

Edgar Filing: CULP INC - Form 10-Q

CULP INC  
Form 10-Q  
March 12, 2008

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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 27, 2008

Commission File No. 0-12781

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

NORTH CAROLINA  
(State or other jurisdiction of  
incorporation or other organization)

56-1001967  
(I.R.S. Employer Identification No.)

1823 Eastchester Drive  
High Point, North Carolina  
(Address of principal executive offices)

27265-1402  
(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 of the Securities Exchange Act of 1934 during the preceding 12 months and (2) has been subject to the filing requirements for at least the past 90 days. YES  NO

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

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

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

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

Common shares outstanding at January 27, 2008: 12,634,526  
Par Value: \$0.05 per share

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For the period ended January 27, 2008

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Item 1. Financial Statements

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CULP, INC.  
 CONSOLIDATED STATEMENTS OF NET INCOME (LOSS)  
 FOR THE THREE MONTHS AND NINE MONTHS ENDED JANUARY 27, 2008 AND JANUARY 28, 2007  
 (UNAUDITED)  
 (Amounts in Thousands, Except for Per Share Data)

	THREE MONTHS ENDED			
	Amounts			
	January 27, 2008	January 28, 2007	% Over (Under)	Janu 2
Net sales	\$ 60,482	\$ 55,712	8.6 %	
Cost of sales	53,706	51,001	5.3 %	
Gross profit	6,776	4,711	43.8 %	
Selling, general and administrative expenses	5,117	6,394	(20.0) %	
Restructuring expense	412	1,275	(67.7) %	
Income (loss) from operations	1,247	(2,958)	142.2 %	
Interest expense	753	952	(20.9) %	
Interest income	(77)	(50)	54.0 %	
Other income	(72)	(157)	(54.1) %	
Income (loss) before income taxes	643	(3,703)	117.4 %	
Income taxes *	(260)	(1,482)	(82.5) %	
Net income (loss)	\$ 903	\$ (2,221)	(140.7) %	
Net income (loss) per share, basic	\$ 0.07	\$ (0.19)	N.M.	
Net income (loss) per share, diluted	0.07	(0.19)	N.M.	
Average shares outstanding, basic	12,635	11,773	7.3 %	
Average shares outstanding, diluted	12,738	11,773	8.2 %	

	NINE MONTHS ENDED			
	Amounts			
	January 27, 2008	January 28, 2007	% Over (Under)	Janu 2
Net sales	\$ 190,048	\$ 177,337	7.2 %	
Cost of sales	165,794	156,575	5.9 %	
Gross profit	24,254	20,762	16.8 %	
Selling, general and administrative expenses	17,275	19,240	(10.2) %	

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Restructuring expense	759	1,742	(56.4) %
Income (loss) from operations	6,220	(220)	N.M.
Interest expense	2,380	2,841	(16.2) %
Interest income	(197)	(147)	34.0 %
Other expense (income)	625	(98)	N.M.
Income (loss) before income taxes	3,412	(2,816)	221.2 %
Income taxes *	105	(1,540)	(106.8) %
Net income (loss)	\$ 3,307	\$ (1,276)	359.2 %
Net income (loss) per share, basic	\$ 0.26	\$ (0.11)	N.M.
Net income (loss) per share, diluted	0.26	(0.11)	N.M.
Average shares outstanding, basic	12,617	11,710	7.7 %
Average shares outstanding, diluted	12,770	11,710	9.1 %

\*Percent of sales column for income taxes is calculated as a % of income (loss) before income tax

See accompanying notes to consolidated financial statements.

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CULP, INC.  
CONSOLIDATED BALANCE SHEETS  
JANUARY 27, 2008, JANUARY 28, 2007 AND APRIL 29, 2007  
(UNAUDITED)  
(Amounts in Thousands)

	Amounts		Increase
	January 27, 2008	January 28, 2007	(Decrease) Dollars
Current assets:			
Cash and cash equivalents	\$ 15,500	\$ 10,675	4,825
Accounts receivable, net	23,370	23,755	(385)
Inventories	37,923	42,717	(4,794)
Deferred income taxes	5,376	7,120	(1,744)
Assets held for sale	4,972	1,231	3,741
Income taxes receivable	423	-	423
Other current assets	995	2,710	(1,715)
Total current assets	88,559	88,208	351
Property, plant and equipment, net	32,218	40,784	(8,566)
Goodwill	4,114	4,114	-
Deferred income taxes	25,993	23,232	2,761
Other assets	2,442	2,683	(241)

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Total assets	\$	153,326	\$	159,021	(5,695)
-----					
Current liabilities:					
Current maturities of long-term debt	\$	8,569	\$	4,744	3,825
Lines of credit		2,783		-	2,783
Accounts payable		19,036		18,051	985
Accrued expenses		10,422		7,704	2,718
Accrued restructuring		1,875		3,490	(1,615)
Income taxes payable - current		-		4,136	(4,136)
-----					
Total current liabilities		42,685		38,125	4,560
Income taxes payable - long-term		4,497		-	4,497
Long-term debt, less current maturities		22,026		41,965	(19,939)
-----					
Total liabilities		69,208		80,090	(10,882)
Commitments and Contingencies (Notes 8 and 17)					
Shareholders' equity		84,118		78,931	5,187
-----					
Total liabilities and shareholders' equity	\$	153,326	\$	159,021	(5,695)
=====					
Shares outstanding		12,635		12,555	80
=====					

\* Derived from audited financial statements.

See accompanying notes to consolidated financial statements.

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CULP, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
FOR THE NINE MONTHS ENDED JANUARY 27, 2008 AND JANUARY 28, 2007  
(UNAUDITED)  
(Amounts in Thousands)

Cash flows from operating activities:

-----  
January  
2008  
-----

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Net income (loss)	\$
Adjustments to reconcile net income (loss) to net cash provided by operating activities:	
Depreciation	
Amortization of other assets	
Stock-based compensation	
Excess tax benefit related to stock options exercised	
Deferred income taxes	
Loss on impairment of equipment	
Restructuring expenses, net of gain on sale of related assets	
Changes in assets and liabilities:	
Accounts receivable	
Inventories	
Other current assets	
Other assets	
Accounts payable	
Accrued expenses	
Accrued restructuring	
Income taxes	
	-----
Net cash provided by operating activities	-----
	-----
Cash flows from investing activities:	
Capital expenditures	
Acquisition of assets	
Proceeds from the sale of buildings and equipment	
	-----
Net cash used in investing activities	-----
	-----
Cash flows from financing activities:	
Net proceeds from lines of credit	
Payments on vendor-financed capital expenditures	
Payments on long-term debt	
Proceeds from the issuance of long-term debt	
Proceeds from common stock issued	
Excess tax benefit related to stock options exercised	
	-----
Net cash used in financing activities	-----
	-----
Increase in cash and cash equivalents	
Cash and cash equivalents at beginning of period	
	-----
Cash and cash equivalents at end of period	\$ =====

See accompanying notes to consolidated financial statements.

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(Dollars in thousands, except share data)

	Common Stock		Capital Contributed	Retained	Accu
	Shares	Amount	in Excess of Par Value	Earnings	Inco
Balance, April 30, 2006	11,654,959	\$ 584	40,350	33,571	
Net loss	-	-	-	(1,316)	
Stock-based compensation	-	-	525	-	
Loss on cash flow hedge, net of taxes	-	-	-	-	
Common stock issued in connection with acquisition of assets	798,582	40	5,043	-	
Common stock issued in connection with stock option plans	115,750	5	279	-	
Balance, April 29, 2007	12,569,291	629	46,197	32,255	
Net income	-	-	-	3,307	
Stock-based compensation	-	-	520	-	
Loss on cash flow hedge, net of taxes	-	-	-	-	
Excess tax benefit related to stock options exercised	-	-	21	-	
Common stock issued in connection with stock option plans	65,235	3	402	-	
Cumulative effect of adopting FASB Interpretation No. 48	-	-	-	847	
Balance, January 27, 2008	12,634,526	\$ 632	47,140	36,409	

See accompanying notes to consolidated financial statements.

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

1. Basis of Presentation

The accompanying unaudited consolidated financial statements of Culp, Inc. and subsidiaries (the "company") include all adjustments, which are, in the opinion of management, necessary for fair presentation of the results of operations and financial position. All of these adjustments are of a normal recurring nature except as disclosed in notes 11, 12 and 15 to the consolidated financial statements. 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 19, 2007 for the fiscal year ended April 29, 2007.

The company's nine months ended January 27, 2008 and January 28, 2007 represent

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39 week periods.

### Foreign Currency Adjustments

The United States dollar is the functional currency for the company, including its Canadian and Chinese subsidiaries. All foreign currency asset and liability accounts are remeasured into U.S. dollars at exchange rates at the end of each reporting period, except for inventories, and property, plant, and equipment, which are recorded at historical rates. Foreign currency revenues and expenses are remeasured at average exchange rates in effect during each reporting period, except for certain expenses related to balance sheet amounts recorded at historical exchange rates. Exchange gains and losses from remeasurement of foreign currency denominated monetary assets and liabilities are recorded in the other expense (income) line item in the Consolidated Statements of Net Income (Loss) in the period in which they occur.

The value of the U.S. dollar relative to the Canadian dollar strengthened by 5% for the three-month periods ending January 27, 2008 and January 28, 2007. Foreign currency remeasurement gains for the Canadian subsidiary were \$112,000 and \$119,000 for the three-month periods ending January 27, 2008 and January 28, 2007, respectively. The Chinese subsidiary had a remeasurement loss of \$13,000 for the three-month period ending January 27, 2008, and a remeasurement gain of \$100,000 for the three-month period ending January 28, 2007.

The value of the U.S. dollar relative to the Canadian dollar declined 11% and strengthened by 5% for the nine-month periods ending January 27, 2008 and January 28, 2007, respectively. The foreign currency remeasurement loss for the Canadian subsidiary was \$389,000 for the nine-month period ending January 27, 2008. The foreign currency remeasurement gain for the Canadian subsidiary was \$78,000 for the nine-month period ending January 28, 2007. The Chinese subsidiary had a remeasurement loss of \$80,000 for the nine-month period ending January 27, 2008, and a remeasurement gain of \$211,000 for the nine-month period ending January 28, 2007.

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

### Accounting for Uncertainty in Income Taxes

During the first quarter of fiscal 2008, the company adopted Financial Accounting Standards Board (FASB) Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (FIN 48) which supplements SFAS No. 109, "Accounting for Income Taxes", by defining the confidence level that a tax position must meet in order to be recognized in the financial statements. FIN 48 requires that the tax effects of a position to be recognized only if it is "more-likely-than-not" to be sustained based solely on its technical merits as of the reporting date. The more-likely-than-not threshold represents a positive assertion by management that a company is entitled to the economic benefits of a tax position. If a tax position is not considered more-likely-than-not to be sustained based solely on its technical merits, no benefits of the tax position are to be recognized. Moreover, the more-likely-than-not threshold must continue to be met in each reporting period to support continued recognition of the benefit. With the adoption of FIN 48, entities are required to adjust their financial statements to reflect only those tax positions that are more-likely-than-not to be sustained. Any necessary adjustment would be recorded directly to retained earnings and reported as a change in accounting principle. The company adopted FIN 48 as of April 30, 2007, and recorded an increase in



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retained earnings of \$847,000 as a cumulative effect of a change in accounting principle. Refer to Note 15 for more information regarding the impact of adopting FIN 48. Adjustments subsequent to initial adoption are reflected within the company's income tax expense.

### 2. Stock-Based Compensation

#### Overview

Effective May 1, 2006, the company began recording compensation expense associated with its stock option plans in accordance with SFAS No. 123R, "Share-Based Payment" which requires the measurement of the cost of employee services received in exchange for an award of an equity instrument based on the grant date fair value of the award. The company adopted the modified prospective transition method provided for under SFAS No. 123R, and consequently has not retroactively adjusted results from prior periods. Under this transition method, compensation expense associated with stock options granted on or after May 1, 2006 is recorded in accordance with the provisions of SFAS No. 123R and stock compensation expense associated with the remaining unvested portion of options granted prior to May 1, 2006 is recorded based on their grant date fair value estimated in accordance with the original provisions of SFAS No. 123, "Accounting for Stock-Based Compensation."

The company recorded \$154,000 and \$520,000 of compensation expense for stock options within selling, general, and administrative expense for the three-month and nine-month periods ended January 27, 2008. The company recorded \$119,000 and \$406,000 of compensation expense for stock options within selling, general, and administrative expense for the three-month and nine-month periods ended January 28, 2007.

Prior to the adoption of SFAS No. 123R, the benefit of tax deductions in excess of recognized compensation costs were reported as a reduction of taxes paid within operating cash flow. SFAS No. 123R requires such benefits be recorded as a financing cash flow. For the nine-month period ended January 27, 2008, the company recognized \$21,000 of excess tax benefits. There were no excess tax benefits during the nine-month period ended January 28, 2007.

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

The remaining unrecognized compensation costs related to unvested awards at January 27, 2008 is \$965,000 which is expected to be recognized over a weighted average period of 3.1 years.

#### Equity Incentive Plans

On September 20, 2007, the company's shareholders approved a new equity incentive plan entitled the Culp, Inc. 2007 Equity Incentive Plan (the "2007 Plan"). The 2007 Plan will expand the types of equity based awards available for grant by the company's Compensation Committee. The types of equity based awards available for grant include stock options, stock appreciation rights, restricted stock and restricted stock units, performance units, and other discretionary awards as determined by the Compensation Committee. An aggregate of 1,200,000 shares of common stock were authorized for issuance under the 2007 Plan. In conjunction with the approval of the 2007 Plan, the company's 2002 Stock Option Plan was terminated (with the exception of currently outstanding options) and no

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additional options will be granted under the 2002 Stock Plan.

Under the company's prior stock option plans (terminated with the approval of the 2007 Plan) and the 2007 Plan, employees and directors were and may be granted options to purchase shares of common stock at the fair market value on the date of grant. Options granted to employees under these plans generally vest over four to five years and expire five to ten years after the date of grant. Options granted to outside directors under these plans vest immediately on the date of grant and expire ten years after the date of grant. The fair value of each option award was estimated on the date of grant using a Black-Scholes option-pricing model. The fair value of stock options granted to employees at each grant date under the 2002 stock option plan during the nine-month periods ended January 27, 2008 and January 28, 2007 was \$4.74 and \$2.43 per share using the following assumptions:

	2008
Risk-free interest rate	4.92% - 5.09%
Dividend yield	0.00%
Expected volatility	38.59% - 65.74%
Expected term (in years)	1.1 - 8.0

The fair value of stock options granted to outside directors at each grant date under the 2007 Plan for the nine-month period ended January 27, 2008 and the 2002 stock option plan for the nine-month period ended January 28, 2007 were \$7.19 and \$3.68 per share using the following assumptions:

	2008
Risk-free interest rate	4.56%
Dividend yield	0.00%
Expected volatility	66.28%
Expected term (in years)	8.0

The assumptions utilized in the model are evaluated and revised, as necessary, to reflect market conditions, actual historical experience, and groups of employees (executives and non-executives) that have similar exercise patterns that are considered separately for valuation purposes. The risk-free interest rate for periods within the contractual life of the option was based on the U.S. Treasury yield curve in effect at the time of grant. The dividend yield was calculated based on the company's annual dividend as of the option grant date. The expected volatility was derived using a term structure based on historical volatility and the volatility implied by exchange-traded options on the company's common stock. The expected term of the options is based on the contractual term of the stock options, expected employee exercise and post-vesting employment termination trends.

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(unaudited)

The following table summarizes the stock options (vested and unvested) as of January 27, 2008 and option activity during the nine-month period then ended:

	Shares	Weighted- Average Exercise Price	Weighted- Average Contractual Term
Outstanding, April 29, 2007	926,000	\$ 7.22	
Granted	145,500	8.81	
Expired/Cancelled	(199,999)	13.04	
Exercised	(65,235)	6.10	
Outstanding, January 27, 2008	806,266	\$ 6.16	3.85 Years

At January 27, 2008, there were 1,194,000 shares available for future grants under the company's 2007 Plan. Outstanding options to purchase 395,393 shares were exercisable and had a weighted average exercise price of \$6.30 per share, an aggregate intrinsic value of \$564,000 and a weighted average contractual term of 2.63 years.

### Stock Option Modifications

On December 12, 2007, the compensation committee of the board of directors approved a modification of the June 25, 2007 stock option grant to change the vesting period from 2 to 5 years from the original date of grant. There were no other changes to the original stock option grant and no inducements were given to the participating employees in exchange for this modification. The option modification agreements were agreed to by all of the participating employees (20 in total) and were effective January 22, 2008 (modification date). No incremental compensation cost was recognized for this modification as the fair value of the revised award was less than the fair value of the original award as of the modification date.

Effective December 31, 2007, an executive officer resigned from the company and agreed to a separation agreement. As part of the separation agreement, the exercise period for vested stock options was extended from 90 days from the date of resignation (terms stated in the original option agreements) to September 28, 2009. The incremental compensation cost recognized from this modification approximated \$54,000.

### Other Share-Based Arrangements

The company has a stock-based compensation agreement with an individual 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 27, 2008, this agreement was indexed by approximately 85,000 shares of the company's common stock. The fair value of this agreement is included in accrued expenses and was approximately \$608,000 and \$870,000 at January 27, 2008 and April 29, 2007, respectively.

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

3. Accounts Receivable

A summary of accounts receivable follows:

(dollars in thousands)	January 27, 2008
Customers	\$ 24,748
Allowance for doubtful accounts	(843)
Reserve for returns and allowances and discounts	(535)
	\$ 23,370

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

(dollars in thousands)	January 27, 2008	Nine months ended
Beginning balance	\$ (1,332)	J
(Provision) recovery of bad debt expense	320	
Write-offs, net of recoveries	169	
Ending balance	\$ (843)	

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

(dollars in thousands)	January 27, 2008	Nine months ended
Beginning balance	\$ (570)	J
Provision for returns and allowances and discounts	(1,937)	
Discounts taken	1,972	
Ending balance	\$ (535)	

4. 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 27, 2008
------------------------	------------------

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Raw materials	\$	9,835
Work-in-process		1,573
Finished goods		26,515
		-----
	\$	37,923
		-----

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

5. Other Assets

A summary of other assets follows:

(dollars in thousands)	January 27, 2008
Cash surrender value - life insurance	\$ 1,213
Non-compete agreement, net	861
Other	368
	-----
	\$ 2,442
	-----

At January 27, 2008 and April 29, 2007, the gross carrying amount of the non-compete agreement was \$1.1 million. At January 27, 2008 and April 29, 2007 accumulated amortization for the non-compete agreement was \$287,000 and \$72,000, respectively. The non-compete agreement will be amortized on a straight-line basis over the four year life of the agreement. Amortization expense for this non-compete agreement for the three-month and nine month periods ended January 27, 2008 were \$72,000 and \$215,000, respectively. No amortization expense for this non-compete agreement was incurred during the three-month and nine-month periods ended January 28, 2007. The remaining amortization expense for the next four fiscal years follows: FY 2008 - \$72,000; FY 2009 - \$287,000; FY 2010 - \$287,000; and FY 2011 - \$215,000.

6. Accounts Payable

A summary of accounts payable follows:

(dollars in thousands)	January 27, 2008
Accounts payable-trade	\$ 18,312
Accounts payable-capital expenditures	724
	-----
	\$ 19,036
	-----

7. Accrued Expenses

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A summary of accrued expenses follows:

(dollars in thousands)	January 27, 2008
Compensation, commissions and related benefits	\$ 5,251
Interest	766
Accrued rebates	1,921
Other	2,484
	\$ 10,422

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

### 8. Long-Term Debt and Lines of Credit

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

(dollars in thousands)	January 27, 2008
Unsecured term notes	\$ 23,420
Real estate loan - I	3,882
Real estate loan - II	2,500
Canadian government loan	793
	30,595
Current maturities of long-term debt	(8,569)
Long-term debt, less current maturities	\$ 22,026
Lines of credit	\$ 2,783
Total borrowings	\$ 33,378

#### Term Notes

The company's unsecured term notes have a fixed interest rate of 8.80% (payable semi-annually in March and September and subject to prepayment provisions each fiscal quarter as defined in the agreement) and are payable over an average remaining term of two years through March 2010. The principal payments are required to be paid in annual installments as follows: March 2008 - \$8.3 million; March 2009 - \$7.5 million; and March 2010 - \$7.5 million. The company prepaid \$2.2 million during the first quarter, \$1.0 million in the second quarter, and \$4.3 million in the third quarter, all of which was scheduled to be due in March 2008.

On February 19, 2008, the company entered into a fourth amendment. This

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amendment provided greater flexibility by increasing the capital expenditure limit on a cash basis from \$4.0 million to \$5.0 million for fiscal year 2008 and \$4.0 million plus an additional amount as defined in the agreement for any fiscal year thereafter.

### Real Estate Loan - I

The company has a real estate loan that is secured by a lien on the company's corporate headquarters office located in High Point, NC. This term loan bears interest at the one-month LIBOR plus an adjustable margin (6.49% at January 27, 2008) based on the company's debt/EBITDA ratio, as defined in the agreement and is payable in varying monthly installments through September 2010, with a final payment of \$3.3 million in October 2010.

### Real Estate Loan - II

The company has a term loan in the amount of \$2.5 million in connection with the ITG asset purchase agreement. This term loan is secured by a lien on the company's corporate headquarters office located in High Point, NC and bears interest at the one-month LIBOR plus an adjustable margin (7.87% at January 27, 2008) based on the company's debt/EBITDA ratio, as defined in the agreement. This agreement requires the company to pay interest monthly with the entire principal due on June 30, 2010.

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

### Revolving Credit Agreement - United States

The company has an unsecured credit agreement that provides for a revolving loan commitment of \$6.5 million, including letters of credit up to \$5.5 million. This agreement bears interest at the one-month LIBOR plus an adjustable margin (6.49% at January 27, 2008) based on the company's debt/EBITDA ratio, as defined in the agreement. As of January 27, 2008, there were \$1.3 million in outstanding letters of credit (all of which related to workers compensation) and no borrowings outstanding under the agreement.

On December 27, 2007, the company entered into a twelfth amendment. This amendment extended the expiration date to December 31, 2008, provided greater flexibility by increasing the capital expenditure limit on a cash basis from \$4.0 million to \$5.0 million for fiscal year 2008, and amended certain other financial covenants as defined in the agreement.

### Revolving Credit Agreement - China

The company's China subsidiary has an unsecured revolving credit agreement with a bank in China to provide a line of credit available up to approximately \$5 million, of which approximately \$1 million includes letters of credit. The company borrowed a total of \$4.0 million in installments of \$1.3 million in February 2007, \$1.3 million in March 2007, and \$1.4 million in October 2007. There were no borrowings in the third quarter of fiscal 2008. Each installment is up for renewal one year from the date of borrowing and the bank is required to provide an advance notice of one year for repayment of each respective installment. The company paid off the \$1.3 million February 2007 installment in the third quarter of fiscal 2008. Interest is paid on a quarterly basis at a rate determined by the Chinese government (with interest rates ranging from 6.07% to 6.53% at January 27, 2008). As of January 27, 2008, approximately \$2.8

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million was outstanding under the agreement.

### Canadian Government Loan

The company has an agreement with the Canadian government to provide for a term loan that is non-interest bearing and is payable in 48 equal monthly installments commencing December 1, 2009. The proceeds are to partially finance capital expenditures at the company's Rayonese facility located in Quebec, Canada.

### Overall

The company's loan agreements require that the company maintain compliance with certain financial ratios. At January 27, 2008, the company was in compliance with these financial covenants.

The principal payment requirements of long-term debt during the next five years are: Year 1 - \$8.6 million; Year 2 - \$7.8 million; Year 3 - \$13.6 million; Year 4 - \$198,000; Year 5 - \$198,000; and thereafter - \$165,000.

### 9. Interest Rate Hedging

In connection with one of the company's real estate loans, the company was required to have an agreement to hedge the interest rate risk exposure on the real estate loan. The company entered into a \$2,170,000 notional principal interest rate swap, which represents 50% of the principal amount of the real estate loan, that effectively converted the floating rate LIBOR based payments to fixed payments at 4.99% plus the spread calculated under the real estate loan agreement. This agreement expires October 2010.

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The company accounts for the interest rate swap as a cash flow hedge whereby the fair value of this contract is reflected in other assets if the contract is in the company's favor or accrued expenses if the contract is in the bank's favor in the accompanying consolidated balance sheets with the offset recorded as accumulated other comprehensive income (loss). The fair value of the interest rate swap at January 27, 2008, was \$101,000 in the bank's favor and was immaterial to the company's financial statements at April 29, 2007. The fair value of the interest rate swap agreement was determined by quoted market prices.

### 10. Cash Flow Information

Payments for interest and income taxes are as follows:

(dollars in thousands)	January 27, 2008	Nine months ended J
Interest	\$ 2,026	
Income taxes (received) paid		436



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The company did not utilize any vendor financing for its capital expenditures for the nine months ended January 27, 2008 and January 28, 2007. Interest costs totaling \$98,000 were capitalized for the construction of qualifying fixed assets for the nine-months ended January 27, 2008. No interest costs were capitalized for the nine-months ending January 28, 2007.

### 11. Restructuring and Related Charges

The following summarizes the fiscal 2008 activity in the restructuring accrual (dollars in thousands):

(dollars in thousands)	Balance, April 29, 2007	Employee Termination Benefit Adjustments	Employee Termination Benefit Payments Net of Cobra Premiums	Lease Termination and Other Exit Cost Adjustments
December 2006 Upholstery fabrics (1)	\$ 1,545	\$ 6	\$ (465)	\$ 474
September 2005 Upholstery fabrics (2)	258	(34)	3	-
August 2005 Upholstery fabrics (3)	18	(32)	14	100
Fiscal 2005 Upholstery fabrics (4)	154	(87)	5	33
Fiscal 2003 Culp Decorative fabrics (5)	1,307	(13)	(32)	5
<b>Totals</b>	<b>\$ 3,282</b>	<b>\$ (160)</b>	<b>\$ (475)</b>	<b>\$ 612</b>

- (1) The restructuring accrual at January 27, 2008, represents employee termination benefits and lease termination and exit costs of \$847 and \$389, respectively. The restructuring accrual at April 29, 2007, represents employee termination benefits and lease termination and exit costs of \$1,304 and \$241, respectively.
- (2) The restructuring accrual at January 27, 2008, represents other exit costs of \$196. The restructuring accrual at April 29, 2007, represents employee termination benefits and lease termination and exit costs of \$31 and \$227, respectively.

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- (3) The restructuring accrual at April 29, 2007, represents employee termination benefits of \$18.
- (4) The restructuring accrual at January 27, 2008, represents employee termination benefits and lease termination and exit costs of \$18 and \$2, respectively. The restructuring accrual at April 29, 2007, represents employee termination benefits and lease termination and exit costs of \$100 and \$54, respectively.
- (5) The restructuring accrual at January 27, 2008, represents and lease termination and other exit costs of \$423. The restructuring accrual at April 29, 2007, represents employee termination benefits and lease termination and exit costs of \$43 and \$1,264, respectively.
- (6) The company's existing restructuring plans as of January 27, 2008, will be substantially completed by the end of fiscal 2008.

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The following summarizes restructuring and related charges incurred for the nine-month period ending January 27, 2008 (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	Emp Ter Be
December 2006 Upholstery fabrics (7)	\$ 953	\$ 474	\$ 482	\$ 535	\$ 184	\$
September 2005 Upholstery fabrics (8)	-	-	-	-	-	-
August 2005 Upholstery fabrics (9)	-	100	-	-	-	-
Fiscal 2005 Upholstery fabrics (10)	-	33	-	-	-	-
Fiscal 2003 Culp Decorative fabrics (11)	32	5	-	-	-	-
Totals	\$ 985	\$ 612	\$ 482	\$ 535	\$ 184	\$

- (7) Of this total charge, \$1,423 was recorded in cost of sales, \$65 was recorded in selling, general and administrative expense, and \$787 was recorded in restructuring expense in the 2008 Consolidated Statement of Net Income.
- (8) This \$34 credit was recorded in restructuring expense in the 2008 Consolidated Statement of Net Income.
- (9) This \$68 charge was recorded in restructuring expense in the 2008 Consolidated Statement of Net Income.
- (10) This \$54 credit was recorded in restructuring expense in the 2008 Consolidated Statement of Net Income.
- (11) Of this total charge, a credit of \$8 was recorded in restructuring expense and a charge of \$32 was recorded in cost of sales in the 2008 Consolidated Statement of Net Income.

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The following summarizes restructuring and related charges for the nine-month period ending January 28, 2007. (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	Accelerated Depreciation	Asset Movemen Costs
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December 2006 Upholstery fabrics (12)	\$	-	\$	-	\$	-	\$	2,161	\$	665	\$	
September 2005 Upholstery fabrics (13)		450		273		(40)		-		-		21
August 2005 Upholstery fabrics (14)		(19)		6		307		-		-		4
Fiscal 2005 Upholstery fabrics (15)		321		138		67		238		-		65
Fiscal 2003 Culp Decorative fabrics (16)		24		(22)		-		-		-		
Fiscal 2001 Culp Decorative fabrics (17)		26		-		-		-		-		
Totals	\$	802	\$	395	\$	334	\$	2,399	\$	665	\$	91

- (12) Of this total charge, \$2,826 was recorded in cost of sales and \$1,284 was recorded in restructuring expense in the 2007 Consolidated Statement of Net Loss. This restructuring plan was initiated in the third quarter of fiscal 2007.
- (13) Of this total charge, \$450 was recorded in cost of sales and \$62 was recorded in restructuring expense in the 2007 Consolidated Statement of Net Loss.
- (14) Of this total credit, a credit of \$19 was recorded in cost of sales, and a credit of \$127 was recorded in restructuring expense in the 2007 Consolidated Statement of Net Loss.
- (15) Of this total charge, \$502 was recorded in cost of sales, \$58 was recorded in selling, general, and administrative expenses and \$550 was recorded in restructuring expense in the 2007 Consolidated Statement of Net Loss.
- (16) Of this total charge, a credit of \$22 was recorded in restructuring expense and a charge of \$24 was recorded in cost of sales in the 2007 Consolidated Statement of Net Loss.
- (17) Of this total charge, \$26 was recorded in cost of sales and a credit of \$5 was recorded in restructuring expense in the 2007 Consolidated Statement of Net Loss.

The following summarizes restructuring and related charges incurred in the third quarter of fiscal 2008 (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	Em Term Be
December 2006 Upholstery fabrics (18)	\$ 211	\$ 57	\$ 93	\$ 131	\$ 57	\$
September 2005 Upholstery fabrics (19)	-	1	-	-	-	
August 2005 Upholstery fabrics (20)	-	-	-	-	-	
Fiscal 2005 Upholstery fabrics (21)	-	3	-	-	-	
Fiscal 2003 Culp Decorative fabrics (22)	20	7	-	-	-	

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Totals \$ 231 \$ 68 \$ 93 \$ 131 \$ 57 \$

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- (18) Of this total charge, \$329 was recorded in cost of sales, \$13 was recorded in selling, general, and administrative expenses, and \$430 was recorded in restructuring expense in the 2008 Consolidated Statement of Net Income.
- (19) This \$1 charge was recorded in restructuring expense in the 2008 Consolidated Statement of Net Income.
- (20) This \$4 credit was recorded in restructuring expense in the 2008 Consolidated Statement of Net Income.
- (21) This \$17 credit was recorded in restructuring expense in the 2008 Consolidated Statement of Net Income.
- (22) Of this total charge, \$20 charge was recorded in cost of sales and \$2 was recorded in restructuring expense in the 2008 Consolidated Statement of Net Income.

The following summarizes restructuring and related charges incurred in the third quarter of fiscal 2007 (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	Accelerated Depreciation	Asset Movement Costs	Em Ter B
December 2006 Upholstery fabrics (23)	\$ -	\$ -	\$ -	\$ 2,161	\$ 665	\$ -	\$ -
September 2005 Upholstery fabrics (24)	-	14	-	-	-	-	3
August 2005 Upholstery fabrics (25)	(68)	6	272	-	-	-	-
Fiscal 2005 Upholstery fabrics (26)	36	41	-	-	-	-	178
Fiscal 2003 Culp Decorative fabrics (27)	8	-	-	-	-	-	-
<b>Totals</b>	<b>\$ (24)</b>	<b>\$ 61</b>	<b>\$ 272</b>	<b>\$ 2,161</b>	<b>\$ 665</b>	<b>\$ 181</b>	<b>\$ -</b>

- (23) Of this total charge, \$2,826 was recorded in cost of sales and \$1,284 was recorded in restructuring expense in the 2007 Consolidated Statements of Net Loss. This restructuring plan was initiated in the third quarter of fiscal 2007.
- (24) This \$20 credit was recorded in restructuring expense in the 2007 Consolidated Statement of Net Loss.
- (25) Of this total credit, a credit of \$68 was recorded in cost of sales and a credit of \$177 was recorded in restructuring expense in the 2007 Consolidated Statement of Net Loss.

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- (26) Of this total charge, \$7 was recorded in cost of sales, \$28 was recorded in selling, general, and administrative expenses, and \$188 was recorded in restructuring expense in the 2007 Consolidated Statement of Net Loss.
- (27) This \$8 charge was recorded in cost of sales in the 2007 Consolidated Statement of Net Loss.

### 12. Assets Held for Sale and Related Impairments

At January 27, 2008, the company had assets held for sale with carrying values totaling \$5.0 million. These assets held for sale consist of the company's corporate headquarters and certain equipment related to the mattress fabrics segment with carrying values of \$4.8 million and \$189,000, respectively. The carrying value of these assets held for sale are presented separately in the 2008 Consolidated Balance Sheet and are no longer being depreciated.

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Culp, Inc.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

Effective October 29, 2007, the company adopted a plan to sell its corporate headquarters as the company is only utilizing one-half of the available space and with the sale can lower costs and reduce debt. The company expects that the final sale and disposal of the assets will be completed within a year from the date the plan was adopted and the sales proceeds will be used to repay the outstanding \$6.4 million mortgage balance. In connection with the plan of disposal, the company determined that the carrying value of their corporate headquarters was less than its fair value. Consequently, no impairment loss was recorded. The Company has entered into a contract dated March 11, 2008 providing for the sale of its headquarters building in High Point, North Carolina to Schwartz Properties, L.L.C., for a purchase price of \$7,350,000. The contract also contemplates that the Company would lease the building back from the purchaser for an initial term of five years, at a rental rate of \$56,800 per month on a "triple net" basis. The contract is subject to the purchaser's ability to obtain financing and is subject to a 90 day due diligence period, during which the purchaser may inspect the premises, conduct appraisals and other examinations, and during which the purchaser may terminate the contract without penalty. The closing is anticipated to occur during the first quarter of the Company's 2009 fiscal year. Based on the current terms of the contract, any gain realized from the final sale would be amortized over the life of the lease agreement, in accordance with SFAS No. 13, "Accounting for Leases," SFAS No. 28, "Accounting for Sales with Leasebacks (an amendment of SFAS No. 13), SFAS No. 66, "Accounting for Sales of Real Estate," and SFAS No. 98, "Accounting for Leases."

Effective January 2, 2008, the company adopted a plan to sell certain older and existing equipment related to its mattress fabrics segment that is being replaced by newer and more efficient equipment. In connection with the plan of disposal, the company determined that the carrying value of this equipment exceeded its fair value. Consequently, the company recorded an impairment loss of approximately \$256,000, which represents the excess of the carrying value of the assets over their values, less cost to sell. This impairment loss of \$256,000 was recorded in cost of sales in the 2008 Consolidated Statement of Net Income. The company sold these assets held for sale subsequent to the end of the third quarter of fiscal 2008 for \$189,000.

At April 29, 2007, the company had assets held for sale with carrying values totaling \$2.5 million. These assets held for sale consisted of buildings and certain equipment to be sold from the closure of the company's Lincolnton, NC and Graham, NC plant facilities. At January 27, 2008, all buildings and

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equipment classified as held for sale at April 29, 2007 have been sold. The company received sales proceeds totaling \$1.9 million and recorded impairment losses of \$482,000 in restructuring expense on these assets held sale in fiscal 2008. The carrying value of these assets held for sale are presented separately in the 2007 Consolidated Balance Sheet and were not depreciated in fiscal 2008.

### 13. Net Income (Loss) Per Share

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

(amounts in thousands)	January 27, 2008	Three months ended January 28, 2007
Weighted average common shares outstanding, basic	12,635	
Effect of dilutive stock options	103	
Weighted average common shares outstanding, diluted	12,738	

Options to purchase 178,500 and 458,750 shares of common stock were not included in the computation of diluted net income (loss) per share for the three months ended January 27, 2008 and January 28, 2007, respectively, because the exercise price of the options was greater than the average market price of the common shares.

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Options to purchase 2,847 shares of common stock were not included in the computation of diluted loss per share for the three months ended January 28, 2007, because the company incurred a net loss for the period.

(amounts in thousands)	January 27, 2008	Nine months ended January 28, 2007
Weighted average common shares outstanding, basic	12,617	
Effect of dilutive stock options	153	
Weighted average common shares outstanding, diluted	12,770	

Options to purchase 28,500 and 452,792 shares of common stock were not included in the computation of diluted net income (loss) per share for the nine months ended January 27, 2008 and January 28, 2007, respectively, because the exercise

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price of the options was greater than the average market price of the common shares.

Options to purchase 3,168 shares of common stock were not included in the computation of diluted net loss per share for the nine months ended January 28, 2007, because the company incurred a net loss for the period.

14. Segment Information

The company's operations are classified into two 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.

The company evaluates the operating performance of its segments based upon income (loss) from operations before restructuring and related charges or credits, certain unallocated corporate expenses, and certain other non-recurring items. 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 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 other current and non-current assets associated with the ITG acquisition. The upholstery fabrics segment also includes assets held for sale in segment assets.

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Financial information for the company's operating segments is as follows:

(dollars in thousands)	January 27, 2008	Three months ended J
-----		
Net sales:		
Mattress Fabrics	\$ 30,880	
Upholstery Fabrics	29,602	
-----		
Total net sales	\$ 60,482	
-----		
Gross profit:		
Mattress Fabrics	\$ 4,200	
Upholstery Fabrics	3,181	
-----		
Total segment gross profit	7,381	
Loss on impairment of equipment	(256)	(1)
Restructuring related charges	(349)	(2)
-----		
Total gross profit	\$ 6,776	
-----		
Selling, general, and administrative expenses:		
Mattress Fabrics	\$ 1,571	
Upholstery Fabrics	2,787	

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Total segment selling, general, and administrative expenses		4,358
Unallocated corporate expenses		746
Restructuring related charges		13 (2)
<hr/>		
Total selling, general, and administrative expenses	\$	5,117
<hr/>		
Income (loss) from operations:		
Mattress Fabrics	\$	2,628
Upholstery Fabrics		395
<hr/>		
Total segment income from operations		3,023
Unallocated corporate expenses		(746)
Loss on impairment of equipment		(256) (1)
Restructuring and related charges		(774) (3)
<hr/>		
Total income (loss) from operations		1,247
Interest expense		(753)
Interest income		77
Other income		72
<hr/>		
Income (loss) before income taxes	\$	643

- (1) The \$256 represents an impairment loss on older and existing equipment that was sold after January 27, 2008 and is being replaced by newer and more efficient equipment. This impairment loss pertains to the mattress fabrics segment.
- (2) The \$349 restructuring related charge represents \$218 for other operating costs associated with closed plant facilities and \$131 for inventory markdowns. The \$13 restructuring related charge represents other operating costs associated with closed plant facilities.
- (3) The \$774 restructuring and related charges represents \$238 for employee termination benefits, \$231 for other operating costs associated with closed plant facilities, \$131 for inventory markdowns, \$93 for a write-down of a building, \$68 for lease termination and other exit costs, \$57 for asset movement costs, and a credit of \$44 for sales proceeds received on equipment with no carrying value. Of this total charge, \$349 was recorded in cost of sales, \$13 was recorded in selling, general, and administrative expenses, and \$412 was recorded in restructuring expense. The total \$774 restructuring and related charge pertains to the upholstery fabrics segment.

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- (4) The \$2.8 million represents restructuring related charges of \$2.2 million for inventory markdowns, \$665 for accelerated depreciation, and a credit of \$52 for other operating costs associated with closed plant facilities. The \$28 restructuring related charge represents other operating costs associated with closed plant facilities.
- (5) The \$4.1 million restructuring and related charges represents \$2.2 million for inventory markdowns, \$1.2 million for employee termination benefits, \$665 for accelerated depreciation, \$272 for write-downs of equipment, \$181 for asset movement costs, \$61 for lease termination and other exit costs, a credit of \$24 for other operating costs associated with closed plant facilities, and a credit of \$455 for sales proceeds received on equipment



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with no carrying value. Of this total charge, \$2.8 million was recorded in cost of sales, \$28 was recorded in selling, general, and administrative expenses, and \$1.3 million was recorded in restructuring expense. The total \$4.1 million restructuring and related charge pertains to the upholstery fabrics segment.

(dollars in thousands)	January 27, 2008	Nine months ended J
-----		
Net sales:		
Mattress Fabrics	\$ 103,426	
Upholstery Fabrics	86,622	
-----		
Total net sales	\$ 190,048	
-----		
Gross profit:		
Mattress Fabrics	\$ 16,043	
Upholstery Fabrics	9,922	
-----		
Total segment gross profit	25,965	
Loss on impairment of equipment	(256)	(1)
Restructuring related charges	(1,455)	(6)
-----		
Total gross profit	\$ 24,254	
-----		
Selling, general, and administrative expenses:		
Mattress Fabrics	\$ 5,779	
Upholstery Fabrics	8,877	
-----		
Total segment selling, general, and administrative expenses	14,656	
Unallocated corporate expenses	2,554	
Restructuring related charges	65	(6)
-----		
Total selling, general, and administrative expenses	\$ 17,275	
-----		

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Income (loss) from operations:		
Mattress Fabrics	\$ 10,264	
Upholstery Fabrics	1,045	
-----		
Total segment income from operations	11,309	
Unallocated corporate expenses	(2,554)	
Loss on impairment of equipment	(256)	(1)
Restructuring and related charges	(2,279)	(7)
-----		
Total income (loss) from operations	6,220	
Interest expense	(2,380)	

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Interest income		197
Other expense (income)		(625)
Income (loss) before income taxes	\$	3,412

- (6) The \$1.4 million restructuring related charge represents \$920 for other operating costs associated with closed plant facilities and \$535 for inventory markdowns. The \$65 restructuring related charge represents other operating costs associated with closed plant facilities.
- (7) The \$2.3 million restructuring and related charge represents \$985 for other operating costs associated with closed plant facilities, \$612 for lease termination and other exit costs, \$535 for inventory markdowns, \$482 for write-downs of buildings and equipment, \$184 for asset movement costs, a credit of \$160 for employee termination benefits, and a credit of \$359 for sales proceeds received on equipment with no carrying value. Of this total charge, \$1.4 million was recorded in cost of sales, \$65 was recorded in selling, general, and administrative expenses, and \$759 was recorded in restructuring expense. The total \$2.3 million restructuring and related charge pertains to the upholstery fabrics segment.
- (8) The \$3.8 million represents restructuring related charges of \$2.3 million for inventory markdowns, \$744 for other operating costs associated with the closed plant facilities, and \$665 for accelerated depreciation. The \$58 restructuring related charge represents other operating costs associated with closed plant facilities.
- (9) The \$5.6 million represents restructuring and related charges of \$2.3 million for inventory markdowns, \$990 for employee termination benefits, \$914 for asset movement costs, \$802 for other operating costs associated with closed plant facilities, \$665 for accelerated depreciation, \$395 for lease termination and other exit costs, \$334 for write-downs of buildings and equipment, and a credit of \$890 for sales proceeds received on equipment with no carrying value. Of this total charge, \$3.8 million was recorded in cost of sales, \$58 was recorded in selling, general, and administrative expenses, and \$1.7 million was recorded in restructuring expense. The total \$5.6 million restructuring and related charge pertains to the upholstery fabrics segment.

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

(dollars in thousands)		January 27, 2008
Segment assets:		
Mattress Fabrics		
Current assets (10)	\$	27,574
Assets held for sale		189
Non-compete agreement, net		861
Goodwill		4,114
Property, plant and equipment (11)		19,763
Total mattress fabrics assets		52,501

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Upholstery Fabrics	
Current assets (12)	33,719
Assets held for sale	-
Property, plant and equipment (13)	12,415
-----	
Total upholstery fabrics assets	46,134
-----	
Total segment assets	98,635
Non-segment assets:	
Cash and cash equivalents	15,500
Assets held for sale	4,783
Deferred income taxes	31,369
Other current assets	995
Income taxes receivable	423
Property, plant and equipment	40
Other assets	1,581
-----	
Total assets	\$ 153,326
-----	

(dollars in thousands)	January 27, 2008	Nine months ended January 27, 2008
Capital expenditures:		
Mattress Fabrics	\$ 1,680	
Upholstery Fabrics	2,361	
-----		
Total capital expenditures	\$ 4,041	
-----		
Depreciation expense:		
Mattress Fabrics	\$ 2,668	
Upholstery Fabrics	1,596	
-----		
Total segment depreciation expense	4,264	
Accelerated depreciation	-	
	\$ 4,264	
-----		

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- (10) Current assets represent accounts receivable and inventory. At April 29, 2007 current assets also included a credit of future purchases of inventory associated with the ITG acquisition of \$527,000. This credit of future purchases of inventory was fully utilized at January 27, 2008.
- (11) The \$19.8 million at January 27, 2008, represents property, plant and equipment located in the U.S. of \$10.2 million, located in Canada at \$9.4 million, and various corporate allocations of \$177,000. The \$22.8 million at April 29, 2007, represents property, plant and equipment located in the U.S. of \$10.9 million, located in Canada at \$10.0 million, and various corporate allocations of \$1.9 million. The corporate allocation of \$1.9 million at April 29, 2007 primarily related to the corporate headquarters which is classified in assets held for sale at January 27, 2008.
- (12) Current assets represent accounts receivable and inventory for the respective segment.

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- (13) The \$12.4 million at January 27, 2008, represents property, plant and equipment located in China of \$9.2 million, located in the U.S. of \$2.7 million, and various corporate allocations of \$532,000. The \$14.9 million at April 29, 2007, represents property, plant and equipment located in China of \$7.7 million, located in the U.S. of \$3.4 million, and various corporate allocations of \$3.8 million. The corporate allocation of \$3.8 million at April 29, 2007 primarily related to the company's corporate headquarters which is classified in assets held for sale at January 27, 2008.

### 15. Income Taxes

#### Uncertainty In Income Taxes

During the first quarter of fiscal 2008, the company adopted Financial Accounting Standards Board (FASB) Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (FIN 48) which supplements SFAS No. 109, "Accounting for Income Taxes", by defining the confidence level that a tax position must meet in order to be recognized in the financial statements. FIN 48 requires that the tax effects of a position to be recognized only if it is "more-likely-than-not" to be sustained based solely on its technical merits as of the reporting date. The more-likely-than-not threshold represents a positive assertion by management that a company is entitled to the economic benefits of a tax position. If a tax position is not considered more-likely-than-not to be sustained based solely on its technical merits, no benefits of the tax position are to be recognized. Moreover, the more-likely-than-not threshold must continue to be met in each reporting period to support continued recognition of the benefit. With the adoption of FIN 48, entities are required to adjust their financial statements to reflect only those tax positions that are more-likely-than-not to be sustained. Any necessary adjustment would be recorded directly to retained earnings and reported as a change in accounting principle. The company adopted FIN 48 as of April 30, 2007, and recorded an increase in retained earnings of \$847,000 as a cumulative effect of a change in accounting principle.

In May 2007, FASB issued FASB Staff Position FIN 48-1, "Definition of Settlement in FASB Interpretation No.48" ("FSP FIN 48-1"). FSP FIN 48-1 provides guidance on whether a tax position is effectively settled for the purpose of recognizing previously unrecognized tax benefits. No adjustment was made upon adoption of FSP FIN 48-1.

Upon adoption of FIN 48 as of April 30, 2007, the company had approximately \$3.4 million of total gross unrecognized tax benefits, of which \$3.1 million represents the amount of gross unrecognized tax benefits that, if recognized, would favorably affect the income tax rate in future periods. At January 27, 2008, the company had approximately \$4.5 million of total gross unrecognized tax benefits, of which \$4.2 million represents the amount of gross unrecognized tax benefits that, if recognized, would favorably affect the income tax rate in future periods. The total gross unrecognized tax benefits of \$4.5 million as of January 27, 2008, are classified as income taxes payable - long-term in the accompanying consolidated balance sheets.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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The company has elected to classify interest and penalties, accrued as required by FIN 48, as part of income tax expense. Upon adoption of FIN 48 as of April 30, 2007 and at January 27, 2008, the gross amount of interest and penalties due

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to unrecognized tax benefits was \$98,000 and \$88,000, respectively. We anticipate that the amount of unrecognized tax benefits will increase by approximately \$1.4 million by the end of the fiscal year. This increase primarily relates to double taxation under applicable tax treaties with foreign tax jurisdictions. United States federal and state tax returns filed by the company remain subject to examination for tax years 2002 and subsequent due to loss carryforwards. Canadian federal and provincial returns remain subject to examination of tax years 2003 and subsequent.

### Deferred Income Taxes

In making the judgment about the realization of the deferred tax assets, management has considered both the negative and positive evidence, and concluded that sufficient positive evidence exists to overcome the cumulative losses experienced in recent years. Specifically, management considered the following, among other factors: nature of the company's products; history of positive earnings in the mattress fabrics segment; capital projects in progress to further enhance the company's globally competitive cost structure in the mattress fabrics segment; recent restructuring actions in the U.S. upholstery fabrics business to adjust the U.S. cost structure and bring U.S. manufacturing capacity in line with demand; development of offshore manufacturing and sourcing programs to meet changing demands of upholstery fabric customers in the U.S.; and the incremental sales volume from the purchase of certain assets from ITG related to the mattress fabric product line of ITG's Burlington House Division. Management's analysis of taxable income also included the following considerations: none of the company's net operating loss carryforwards have previously expired unused; the U.S. federal carryforward period is 20 years; and the company's current income tax loss carryforwards principally expire in 16-20 years; fiscal 2022 through 2027. The amount of the deferred tax assets is considered realizable, however, could be reduced if estimates of future taxable income during the carryforward period are reduced.

U.S. Federal and state net operating loss carryforwards with related future tax benefits on a gross basis were approximately \$72.0 million at January 27, 2008.

### Effective Income Tax Rate

The effective income rate (income taxes as a percentage of income before income taxes) for the nine month period ended January 27, 2008, was 3.1% compared to an income tax benefit of 54.7% for the nine month period ended January 28, 2007. This effective income tax rate of 3.1% primarily reflects higher taxable income from the company's U.S. operations in fiscal 2008 compared to fiscal 2007, offset by the projected income tax effects related to the fiscal 2008 foreign exchange loss on Canadian income taxes, and an income tax refund of \$470,000 in the third quarter of fiscal 2008 related to income tax incentives in China. This higher taxable income from the company's U.S. operations reflects increased profitability in the mattress fabrics segment and lower estimated restructuring and related charges for fiscal 2008 compared to fiscal 2007. The income tax benefit of 54.7% for the nine month period ended January 28, 2007, primarily reflected pre-tax losses from the company's U.S. operations due to restructuring activities and lower income tax rates on income from foreign sources.

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Culp, Inc.  
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The company's income tax expense and effective income tax rate for the nine month periods ended January 27, 2008 and January 28, 2007, were based upon the

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estimated effective income tax rate applicable for the full years after giving effect to any significant items related specifically to interim periods. The effective income tax rate can be impacted over the fiscal year by the mix and timing of actual earnings from the company's U.S. operations and foreign sources versus annual projections and changes in the foreign currency in relation to the U.S. dollar.

### 16. Statutory Reserves

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

The transfer to this reserve must be made before distribution of any dividend to shareholders. As of January 27, 2008, the company's statutory surplus reserve was \$1.1 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.

### 17. Commitments and Contingencies

At January 27, 2008, the company had commitments to acquire equipment with regards to its mattress fabrics segment for approximately \$4.0 million.

A lawsuit was filed against the Company and other defendants (Chromatex, Inc., Rossville Industries, Inc., Rossville Companies, Inc. and Rossville Investments, Inc.) on February 5, 2008 in the United States District Court for the Middle District of Pennsylvania. The plaintiffs are Alan Shulman, Stanley Siegel, Ruth Cherson as Personal Representative of the Estate of Alan Cherson, 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. the Company leased and operated the Site as part of the Company's 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 totaling approximately \$8.6 million. 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 the 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 Company does not believe it has any liability for the matters described in this litigation and intends to defend itself vigorously. In addition, the Company has an indemnification agreement with certain other defendants in the litigation pursuant to which the other defendants agreed to indemnify the Company for any damages it incurs as a result of the environmental matters that are the subject of this litigation and consequently no reserve has been recorded.

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### 18. Recently Issued Accounting Pronouncements

In September 2006, The FASB issued SFAS No. 157, "Fair Value of Measurements," which provides enhanced guidance for using fair value to measure assets and liabilities. SFAS No. 157 establishes a common definition of fair value, provides a framework for measuring fair value under accounting principles generally accepted in the United States and expands disclosure requirements about fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 and is effective for the company in the first quarter of fiscal 2009. The company is currently evaluating the impact, if any, the adoption of SFAS No. 157 will have on its 2009 consolidated financial statements.

In February 2007, the FASB issued Statement No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities." This statement, which is expected to expand fair value measurement, permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007 and is effective for the company in the first quarter of fiscal 2009. The company is currently evaluating the impact, if any, the adoption of SFAS No. 159 will have on its 2009 consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007) "Business Combinations." SFAS No. 141 requires the acquiring entity in a business combination to recognize all the assets acquired and liabilities assumed in the transaction; establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; and requires the acquirer to disclose all information required to evaluate and understand the nature and financial effect of the business combination. This statement is effective for acquisition dates on or after the beginning of the first annual reporting period beginning after December 15, 2008. This statement is effective for the company in fiscal 2010 and is not expected to have a material effect on our consolidated financial statements to the extent that we do not enter into business combinations subsequent to adoption.

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### 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 derivatives, 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 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

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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. Finally, unanticipated delays or costs in executing restructuring actions could cause the cumulative effect of restructuring actions to fail to meet the objectives set forth by management. 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 19, 2007 for the fiscal year ended April 29, 2007.

### 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.

#### Overview

Culp, Inc. has operations classified into two business segments: mattress fabrics and upholstery fabrics. The mattress fabrics segment manufactures, sources, and sells fabrics to bedding manufacturers. The upholstery fabrics segment sources, manufactures, and sells fabrics 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.

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The company evaluates the operating performance of its segments based upon income (loss) from operations before restructuring and related charges or credits, certain unallocated corporate expenses, and certain other non-recurring items. 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 in segment assets, assets held for sale, goodwill and other current and non-current assets associated with the ITG acquisition. The upholstery fabrics segment also includes assets held



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for sale in segment assets.

The following tables set forth the net sales, gross profit, selling, general and administrative expenses and operating income (loss) by segment for the three months and nine months ended January 27, 2008, and January 28, 2007.

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CULP, INC.  
SALES, GROSS PROFIT AND OPERATING INCOME (LOSS) BY SEGMENT  
FOR THE THREE MONTHS ENDED JANUARY 27, 2008 AND JANUARY 28, 2007

(Amounts in thousands)

Net Sales by Segment	THREE MONTHS ENDED (UNAUDITED)			
	Amounts			Percent
	January 27, 2008	January 28, 2007	% Over (Under)	January 27, 2008
Mattress Fabrics	\$ 30,880	24,396	26.6 %	51.
Upholstery Fabrics	29,602	31,316	(5.5) %	48.
Net Sales	\$ 60,482	55,712	8.6 %	100.
Gross Profit by Segment	Gross			
Mattress Fabrics	\$ 4,200	4,215	(0.4) %	13.
Upholstery Fabrics	3,181	3,269	(2.7) %	10.
Subtotal	7,381	7,484	(1.4) %	12.
Loss on impairment of equipment	(256) (1)	-	(100.0) %	(0.
Restructuring related charges	(349) (2)	(2,773) (4)	(87.4) %	(0.
Gross Profit	\$ 6,776	4,711	43.8 %	11.
Selling, General and Administrative expenses by Segment	Perc			
Mattress Fabrics	\$ 1,571	1,706	(7.9) %	5.
Upholstery Fabrics	2,787	3,765	(26.0) %	9.
Unallocated Corporate expenses	746	895	(16.6) %	1.
Subtotal	5,104	6,366	(19.8) %	8.
Restructuring related charges	13 (2)	28 (4)	(53.6) %	0.

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Selling, General and Administrative expenses	\$	5,117	6,394	(20.0)%	8.
		=====	=====	=====	=====
Operating Income (loss) by Segment					
-----					
Mattress Fabrics	\$	2,628	2,509	4.7 %	8.
Upholstery Fabrics		395	(496)	179.6 %	1.
Unallocated corporate expenses		(746)	(895)	(16.6)%	(1.
		-----	-----	-----	-----
Subtotal		2,277	1,118	103.7 %	3.
Loss on impairment of equipment		(256) (1)	-	(100.0)%	(0.
Restructuring expense and restructuring related charges		(774) (3)	(4,076) (5)	(81.0)%	(1.
		-----	-----	-----	-----
Operating income (loss)	\$	1,247	(2,958)	142.2 %	2.
		=====	=====	=====	=====
Depreciation by Segment					
-----					
Mattress Fabrics	\$	874	912	(4.2)%	
Upholstery Fabrics		497	710	(30.0)%	
		-----	-----	-----	
Subtotal		1,371	1,622	(15.5)%	
Accelerated Depreciation		-	665	(100.0)%	
		-----	-----	-----	
Total Depreciation		1,371	2,287	(40.1)%	
		=====	=====	=====	

Notes:

- (1) The \$256 represents an impairment loss on older and existing equipment that was sold after January 1, 2018, as it is being replaced by newer and more efficient equipment. This impairment loss pertains to the upholstery fabrics segment.
- (2) The \$349 restructuring related charge represents \$218 for other operating costs associated with closed plant facilities and \$131 for inventory markdowns. The \$13 restructuring related charge represents other operating costs associated with closed plant facilities.
- (3) The \$774 restructuring and related charges represents \$238 for employee termination benefits, \$131 for inventory markdowns, \$93 for other operating costs associated with closed plant facilities, \$131 for inventory markdowns, \$93 for lease termination and other exit costs, \$57 for asset movement costs, and a credit of \$24 for other operating costs associated with closed plant facilities. Of this total charge, \$349 was recorded in cost of sales, \$13 was recorded in selling, general, and administrative expenses, and \$412 was recorded in restructuring expense. The total \$774 restructuring and related charge pertains to the upholstery fabrics segment.
- (4) The \$2.8 million represents restructuring related charges of \$2.2 million for inventory markdowns, \$665 for accelerated depreciation, and a credit of \$52 for other operating costs associated with closed plant facilities. The \$28 restructuring related charge represents other operating costs associated with closed plant facilities.
- (5) The \$4.1 million restructuring and related charges represents \$2.2 million for inventory markdowns, \$665 for accelerated depreciation, \$272 for write-downs of other operating costs, \$61 for lease termination and other exit costs, a credit of \$24 for other operating costs associated with closed plant facilities, and a credit of \$455 for sales proceeds received on equipment with no carrying value. Of this total charge, \$2.8 million was recorded in cost of sales, \$28 was recorded in selling, general, and administrative expenses and \$1.3 million was recorded in restructuring expense. The total \$4.1 million restructuring and related charge pertains to the upholstery fabrics segment.

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CULP, INC.  
 SALES, GROSS PROFIT AND OPERATING INCOME (LOSS) BY SEGMENT  
 FOR THE NINE MONTHS ENDED JANUARY 27, 2008 AND JANUARY 28, 2007

(Amounts in thousands)

	NINE MONTHS ENDED (UNAUDITED)			
	Amounts		% Over (Under)	Percent January 27, 2008
	January 27, 2008	January 28, 2007		
Net Sales by Segment				
Mattress Fabrics	\$ 103,426	69,734	48.3 %	54
Upholstery Fabrics	86,622	107,603	(19.5) %	45
Net Sales	\$ 190,048	177,337	7.2 %	100
Gross Profit by Segment				
Mattress Fabrics	\$ 16,043	11,880	35.0 %	15
Upholstery Fabrics	9,922	12,691	(21.8) %	11
Subtotal	25,965	24,571	5.7 %	13
Loss on impairment of equipment	(256) (1)	-	(100.0) %	(0)
Restructuring related charges	(1,455) (2)	(3,809) (4)	(61.8) %	(0)
Gross Profit	\$ 24,254	20,762	16.8 %	12
Selling, General and Administrative expenses by Segment				
Mattress Fabrics	\$ 5,779	5,043	14.6 %	5
Upholstery Fabrics	8,877	11,219	(20.9) %	10
Unallocated Corporate expenses	2,554	2,920	(12.5) %	1
Subtotal	17,210	19,182	(10.3) %	9
Restructuring related charges	65 (2)	58 (4)	12.1 %	0
Selling, General and Administrative expenses	\$ 17,275	19,240	(10.2) %	9
Operating Income (loss) by Segment				

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Mattress Fabrics	\$	10,264	6,837	50.1 %	9
Upholstery Fabrics		1,045	1,472	(29.0) %	1
Unallocated corporate expenses		(2,554)	(2,920)	(12.5) %	(1)
		-----	-----	-----	-----
Subtotal		8,755	5,389	62.5 %	4
Loss on impairment of equipment		(256) (1)	-	(100.0) %	(0)
Restructuring expense and restructuring related charges		(2,279) (3)	(5,609) (5)	(59.4) %	(1)
		-----	-----	-----	-----
Operating income (loss)	\$	6,220	(220)	N.M.	3
		=====	=====	=====	=====

Depreciation by Segment

-----

Mattress Fabrics	\$	2,668	2,771	(3.7) %
Upholstery Fabrics		1,596	2,215	(27.9) %
		-----	-----	-----
Subtotal		4,264	4,986	(14.5) %
Accelerated Depreciation		-	665	(100.0) %
		-----	-----	-----
Total Depreciation		4,264	5,651	(24.5) %
		=====	=====	=====

Notes:

- (1) The \$256 represents an impairment loss on older and existing equipment that was sold after January 27, 2008, after being replaced by newer and more efficient equipment. This impairment loss pertains to the mattress fabrics segment.
- (2) The \$1.4 million restructuring related charge represents \$920 for other operating costs associated with the closed plant facilities and \$535 for inventory markdowns. The \$65 restructuring related charge represents other operating costs associated with plant facilities.
- (3) The \$2.3 million represents \$985 for other operating costs associated with closed plant facilities, \$482 for write-downs of buildings and equipment, \$535 for inventory markdowns, \$482 for write-downs of buildings and equipment, a credit of \$160 for employee termination benefits, and a credit of \$160 for equipment received on equipment with no carrying value. Of this total charge, \$1.4 million was recorded in selling, general, and administrative expenses, and \$759 was recorded in restructuring expense. The total \$2.3 million restructuring and related charge pertains to the upholstery fabrics segment.
- (4) The \$3.8 million represents restructuring related charges of \$2.3 million for inventory markdowns, \$665 for accelerated depreciation, and \$890 for sales proceeds received on equipment. The \$665 restructuring related charge represents other operating costs associated with closed plant facilities.
- (5) The \$5.6 million represents restructuring and related charges of \$2.3 million for inventory markdowns, \$914 for asset movement costs, \$802 for other operating costs associated with closed plant facilities, \$665 for accelerated depreciation, \$395 for lease termination and other exit costs, and a credit of \$890 for sales proceeds received on equipment. Of this total charge, \$3.8 million was recorded in cost of sales, \$58 was recorded in selling, general, and administrative expenses, and \$1.7 million was recorded in restructuring expense. The total \$5.6 million restructuring and related charge pertains to the upholstery fabrics segment.

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Three and Nine Months ended January 27, 2008 compared with the Three and Nine Months ended January 28, 2007

Overview

For the three months ended January 27, 2008, net sales were \$60.5 million, up 9% compared with \$55.7 million for the third quarter of fiscal 2007. The company reported net income of \$903,000, or \$0.07 per diluted share, for the third quarter of fiscal 2008, which included restructuring and related pre-tax charges

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of \$774,000. The company reported a net loss of \$2.2 million, or \$0.19 per diluted share, for the third quarter of fiscal 2007, which included restructuring and related pre-tax charges of \$4.1 million.

For the nine months ended January 27, 2008, net sales were \$190.0 million, up 7% compared with \$177.3 million for the nine months ended January 28, 2007. The company reported net income of \$3.3 million, or \$0.26 per diluted share, for the nine months ended January 27, 2008, which included restructuring and related pre-tax charges of \$2.3 million. The company reported a net loss of \$1.3 million, or \$0.11 per diluted share for the nine months ended January 28, 2007, which included restructuring and related pre-tax charges of \$5.6 million.

### Restructuring and Related Charges

During the third quarter of fiscal 2008, total restructuring and related charges were \$774,000, of which \$238,000 related to employee termination benefits, \$231,000 for other operating costs associated with closed plant facilities, \$131,000 for inventory markdowns, \$93,000 for a write-down of a building, \$68,000 for lease termination and other exit costs, \$57,000 for asset movement costs, and a credit of \$44,000 for sales proceeds received on equipment with no carrying value. Of this total charge, \$349,000 was recorded in cost of sales, \$13,000 was recorded in selling, general, and administrative expense, and \$412,000 was recorded in restructuring expense in the 2008 Consolidated Statement of Net Income. These charges primarily relate to the December 2006 Upholstery Fabrics restructuring plan.

During the third quarter of fiscal 2007, total restructuring and related charges were \$4.1 million, of which \$2.2 million related to inventory markdowns, \$1.2 million for employee termination benefits, \$665,000 for accelerated depreciation, \$272,000 for write-downs of equipment, \$181,000 for asset movement costs, \$61,000 for lease termination and other exit costs, a credit of \$24,000 for other operating costs associated with closed plant facilities, and a credit of \$455,000 for sales proceeds received on equipment with no carrying value. Of this total charge, \$2.8 million was recorded in cost of sales, \$28,000 was recorded in selling, general, and administrative expense, and \$1.3 million was recorded in restructuring expense in the 2007 Consolidated Statement of Net Loss. These charges primarily relate to the December 2006 Upholstery Fabrics restructuring plan.

During the nine months ended January 27, 2008, total restructuring and related charges were \$2.3 million, of which \$985,000 related to other operating costs associated with closed plant facilities, \$612,000 for lease termination and other exit costs, \$535,000 for inventory markdowns, \$482,000 for write-downs of buildings and equipment, \$184,000 for asset movement costs, a credit of \$160,000 for employee termination benefits, and a credit of \$359,000 for sales proceeds received on equipment with no carrying value. Of this total charge, \$1.4 million was recorded in cost of sales, \$65,000 was recorded in selling, general, and administrative expense, and \$759,000 was recorded in restructuring expense in the 2008 Consolidated Statement of Net Income. These charges primarily relate to the December 2006 Upholstery Fabrics restructuring plan.

During the nine months ended January 28, 2007, total restructuring and related charges were \$5.6 million, of which \$2.3 million related to inventory markdowns, \$990,000 for employee termination benefits, \$914,000 for asset movement costs, \$802,000 for other operating costs associated with closed plant facilities, \$665,000 for accelerated depreciation, \$395,000 for lease termination and other exit costs, \$334,000 for write-downs of buildings and equipment, and a credit of \$890,000 for sales proceeds received on equipment with no carrying value. Of this total charge, \$3.8 million was recorded in cost of sales, \$58,000 was recorded in selling, general, and administrative expense, and \$1.7 million was recorded in restructuring expense in the 2007 Consolidated Statement of Net Loss. These charges primarily relate to the December 2006, September 2005, and

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Fiscal 2005 Upholstery Fabrics restructuring plans.

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### Mattress Fabrics Segment

Net Sales -- Mattress fabrics (known as mattress ticking) net sales for the third quarter of fiscal 2008 were \$30.9 million, a 27% increase compared with \$24.4 million for the third quarter of fiscal 2007. Mattress fabric sales represented 51% of total company sales for the third quarter of fiscal 2008, compared with 44% for the third quarter of fiscal 2007. On a unit volume basis, total yards sold for the third quarter of fiscal 2008 increased by 21% compared with the third quarter of fiscal 2007. This trend primarily reflects the incremental sales related to the company's acquisition of ITG's mattress fabrics product line in January 2007. The increase in net sales for the third quarter of fiscal 2008 of 27% compared to the third quarter of fiscal 2007 is lower than the previous quarters since the acquisition due to the planned discontinuance of certain ITG products that did not fit the company's business model.

For the nine months ended January 27, 2008, net sales were \$103.4 million, a 48% increase compared with \$69.7 million for the nine months ended January 28, 2007. On a unit volume basis, total yards sold for the nine months ended January 27, 2008, increased by 42% compared with the nine months ended January 28, 2007. Mattress fabric sales represented 54% of total company sales for the nine-month period ending January 27, 2008, compared with 39% for the nine-month period ending January 28, 2007. These trends primarily reflect the incremental sales related to the company's acquisition of ITG's mattress fabrics product line in January 2007.

The average selling price of \$2.42 for the third quarter of fiscal 2008 increased 4% over the same period a year ago. The average selling price of \$2.42 for the nine months ended January 27, 2008, increased 5% over the same period a year ago. This trend reflects a shift in product mix toward more knitted fabrics, which have a higher average selling price.

Operating Income -- For the third quarter of fiscal 2008, the mattress fabrics segment reported operating income of \$2.6 million, or 9% of net sales, compared to \$2.5 million, or 10% of net sales, for the third quarter of fiscal 2007. For the nine months ended January 27, 2008, the mattress fabrics segment reported operating income of \$10.3 million, or 10% of net sales, compared to \$6.8 million, or 10% of net sales for the nine months ended January 28, 2007. The increase in operating income attributed to the incremental sales related to the company's acquisition of ITG's mattress fabrics product line was offset by higher raw material costs, increased Canadian operating expenses due to the strengthening of the Canadian currency as compared to the same period last year, transition costs associated with the ITG acquisition of approximately \$500,000 in the first quarter of fiscal 2008, and the sale of some excess inventory related to the ITG acquisition at reduced margins.

To offset these higher costs, the company has implemented a price increase, effective in March 2008. In addition, the company is making strategic investments to enhance its manufacturing platform and provide additional reactive capacity in mattress fabrics. During the next few months, the company will be implementing a \$5 million capital project that includes expansion of the weaving and finishing operations in the Stokesdale, NC facility. This project is expected to be completed during the first quarter of fiscal 2009. This state-of-the-art equipment and additional capacity will allow this segment to operate more efficiently on lower inventories and provide even faster response time to our customers. Additionally, this capital project will more effectively position the company to pursue additional growth opportunities and further

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extend our leadership position in mattress fabrics.

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Selling, general, and administrative expenses as a percentage of net sales were 5.1% in the third quarter of fiscal 2008 compared with 7.0% in the third quarter of fiscal 2007. Selling, general, and administrative expenses were 5.6% and 7.2% for the nine months ended January 27, 2008 and January 28, 2007, respectively. This trend primarily reflects the additional sales from the ITG acquisition.

Segment assets -- Segment assets consist of accounts receivable, inventory, a non-compete agreement associated with the ITG acquisition, goodwill, assets held for sale, and property, plant, and equipment. As of January 27, 2008, accounts receivable and inventory totaled \$27.6 million compared with \$32.9 million at April 29, 2007. At April 29, 2007, current assets for this segment also included a credit for future purchases of inventory associated with the ITG acquisition of \$527,000. This credit for future purchases of inventory was fully utilized at January 27, 2008. As of January 27, 2008 and April 29, 2007, the carrying values of the non-compete agreement were \$861,000 and \$1.1 million, respectively. As of January 27, 2008 and April 29, 2007, the carrying value of the segment's goodwill was \$4.1 million.

As of January 27, 2008, this segment had assets held for sale with carrying values totaling \$189,000. The company adopted a plan to sell certain older and existing equipment related to its mattress fabrics segment that is being replaced by newer and more efficient equipment. The company sold these assets held for sale subsequent to third quarter of fiscal 2008 for \$189,000.

Also as of January 27, 2008, property, plant and equipment totaled \$19.8 million compared with \$22.8 million at April 29, 2007. The \$19.8 million at January 27, 2008 represents property plant and equipment located in the U.S. of \$10.2 million, located in Canada at \$9.4 million, and various corporate allocations of \$177,000. The \$22.8 million at April 29, 2007 represents property, plant, and equipment located in the U.S. of \$10.9 million, located in Canada at \$10.0 million, and various corporate allocations of \$1.9 million. The corporate allocation of \$1.9 million at April 29, 2007 primarily related to the corporate headquarters which is classified in assets held for sale at January 27, 2008.

### Upholstery Fabrics Segment

Net Sales -- Upholstery fabric net sales (which includes both fabric and cut and sewn kits) for the third quarter of fiscal 2008 were \$29.6 million, a 6% decline compared with \$31.3 million in the third quarter of fiscal 2007. On a unit volume basis, total yards sold for the third quarter of fiscal 2008 decreased by 12% compared with the third quarter of fiscal 2007. Average selling prices of \$4.23 increased 5% for the third quarter of fiscal 2008 compared with the third quarter of fiscal 2007. Upholstery fabric net sales for the nine months ended January 27, 2008 were \$86.6 million, a 20% decline compared to \$107.6 million for the nine months ended January 28, 2007. On a unit volume basis, total yards sold for the nine months ended January 27, 2008 decreased by 26% compared with the nine months ended January 28, 2007. Average selling prices of \$4.23 increased 2% for the nine months ended January 27, 2008 compared to the nine months ended January 28, 2007. Upholstery fabric sales reflect very weak demand industry wide, as well as continued soft demand for U.S. produced upholstery fabrics driven by consumer preference for leather and suede furniture and other imported furniture and fabrics.

Operating Income - Operating income for the third quarter of fiscal 2008 was \$395,000 compared with an operating loss of \$496,000 for the third quarter of fiscal 2007. Operating income for the nine months ended January 27, 2008 was \$1.0 million compared with operating income of \$1.5 million for the nine months

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ended January 28, 2007. These results reflect the very difficult operating environment for the retail furniture industry. Discretionary consumer spending for furniture continues to be very soft due to a slowing economy, weak housing market and high energy prices. Considering the unfavorable market conditions, the company was able to report a profitable performance in this segment based on a significantly improved cost structure with its China platform and substantially reduced selling, general, and administrative expenses.

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Selling, general and administrative expenses for third quarter of fiscal 2008 were down 26% from the third quarter of fiscal 2007. For the nine months ended January 27, 2008, selling, general, and administrative expenses were down 21% compared with the nine months ended January 28, 2007. This reduction is due to the company's restructuring activities, and this year over year improvement is expected to continue throughout fiscal 2008.

Non-U.S. Produced Sales - Net sales of upholstery fabrics produced outside the company's U.S. manufacturing operations were \$20.2 million in the third quarter of fiscal 2008, an increase of 17% from \$17.4 million in the third quarter of fiscal 2007. The year over year growth in non-U.S. produced fabrics reverses a trend reflected in the results for the previous two fiscal quarters of 2008. The results reflected in the third quarter of fiscal 2008 represent the company's strategic focus on product development, innovation, and improved supply chain performance. Net sales of upholstery fabrics produced outside the company's U.S. manufacturing operations were \$56.0 million for the nine months ended January 27, 2008, a decrease of 9% from \$61.5 million for the nine months ended January 28, 2007. This decline reflects the overall very weak demand industry wide.

Net sales of upholstery fabrics produced outside the company's U.S. manufacturing operations accounted for approximately 68% of upholstery fabric sales for the third quarter of fiscal 2008 compared to 55% for the third quarter of fiscal 2007. Net sales of upholstery fabrics produced outside the company's U.S. manufacturing operations accounted for approximately 65% for the nine months ended January 27, 2008 compared to 57% for the nine months ended January 28, 2007. Sales of cut and sewn kits increased 33% for the third quarter of fiscal 2008 compared with the third quarter of fiscal 2007. Sales of cut and sewn kits increased 151% for the nine months ended January 27, 2008 compared with the nine months ended January 28, 2007. This trend toward higher non-U.S. produced sales in relation to U.S. produced sales is expected to continue as the company's U.S. customers and U.S. furniture retailers have continued to move an increasing amount of their fabric and furniture purchases to Asia and the company has moved with them and responded with an operation designed to meet their fabric needs.

U.S. Produced Sales - Net sales of U.S. produced upholstery fabrics were \$9.4 million in the third quarter of fiscal 2008, a decrease of 33% from \$14.0 million in the third quarter of fiscal 2007. Net sales of U.S. produced upholstery fabrics were \$30.6 million for the nine months ending January 27, 2008, a decrease of 34% from \$46.1 million for the nine months ending January 28, 2007. As a result of higher costs related to raw materials and lower volume, the company will be implementing a price increase on U.S. produced products during the fourth quarter of fiscal 2008. Management has continued to take aggressive actions over the past several years to bring U.S. manufacturing costs and capacity in line with current and expected demand trends. As a result of these activities, the company now has only one U.S. manufacturing facility operating in the upholstery fabrics segment. As of January 27, 2008, the carrying value of the company's U.S. based upholstery fabrics fixed assets was \$2.7 million.

While management believes it is strategically important to produce some level of



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upholstery fabrics in the U.S. to support its customers' domestic fabric requirements, management remains committed to taking additional steps if necessary to address the low profitability of the company's U.S. upholstery operations. The company could experience additional inventory markdowns, write-downs of its property, plant, and equipment, and further restructuring charges in the U.S. upholstery operations if sales and profitability continue to decline and further restructuring actions become necessary.

Segment Assets -- Segment assets consist of accounts receivable, inventory, property, plant, and equipment, and assets held for sale. As of January 27, 2008, accounts receivable and inventory totaled \$33.7 million compared to \$37.5 million at April 29, 2007. This decline reflects lower sales and improved working capital management. As of January 27, 2008, property, plant, and equipment totaled \$12.4 million compared to \$14.9 million at April 29, 2007. The \$12.4 million at January 27, 2008, represents property, plant, and equipment located in China of \$9.2 million, located in the U.S. of \$2.7 million, and various corporate allocations of \$532,000. The \$14.9 million at April 29, 2007, represents property, plant, and equipment located in China of \$7.7 million, located in the U.S. of \$3.4 million, and various corporate allocations of \$3.8 million. The corporate allocation of \$3.8 million at April 29, 2007 primarily related to the company's corporate headquarters which is classified in assets held for sale at January 27, 2008.

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At April 29, 2007, the company had assets held for sale with carrying values totaling \$2.5 million. These assets held for sale consisted of buildings and certain equipment to be sold from the closure of the company's Lincolnton, NC and Graham, NC plant facilities. At January 27, 2008, all buildings and equipment classified as held for sale at April 29, 2007 have been sold. The company received sales proceeds totaling \$1.9 million and recorded impairment losses of \$482,000 in restructuring expense on these assets held for sale in fiscal 2008.

### Other Expense Categories

Selling, General and Administrative Expenses - Selling, general, and administrative expenses (SG&A) for the company as a whole were \$5.1 million for the third quarter of fiscal 2008 compared with \$6.4 million for the third quarter of fiscal 2007, a decrease of 20%. As a percent of net sales, SG&A expenses were 8.5% in the third quarter of fiscal 2008 compared with 11.5% in the third quarter of fiscal 2007. SG&A expenses for the nine months ended January 27, 2008 were \$17.3 million compared with \$19.2 million for the nine months ended January 28, 2007, a decrease of 10%. As a percent of net sales, SG&A expenses were 9.1% for the nine months ended January 27, 2008 and 10.8% for the nine months ended January 28, 2007. These trends primarily reflect the company's restructuring efforts associated with its U.S. upholstery fabric operations, increased mattress fabric sales associated with the ITG acquisition, and a reduction in bad debt expense compared to same period a year ago.

Interest Expense (Income) -- Interest expense for the third quarter of fiscal 2008 was \$753,000 compared to \$952,000 for the third quarter of fiscal 2007. Interest expense for the nine months ended January 27, 2008 was \$2.4 million compared to \$2.8 million for the nine months ended January 28, 2007. This trend primarily reflects lower outstanding balances on the company's unsecured term notes. Interest income was \$77,000 for the third quarter of fiscal 2008 compared to \$50,000 for the third quarter of fiscal 2007. Interest income was \$197,000 for the nine months ended January 27, 2008 and \$147,000 for the nine months ended January 28, 2007. This trend reflects higher cash and cash equivalent balances, which were invested in money market funds.

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Other Expense (Income) - Other income for the third quarter of fiscal 2008 was \$72,000 compared with other income of \$157,000 for the third quarter of fiscal 2007. Other expense for the nine months ended January 27, 2008 was \$625,000 compared to other income of \$98,000 for the nine months ended January 28, 2007. Other expense for the nine months ended January 27, 2008 reflects foreign exchange remeasurement losses primarily related to an 11% decline in value of the U.S. dollar relative to the Canadian dollar. Other income for the nine months ended January 28, 2007 reflects foreign exchange remeasurement gains primarily related the U.S. dollar strengthening by 5% relative to the Canadian dollar.

Income Taxes - The effective income tax rate (income taxes as a percentage of income before income taxes) for the nine month period ended January 27, 2008, was 3.1% compared to an income tax benefit of 54.7% for the nine month period ended January 28, 2007. This effective income tax rate of 3.1% primarily reflects higher taxable income from the company's U.S. operations in fiscal 2008 compared to fiscal 2007, offset by the projected income tax effects related to the fiscal 2008 foreign exchange loss on Canadian income taxes, and an income tax refund of \$470,000 in the third quarter of fiscal 2008 related to income tax incentives in China. This higher taxable income from the company's U.S. operations reflects increased profitability in the mattress fabrics segment and lower estimated restructuring and related charges for fiscal 2008 compared to fiscal 2007. The income tax benefit of 54.7% for the nine month period ended January 28, 2007, primarily reflected pre-tax losses from the company's U.S. operations due to restructuring activities and lower income tax rates on income from foreign sources.

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The company's income tax expense and effective income tax rate, for the nine month periods ended January 27, 2008 and January 28, 2007, were based upon the estimated effective income tax rate applicable for full years after giving effect to any significant items related specifically to interim periods. The effective income tax rate can be impacted over the fiscal year by the mix and timing of actual earnings from the company's U.S. operations and foreign sources versus annual projections and changes in the foreign currency in relation to the U.S. dollar.

In making a judgment about the realization of the deferred tax assets, management has considered both negative and positive evidence, and concluded that sufficient positive evidence exists to overcome the cumulative losses experienced in recent years. Specifically, management considered the following, among other factors: nature of the company's products; history of positive earnings in the mattress fabrics segment; capital projects in progress to further enhance the company's globally competitive cost structure in the mattress fabrics segment; recent restructuring actions in the U.S. upholstery fabrics business to adjust the U.S. cost structure and bring U.S. manufacturing capacity in line with demand; development of offshore manufacturing and sourcing programs to meet changing demands of upholstery fabric customers in the U.S.; and the incremental sales volume from the purchase of certain assets from ITG related to the mattress fabric product line of ITG's Burlington House Division. Management's analysis of taxable income also included the following considerations: none of the company's net operating loss carryforwards have previously expired unused; the U.S. federal carryforward period is 20 years; and the company's current income tax loss carryforwards principally expire in 16-20 years; fiscal 2022 through 2027. The amount of the deferred tax assets considered realizable, however, could be reduced if estimates of future taxable income during the carryforward period are reduced.

U.S. federal and state net operating loss carryforwards with related future tax benefits on a gross basis were approximately \$72.0 million at January 27, 2008.

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### Liquidity and Capital Resources

Liquidity - The company's sources of liquidity include cash and cash equivalents, cash flow from operations, assets held for sale, and amounts available under its unsecured revolving credit lines. These sources have been adequate for day-to-day operations. The company believes its sources of liquidity continue to be adequate to meet its current needs.

Cash and cash equivalents as of January 27, 2008, were \$15.5 million compared with \$10.2 million as of April 29, 2007. The company's cash position reflects improvement in cash flow from operations of \$14.8 million for the nine months ended January 27, 2008 compared with \$4.4 million for the nine months ended January 28, 2007. This improvement reflects increased profitability and significant improvement in working capital management. The company's cash position also reflects total debt payments of \$7.6 million, cash outlays for capital expenditures of \$4.3 million, and proceeds of \$2.3 million primarily from the sale of buildings and equipment for the nine month period ended January 27, 2008.

The strong cash flow is allowing the company to substantially reduce its total debt during the fiscal year. During the third quarter, the company reduced total borrowings by \$5.6 million, which brings the total debt reduction to \$7.6 million through the third quarter of fiscal 2008. With the scheduled repayment of \$8.3 million on the company's unsecured term notes in March 2008, the company expects to have reduced total debt by almost \$16 million by the end of fiscal 2008. Total debt was \$33.4 million at January 27, 2008 compared to \$46.7 million at January 28, 2007. Currently, the company has sufficient funds available to make the remaining principal payment due in March 2008.

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The company is taking further steps to support its liquidity, including ongoing efforts to improve operating working capital turnover, sell certain assets, reduce further selling, general, and administrative expenses in its upholstery fabrics segment, and debt reduction. Effective October 29, 2007, the company adopted a plan to sell its corporate headquarters as the company is only utilizing one-half of the available space and with the sale can lower costs and reduce debt. The carrying value of the company's headquarters is approximately \$4.8 million and is recorded in assets held for sale in the 2008 Consolidated Balance Sheet. The company expects that the final sale and disposal of the assets will be completed within a year from the date the plan was adopted and the sales proceeds will be used to repay the outstanding \$6.4 million mortgage balance. The Company has entered into a contract dated March 11, 2008 providing for the sale of its headquarters building in High Point, North Carolina to Schwartz Properties, L.L.C., for a purchase price of \$7,350,000. The contract also contemplates that the Company would lease the building back from the purchaser for an initial term of five years, at a rental rate of \$56,800 per month on a "triple net" basis. The contract is subject to the purchaser's ability to obtain financing and is subject to a 90 day due diligence period, during which the purchaser may inspect the premises, conduct appraisals and other examinations, and during which the purchaser may terminate the contract without penalty. The closing is anticipated to occur during the first quarter of the Company's 2009 fiscal year. Based on the current terms of the contract, any gain realized from the final sale would be amortized over the life of the lease agreement, in accordance with SFAS No. 13, "Accounting for Leases," SFAS No. 28, "Accounting for Sales with Leasebacks (an amendment of SFAS No. 13), SFAS No. 66, "Accounting for Sales of Real Estate," and SFAS No. 98, "Accounting for Leases."

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The company's cash position may be adversely affected by factors beyond its control, such as weakening industry demand, delays in receipt of payment on accounts receivable and the availability of trade credit.

Working Capital -- Accounts receivable as of January 27, 2008 decreased 20% in comparison to April 29, 2007. Days sales outstanding totaled 32 days at January 27, 2008, compared with 36 days at April 29, 2007 and January 28, 2007, respectively. This improvement primarily reflects the shift in net sales from the upholstery fabrics to the mattress fabrics segment, in which customers associated with the mattress fabrics segment more frequently take advantage of cash discounts, as well as tighter management of accounts receivable. Inventories as of January 27, 2008, decreased \$5 million or 11% in comparison to January 28, 2007. This decrease primarily represents a decrease in inventories in the upholstery fabrics segment primarily due to lower sales and improved inventory management. Inventory turns for the third quarter of fiscal 2008 were 5.6 versus 5.3 for the third quarter of fiscal 2007. Operating working capital (comprised of accounts receivable and inventories, less trade accounts payable) was \$42.3 million at January 27, 2008, down from \$48.4 million at January 28, 2007. Working capital turnover was 5.8 and 5.2 at January 27, 2008 and January 28, 2007, respectively.

### Financing Arrangements

#### Term Notes

The company's unsecured term notes have a fixed interest rate of 8.80% (payable semi-annually in March and September and subject to prepayment provisions each fiscal quarter as defined in the agreement) and are payable over an average remaining term of two years through March 2010. The principal payments are required to be paid in annual installments as follows: March 2008 - \$8.3 million; March 2009 - \$7.5 million; and March 2010 - \$7.5 million. The company prepaid \$2.2 million during the first quarter, \$1.0 million in the second quarter, and \$4.3 million in the third quarter all of which was scheduled to be due in March 2008.

On February 19, 2008, the company entered into a fourth amendment. This amendment provided greater flexibility by increasing the capital expenditure limit on a cash basis from \$4.0 million to \$5.0 million for fiscal year 2008 and \$4.0 million plus an additional amount as defined in the agreement for any fiscal year thereafter.

#### Real Estate Loan - I

The company has a real estate loan that is secured by a lien on the company's corporate headquarters office located in High Point, NC. This term loan bears interest at the one-month LIBOR plus an adjustable margin (6.49% at January 27, 2008) based on the company's debt/EBITDA ratio, as defined in the agreement and is payable in varying monthly installments through September 2010, with a final payment of \$3.3 million in October 2010.

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#### Real Estate Loan - II

The company has a term loan in the amount of \$2.5 million in connection with the ITG asset purchase agreement. This term loan is secured by a lien on the company's corporate headquarters office located in High Point, NC and bears interest at the one-month LIBOR plus an adjustable margin (7.87% at January 27, 2008) based on the company's debt/EBITDA ratio, as defined in the agreement. This agreement requires the company to pay interest monthly with the entire

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principal due on June 30, 2010.

### Revolving Credit Agreement - United States

The company has an unsecured credit agreement that provides for a revolving loan commitment of \$6.5 million, including letters of credit up to \$5.5 million. This agreement bears interest at the one-month LIBOR plus an adjustable margin (6.49% at January 27, 2008) based on the company's debt/EBITDA ratio, as defined in the agreement. As of January 27, 2008, there were \$1.3 million in outstanding letters of credit (all of which related to workers compensation) and no borrowings outstanding under the agreement.

On December 27, 2007, the company entered into a twelfth amendment. This amendment extended the expiration date to December 31, 2008, provided greater flexibility by increasing the capital expenditure limit on a cash basis from \$4.0 million to \$5.0 million for fiscal year 2008, and amended certain other financial covenants as defined in the agreement.

### Revolving Credit Agreement - China

The company's China subsidiary has an unsecured revolving credit agreement with a bank in China to provide a line of credit available up to approximately \$5 million, of which approximately \$1 million includes letters of credit. The company borrowed a total of \$4.0 million in installments of \$1.3 million in February 2007, \$1.3 million in March 2007, and \$1.4 million in October 2007. There were no borrowings in the third quarter of fiscal 2008. Each installment is up for renewal one year from the date of borrowing and the bank is required to provide an advance notice of one year for repayment of each respective installment. The company paid off the \$1.3 million February 2007 installment in the third quarter of fiscal 2008. Interest is paid on a quarterly basis at a rate determined by the Chinese government (with interest rates ranging from 6.07% to 6.53% at January 27, 2008). As of January 27, 2008, approximately \$2.8 million was outstanding under the agreement.

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### Canadian Government Loan

The company has an agreement with the Canadian government to provide for a term loan that is non-interest bearing and is payable in 48 equal monthly installments commencing December 1, 2009. The proceeds are to partially finance capital expenditures at the company's Rayonese facility located in Quebec, Canada.

### Overall

The company's loan agreements require that the company maintain compliance with certain financial ratios. At January 27, 2008, the company was in compliance with these financial covenants.

The principal payment requirements of long-term debt during the next five years are: Year 1 - \$8.6 million; Year 2 - \$7.8 million; Year 3 - \$13.6 million; Year 4 - \$198,000; Year 5 - \$198,000; and thereafter - \$165,000.

Capital Expenditures - Cash outlays for capital expenditures during the nine months ended January 27, 2008 were \$4.3 million, for the company's China and mattress fabric operations. The company did not utilize any vendor financing for any of its capital expenditures for the nine months ending January 27, 2008. The company expects total capital expenditures to be approximately \$7.3 million for fiscal 2008, of which \$5 million represents cash outlays with the remaining \$2.3

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million to be provided by vendor financing to be repaid in fiscal 2009 through 2011.

The company's current estimate of cash outlays for capital projects initiated in fiscal 2009 (not provided by vendor-financing) is \$2 million to \$3 million. The company will have an additional capital expenditure of \$1.6 million that will be vendor-financed on a project initiated in fiscal 2008. The company expects that the availability of funds from cash flow from operations, vendor financing, and its revolving credit lines will be sufficient to fund its planned capital needs.

Vendor-financed capital expenditures totaling \$4.6 million on projects initiated prior to the end of fiscal 2008 are expected to be repaid over the next three fiscal as follows: Fiscal 2009 - \$2.5 million; Fiscal 2010 - \$1.6 million; and Fiscal 2011 - \$500,000.

Depreciation for the nine months ended January 27, 2008, was \$4.3 million and is estimated to be \$6 million for fiscal 2008. The company's current estimate of depreciation is estimated to be \$6 million for fiscal 2009.

### Critical Accounting Policies and Recent Accounting Developments

As more fully described in Item 7 of the company's annual report on Form 10-K for the year ended April 29, 2007 (filed July 19, 2007), the preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions about future events that affect the amounts reported in the financial statements and accompanying notes. Future events and their effects cannot be determined with absolute certainty. Therefore, the determination of estimates requires exercise of judgment.

As more fully disclosed in Notes 1 and 15 of the Notes to Consolidated Financial Statements, the company adopted FIN 48, Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109, on April 30, 2007. The company considers many factors when evaluating and estimating income tax uncertainties. These factors include an evaluation of the technical merits of the tax position as well as the amounts and probabilities of the outcomes that could be realized upon ultimate settlement. The actual resolution of those uncertainties will inevitably differ from those estimates, and such differences may be material to the financial statements.

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### Recently Issued Accounting Standards

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements," which provides enhanced guidance for using fair value to measure assets and liabilities. SFAS No. 157 establishes a common definition of fair value, provides a framework for measuring fair value under accounting principles generally accepted in the United States and expands disclosure requirements about fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007, and is effective for the company in the first quarter of fiscal 2009. The company is currently evaluating the impact, if any, the adoption of SFAS No. 157 will have on its 2009 consolidated financial statements.

In February 2007, the FASB issued Statement No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities." This statement, which is expected to expand fair value measurement, permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS No. 159 is

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effective for fiscal years beginning after November 15, 2007, and is effective for the company in the first quarter of fiscal 2009. The company is currently evaluating the impact, if any, the adoption of SFAS No. 159 will have on its 2009 consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007) "Business Combinations." SFAS No. 141 requires the acquiring entity in a business combination to recognize all the assets acquired and liabilities assumed in the transaction; establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; and requires the acquirer to disclose all information required to evaluate and understand the nature and financial effect of the business combination. This statement is effective for acquisition dates on or after the beginning of the first annual reporting period beginning after December 15, 2008. This statement is effective for the company in fiscal 2010 and is not expected to have a material effect on our consolidated financial statements to the extent that we do not enter into business combinations subsequent to adoption.

### Contractual Obligations

#### Capital Expenditures

At January 27, 2008, the company had commitments to acquire equipment with regards to its mattress fabrics segment for approximately \$4.0 million. Of this total commitment of \$4.0 million, \$3.6 million is to be provided by vendor-financing. This \$3.6 million is projected to be repaid as follows: Fiscal 2009 - \$1.7 million; Fiscal 2010 \$1.4 million; and Fiscal 2011 - \$500,000.

At January 27, 2008, the company had total contractual obligations from capital projects initiated prior to fiscal 2008 totaling \$724,000. This amount is to be repaid in Fiscal 2009.

#### Uncertainty In Income Taxes

As more fully disclosed in Notes 1 and 15 of Notes to the Consolidated Financial Statements, the company adopted FIN 48, Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109, on April 30, 2007. At January 27, 2008, the company has recognized \$4.5 million of liabilities for unrecognized tax benefits. The final outcome of these tax uncertainties is dependent upon various matters including tax examinations, legal proceedings, competent authority proceedings, changes in regulatory tax laws, or interpretations of those tax laws, or expiration of statutes of limitation. As of January 27, 2008, the company classified the \$4.5 million of liabilities for unrecognized tax benefits as income taxes payable - long-term. While the company cannot reasonably predict the timing of the cash flows associated with its liabilities for unrecognized tax benefits, it believes that no significant cash payments will be made within the next five years due to its federal and state net operating loss carryforwards.

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#### Inflation

The cost of certain of the company's raw materials, principally yarn from petroleum derivatives, and utility/energy costs, increased during the first three quarters of fiscal 2008 as oil and energy prices increased and had an impact on the company's financial results. Any significant increase in the company's raw material costs, utility/energy costs and general economic inflation could have a material adverse impact on the company, because

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competitive conditions have limited the company's ability to pass significant operating cost increases on to its customers.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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The company is exposed to market risk from changes in interest rates on debt and foreign currency exchange rates. The company's market risk sensitive instruments are not entered into for trading purposes. The company's exposure to interest rate risk consists of floating rate debt based on the London Interbank Offered Rate (LIBOR) plus an adjustable margin under the company's revolving credit agreement in the United States and its real estate term loans. As of January 27, 2008, there were \$6.4 million in borrowings outstanding under the company's real estate term loans and no borrowings under the company's revolving credit agreement in the United States. In connection with the first real estate term loan, the company entered into a \$2,170,000 notional principal interest rate swap agreement, which represents 50% of the principal amount on the real estate term loan, and effectively converts the floating rate LIBOR based payments to fixed payments at 4.99% plus the spread calculated under the real estate term loan agreement. The company's unsecured term notes have a fixed interest rate of 8.80% and the Canadian government loan is non-interest bearing. The company's revolving credit agreement associated with its China subsidiary has fixed interest rates ranging from 6.07% to 6.53% at January 27, 2008. Additionally, \$28.9 million on the company's total borrowings of \$33.4 million (approximately 87%) are at a fixed rate or non-interest bearing. Thus, any foreseeable change in interest rates would not have a material effect on the company's interest expense.

The company's exposure to fluctuations in foreign currency exchange rates are due to foreign subsidiaries domiciled in China and Canada. These subsidiaries use the United States dollar as their functional currency. The company generally does not use financial derivative instruments to hedge foreign currency exchange rate risks associated with its foreign subsidiaries. A 10% change in the Canadian exchange rate at January 27, 2008, would impact the company's consolidated income before income taxes by approximately \$350,000. This impact on the company's consolidated income before income taxes would be offset by approximately \$1.0 million for the income tax effects of a 10% change in the Canadian exchange rate on Canadian income taxes. A 10% change in the Chinese exchange rate at January 27, 2008, would not have a significant impact on the company's results of operations or financial position.

### ITEM 4. CONTROLS AND PROCEDURES

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The company conducted a review and evaluation of its disclosure controls and procedures, under the supervision and with the participation of the company's principal executive officer and principal financial officer as of January 27, 2008, and the principal executive officer and principal financial officer have concluded that the company's disclosure controls and procedures are adequate and effective. In addition, no change in the company's internal control over financial reporting has occurred during, or subsequent to, the period covered by this report that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting.

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## Part II - Other Information

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Item 1. Legal Proceedings



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A lawsuit was filed against the Company and other defendants (Chromatex, Inc., Rossville Industries, Inc., Rossville Companies, Inc. and Rossville Investments, Inc.) on February 5, 2008 in the United States District Court for the Middle District of Pennsylvania. The plaintiffs are Alan Shulman, Stanley Siegel, Ruth Cherenon as Personal Representative of the Estate of Alan Cherenon, 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., the Company leased and operated the Site as part of the Company's 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 totaling approximately \$8.6 million. 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 the 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 Company does not believe it has any liability for the matters described in this litigation and intends to defend itself vigorously. In addition, the Company has an indemnification agreement with certain other defendants in the litigation pursuant to which the other defendants agreed to indemnify the Company for any damages it incurs as a result of the environmental matters that are the subject of this litigation and consequently no reserve has been recorded.

### Item 1A. Risk Factors

There have been no material changes to our risk factors during the nine months ended January 27, 2008. Our risk factors are disclosed in the company's annual report on Form 10-K filed with the Securities and Exchange Commission on July 19, 2007 for the fiscal year ended April 29, 2007.

### Item 5. Other Information.

The company has received notification from the New York Stock Exchange ("NYSE") that it is now considered a "company in good standing" under the NYSE's continued listing standards and will be removed from its "Watch List." The NYSE's decision comes as a result of the company's consistent positive performance with respect to its business plan submitted to the NYSE in September 2006 and its compliance with the NYSE's minimum market capitalization and shareholders' equity standard over the past six quarters. After a twelve month follow up period to ensure continuing compliance, the company will be subject to normal NYSE monitoring procedures.

The Company has entered into a contract dated March 11, 2008 providing for the sale of its headquarters building in High Point, North Carolina to Schwartz Properties, L.L.C., for a purchase price of \$7,350,000. The contract also contemplates that the Company would lease the building back from the purchaser for an initial term of five years, at a rental rate of \$56,800 per month on a "triple net" basis. The contract is subject to the purchaser's ability to obtain financing and is subject to a 90 day due diligence period, during which the purchaser may inspect the premises, conduct appraisals and other examinations, and during which the purchaser may terminate the contract without penalty. The closing is anticipated to occur during the first quarter of the Company's 2009 fiscal year. Based on the current terms of the contract, any gain realized from the final sale would be amortized over the life of the lease agreement, in accordance with SFAS No. 13, "Accounting for Leases," SFAS No. 28,

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"Accounting for Sales with Leasebacks (an amendment of SFAS No. 13), SFAS No. 66, "Accounting for Sales of Real Estate," and SFAS No. 98, "Accounting for Leases."

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### 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, and are incorporated herein by reference.
- 3(ii) Restated and Amended Bylaws of the company, as amended June 12, 2001, were filed as Exhibit 3(ii) to the company's Form 10-Q for the quarter ended July 29, 2001, filed September 12, 2001, and are incorporated herein by reference. 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 filed on November 13, 2007, and are incorporated herein by reference.
- 3 (iii) 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.
- 10.1 Separation agreement and Waiver of Claims between the company and Kenneth M. Ludwig dated December 11, 2007, filed as Exhibit 10.1 to the company's Form 10-Q for the quarter ended October 28, 2007, and incorporate herein by reference.
- 10.2 Twelfth Amendment to Amended and Restated Credit Agreement dated as of December 27, 2007 among Culp, Inc. and Wachovia Bank, National Association, as Agent and as Bank, filed as Exhibit 10.1 to the company's Form 8-K dated December 27, 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.

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### SIGNATURES

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

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CULP, INC.  
(Registrant)

Date: March 12, 2008

By: /s/ Kenneth R. Bowling

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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.

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

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EXHIBIT INDEX

Exhibit Number	Exhibit
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