsecured Term Notes

In connection with the Bodet & Horst acquisition, we entered into a note agreement dated August 11, 2008. This agreement provided for the issuance of $11.0 million of unsecured term notes with a fixed interest rate of 8.01% and a term of seven years. Principal payments of $2.2 million per year are due on the notes beginning August 11, 2011. The principal payments are payable over an average term of 4.5 years through August 11, 2015. This agreement contains customary financial and other covenants as defined in the agreement.

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Government of Quebec Loan

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

Revolving Credit Agreement – United States

On August 13, 2010, we entered into a sixteenth amendment to our revolving credit agreement. This agreement currently provides for a loan commitment of $6.5 million, including letters of credit of $3.0 million. This agreement expires August 15, 2012 and provides for a pricing matrix to determine the interest rate payable on loans made under this agreement (applicable interest rate of 2.26% at January 30, 2011). As of January 30, 2011, there were $125,000 in outstanding letters of credit (all of which related to workers compensation). At January 30, 2011 and May 2, 2010, there were no borrowings outstanding under the agreement.

The sixteenth amendment to this revolving credit agreement also increased the annual capital expenditure limit from $4.0 million to $10.0 million.

Revolving Credit Agreement – China

We have an unsecured credit agreement that provides for a line of credit of up to approximately $6.0 million and expires on March 2, 2011. This agreement bears interest at a rate determined by the Chinese government. There were no borrowings outstanding under the agreement as of January 30, 2011 and May 2, 2010.

Overall

Our loan agreements require, among other things, that we maintain compliance with certain financial covenants. At January 30, 2011, the company was in compliance with these financial covenants.

At January 30, 2011, the principal payment requirements of long-term debt during the next five years are: Year 1 – $2.4 million; Year 2 - $2.4 million; Year 3 - $2.4 million; Year 4 - $2.2 million; and Year 5 - $2.2 million.

10. Fair Value of Financial Instruments

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

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The fair value of the company's long-term debt is estimated by discounting the future cash flows at rates currently offered to the company for similar debt instruments of comparable maturities. At January 30, 2011, the carrying value of the company's long-term debt was $11.6 million and the fair value was $10.4 million. At May 2, 2010, the carrying value of the company's long-term debt was $11.7 million and the fair value was $11.1 million.

11. Derivatives

Canadian Dollar Foreign Exchange Contract

On January 21, 2009, we entered into a Canadian dollar foreign exchange contract to mitigate the risk of foreign exchange rate fluctuations associated with our loan with the Government of Quebec. The agreement effectively converted the Canadian dollar principal payments at a fixed Canadian dollar foreign exchange rate compared with the United States dollar of 1.21812 and was due to expire on November 1, 2013. During the first quarter of fiscal 2011, we elected to terminate this contract due to the favorable Canadian dollar foreign exchange rates in comparison to the fixed contractual rate noted above.

In accordance with the provisions ASC Topic 815, Derivatives and Hedging, our Canadian dollar foreign exchange contract was designated as a cash flow hedge, with the fair value of this financial instrument recorded in other assets and changes in fair value recorded in accumulated other comprehensive income. ASC Topic 815 requires disclosure of gains and losses on derivative instruments in the following tabular format.

(Amounts in Thousands)

| | Fair Values of Derivative Instruments As of, | | | |
|---|---|---|---|---|
| | January 30, 2011 | | May 2, 2010 | |
| Derivatives designated as hedging instruments under ASC Topic 815 | Balance Sheet Location | Fair Value | Balance Sheet Location | Fair Value |
| Canadian dollar foreign exchange contract | Other assets | $- | Other assets | $103 |

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| 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 Other assets or Accrued Expenses at Fair Value | Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) | Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) | Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount | Amount of Gain (net of tax) or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing) |
|---|---|---|---|---|---|

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | | | | | Excluded from Effectiveness Testing) | | |
| | January 30, 2011 | January 31, 2010 | | January 30, 2011 | January 31, 2010 | | January 30, 2011 | January 31, 2010 |
| Canadian Dollar Foreign Exchange Contract | $(103) | $ 62 | Other Expense | $5 | $ 4 | Other Expense | $79 | $ - |

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12. Cash Flow Information

Payments for interest and income taxes follows:

| (dollars in thousands) | Nine months ended January 30, 2011 | January 31, 2010 |
|---|---|---|
| Interest | $ 454 | $ 727 |
| Net income tax payments | 1,054 | 1,152 |

Interest costs of $17,000 for the construction of qualifying property, plant, and equipment were capitalized for the nine-month period ending January 30, 2011. Interest costs of $22,000 were capitalized for the nine-month period ending January 31, 2010.

During the nine-month period ending January 30, 2011, 33,835 shares of common stock were surrendered to satisfy withholding tax liabilities and other costs incurred in connection with 40,000 shares of common stock issued and related to the vesting of performance based restricted stock units and the exercise of 72,000 options to purchase common stock. The total withholding tax liabilities and other costs incurred totaled $329,000.

During the nine-month period ending January 31, 2010, 9,064 shares of common stock were surrendered to satisfy withholding tax liabilities totaling $51,000 in connection with 40,000 shares of common stock issued and related to the vesting of performance based restricted stock units.

13. Net Income Per Share

Basic net income per share is computed using the weighted-average number of shares outstanding during the period. Diluted net income per share uses the weighted-average number of shares outstanding during the period plus the dilutive effect of stock-based compensation calculated using the treasury stock method. Weighted average shares used in the computation of basic and diluted net income per share follows:

| (amounts in thousands) | Three months ended January 30, 2011 | January 31, 2010 |
|---|---|---|
| Weighted average common shares outstanding, basic | 13,005 | 12,713 |
| Dilutive effect of stock-based compensation | 223 | 361 |
| Weighted average common shares outstanding, diluted | 13,228 | 13,074 |

All options of common stock were included in the computation of diluted net income per share as the exercise price of the options was less than the average market price of the common shares for the three-month periods ended January 30, 2011 and January 31, 2010, respectively.

The computation of basic net income per share for the three-months ended January 30, 2011, did not include 195,000 shares of time vested restricted common stock as these shares were unvested. The computation of basic net income per share for the three-months ended January 31, 2010, did not include 195,000 shares of time vested restricted common stock and 40,000 shares of performance restricted stock units as these awards were unvested.

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| (amounts in thousands) | Nine months ended January 30, 2011 | January 31, 2010 |
|---|---|---|
| Weighted average common shares outstanding, basic | 12,936 | 12,679 |
| Dilutive effect of stock-based compensation | 282 | 281 |
| Weighted average common shares outstanding, diluted | 13,218 | 12,960 |

All options of common stock were included in the computation of diluted net income per share for the nine-months ended January 30, 2011, as the exercise price of the options was less than the average market price of the common shares. Options to purchase 157,500 shares of common stock were not included in the computation of diluted net income per share for the nine-months ended January 31, 2010, as the exercise price of the options was greater than the average market price of the common shares.

The computation of basic net income per share for the nine-months ended January 30, 2011, did not include 195,000 shares of time vested restricted common stock as these shares were unvested. The computation of basic net income per share for the nine-months ended January 31, 2010, did not include 195,000 shares of time vested restricted common stock and 40,000 shares of performance restricted stock units as these awards were unvested.

14. Comprehensive Income

Comprehensive income is the total income and other changes in shareholders' equity, except those resulting from investments by shareholders and distributions to shareholders not reflected in net income.

A summary of comprehensive income follows:

| (dollars in thousands) | Nine months ended January 30, 2011 | January 31, 2010 |
|---|---|---|
| Net income | $ 10,174 | $ 7,755 |
| (Loss) gain on cash flow hedge, net of income taxes | (103 ) | 62 |
| Comprehensive income | $ 10,071 | $ 7,817 |

15. Segment Information

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

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We evaluate the operating performance of our segments based upon income (loss) from operations before restructuring and related charges or (credits), certain unallocated corporate expenses, and other non-recurring items. Cost of sales in both segments include costs to manufacture or source our products, including costs such as raw material and finished goods purchases, direct and indirect labor, overhead and incoming freight charges. Unallocated corporate expenses primarily represent compensation and benefits for certain executive officers and all costs related to being a public company. Segment assets include assets used in the operations of each segment and primarily consist of accounts receivable, inventories, and property, plant and equipment. The mattress fabrics segment also includes in segment assets, assets held for sale, goodwill and non-compete agreements associated with certain acquisitions. The upholstery fabrics segment also includes assets held for sale in segment assets. Financial information for the company's operating segments follows:

| | Three months ended | | | |
|---|---|---|---|---|
| (dollars in thousands) | January 30, 2011 | | January 31, 2010 | |
| Net sales: | | | | |
| Mattress Fabrics | $27,991 | | $26,953 | |
| Upholstery Fabrics | 23,661 | | 27,027 | |
| | $51,652 | | $53,980 | |
| | | | | |
| Gross profit: | | | | |
| Mattress Fabrics | $4,596 | | $5,587 | |
| Upholstery Fabrics | 3,643 | | 5,098 | |
| Total segment gross profit | 8,239 | | 10,685 | |
| Restructuring related charges | - | | (28 | ) (2) |
| | $8,239 | | $10,657 | |
| | | | | |
| Selling, general, and administrative expenses: | | | | |
| Mattress Fabrics | $1,780 | | $2,031 | |
| Upholstery Fabrics | 2,517 | | 2,627 | |
| Total segment selling, general, and administrative expenses | 4,297 | | 4,658 | |
| Unallocated corporate expenses | 832 | | 1,777 | |
| | $5,129 | | $6,435 | |
| | | | | |
| Income from operations: | | | | |
| Mattress Fabrics | $2,816 | | $3,556 | |
| Upholstery Fabrics | 1,126 | | 2,471 | |
| Total segment income from operations | 3,942 | | 6,027 | |
| Unallocated corporate expenses | (832 | ) | (1,777 | ) |
| Restructuring and related charges | (7 | ) (1) | (54 | ) (2) |
| Total income from operations | 3,103 | | 4,196 | |
| Interest expense | (224 | ) | (327 | ) |
| Interest income | 57 | | 52 | |
| Other expense | (28 | ) | (96 | ) |

| | | |
|---|---|---|
| Income before income taxes | $2,908 | $3,825 |

(1) The $7 restructuring charge represents $17 for lease termination and other exit costs offset by a credit of $10 for sales proceeds received on equipment with no carrying value. This restructuring charge relates to the Upholstery Fabrics segment and was recorded in restructuring expense in the fiscal 2011 Consolidated Statement of Net Income.

(2) The $28 restructuring related charge represents other operating costs associated with closed plant facilities. The $54 restructuring and related charge represents $40 for lease termination and other exit costs, $28 for other operating costs associated with closed plant facilities, offset by a credit of $14 for sales proceeds received on equipment with no carrying value. Of this total restructuring and related charge, a charge of $28 was recorded in cost of sales and charge of $26 was recorded in restructuring expense in the 2010 Consolidated Statement of Net Income. This restructuring and related charge relates to the Upholstery Fabrics segment.

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| | Nine months ended | | | |
|---|---|---|---|---|
| (dollars in thousands) | January 30, 2011 | | January 31, 2010 | |
| Net sales: | | | | |
| Mattress Fabrics | $87,244 | | $81,429 | |
| Upholstery Fabrics | 69,199 | | 67,744 | |
| | $156,443 | | $149,173 | |
| Gross profit: | | | | |
| Mattress Fabrics | $15,616 | | $16,245 | |
| Upholstery Fabrics | 9,941 | | 11,175 | |
| Total segment gross profit | 25,557 | | 27,420 | |
| Restructuring related charges | - | | (42 | ) (4) |
| | $25,557 | | $27,378 | |
| Selling, general, and administrative expenses: | | | | |
| Mattress Fabrics | $5,480 | | $5,696 | |
| Upholstery Fabrics | 6,394 | | 6,843 | |
| Total segment selling, general, and administrative expenses | 11,874 | | 12,539 | |
| Unallocated corporate expenses | 2,670 | | 4,177 | |
| | $14,544 | | $16,716 | |
| Income from operations: | | | | |
| Mattress Fabrics | $10,136 | | $10,549 | |
| Upholstery Fabrics | 3,547 | | 4,332 | |
| Total segment income from operations | 13,683 | | 14,881 | |
| Unallocated corporate expenses | (2,670 | ) | (4,177 | ) |
| Restructuring and related credit | - | (3) | 275 | (5) |
| Total income from operations | 11,013 | | 10,979 | |
| Interest expense | (659 | ) | (1,026 | ) |
| Interest income | 144 | | 81 | |
| Other expense | (111 | ) | (714 | ) |
| Income before income taxes | $10,387 | | $9,320 | |

(3) This restructuring activity represents a charge of $23 for lease termination and other exit costs offset by a credit of $13 for employee termination benefits, and a credit of $10 for sales proceeds received on equipment with no carrying value. This activity relates to the Upholstery Fabrics segment.

(4) The $42 restructuring related charge represents a charge of $92 for other operating costs associated with closed plant facilities offset by a credit of $50 for the sale of inventory previously reserved for. This restructuring related charge relates to the Upholstery Fabrics segment.

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(5) The $275 restructuring and related credit represents a credit of $169 for employee termination benefits, a credit of $127 for sales proceeds received on equipment with no carrying value, a credit of $50 for the sale of inventory previously reserved for, a credit of $21 for lease termination and other exit costs, offset by a charge of $92 for other operating costs associated with closed plant facilities. Of this total restructuring and related credit, a credit of $317 was recorded in restructuring credit and charge of $42 was recorded in cost of sales in the 2010 Consolidated Statement of Net Income. This restructuring and related credit relates to the Upholstery Fabrics segment.

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

| (dollars in thousands) | January 30, 2011 | May 2, 2010 |
|---|---|---|
| Segment assets: | | |
| Mattress Fabrics | | |
| Current assets (6) | $ 22,680 | $ 22,307 |
| Assets held for sale | 23 | 34 |
| Non-compete agreements, net | 517 | 843 |
| Goodwill | 11,462 | 11,462 |
| Property, plant and equipment (7) | 28,938 | 26,720 |
| Total mattress fabrics assets | 63,620 | 61,366 |
| Upholstery Fabrics | | |
| Current assets (6) | 20,636 | 23,517 |
| Assets held for sale | 89 | 89 |
| Property, plant and equipment (8) | 912 | 989 |
| Total upholstery fabrics assets | 21,637 | 24,595 |
| Total segment assets | 85,257 | 85,961 |
| Non-segment assets: | | |
| Cash and cash equivalents | 17,259 | 18,295 |
| Short-term investments | 5,518 | 3,023 |
| Income taxes receivable | 407 | 728 |
| Deferred income taxes | 1,618 | 474 |
| Other current assets | 1,521 | 1,698 |
| Property, plant and equipment (9) | 721 | 694 |
| Other assets | 1,576 | 1,725 |
| Total assets | $ 113,877 | $ 112,598 |

| | Nine months ended | |
|---|---|---|
| (dollars in thousands) | January 30, 2011 | January 31, 2010 |
| Capital expenditures (10): | | |
| Mattress Fabrics | $ 5,040 | $ 3,743 |
| Upholstery Fabrics | 170 | 441 |
| Unallocated Corporate | 193 | 247 |

| | | |
|---|---|---|
| Total capital expenditures | $ 5,403 | $ 4,431 |
| Depreciation expense: | | |
| Mattress Fabrics | $ 2,795 | $ 2,620 |
| Upholstery Fabrics | 410 | 422 |
| Total depreciation expense | $ 3,205 | $ 3,042 |

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

(7) The $28.9 million at January 30, 2011, represents property, plant, and equipment of $20.4 million and $8.5 million located in the U.S. and Canada, respectively. The $26.7 million at May 2, 2010, represents property, plant, and equipment of $18.8 million and $7.9 million located in the U.S. and Canada, respectively.

(8) The $912 at January 30, 2011, represents property, plant, and equipment of $719 and $193 located in the U.S. and China, respectively. The $989 at May 2, 2010, represents property, plant, and equipment located in the U.S. of $887 and China of $102, respectively.

(9) The $721 and $694 at January 30, 2011 and May 2, 2010, represent property, plant, and equipment associated with unallocated corporate departments and corporate departments shared by both the mattress and upholstery fabric segments. Property, plant, and equipment associated with corporate are located in the U.S.

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

16. Income Taxes

Effective Income Tax Rate

We recorded income tax expense of $213,000, or 2.1% of income before income tax expense, for the nine-month period ended January 30, 2011, compared to income tax expense of $1.6 million or 16.8% of income before income tax expense, for the nine-month period ended January 31, 2010. Our effective income tax rates for the nine-month periods ended January 30, 2011, and January 31, 2010, were based upon the estimated effective income tax rate applicable for the full year after giving effect to any significant items related specifically to interim periods. The effective income tax rate can be affected over the fiscal year by the mix and timing of actual earnings from our U.S. operations and foreign sources versus annual projections, as well as changes in foreign currencies in relation to the U.S. dollar.

The income tax expense for the nine-month period ended January 30, 2011, is different from the amount obtained by applying our statutory rate of 34% to income before income taxes for the following reasons:

The income tax rate was reduced by 31% for a reduction in our valuation allowance recorded against our net deferred tax assets. Of this 31% reduction in our income tax rate, 19% and 12% pertain to the company's operations located in the U.S. and China, respectively. The 19% reduction in our income tax rate from our U.S. operations is due to the realization of our U.S. net deferred tax assets from ordinary taxable income projected for fiscal 2011. Since the realization of our U.S. net deferred tax assets are from ordinary taxable income in the current fiscal year, its tax effects are included in the computation of the annual effective rate for fiscal 2011. The 12% reduction in our income tax rate from our China operations is due to a change in judgment about the realization of our China net deferred tax assets in future years. Since the realization of our China net deferred tax assets is a result of a change in judgment about future years, we recorded an adjustment of $1.3 million that represents a discrete event in which the full tax effects were recorded for the nine-month period ended January 30, 2011.

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

The income tax rate was reduced by 3% for adjustments made to our Canadian deferred tax liabilities associated with our election to file our Canadian income tax returns in U.S. dollars commencing with our fiscal 2011 tax year. Our Canadian income tax returns were filed in Canadian dollars for fiscal years prior to fiscal 2011. This adjustment totaled $315,000 and represents a discrete event in which the full tax effects were recorded during the nine-month period ended January 30, 2011.

The income tax rate increased 9% for an increase in unrecognized tax benefits. This 9% increase in the income tax rate also includes an income tax benefit of $107,000 or a reduction in the income tax rate of 1% for the subsequent recognition of unrecognized tax benefits. This adjustment of $107,000 represents a discrete event in which the full tax effects were recorded during the nine-month period ended January 30, 2011.

The income tax rate was increased by 0.1% for stock-based compensation and other miscellaneous items.

The income tax expense for the nine-month period ending January 31, 2010, is different from the amount obtained by applying our statutory rate of 34% to income before income taxes for the following reasons:

The income tax rate was reduced by 27% for a reduction in the valuation allowance recorded against substantially all of the company's net deferred tax assets. This reduction in the valuation allowance is primarily due to the U.S. taxable income generated by the repatriation of undistributed earnings from our subsidiaries located in China and the resulting utilization of the U.S. net operating loss carryforwards.

The income tax rate was reduced by 9% for the tax effects of foreign exchange losses on U.S. denominated account balances in which income taxes are paid in Canadian dollars. The Canadian foreign exchange rate in relation to the U.S. dollar has been very volatile due to global economic conditions.

The income tax rate was reduced by 6% for taxable income subject to lower statutory income tax rates in foreign jurisdictions (Canada and China) compared with the statutory income tax rate of 34% for the United States.

The income tax rate increased 14% for the recording of a deferred tax liability for estimated U.S. income taxes that will be payable upon anticipated future repatriation of undistributed earnings from our subsidiaries located in China. During the first quarter of fiscal 2010, we received authorization from the Chinese government to repatriate additional funds that would not be subject to withholding taxes payable in China.

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The income tax rate increased 11% for an increase in income tax reserves for unrecognized tax benefits.

The income tax rate decreased 0.2% for stock-based compensation and other miscellaneous items.

Deferred Income Taxes

In accordance with ASC Topic 740, we evaluate our deferred income taxes each reporting period to determine if a valuation allowance is required. ASC Topic 740 requires that companies assess whether a valuation allowance is necessary based on the consideration of all available positive and negative evidence using a "more likely than not" standard, with significant weight being given to evidence that can be objectively verified compared with evidence that represents future events and therefore, is more subjective. 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.

United States

Our net deferred tax asset regarding our U.S. operations primarily pertains to incurring significant U.S. pre-tax losses over the last several years, with U.S. loss carryforwards totaling $64.0 million at May 2, 2010. Due to the favorable results of our multi-year restructuring process in our upholstery fabric operations and key acquisitions and capital investments made for our mattress fabrics segment, on a cumulative three-year basis ending January 30, 2011, our U.S. operations have earned a marginal pre-tax income (achieved in the second quarter of fiscal 2011). Although our U.S. operations have earned a marginal pre-tax income on a cumulative three-year basis ending January 30, 2011, this did not represent sufficient positive evidence to demonstrate future pre-tax income, due to the significance of the cumulative pre-tax losses that have been incurred over a much longer time period. In addition, the significant uncertainty in the current and expected demand for furniture and mattresses, increasing raw material prices in both our upholstery and mattress businesses, and the prevailing uncertainty in the overall economic climate, has made it very difficult to forecast our financial results associated with our U.S. operations. Based on the significant negative evidence noted above, we maintained our position that it is more-likely-than-not that our U.S. net deferred tax assets will not be fully recovered. As a result, we recorded a full valuation allowance totaling $20.4 million against our U.S. net deferred tax assets as of January 30, 2011.

China

Our net deferred tax asset regarding our China operations primarily pertains to the book versus tax basis difference associated with our China operations' fixed assets. This book versus tax basis difference resulted from our impairment losses and fixed asset write-downs associated with our September 2008 upholstery fabrics restructuring plan. In order for this net deferred tax asset to be realized, our China operations must have sufficient pre-tax income levels to utilize tax depreciation expense each of the next four fiscal years. During the second quarter of fiscal 2011, management assessed both positive and negative evidence and concluded that there was sufficient positive evidence that our net deferred tax assets regarding our China operations will more likely than not be realized. Due to the favorable results from our restructuring activities and profit improvement plan initiated in the second quarter of fiscal 2009, our China operations have been profitable, reporting pre-tax income of $3.6 million for the first two quarters of fiscal 2011 and $7.9 million in fiscal 2010. In addition, our China operations earned pre-tax income of $6.8 million over a cumulative three-year period ending October 31, 2010 (the end of our second quarter of fiscal 2011). As a result of the improvement of our China operations' pre-tax income levels that have been demonstrated over a cumulative period of three-years at the end of our second quarter of fiscal 2011, there was sufficient positive evidence that our China operations can provide sufficient pre-tax income levels to utilize tax depreciation expense each of the next four fiscal years. This improvement continued as our China operations reported pre-tax income of $2.1 million for the third quarter of fiscal 2011. Based on this significant positive evidence, we maintained our position not to record a valuation allowance against our China net deferred tax assets at January 30, 2011. During the second quarter of fiscal 2011 we recognized an income tax benefit of $1.3 million to reduce the valuation allowance of $1.3 million recorded at May 2, 2010 (the beginning of our fiscal year). This $1.3 million income tax benefit was treated as a discrete event in which the full tax effects of this adjustment were recorded in the nine-month period ended January 30, 2011, as it pertained to a change in judgment about future years.

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The recorded valuation allowance of $20.4 million has no effect on our operations, loan covenant compliance, or the possible realization of the U.S. income tax loss carryforwards in the future. If it is determined that it is more-likely-than-not that we will realize any of these U.S. income tax loss carryforwards, an income tax benefit would be recognized at that time.

At January 30, 2011, the current deferred tax asset of $296,000 represents $78,000 and $218,000 from our operations located in Canada and China, respectively. At May 2, 2010, the current deferred tax asset of $150,000 represents $84,000 and $66,000 from our operations located in Canada and China, respectively. At January 30, 2011, the non-current deferred tax asset of $1.3 million pertains to our operations located in China. At May 2, 2010, the non-current deferred tax asset of $324,000 pertains to our operations located in China. At January 30, 2011, the non-current deferred tax liability of $622,000 pertains to our operations located in Canada. At May 2, 2010, the non-current deferred tax liability of $982,000 pertains to our operations located in Canada.

Uncertainty In Income Taxes

At January 30, 2011, we had $11.1 million of total gross unrecognized tax benefits, of which $3.9 million represents the amount of gross unrecognized tax benefits that, if recognized, would favorably affect the income tax rate in future periods. Of the $11.1 million in gross unrecognized tax benefits as of January 30, 2011, $7.2 million were classified as net non-current deferred income taxes and $3.9 million were classified as income taxes payable –long-term in the accompanying consolidated balance sheets.

We estimate that the amount of gross unrecognized tax benefits will increase by approximately $1.5 million for fiscal 2011. This increase primarily relates to double taxation under applicable tax treaties with foreign tax jurisdictions.

17. Statutory Reserves

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

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The transfer to this reserve must be made before distributions of any dividend to shareholders. As of January 30, 2011, the company's statutory surplus reserve was $2.7 million, representing 10% of accumulated earnings and profits determined in accordance with PRC accounting rules and regulations. The surplus reserve fund is non-distributable other than during liquidation and can be used to fund previous years' losses, if any, and may be utilized for business expansion or converted into share capital by issuing new shares to existing shareholders in proportion to their shareholding or by increasing the par value of the shares currently held by them provided that the remaining reserve balance after such issue is not less than 25% of the registered capital.

Our subsidiaries located in China can transfer funds to the parent company with the exception of the statutory surplus reserve of $2.7 million to assist with debt repayment, capital expenditures, and other expenses of the company's business.

18. Restructuring

The following summarizes the fiscal 2011 activity in the restructuring accrual (dollars in thousands):

| (dollars in thousands) | Balance, May 2, 2010 | Employee Termination Benefit Adjustments | Employee Termination Benefit Payments Net of Cobra Premiums | Lease Termination and Other Exit Cost Adjustments | Lease Termination and Other Exit Cost Receipts (Payments) | Balance January 30, 2011 |
|---|---|---|---|---|---|---|
| December 2006 Upholstery fabrics (1) | $86 | (13) | - | (43) | 37 | 67 |
| Fiscal 2003 Culp Decorative fabrics (2) | 238 | - | - | 66 | (300) | 4 |
| Totals | $324 | $ (13) | $ - | $ 23 | $ (263) | $ 71 |

(1) The restructuring accrual at January 30, 2011, represents lease termination and other exit costs of $67. The restructuring accrual at May 2, 2010, represents employee termination benefits and lease termination and other exit costs of $13 and $73, respectively.
(2) The restructuring accrual at January 30, 2011 and May 2, 2010 represents lease termination and other exit costs of $4 and $238, respectively.

The following summarizes restructuring and related charges incurred for the nine-month period ending January 30, 2011 (dollars in thousands):

| | Operating Costs on Closed | Lease Termination and Other | Write-Downs | Inventory | Asset Movement | Employee Termination | Sales Proceeds from Equipment With No |
|---|---|---|---|---|---|---|---|

| (dollars in thousands) | Facilities | Exit Costs | of Buildings and Equipment | Markdowns | Costs | Benefits | Carrying Value | Total |
|---|---|---|---|---|---|---|---|---|
| December 2006 Upholstery fabrics (3) | $ - | (43 ) | - | - | - | (13 ) | (10 ) | $ (66 ) |
| Fiscal 2003 Upholstery fabrics (4) | - | 66 | - | - | - | - | - | 66 |
| Totals | $ - | $ 23 | $ - | $ - | $ - | $ (13 ) | $ (10 ) | $ - |

(3) This $66 credit was recorded in the restructuring activity in the 2011 Consolidated Statement of Net Income.

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(4) This $66 charge was recorded in the restructuring activity in the 2011 Consolidated Statement of Net Income.

The following summarizes restructuring and related charges incurred for the nine-month period ending January 31, 2010 (dollars in thousands):

| (dollars in thousands) | Operating Costs on Closed Facilities | Lease Termination and Other Exit Costs | Write-Downs of Buildings and Equipment | Inventory Markdowns | Asset Movement Costs | Employee Termination Benefits | Sales Proceeds from Equipment With No Carrying Value | Total |
|---|---|---|---|---|---|---|---|---|
| September 2008 Upholstery fabrics (5) | $ - | $ (101 ) | $ - | $ - | $ - | $ - | $ - | $ (101 ) |
| December 2006 Upholstery fabrics (6) | 92 | 13 | - | (50 ) | - | (169 ) | (127 ) | (241 ) |
| Fiscal 2003 Upholstery fabrics (7) | - | 67 | - | - | - | - | - | 67 |
| Totals | $ 92 | $ (21 ) | $ - | $ (50 ) | $ - | $ (169 ) | $ (127 ) | $ (275 ) |

(5) This $101 credit was recorded in restructuring credit in the 2010 Consolidated Statement of Net Income.
(6) Of this $241 credit, a charge of $42 was recorded in cost of sales and a credit of $283 was recorded in restructuring credit in the 2010 Consolidated Statement of Net Income.
(7) This $67 charge was recorded in restructuring credit in the 2010 Consolidated Statement of Net Income.

19. Commitments and Contingencies

Chattanooga, TN Lease Agreement

We leased a manufacturing facility in Chattanooga, Tennessee from Joseph E. Proctor d/b/a Jepco Industrial Warehouses (the “Landlord’) for a term of 10 years. This lease expired on April 30, 2008. The company closed this facility approximately eight years ago and had not occupied the facility except to provide supervision and security. A $1.4 million lawsuit was filed by the Landlord on April 10, 2008, in the Circuit Court for Hamilton County Tennessee to collect certain amounts due under the lease. During the third quarter of fiscal 2011, this lawsuit was concluded, which did not have a material impact on the company's results of operations and financial condition.

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Chromatex Environmental Claim

A lawsuit was filed against us and other defendants (Chromatex, Inc., Rossville Industries, Inc., Rossville Companies, Inc. and Rossville Investments, Inc.) on February 5, 2008 in United States District Court for the Middle District of Pennsylvania. The plaintiffs are Alan Shulman, Stanley Siegel, Ruth Cherenson as Personal Representative of Estate of Alan Cherenson, and Adrienne Rolla and M.F. Rolla as Executors of the Estate of Joseph Byrnes. The plaintiffs were partners in a general partnership that formerly owned a manufacturing plant in West Hazleton, Pennsylvania (the "Site"). Approximately two years after this general partnership sold the Site to defendants Chromatex, Inc. and Rossville Industries, Inc. we leased and operated the Site as part of our Rossville/Chromatex division. The lawsuit involves court judgments that have been entered against the plaintiffs and against defendant Chromatex, Inc. requiring them to pay costs incurred by the United States Environmental Protection Agency ("USEPA") responding to environmental contamination at the Site, in amounts approximating $8.6 million, plus unspecified future environmental costs. Neither USEPA nor any other governmental authority has asserted any claim against the company on account of these matters. The plaintiffs seek contribution from the company and other defendants and a declaration that the company and the other defendants are responsible for environmental response costs under environmental laws and certain agreements. The plaintiffs also assert that we tortiously interfered with contracts between them and other defendants in the case and diverted assets to prevent the plaintiffs from being paid monies owed to them. We do not believe we have any liability for the matters described in this litigation and intend to defend ourselves vigorously. In addition, we have an indemnification agreement with certain other defendants in the litigation pursuant to which the other defendants agreed to indemnify us for any damages we incur as a result of the environmental matters that are subject of this litigation, although it is unclear whether the indemnitors have significant assets at this time. For these reasons, no reserve has been recorded.

Overall

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

Purchase Commitments

At January 30, 2011, the company had open purchase commitments to acquire equipment with regards to its mattress fabrics segment totaling $295,000.

CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING INFORMATION

This report and the exhibits attached hereto contain statements that may be deemed “forward-looking statements” within the meaning of the federal securities laws, including the Private Securities Litigation Reform Act of 1995 (Section 27A of the Securities Act of 1933 and Section 27A of the Securities and Exchange Act of 1934). Such statements are inherently subject to risks and uncertainties. Further, forward looking statements are intended to speak only as of the date on which they are made. 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 derivativ and include but are not limited to statements about expectations for the company’s future operations or success, sales, gross profit margins, operating income, SG&A, income taxes, capital expenditures or other expenses, and earnings, as well as any statements regarding future economic or industry trends or future developments. Factors that could influence the matters discussed in such statements include the level of housing starts and sales of existing homes, consumer confidence, trends in disposable income, increases in utility and energy costs, and general economic conditions. Decreases in these economic indicators could have a negative effect on the company’s 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 the company adversely. In addition, changes in consumer preferences for various categories of furniture and bedding coverings, as well as changes in costs to produce such products (including import duties and quotas or other import costs) can have a significant effect on demand for the company’s products. Changes in the value of the U.S. dollar versus other currencies can affect the company’s financial results because a significant portion of the company’s operations are located outside the United States. Strengthening of the U.S. dollar against other currencies could make the company’s 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 the company’s sales of products produced in those countries. Further, economic and political instability in international areas could affect the company’s operations or sources of goods in those areas, as well as demand for the company’s products in international markets. Further information about these factors, as well as other factors that could affect the company’s future operations or financial results and the matters discussed in forward-looking statements are included in Item 1A “Risk Factors” section in the company’s Form 10-K filed with the Securities and Exchange Commission on July 15, 2010 for the fiscal year ended May 2, 2010.

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

### Results of Operations

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

### General

Our fiscal year is the 52 or 53 week period ending on the Sunday closest to April 30. The nine months ended January 30, 2011, and January 30, 2010, represent 39 week periods, respectively. Our operations are classified into two business segments: mattress fabrics and upholstery fabrics. The mattress fabrics segment manufacturers, sources and sells fabrics primarily to bedding manufacturers. The upholstery fabrics segment sources, manufactures and sells fabrics primarily to residential and commercial (contract) furniture manufacturers. We believe that Culp is the largest marketer of mattress fabrics in North America, and one of the largest marketers of upholstery fabrics for furniture in North America, both measured by total sales.

We evaluate the operating performance of our segments based upon income (loss) from operations before restructuring and related charges or credits, certain unallocated corporate expenses, and other non-recurring items. Cost of sales in both segments include costs to manufacture or source our products, including costs such as raw material and finished goods purchases, direct and indirect labor, overhead and incoming freight charges. Unallocated corporate expenses represent primarily compensation and benefits for certain executive officers and all costs related to being a public company. Segment assets include assets used in operations of each segment and primarily consist of accounts receivable, inventories, and property, plant, and equipment. The mattress fabrics segment also includes assets held for sale, goodwill and non-compete agreements associated with certain acquisitions in its segment assets. The upholstery fabrics segment also includes assets held for sale in its segment assets.

### Executive Summary

Net sales were $51.7 million for the third quarter of fiscal 2011, a decrease of 4% compared with $54.0 million for the third quarter of fiscal 2010. Net sales were $156.4 million for the nine months ended January 30, 2011, an increase of 5% compared with $149.2 million for the nine months ended January 30, 2010. Our increase in net sales on a year-to-date basis was primarily driven by strong consumer demand in the first quarter of fiscal 2011 for both bedding and furniture products. Net sales in the first quarter of fiscal 2011 were $55.9 million, an increase of 23% compared with the first quarter of fiscal 2010. However, net sales in the second and third quarters of fiscal 2011 were significantly lower than the first quarter and totaled $48.9 million and $51.7 million, respectively. The decreases in net sales in our second and third quarters reflect a much weaker U.S. retail environment compared with the first quarter of fiscal 2011. We believe this weaker U.S. retail environment is a result of the persistent uncertainties surrounding the economic outlook, a continued weak housing market, and high unemployment. This trend is expected to continue into the company's fourth quarter of fiscal 2011.

Income before income taxes was $2.9 million for the third quarter of fiscal 2011 a decrease of 24% compared with $3.8 million for the third quarter of fiscal 2010. Although income before income taxes declined in the third quarter of fiscal 2011 compared to the third quarter of fiscal 2010, we are pleased with our results given the current economic challenges in the U.S. and increasing raw material costs the company is now facing in both business segments.

Income before income taxes was $10.4 million for the nine months ended January 30, 2011, an increase of 11% compared with $9.3 million for the nine months ended January 31, 2010. Our increase in income before income taxes on a year-to-date basis was driven by higher sales in the first quarter of fiscal 2011 and the benefits of a leaner and more cost-efficient operating platform. However, the year-to-date and third quarter results also reflect a weaker U.S. retail environment compared to the first quarter of fiscal 2011, rising raw material costs, and increased competitive customer pricing pressure in both our business segments. These trends are expected to continue into the company's fourth quarter of fiscal 2011. To partially offset these higher costs, we have announced price increases that will be in effect for most of our fourth quarter, but these price increases are not expected to fully restore our profit margins.

Net income was $2.4 million, or $0.18 per diluted share, in the third quarter of fiscal 2011 compared with $3.0 million, or $0.23 per diluted share, in the third quarter of fiscal 2010. Net income for the third quarter of fiscal 2011 includes income tax expense of $483,000 and net income for the third quarter of fiscal 2010 includes income tax expense of $825,000. Net income was $10.2 million, or $0.77 per diluted share, for the nine months ended January 30, 2011, compared with $7.8 million, or $0.60 per diluted share, for the nine months ended January 31, 2010. Net income for the nine months ended January 30, 2011 includes income tax expense of $213,000 and net income for the nine months ended January 31, 2010, includes income tax expense of $1.6 million. Income tax expense of $213,000 for the nine months ended January 30, 2011 includes a $1.3 million non-cash reversal during the second fiscal quarter of the company's valuation allowance associated with its China operations.

Despite the ongoing economic uncertainties, we have maintained a strong financial position. Our cash and cash equivalents and short-term investment balance totaled $22.8 million at January 30, 2011 compared with $21.3 million at May 2, 2010. Our cash and cash equivalents and short-term investment balance of $22.8 million exceeded our total debt (current maturities of long-term debt and long-term debt) of $11.6 million and represents 30% of shareholders equity. Our next major scheduled long-term debt principal payment of $2.2 million is not due until August 2011. As of January 30, 2011 our lines of credit totaling $12.5 million had no outstanding balances. All of our long-term debt and line of credit agreements are unsecured. Our strong financial position is enabling us to pursue an aggressive growth strategy as noted below during these challenging economic conditions.

The company recently disclosed two initiatives in Europe as part of its continuing effort to look for new market opportunities outside the U.S. The first is the formation of a wholly-owned subsidiary in Poland, called Culp Europe. We plan for this operation to sell and distribute upholstery fabrics and make and sell cut and sewn kits in Europe, using fabrics sourced from our China platform, U.S. operations, and possibly directly from outside suppliers. Sales activities for Culp Europe are expected to begin during the fourth quarter of fiscal 2011.

In addition, we have entered into a non-binding letter of intent to form a new company in the United Kingdom that would source and market upholstery fabrics there. The new company, to be known as Culp U.K., would be a joint venture with Flameproofings Ltd. of Manchester, England. Flameproofings' primary business is flame retardant (FR) coating for fabrics, but it also has a small upholstery fabrics business. Under the terms of the letter of intent, Culp would partner with Flameproofings to own and operate this business and build an upholstery sourcing, distribution and marketing operation based in Manchester to sell fabrics throughout the United Kingdom. Although the formation of this venture remains subject to negotiation of definitive agreements, current plans call for Culp U.K. to start operations during the first quarter of our 2012 fiscal year.

The following tables set forth the company's statement of operations by segment for the three and nine months ended January 30, 2011, and January 31, 2010.

CULP, INC.
STATEMENTS OF OPERATIONS BY SEGMENT
FOR THE THREE MONTHS ENDED JANUARY 30, 2011 AND JANUARY 31, 2010
(Unaudited)

(Amounts in thousands)

| | THREE MONTHS ENDED | | | | |
|---|---|---|---|---|---|
| | Amounts | | | Percent of Total Sales | |
| Net Sales by Segment | January 30, 2011 | January 31, 2010 | % Over (Under) | January 30, 2011 | January 31, 2010 |
| Mattress Fabrics | $ 27,991 | 26,953 | 3.9 % | 54.2 % | 49.9 % |
| Upholstery Fabrics | 23,661 | 27,027 | (12.5 ) % | 45.8 % | 50.1 % |
| Net Sales | $ 51,652 | 53,980 | (4.3 ) % | 100.0 % | 100.0 % |
| Gross Profit by Segment | | | | Gross Profit Margin | |
| Mattress Fabrics | $ 4,596 | 5,587 | (17.7 ) % | 16.4 % | 20.7 % |
| Upholstery Fabrics | 3,643 | 5,098 | (28.5 ) % | 15.4 % | 18.9 % |
| Subtotal | 8,239 | 10,685 | (22.9 ) % | 16.0 % | 19.8 % |
| Restructuring related charges | - | (28 ) (2 ) | (100.0 ) % | 0.0 % | (0.1 ) % |
| Gross Profit | $ 8,239 | 10,657 | (22.7 ) % | 16.0 % | 19.7 % |
| Selling, General and Administrative expenses by Segment | | | | Percent of Sales | |
| Mattress Fabrics | $ 1,780 | 2,031 | (12.4 ) % | 6.4 % | 7.5 % |
| Upholstery Fabrics | 2,517 | 2,627 | (4.2 ) % | 10.6 % | 9.7 % |
| Unallocated Corporate expenses | 832 | 1,777 | (53.2 ) % | 1.6 % | 3.3 % |
| Selling, General and Administrative expenses | $ 5,129 | 6,435 | (20.3 ) % | 9.9 % | 11.9 % |
| Operating Income (loss) by Segment | | | | Operating Income (Loss) Margin | |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Mattress Fabrics | $ 2,816 | | 3,556 | | (20.8 ) % | 10.1 % | 13.2 % |
| Upholstery Fabrics | 1,126 | | 2,471 | | (54.4 ) % | 4.8 % | 9.1 % |
| Unallocated corporate expenses | (832 ) | | (1,777 ) | | (53.2 ) % | (1.6 ) % | (3.3 ) % |
| Subtotal | 3,110 | | 4,250 | | (26.8 ) % | 6.0 % | 7.9 % |
| Restructuring and related charges | (7 ) | (1 ) | (54 ) | (2 ) | (87.0 ) % | (0.0 ) % | (0.1 ) % |
| Operating income | $ 3,103 | | 4,196 | | (26.0 ) % | 6.0 % | 7.8 % |

Depreciation by Segment

| | | | |
|---|---|---|---|
| Mattress Fabrics | $ 974 | 842 | 15.7 % |
| Upholstery Fabrics | 134 | 149 | (10.1 ) % |
| Subtotal | $ 1,108 | 991 | 11.8 % |

Notes:

(1) The $7 restructuring charge represents $17 for lease termination and other exit costs offset by a credit of $10 for sales proceeds received on equipment with no carrying value.

(2) The $28 restructuring related charge represents other operating costs associated with closed plant facilities. The $54 restructuring and restructuring related charge represents $40 for lease termination and other exit costs, $28 for other operating costs associated with closed plant facilities, offset by a credit of $14 for sales proceeds received on equipment with no carrying value.

CULP, INC.
STATEMENTS OF OPERATIONS BY SEGMENT
FOR THE NINE MONTHS ENDED JANUARY 30, 2011 AND JANUARY 31, 2010
(Unaudited)
(Amounts in thousands)

| | NINE MONTHS ENDED | | | | |
|---|---|---|---|---|---|
| | Amounts | | | Percent of Total Sales | |
| Net Sales by Segment | January 30, 2011 | January 31, 2010 | % Over (Under) | January 30, 2011 | January 31, 2010 |
| Mattress Fabrics | $ 87,244 | 81,429 | 7.1 % | 55.8 % | 54.6 % |
| Upholstery Fabrics | 69,199 | 67,744 | 2.1 % | 44.2 % | 45.4 % |
| Net Sales | $ 156,443 | 149,173 | 4.9 % | 100.0 % | 100.0 % |
| Gross Profit by Segment | | | | Gross Profit Margin | |
| Mattress Fabrics | $ 15,616 | 16,245 | (3.9 ) % | 17.9 % | 19.9 % |
| Upholstery Fabrics | 9,941 | 11,175 | (11.0 ) % | 14.4 % | 16.5 % |
| Subtotal | 25,557 | 27,420 | (6.8 ) % | 16.3 % | 18.4 % |
| Restructuring related charges | - | (42 ) (2 ) | (100.0 ) % | 0.0 % | (0.0 ) % |
| Gross Profit | $ 25,557 | 27,378 | (6.7 ) % | 16.3 % | 18.4 % |
| Selling, General and Administrative expenses by Segment | | | | Percent of Sales | |
| Mattress Fabrics | $ 5,480 | 5,696 | (3.8 ) % | 6.3 % | 7.0 % |
| Upholstery Fabrics | 6,394 | 6,843 | (6.6 ) % | 9.2 % | 10.1 % |
| Unallocated Corporate expenses | 2,670 | 4,177 | (36.1 ) % | 1.7 % | 2.8 % |
| Subtotal | $ 14,544 | 16,716 | (13.0 ) % | 9.3 % | 11.2 % |
| Operating Income (loss) by Segment | | | | Operating Income (Loss) Margin | |
| Mattress Fabrics | $ 10,136 | 10,549 | (3.9 ) % | 11.6 % | 13.0 % |
| Upholstery Fabrics | 3,547 | 4,332 | (18.1 ) % | 5.1 % | 6.4 % |

| | | | | | |
|---|---|---|---|---|---|
| Unallocated corporate expenses | (2,670) | (4,177) | (36.1) % | (1.7) % | (2.8) % |
| Subtotal | 11,013 | 10,704 | 2.9 % | 7.0 % | 7.2 % |
| | | | | | |
| Restructuring and related credit | - (1) | 275 (3) | (100.0) % | 0.0 % | 0.2 % |
| | | | | | |
| Operating income | $ 11,013 | 10,979 | 0.3 % | 7.0 % | 7.4 % |
| | | | | | |
| Depreciation by Segment | | | | | |
| | | | | | |
| Mattress Fabrics | $ 2,795 | 2,620 | 6.7 % | | |
| Upholstery Fabrics | 410 | 422 | (2.8) % | | |
| Subtotal | $ 3,205 | 3,042 | 5.4 % | | |

Notes:

(1) Restructuring activity represents a charge of $23 for lease termination and other exit costs offset by a credit of $13 for employee termination benefits, and a credit of $10 for sales proceeds received on equipment with no carrying value.

(2) The $42 restructuring related charge represents a charge of $92 for operating costs associated with closed plant facilities offset by a credit of $50 for the sale of inventory previously reserved for.

(3) The $275 restructuring and related credit represents a credit of $169 for employee termination benefits, a credit of $127 for sales proceeds received on equipment with no carrying value, a credit of $50 for the sale of inventory previously reserved for, a credit of $21 for lease termination and other exit costs, offset by a charge of $92 for other operating costs associated with closed plant facilities.

Three and Nine months ended January 30, 2011 compared with the Three and Nine Months ended January 31, 2010

Mattress Fabrics Segment

Net Sales

Net sales were $28.0 million for the third quarter of fiscal 2011, an increase of 4% compared with $27.0 million for the third quarter of fiscal 2010. These results were achieved in spite of the discontinuance of a product line in the prior year period. Continuing product lines increased 8% in the third quarter of fiscal 2011 compared with the third quarter of fiscal 2010.

Net sales were $87.2 million for the nine months ended January 30, 2011, an increase of 7% compared with $81.4 million for the nine months ended January 31, 2010. This increase in net sales on a year-to-date basis reflects the strong consumer demand in the bedding industry in the first quarter of this fiscal year compared to the same period a year ago and the closure of a key competitor in late calendar 2009. Net sales in the first quarter of fiscal 2011 were $30.9 million, an increase of 18% compared with the first quarter of fiscal 2010. However, net sales in the second and third quarters of fiscal 2011 were lower than the first quarter and totaled $28.3 million and $28.0 million, respectively. The decreases in net sales in our second and third quarters reflect weaker consumer demand in the bedding industry compared with the first quarter of fiscal 2011. This trend is expected to continue into the fourth quarter of fiscal 2011.

Gross Profit and Operating Income

Gross profit was $4.6 million for the third quarter of fiscal 2011, or 16% of net sales, compared with $5.6 million, or 21% of net sales for the third quarter of fiscal 2010. Selling, general, and administrative (SG&A) expenses for the third quarter of fiscal 2011 were $1.8 million compared with $2.0 million for the third quarter of fiscal 2010. Operating income was $2.8 million for the third quarter of fiscal 2011 compared with $3.6 million for the third quarter of fiscal 2010. Operating margins were 10% and 13% of net sales in the third quarter of fiscal 2011 and 2010, respectively.

Gross profit was $15.6 million for the nine months ended January 30, 2011, or 18% of net sales, compared with $16.2 million, or 20% of net sales for the nine months ended January 31, 2010. SG&A expenses were $5.5 million for the nine months ended January 30, 2011 compared with $5.7 million for the nine months ended January 31, 2010. Operating income was $10.1 million for the nine months ended January 30, 2011, compared with $10.5 million for the nine months ended January 31, 2010. Operating margins were 11.6% and 13.0% of net sales for the nine month periods ending January 30, 2011 and January 31, 2010, respectively.

Although net sales increased 4% in the third quarter of fiscal 2011 compared with the third quarter of fiscal 2010, gross profit and operating income decreased by 18% and 21%, respectively. In addition, gross profit and operating income decreased by 4% for the nine month period ending January 30, 2011, compared with the 2010 period, despite net sales increasing 7% for the same year over year periods. This trend in decreased profitability was primarily due to increased competitive customer pricing pressure and higher raw material costs experienced in the second and third quarters of fiscal 2011. These trends are expected to continue into the company’s fourth quarter of fiscal 2011. To partially offset these higher costs, we have announced price increases that will be in effect for most of our fourth quarter, but these price increases are not expected to fully restore our profit margins.

During fiscal 2011, we completed a multi-year expansion of our mattress fabrics business which included the expansion of internal production capacity for our knitted fabrics product line, our fastest growing product category, and the completion of an energy initiative in our Canadian operation that will have an environmental benefit and reduce future operating costs. The total investment for this multi-year expansion totaled $45 million, which included

$25 million in capital expenditures and $20 million spent for two successful acquisitions. As a result of these investments, we are well positioned with a large and modern vertically integrated manufacturing platform in the two major product categories of the mattress fabrics industry and have been able to substantially improve our supply logistics from pattern inception to fabric delivery.

Segment assets

Segment assets consist of accounts receivable, inventory, assets held for sale, non-compete agreements associated with the certain acquisitions, goodwill, and property, plant, and equipment.

As of January 30, 2011, accounts receivable and inventory totaled $22.7 million compared with $22.3 million at May 2, 2010.

As of January 30, 2011, property, plant and equipment totaled $28.9 million compared with $26.7 million at May 2, 2010. The $28.9 million at January 30, 2011 represents property, plant, and equipment of $20.4 million and $8.5 million located in the U.S. and Canada, respectively. The $26.7 million at May 2, 2010, represents property, plant, and equipment of $18.8 million and $7.9 million located in the U.S. and Canada, respectively. The increase in property, plant, and equipment during fiscal 2011 represents capital expenditures of $5.0 million for the capital investment programs noted above, offset by depreciation of $2.8 million.

As of January 30, 2011, and May 2, 2010, the carrying value of the segment's goodwill was $11.5 million. As of January 30, 2011, and May 2, 2010, the carrying values of the non-compete agreements were $517,000 and $843,000, respectively. The decrease in the carrying values of these non-compete agreements during fiscal 2011 primarily represents amortization expense. At January 30, 2011, and May 2, 2010, assets held for sale totaled $23,000 and $34,000, respectively

Upholstery Fabrics Segment

Net Sales

Upholstery fabric net sales (which include both fabric and cut and sewn kits) for the third quarter of fiscal 2011 were $23.7 million, a 13% decrease compared with $27.0 million in the third quarter of fiscal 2010. Net sales of upholstery fabrics produced outside our U.S. manufacturing operations were $20.7 million in the third quarter of fiscal 2011, a 12% decrease compared with $23.5 million in the third quarter of fiscal 2010. Net sales of U.S. produced upholstery fabrics were $2.9 million in the third quarter of fiscal 2011, a decrease of 18% from $3.6 million in the third quarter of fiscal 2010. These decreases in net sales reflect weaker U.S. consumer demand for furniture. This trend is expected to continue into the fourth quarter of fiscal 2011.

Upholstery fabric net sales for the nine months ended January 30, 2011 were $69.2 million, a 2% increase compared with $67.7 million for the nine months ended January 31, 2010. Net sales of upholstery fabrics produced outside our U.S. manufacturing operations were $60.0 million for the nine months ended January 30, 2011 a 4% increase compared with $57.5 million for the nine months ended January 31, 2010. Net sales of U.S. produced upholstery fabrics were $9.2 million for the nine months ended January 30, 2011, a decrease of 10% from $10.3 million for the nine months ended January 31, 2010.

Our increase of 2% in net sales on a year-to-date basis was primarily driven by a stronger consumer demand in the first quarter of fiscal 2011 compared to the same period a year ago, offset by the discontinuation of certain U.S. products in fiscal 2010, and a significant increase in the provision for returns, allowances, and discounts in fiscal 2010 that did not recur in fiscal 2011. Net sales in the first quarter of fiscal 2011 were $25.0 million, an increase of 30% compared with the first quarter of fiscal 2010. However, net sales in the second and third quarters of fiscal 2011 were lower than the first quarter and totaled $20.5 million and $23.7 million, respectively. The decreases in net sales in the second and third quarters reflect weaker U.S. consumer demand for furniture in comparison to the first quarter of fiscal 2011. This trend is expected to continue into the company's fourth quarter of fiscal 2011.

Our upholstery fabric net sales continue to be driven by our operations located in China, accounting for 88% and 87% of upholstery fabric net sales in the third quarter of fiscal 2011 and for the nine months ended January 30, 2011, respectively. Although most of our China produced products have traditionally been sold to our U.S. customers, we have expanded our sales to the local China market. The net sales in the local China market to date have been small, but we are encouraged with the favorable customer response to our products and the ability to leverage these opportunities from our China platform.

European Sales and Marketing Initiatives

We have recently disclosed two initiatives in Europe as part of its continuing effort to look for new market opportunities outside the U.S.

Culp has entered into a non-binding letter of intent to form a new company in the United Kingdom that would source and market upholstery fabrics there. The new company, to be known as Culp U.K., would be a joint venture with Flameproofings Ltd. of Manchester, England. Flameproofings' primary business is flame retardant (FR) coating for fabrics, but it also has a small upholstery fabrics business. Under the terms of the letter of intent, Culp would team with Flameproofings to own and operate this business and build an upholstery sourcing, distribution and marketing operation based in Manchester to sell fabrics throughout the United Kingdom. In connection with the formation of Culp U.K., Flameproofings would exit the residential upholstery (face fabrics) business. Current plans call for Culp U.K. to start operations during the first quarter of Culp's 2012 fiscal year. Prior to that time, we expect to negotiate definitive agreements for the formation of Culp U.K. and to set up a warehouse, showroom and distribution facility from which the business would operate. Once operational, we expect Culp U.K. to source fabrics primarily from Culp's China platform, but also from Culp's U.S. operations and directly from other suppliers. Culp U.K. would obtain FR coating services from Flameproofings, which will ensure compliance with unique British FR requirements. The letter of intent calls for Culp U.K. to be owned 51% by Culp and 49% by Flameproofings, with Culp providing up to 100,000 initial equity capital to start the venture, and possibly loans for future capital needs. The consumation of this transaction remains subject to negotiation of definitive agreements and other conditions.

We have recently formed a new wholly-owned subsidiary in Poland, called Culp Europe. We plan for this operation to sell and distribute upholstery fabrics and make and sell cut and sewn kits in Europe, using fabrics sourced primarily from our China platform, but also from the company's U.S. operations and possibly directly from outside suppliers. Our sales and marketing efforts in Europe also include a program for shipping containers of fabric and cut and sewn kits directly from our operations in China to customers in Europe. Sales activities for Culp Europe are expected to begin during the fourth quarter of fiscal 2011.

We expect these operations to work together to serve the marketplace in Europe because many furniture manufacturers in Poland also sell furniture into the U.K., and a number of U.K. retailers and manufacturers supplement their U.K. furniture production with sourcing from Poland and other Eastern European countries. The initial focus for both of these initiatives is on upholstery fabrics, but once operational we plan to explore the potential for also selling mattress fabrics in Europe from these platforms.

Gross Profit and Operating Income

The upholstery fabrics segment reported a gross profit of $3.6 million, or 15% of net sales, in the third quarter of fiscal 2011 compared with $5.1 million, or 19% of net sales, in the third quarter of fiscal 2010. SG&A expenses for the third quarter of fiscal 2011 were $2.5 million compared with $2.6 million in the third quarter of fiscal 2010. Operating income was $1.1 million in the third quarter of fiscal 2011 compared with operating income of $2.5 million in the third quarter of fiscal 2010. Operating margins were 5% and 9% of net sales in the third quarter of fiscal 2011 and 2010, respectively.

The upholstery fabrics segment reported a gross profit of $9.9 million, or 14.4%, of net sales for the nine months ended January 30, 2011 compared with $11.2 million, or 16.5% of net sales, for the nine months ended January 31, 2010. SG&A expenses for the nine months ended January 30, 2011 were $6.4 million compared with $6.8 million for the nine months ended January 31, 2010. Operating income was $3.5 million for the nine months ended January 30, 2011 compared with $4.3 million for the nine months ended January 31, 2010. Operating margins were 5.1% and 6.4% of net sales for the nine month periods ending January 30, 2011 and January 31, 2010, respectively.

Although net sales increased 2% for the nine months ended January 30, 2011 compared with the nine months ended January 31, 2010, gross profit and operating income decreased 11% and 18%, respectively. In addition, gross profit and operating income decreased 29% and 54% in the third quarter of fiscal 2011 compared with the third quarter of fiscal 2010. This reduction in profitability is primarily the result of rising raw material costs in addition to the lower sales volume experienced in the second and third quarters of fiscal 2011. These trends are expected to continue into the company's fourth quarter of fiscal 2011. In order to partially offset these raw material price increases, we implemented customer price increases that will be in effect for most of the fourth quarter, but these price increases are not expected to fully restore our profit margins.

Segment Assets

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

As of January 30, 2011, accounts receivable and inventory totaled $20.6 million compared to $23.5 million at May 2, 2010. At January 30, 2011 and May 2, 2010, assets held for sale totaled $89,000.

As of January 30, 2011, property, plant, and equipment totaled $912,000 compared with $989,000 at May 2, 2010. The $912,000 at January 30, 2011 represents property, plant, and equipment of $719,000 and $193,000 located in the U.S. and China, respectively. The $989,000 at May 2, 2010 represents property, plant, and equipment of $887,000 and $102,000 located in the U.S. and China, respectively.

Other Income Statement Categories

Selling, General and Administrative Expenses

SG&A expenses for the company as a whole were $5.1 million for the third quarter of fiscal 2011 compared with $6.4 million for the third quarter of fiscal 2010. SG&A expenses were 10% of net sales in the third quarter of fiscal 2011 compared with 12% of net sales in the third quarter of fiscal 2010. SG&A expenses for the company as whole were $14.5 million for the nine months ended January 30, 2011 compared with $16.7 million for the nine months ended January 31, 2010. SG&A expenses were 9% of net sales for the nine months ended January 30, 2011 compared with 11% for the nine months ended January 31, 2010. These decreases in SG&A expenses primarily pertain to (i) a decrease in stock-based compensation expense which reflects a decrease in stock-based awards and the company's stock price, (ii) a decrease in incentive bonus accruals reflecting weaker financial results in relation to pre-established performance targets, and (iii) a decrease in bad debt expense reflecting the decrease in our consolidated accounts receivable balance, as well as management's assessment of estimated credit exposures within its accounts receivable portfolio.

Interest Expense (Income)

Interest expense for the third quarter of fiscal 2011 was $224,000 compared to $327,000 for the third quarter of fiscal 2010. Interest expense for the nine months ended January 30, 2011 was $659,000 compared to $1.0 million for the nine months ended January 31, 2010. This trend reflects lower outstanding balances in the company's long-term debt.

Interest income was $57,000 for the third quarter of fiscal 2011 compared to $52,000 for the third quarter of fiscal 2010. Interest income was $144,000 for the nine months ended January 30, 2011 compared to $81,000 for the nine months ended January 31, 2010. Our increase in interest income is primarily due to higher cash and cash equivalent and short-term investment balances during fiscal 2011 compared with fiscal 2010 and a higher rate of return in fiscal 2011 on short-term investments that were not acquired until the third quarter of fiscal 2010.

Other Expense

Other expense for the third quarter of fiscal 2011 was $28,000 compared with $96,000 for the third quarter of fiscal 2010. Other expense for the nine months ended January 30, 2011 was $111,000 compared with $714,000 for the nine months ended January 31, 2010. This change primarily reflects fluctuations in the foreign currency exchange rate for our subsidiary domiciled in Canada and our ability to maintain a natural hedge by keeping a balance of our assets and liabilities denominated in Canadian dollars during fiscal 2011. Although we will try to maintain a natural hedge by keeping a balance of our assets and liabilities denominated in Canadian dollars, there is no assurance that we will be able to continue to do so in future reporting periods.

Income Taxes

Effective Income Tax Rate

We recorded income tax expense of $213,000, or 2.1% of income before income tax expense, for the nine-month period ended January 30, 2011, compared to income tax expense of $1.6 million or 16.8% of income before income tax expense, for the nine-month period ended January 31, 2010. Our effective income tax rates for the nine-month periods ended January 30, 2011, and January 31, 2010, were based upon the estimated effective income tax rate applicable for the full year after giving effect to any significant items related specifically to interim periods. The effective income tax rate can be affected over the fiscal year by the mix and timing of actual earnings from our U.S. operations and foreign sources versus annual projections, as well as changes in foreign currencies in relation to the U.S. dollar.

The income tax expense for the nine-month period ended January 30, 2011, is different from the amount obtained by applying our statutory rate of 34% to income before income taxes for the following reasons:

The income tax rate was reduced by 31% for a reduction in our valuation allowance recorded against our net deferred tax assets. Of this 31% reduction in our income tax rate, 19% and 12% pertain to the company's operations located in the U.S. and China, respectively. The 19% reduction in our income tax rate from our U.S. operations is due to the realization of our U.S. net deferred tax assets from ordinary taxable income projected for fiscal 2011. Since the realization of our U.S. net deferred tax assets are from ordinary taxable income in the current fiscal year, its tax effects are included in the computation of the annual effective rate for fiscal 2011. The 12% reduction in our income tax rate from our China operations is due to a change in judgment about the realization of our China net deferred tax assets in future years. Since the realization of our China net deferred tax assets is a result of a change in judgment about future years, we recorded an adjustment of $1.3 million that represents a discrete event in which the full tax effects were recorded for the nine-month period ended January 30, 2011.

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

The income tax rate was reduced by 3% for adjustments made to our Canadian deferred tax liabilities associated with our election to file our Canadian income tax returns in U.S. dollars commencing with our fiscal 2011 tax year. Our Canadian income tax returns were filed in Canadian dollars for fiscal years prior to fiscal 2011. This adjustment totaled $315,000 and represents a discrete event in which the full tax effects were recorded during the nine-month period ended January 30, 2011.

The income tax rate increased 9% for an increase in unrecognized tax benefits. This 9% increase in the income tax rate also includes an income tax benefit of $107,000 or a reduction in the income tax rate of 1% for the subsequent recognition of unrecognized tax benefits. This adjustment of $107,000 represents a discrete event in which the full tax effects were recorded during the nine-month period ended January 30, 2011.

The income tax rate was increased by 0.1% for stock-based compensation and other miscellaneous items.

The income tax expense for the nine-month period ending January 31, 2010, is different from the amount obtained by applying our statutory rate of 34% to income before income taxes for the following reasons:

The income tax rate was reduced by 27% for a reduction in the valuation allowance recorded against substantially all of the company's net deferred tax assets. This reduction in the valuation allowance is primarily due to the U.S. taxable income generated by the repatriation of undistributed earnings from our subsidiaries located in China and the resulting utilization of the U.S. net operating loss carryforwards.

The income tax rate was reduced by 9% for the tax effects of foreign exchange losses on U.S. denominated account balances in which income taxes are paid in Canadian dollars. The Canadian foreign exchange rate in relation to the U.S. dollar has been very volatile due to global economic conditions.

The income tax rate was reduced by 6% for taxable income subject to lower statutory income tax rates in foreign jurisdictions (Canada and China) compared with the statutory income tax rate of 34% for the United States.

The income tax rate increased 14% for the recording of a deferred tax liability for estimated U.S. income taxes that will be payable upon anticipated future repatriation of undistributed earnings from our subsidiaries located in China. During the first quarter of fiscal 2010, we received authorization from the Chinese government to repatriate additional funds that would not be subject to withholding taxes payable in China.

The income tax rate increased 11% for an increase in income tax reserves for unrecognized tax benefits.

The income tax rate decreased 0.2% for stock-based compensation and other miscellaneous items.

Deferred Income Taxes

In accordance with ASC Topic 740, we evaluate our deferred income taxes each reporting period to determine if a valuation allowance is required. ASC Topic 740 requires that companies assess whether a valuation allowance is necessary based on the consideration of all available positive and negative evidence using a "more likely than not" standard, with significant weight being given to evidence that can be objectively verified compared with evidence that represents future events and therefore, is more subjective. 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.

United States

Our net deferred tax asset regarding our U.S. operations primarily pertains to incurring significant U.S. pre-tax losses over the last several years, with U.S. loss carryforwards totaling $64.0 million at May 2, 2010. Due to the favorable results of our multi-year restructuring process in our upholstery fabric operations and key acquisitions and capital investments made for our mattress fabrics segment, on a cumulative three-year basis ending January 30, 2011, our U.S. operations have earned a marginal pre-tax income (achieved in the second quarter of fiscal 2011). Although our U.S. operations have earned a marginal pre-tax income on a cumulative three-year basis ending January 30, 2011, this did not represent sufficient positive evidence to demonstrate future pre-tax income, due to the significance of the cumulative pre-tax losses that have been incurred over a much longer time period. In addition, the significant uncertainty in the current and expected demand for furniture and mattresses, increasing raw material prices in both our upholstery and mattress businesses, and the prevailing uncertainty in the overall economic climate, has made it very difficult to forecast our financial results associated with our U.S. operations. Based on the significant negative evidence noted above, we maintained our position that it is more-likely-than-not that our U.S. net deferred tax assets will not be fully recovered. As a result, we recorded a full valuation allowance totaling $20.4 million against our U.S. net deferred tax assets as of January 30, 2011.

China

Our net deferred tax asset regarding our China operations primarily pertains to the book versus tax basis difference associated with our China operations' fixed assets. This book versus tax basis difference resulted from our impairment losses and fixed asset write-downs associated with our September 2008 upholstery fabrics restructuring plan. In order for this net deferred tax asset to be realized, our China operations must have sufficient pre-tax income levels to utilize tax depreciation expense each of the next four fiscal years. During the second quarter of fiscal 2011, management assessed both positive and negative evidence and concluded that there was sufficient positive evidence that our net deferred tax assets regarding our China operations will more likely than not be realized. Due to the favorable results from our restructuring activities and profit improvement plan initiated in the second quarter of fiscal 2009, our China operations have been profitable, reporting pre-tax income of $3.6 million for the first two quarters of fiscal 2011 and $7.9 million in fiscal 2010. In addition, our China operations earned pre-tax income of $6.8 million over a cumulative three-year period ending October 31, 2010 (the end of our second quarter of fiscal 2011). As a result of the improvement of our China operations' pre-tax income levels that have been demonstrated over a cumulative period of three-years at the end of our second quarter of fiscal 2011, there was sufficient positive evidence that our China operations can provide sufficient pre-tax income levels to utilize tax depreciation expense each of the next four fiscal years. This improvement continued as our China operations reported pre-tax income of $2.1 million for the third quarter of fiscal 2011. Based on this significant positive evidence, we maintained our position not to record a valuation allowance against our China net deferred tax assets at January 30, 2011. During the second quarter of fiscal 2011 we recognized an income tax benefit of $1.3 million to reduce the valuation allowance of $1.3 million recorded at May 2, 2010 (the beginning of our fiscal year). This $1.3 million income tax benefit was treated as a discrete event in which the full tax effects of this adjustment were recorded in the nine-month period ended January 30, 2011, as it pertained to a change in judgment about future years.

Overall

The recorded valuation allowance of $20.4 million has no effect on our operations, loan covenant compliance, or the possible realization of the U.S. income tax loss carryforwards in the future. If it is determined that it is more-likely-than-not that we will realize any of these U.S. income tax loss carryforwards, an income tax benefit would be recognized at that time.

At January 30, 2011, the current deferred tax asset of $296,000 represents $78,000 and $218,000 from our operations located in Canada and China, respectively. At May 2, 2010, the current deferred tax asset of $150,000 represents $84,000 and $66,000 from our operations located in Canada and China, respectively. At January 30, 2011, the non-current deferred tax asset of $1.3 million pertains to our operations located in China. At May 2, 2010, the non-current deferred tax asset of $324,000 pertains to our operations located in China. At January 30, 2011, the non-current deferred tax liability of $622,000 pertains to our operations located in Canada. At May 2, 2010, the non-current deferred tax liability of $982,000 pertains to our operations located in Canada.

Uncertainty In Income Taxes

At January 30, 2011, we had $11.1 million of total gross unrecognized tax benefits, of which $3.9 million represents the amount of gross unrecognized tax benefits that, if recognized, would favorably affect the income tax rate in future periods. Of the $11.1 million in gross unrecognized tax benefits as of January 30, 2011, $7.2 million were classified as net non-current deferred income taxes and $3.9 million were classified as income taxes payable –long-term in the accompanying consolidated balance sheets.

We estimate that the amount of gross unrecognized tax benefits will increase by approximately $1.5 million for fiscal 2011. This increase primarily relates to double taxation under applicable tax treaties with foreign tax jurisdictions.

Liquidity and Capital Resources

Liquidity

Our sources of liquidity include cash and cash equivalents, short-term investments, cash flow from operations, and amounts available under our unsecured revolving credit lines. We believe these will be sufficient to fund our foreseeable business needs, capital expenditures and other contractual obligations.

Our cash and cash equivalents and short-term investment balance totaled $22.8 million at January 30, 2011, compared with $21.3 million at May 2, 2010. This increase primarily reflects cash flow provided by operating activities of $6.4 million, offset by cash capital expenditures of $5.6 million mostly related to our mattress fabrics segment, and cash proceeds from the issuance of common stock totaling $591,000.

Despite the ongoing economic uncertainties, we have maintained a strong financial position. Our cash and cash equivalents and short-term investment balance of $22.8 million exceeded our total debt (current maturities of long-term debt and long-term debt) of $11.6 million. Our next major scheduled long-term debt principal payment of $2.2 million is not due until August 2011. As of January 30, 2011, our lines of credit totaling $12.5 million had no outstanding balances. All of our long-term debt and line of credit agreements are unsecured.

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

Working Capital

Accounts receivable at January 30, 2011, were $16.9 million, a decrease of $4.0 million, or 19%, compared with $20.9 million at January 31, 2010. This decrease primarily reflects a decline in business volume in our upholstery fabrics segment during the third quarter of fiscal 2011 compared with the third quarter of fiscal 2010, and major customers in both our upholstery and mattress fabrics segment taking advantage of cash discounts for early payments. Days' sales outstanding were 28 and 33 days during the quarter ended January 30, 2011, and January 31, 2010, respectively.

Inventories as of January 30, 2011, were $26.4 million, an increase of $2.0 million, or 8%, in comparison with $24.4 million at January 31, 2010. Inventory turns for the third quarter of fiscal 2011 were 6.2 compared with 7.0 for the third quarter of fiscal 2010.

Accounts payable-trade as of January 30, 2011, were $17.1 million, a decrease of $1.5 million, or 8% in comparison with $18.6 million at January 31, 2010.

Operating working capital (comprised of accounts receivable and inventories, less accounts payable-trade and capital expenditures) was $26.0 million at January 30, 2011 compared with $25.6 million at January 31, 2010. Working capital turnover was 8.5 and 8.3 during the quarters ended January 30, 2011 and January 31, 2010, respectively.

Financing Arrangements

Unsecured Term Notes

In connection with the Bodet & Horst acquisition, we entered into a note agreement dated August 11, 2008. This agreement provided for the issuance of $11.0 million of unsecured term notes with a fixed interest rate of 8.01% and a term of seven years. Principal payments of $2.2 million per year are due on the notes beginning August 11, 2011. The principal payments are payable over an average term of 4.5 years through August 11, 2015. This agreement contains customary financial and other covenants as defined in the agreement.

Government of Quebec Loan

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

Revolving Credit Agreement – United States

On August 13, 2010, we entered into a sixteenth amendment to our revolving credit agreement. This agreement currently provides for a loan commitment of $6.5 million, including letters of credit of $3.0 million. This agreement expires August 15, 2012 and provides for a pricing matrix to determine the interest rate payable on loans made under this agreement (applicable interest rate of 2.26% at January 30, 2011). As of January 30, 2011, there were $125,000 in outstanding letters of credit (all of which related to workers compensation). At January 30, 2011 and May 2, 2010, there were no borrowings outstanding under the agreement.

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The sixteenth amendment to this revolving credit agreement also increased the annual capital expenditure limit from $4.0 million to $10.0 million.

Revolving Credit Agreement – China

We have an unsecured credit agreement that provides for a line of credit of up to approximately $6.0 million and expires on March 2, 2011. This agreement bears interest at a rate determined by the Chinese government. There were no borrowings outstanding under the agreement as of January 30, 2011 and May 2, 2010.

Overall

Our loan agreements require, among other things, that we maintain compliance with certain financial covenants. At January 30, 2011, the company was in compliance with these financial covenants.

At January 30, 2011, the principal payment requirements of long-term debt during the next five years are: Year 1 – $2.4 million; Year 2 - $2.4 million; Year 3 - $2.4 million; Year 4 - $2.2 million; and Year 5 - $2.2 million.

Capital Expenditures and Depreciation

Capital expenditures on an accrual and cash basis for the nine months ended January 30, 2011, were $5.4 million and $5.6 million, respectively. Capital expenditures for the nine months ended January 30, 2011 mostly relate to the mattress fabrics segment. Depreciation expense for the nine months ended January 30, 2011 was $3.2 million, and primarily relates to the mattress fabrics segment.

For all of fiscal 2011, we currently expect capital expenditures to be approximately $6.2 million. Capital expenditures for fiscal 2011 primarily relate to the mattress fabrics segment. With the substantial completion of our capital spending in our mattress fabrics segment, we expect capital spending for the company as a whole to be substantially lower in the foreseeable future and are estimating capital spending to be approximately $3.0 million in fiscal 2012. For fiscal 2011, depreciation expense is projected to be $4.4 million, which primarily relates to the mattress fabrics segment. These are management's current expectations only, and changes in our business needs could cause changes in plans for capital expenditures and expectations for related depreciation expense.

At January 30, 2011, we had amounts due regarding capital expenditures totaling $203,000, of which $188,000 was vendor-financed and $15,000 was non-vendor financed. Our vendor-financed arrangement bears interest at a fixed interest rate of 7.14%. The total outstanding amount of $203,000 is required to be paid in full during fiscal 2011.

Critical Accounting Policies and Recent Accounting Developments

As of January 30, 2011, there were no changes in the nature of our significant accounting policies or the application of those policies from those reported in our annual report on Form 10-K for the year ended May 2, 2010.

Refer to Note 2 located in the notes to the consolidated financial statements for recently adopted and issued accounting pronouncements since the filing of our Form 10-K for the year ended May 2, 2010.

Contractual Obligations

As of January 30, 2011, there were no significant changes to or new contractual obligations from those reported in our annual report on Form 10-K for the year ended May 2, 2010, with the exception of open purchase commitments to acquire equipment with regard to the mattress fabrics segment totaling $295,000 at January 30, 2011 compared with

$3.8 million at May 2, 2010.

Inflation

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risk from changes in interest rates on our revolving credit lines. At January 30, 2011, the company's U.S. revolving credit agreement provides for a pricing matrix to determine the interest rate payable on loans made under this agreement. The company's revolving credit line associated with its China subsidiaries bears interest at a rate determined by the Chinese government. At January 30, 2011, there were no borrowings outstanding under these revolving credit lines.

We are not exposed to market risk from changes in interest rates on our long-term debt. The company's unsecured term notes have a fixed interest rate of 8.01%, and the loan associated with the Government of Quebec is non-interest bearing.

We are exposed to market risk from changes in the value of foreign currencies for our subsidiaries domiciled in China and Canada. On January 21, 2009, we entered into a Canadian dollar foreign exchange contract associated with its loan from the Government of Quebec. The agreement effectively converted the Canadian dollar principal debt payments at a fixed Canadian dollar foreign exchange rate versus the United States dollar of 1.21812 and was due to expire on November 1, 2013. During the first quarter of fiscal 2011, we elected to terminate this contract due to the favorable Canadian dollar foreign exchange rates in comparison to the fixed contractual rate noted above. Additionally, 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 China and Canada, 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 either exchange rate at January 30, 2011, would not have had a significant impact on our results of operations or financial position.

ITEM 4. CONTROLS AND PROCEDURES

We have conducted an evaluation of the effectiveness of our disclosure controls and procedures as of January 30, 2011, the end of the period covered by this report. This evaluation was conducted under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer. Based upon that evaluation, we have concluded that these disclosure controls and procedures were effective to ensure that information required to be disclosed in the reports filed by us and submitted under the Securities Exchange Act of 1934, as amended (the "Exchange Act") is recorded, processed, summarized, and reported as and when required. Further, we concluded that our disclosure controls and procedures were effective in all material respects to ensure that information required to be disclosed in reports filed by us under the Exchange Act is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, in a manner to allow timely decisions regarding the required disclosures.

There has been no change in our internal control over financial reporting that occurred during the quarter ended January 30, 2011 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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## Part II – Other Information

### Item 1. Legal Proceedings

There have not been any material changes to our legal proceedings during the nine months ended January 30, 2011. Our legal proceedings are disclosed in the company's annual report on Form 10-K filed with the Securities and Exchange Commission on July 15, 2010 for the fiscal year ended May 2, 2010.

### Item 1A. Risk Factors

There have not been any material changes to our risk factors during the nine months ended January 30, 2011. Our risk factors are disclosed in the company's annual report on Form 10-K filed with the Securities and Exchange Commission on July 15, 2010 for the fiscal year ended May 2, 2010.

### Item 6. Exhibits

The following exhibits are filed as part of this report.

3(i) Articles of Incorporation of the company, as amended, were filed as Exhibit 3(i) to the company's Form 10-Q for the quarter ended July 28, 2002, filed September 11, 2002 (Commission File No. 001-12597), and are incorporated herein by reference.

3(ii) Restated and Amended Bylaws of the company, as amended November 12, 2007, were filed as Exhibit 3.1 to the company's Form 8-K dated November 12, 2007, and incorporated herein by reference.

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.

SIGNATURES

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

CULP, INC.
(Registrant)

Date: March 11, 2011

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

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

EXHIBIT INDEX

| Exhibit Number | Exhibit |
|---|---|
| 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. |