

CULP INC  
Form 10-K  
July 15, 2016  
UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended May 1, 2016

Commission File No. 1-12597

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 27265  
(Address of principal executive offices) (zip code)

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

Securities registered pursuant to Section 12(b) of the Act:

<u>Title of Each Class</u>	<u>Name of Each Exchange On Which Registered</u>
Common Stock, par value \$.05/ Share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
YES NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Securities Exchange Act of 1934. YES NO

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during

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the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).  
YES NO

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 "large accelerated filer, 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 in Rule 12b-2 of the Act). YES NO

As of May 1, 2016, 12,265,489 shares of common stock were outstanding. As of November 1, 2015, the aggregate market value of the voting stock held by non-affiliates of the registrant on that date was \$323,277,203 based on the closing sales price of such stock as quoted on the New York Stock Exchange (NYSE), assuming, for purposes of this report, that all executive officers and directors of the registrant are affiliates.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement to be filed pursuant to Regulation 14A of the Securities and Exchange Commission in connection with its Annual Meeting of Shareholders to be held on September 21, 2016 are incorporated by reference into Part III of this Form 10-K.

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CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING INFORMATION

Parts I and II of this report contain “forward-looking statements” within the meaning of the federal securities laws, including the Private Securities Litigation Reform Act of 1995 (Section 27A of the Securities Act of 1933 and Section 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, and we disclaim any duty to update or alter such statements whether as a result of new information, future events or otherwise. Forward-looking statements are statements that include projections, expectations or beliefs about future events or results or otherwise are not statements of historical fact. Such statements are often but not always characterized by qualifying words such as “expect,” “believe,” “estimate,” “plan,” “project,” “anticipate,” “depend” and their derivatives, and include but are not limited to statements about expectations for our future operations, production levels, sales, gross profit margins, operating income, capital expenditures, income taxes, SG&A or other expenses, earnings, cash flow, and other performance measures, as well as any statements regarding future economic or industry trends or future developments. Factors that could influence the matters discussed in such statements include the level of housing starts and sales of existing homes, consumer confidence, trends in disposable income, and general economic conditions. Decreases in these economic indicators could have a negative effect on our business and prospects. Likewise, increases in interest rates, particularly home mortgage rates, and increases in consumer debt or the general rate of inflation, could affect the company adversely. Changes in consumer tastes or preferences toward products not produced by us could erode demand for our products. Changes in the value of the U.S. dollar versus other currencies could affect our financial results because a significant portion of our operations are located outside the United States. Strengthening of the U.S. dollar against other currencies could make our products less competitive on the basis of price in markets outside the United States, and strengthening of currencies in Canada and China can have a negative impact on our sales in the U.S. of products produced in those places. Also, economic and political instability in international areas could affect our operations or sources of goods in those areas, as well as demand for our products in international markets. Finally, increases in market prices for petrochemical products can significantly affect the prices we pay for raw materials, driving up our operating costs and putting downward pressure on our profits. Further information about these factors, as well as other factors that could affect our future operations or financial results and the matters discussed in forward-looking statements are included in the “Risk Factors” section of this report in Item 1A. A forward-looking statement is neither a prediction nor a guarantee of future events or circumstances, and those future events or circumstances may not occur.

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## PART 1

### ITEM 1. BUSINESS

#### Overview

Culp, Inc. manufactures, sources, and markets mattress fabrics and sewn covers for mattresses, foundations and other bedding products; and upholstery fabrics, including cut and sewn kits, primarily used in the production of upholstered furniture. The company competes in a fashion-driven business, and we strive to differentiate ourselves by placing sustained focus on product innovation and creativity along with excellent and dependable service to our customers. Our focused efforts to protect our financial strength have allowed us to maintain our position as a financially stable and trusted supplier of innovative fabrics to bedding and furniture manufacturers.

We believe Culp is the largest producer of mattress fabrics in North America and one of the largest marketers of upholstery fabrics for furniture in North America, measured by total sales. We have two operating segments — mattress fabrics and upholstery fabrics. The mattress fabrics business markets primarily knitted and woven fabrics, and sewn covers made from those fabrics, which are used in the production of bedding products, including mattresses, foundations, and mattress sets. The upholstery fabrics business markets a variety of fabric products that are used principally in the production of residential and commercial upholstered furniture, including sofas, recliners, chairs, loveseats, sectionals, sofa-beds and office seating.

Culp markets a variety of fabrics in different categories to a global customer base, including fabrics produced at our manufacturing facilities and fabrics produced by other suppliers. We had thirteen active manufacturing plants and distribution facilities as of the end of fiscal 2016, located in North and South Carolina; Quebec, Canada; and Shanghai, China. We also source fabrics from other manufacturers, located primarily in China and Turkey, with almost all of those fabrics produced specifically for Culp and created by Culp designers. We operate distribution centers in North Carolina and Shanghai, China, to facilitate distribution of our products. Over the past decade, the portion of total company sales represented by fabrics produced outside of the U.S. and Canada has increased, while sales of goods produced in the U.S. have decreased. This trend is due primarily to the upholstery fabrics segment, where 91% of our sales now consist of fabrics produced in Asia.

Total net sales in fiscal 2016 were \$312.9 million. The mattress fabrics segment had net sales of \$186.4 million (60% of total net sales), while the upholstery fabrics segment had net sales of \$126.4 million (40% of total net sales).

During fiscal 2016, both segments continued to build upon strategic initiatives and structural changes that were implemented over the last several years. The flexible manufacturing and sourcing platform created through these changes has allowed Culp to place a greater emphasis on product innovation and the introduction of new designs to keep current with industry trends and differentiate our products. This approach has helped us drive continued sales growth, with fiscal 2016 representing our seventh consecutive year of higher net sales.

Industry strength and demand for our products has improved during the past several years, with a stronger recovery in the bedding industry than in the upholstered furniture business. During the same period, we have experienced positive responses from customers to our innovative designs and new product introductions during these years, with improved profitability. Sales and operating income in mattress fabrics increased 4% and 22%, respectively, during fiscal 2016. Net sales for upholstery fabrics were slightly lower in fiscal 2016, but our operating income showed significant improvement due to a more profitable product mix. Both business segments experienced lower raw material costs and lower operating expenses due to more favorable foreign currency exchange rates. An increasing percentage of our sales are now based on new product introductions. For the company as a whole, pre-tax income for fiscal 2016 was \$27.9 million, the highest level in company history, exceeding the record level of the previous year.

The mattress fabrics segment has made strategic investments in capital projects and expansion initiatives in recent years. Investments have been targeted at expanding capacity, continuing improvements in service capabilities, maintaining a flexible approach to fabric sourcing, and dealing with challenging industry conditions. The mattress fabrics segment has also expanded its design capabilities with additional personnel and product software to enhance innovation. During fiscal 2013, this segment announced a joint marketing agreement to market sewn mattress covers, which involved the establishment of a new production facility. In fiscal 2014, we completed an asset purchase and related consulting agreement that provided for, among other things, the purchase of equipment and certain other assets and the restructuring of prior consulting and non-compete agreements. These initiatives have allowed for further expansion of our mattress fabrics business.

Our upholstery fabrics segment underwent major changes over the past decade, transforming from a primarily U.S.-based manufacturing operation with large amounts of fixed assets, to a more flexible variable cost model, with most fabrics sourced in Asia. At the same time, we have maintained control over the key components of fabric production such as design, finishing, quality control, and distribution. These changes involved a multi-year restructuring process that ended in fiscal 2009, during which time our upholstery fabric sales declined considerably. This multi-year trend of declining upholstery revenues and profits has reversed, with sales and income for this segment well above the levels reached during the Great Recession, and pre-tax income establishing a new record in fiscal 2016. Since the end of our multi-year restructuring, we have focused on product innovation and marketing, including the exploration of new markets.

Additional information about trends and developments in each of our business segments is provided in the “Segments” discussion below.

#### General Information

Culp, Inc. was organized as a North Carolina corporation in 1972 and made its initial public offering in 1983. Since 1997, our stock has been listed on the New York Stock Exchange and traded under the symbol “CFI.” Our fiscal year is the 52 or 53 week period ending on the Sunday closest to April 30. Our executive offices are located in High Point, North Carolina. References in this document to “Culp,” the “company,” “we,” “our,” and “us” refer to Culp, Inc. and its consolidated subsidiaries.

Culp maintains an Internet website at [www.culp.com](http://www.culp.com). We will make this annual report and our other annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to these reports available free of charge on our Internet site as soon as reasonably practicable after such material is electronically filed with, or furnished to, the Securities and Exchange Commission. Information included on our website is not incorporated by reference into this annual report.

## Segments

Our two operating segments are mattress fabrics and upholstery fabrics. The following table sets forth certain information for each of our segments.

Segment	Sales by Fiscal Year (\$ in Millions) and Percentage of Total Company Sales					
	Fiscal 2016		Fiscal 2015		Fiscal 2014	
Mattress Fabrics	\$ 186.4	(60 %)	\$ 179.7	(58 %)	\$ 160.7	(56 %)
Upholstery Fabrics						
Non-U.S.-Produced	\$ 115.2	(37 %)	\$ 119.1	(38 %)	\$ 116.0	(40 %)
U.S.-Produced	11.2	(3 %)	11.3	(4 %)	10.5	(4 %)
Total Upholstery	\$ 126.4	(40 %)	\$ 130.4	(42 %)	\$ 126.5	(44 %)
Total company	\$ 312.9	(100%)	\$ 310.2	(100%)	\$ 287.2	(100%)

Additional financial information about our operating segments can be found in Note 16 to the Consolidated Financial Statements included in Item 8 of this report.

**Mattress Fabrics.** The mattress fabrics segment, also known as Culp Home Fashions, manufactures and markets mattress fabric and mattress covers to bedding manufacturers. These products include woven jacquard fabrics, knitted fabrics, and some converted fabrics. Culp Home Fashions has manufacturing facilities located in Stokesdale and High Point, North Carolina, and St. Jerome, Quebec, Canada. One Stokesdale plant and the St. Jerome plant both manufacture and finish jacquard (damask) fabric. The main Stokesdale plant also finishes knitted fabric and houses the division offices and finished goods distribution capabilities, while the High Point and St. Jerome facilities house our knitted mattress fabrics manufacturing operations. During fiscal 2013, the mattress fabrics division established a second plant in Stokesdale to produce cut and sewn mattress covers, a growing product category that is used primarily by producers of specialty (non-innerspring) bedding. We have also maintained flexibility in our supply of the major categories of mattress fabrics and some sewn covers, with sourcing capacity located in Turkey and China. Most of our woven jacquard and knitted fabrics can be produced in multiple facilities (internal or external to the company), providing us with mirrored, reactive capacity involving state of the art capabilities across plant facilities.

Culp Home Fashions had capital expenditures during the past ten years totaling approximately \$56 million, which primarily provided for increased knit machine capacity, faster and more efficient weaving machines, and the initial capital required for our sewn cover business. These capital expenditures also provided high technology finishing equipment for woven and knitted fabric and an improved platform for warehousing and distribution. In order to maintain our leading edge technology and support modernization and expansion projects, we significantly increased our capital investments in the mattress fabrics segment during fiscal 2015 and 2016.



Asset acquisition transactions in fiscal 2009 and fiscal 2014 allowed us to enhance and secure our competitive position and to increase our mattress fabrics business. Taken together, the two transactions allowed us to secure our supply for knitted mattress fabrics, an important and growing product category, while also gaining control of product development and enhancing customer service. The transactions also involved consulting and non-compete agreements that enhanced our mattress fabrics product development and helped to secure our end markets. In addition to these transactions, we have continued to make further investments in knitting machines and finishing equipment, increasing our internal production capacity substantially.

Our sewn mattress cover business, established during fiscal 2013, participates in a joint marketing agreement for the production and marketing of sewn mattress covers and represents a further step in our efforts to respond to industry demands. The marketing venture is known as Culp-Lava Applied Sewn Solutions (CLASS), and is a joint marketing effort with A. Lava & Son Co. of Chicago, a leading provider of mattress covers. This manufacturing operation, located near our other plants in North Carolina, involves leased space and a limited capital investment in equipment. Teaming with A. Lava & Son allows us to have two mirrored manufacturing facilities and great flexibility in meeting demand for mattress covers from bedding producers.

**Upholstery Fabrics.** The upholstery fabrics segment markets fabrics for residential and commercial furniture, including jacquard woven fabrics, velvets, microdenier suedes, woven dobbies, knitted fabrics, piece-dyed woven products, and polyurethane “leather look” fabrics. This segment operates fabric manufacturing facilities in Anderson, South Carolina, and Shanghai, China. We market fabrics produced in these two locations, as well as a variety of upholstery fabrics sourced from third party producers, mostly in China. In the past fiscal year, sales of non-U.S. produced upholstery accounted for approximately 91% of our upholstery fabric sales. Our China facilities near Shanghai include fabric sourcing, finishing, warehousing, quality control and inspection operations, as well as a plant where sourced fabrics are cut and sewn into “kits” made to specifications of furniture manufacturing customers. Important recent developments in our China operations include expansion of our product development and design capabilities in China and further strengthening of key strategic partnerships with mills. We also have expanded our marketing efforts to sell our China products in countries other than the U.S., including the Chinese local market. The U.S. facility in South Carolina produces a variety of woven upholstery fabrics, including velvets and certain decorative fabrics.

During fiscal 2015 we closed our distribution warehouse in Poland that had been established to support sales in Europe. We are currently reviewing the company’s best long-term strategy for marketing upholstery fabrics in Europe.

Our upholstery fabrics business has moved from one that relied on a large fixed capital base that was difficult to adjust to a more flexible and scalable marketer of upholstery fabrics that meets changing levels of customer demand and style preferences. At the same time, we have maintained control of the most important “value-added” aspects of our business, such as design, finishing, quality control, and logistics. This strategic approach has allowed us to limit our investment of capital in fixed assets and control the costs of our products, while continuing to leverage our design and finishing expertise, industry knowledge, and important relationships.

Our upholstery fabrics sales decreased slightly in fiscal 2016 after six consecutive years of growth, while operating income for this segment increased strongly during the year. We believe the positive trends in sales and profits for the upholstery fabrics segment are due primarily to implementation of a business strategy that has included: 1) innovation in a low-cost environment, 2) speed-to-market execution, 3) consistent quality, 4) reliable service and lead times, and 5) increased recognition of and reliance on the Culp brand. Success in upholstery fabrics has been achieved through development of a unique business model that has enabled the upholstery segment to execute a strategy that we believe is clearly differentiated from our competitors. In this way, we have maintained our ability to provide furniture manufacturers with products from every category of fabric used to cover upholstered furniture, and to meet continually changing demand levels and consumer preferences.



## Overview of Industry and Markets

Culp markets products primarily to manufacturers that operate in three principal markets. The mattress fabrics segment supplies the bedding industry, which produces mattress sets (mattresses, box springs, foundations and top of bed components). The upholstery fabrics segment supplies the residential furniture industry and, to a lesser extent, the commercial furniture industry. The residential furniture market includes upholstered furniture sold to consumers for household use, including sofas, sofa-beds, chairs, recliners, and sectionals. The commercial furniture and fabrics market includes upholstered office seating and modular office systems sold primarily for use in offices and other institutional settings, fabrics used in the hospitality industry, and commercial textile wall coverings. The principal industries into which the company sells products are described below. Currently the vast majority of our products are sold to manufacturers for end use in the U.S., and thus the discussions below are focused on that market.

## Overview of Bedding Industry

The bedding industry has contracted and expanded in recent years in accordance with the general economy, although traditionally the industry has been relatively mature and stable. This is due in part to the fact that a majority of bedding industry sales are replacement purchases, which are less volatile than sales based on economic growth and new household formations. Unlike the residential furniture industry, which continues to face intense competition from imports, the U.S. bedding industry has largely remained a North American-based business with limited competition from imports. Imports of bedding into the U.S. have increased in recent years, but imported beds still represent only a small fraction of total U.S. bedding sales. The primary reasons for this fact include: 1) the short lead times demanded by mattress manufacturers and retailers due to their quick service delivery model, 2) the limited inventory carried by manufacturers and retailers requires “just-in-time” delivery of product, 3) the customized nature of each manufacturer’s and retailer’s product lines, 4) high shipping and import duty costs, 5) the relatively low direct labor content in mattresses, and 6) strong brand recognition and importance.

A key trend driving the bedding industry is increased awareness among consumers about the health benefits of better sleep, which has caused an increased focus on the quality of bedding products and an apparent willingness on the part of consumers to upgrade their bedding. Another important trend is the strong and growing emphasis on the design knitted or woven into mattress fabrics to appeal to the customer’s visual attraction and perceived value of the mattress on the retail floor. Mattress fabric design efforts are based on current trends in home decor and fashion. Another trend has been the growth in non-traditional sources for retail mattress sales such as internet sales and wholesale warehouse clubs. These sales channels have the potential to increase overall consumption of goods due to convenience and high traffic volume, which in turn results in higher turnover of product. Among fabric types, knitted fabrics have continued to increase in popularity. Knitted fabric was initially used primarily on premium mattresses, but these products are now being placed increasingly on mattresses at mid-range to lower retail price points.

## Overview of Residential and Commercial Furniture Industry

Sales of residential and commercial furniture were both severely affected by the global economic downturn in 2008-2009, and have now been in recovery for several years along with the overall economy. The pace of recovery since 2010 has been relatively steady, but modest, as has the growth rate for the economy as a whole. Sales of residential furniture are influenced significantly by the housing industry and by trends in home sales and household formations, while demand for commercial furniture generally reflects economic trends affecting businesses.

The sourcing of components and fully assembled furniture from overseas continues to play a major role in the furniture industry. By far, the largest source for these imports continues to be China. Imports of upholstery fabric, both in roll and in “kit” form, have also had a significant impact on the market for upholstery fabrics in recent years. Fabrics entering the U.S. from China and other low labor cost countries have resulted in increased price competition in the upholstery fabric and upholstered furniture markets. Prices for leather have created increased opportunities for suppliers of “leather look” and suede fabrics, and for suppliers of upholstery generally.

In general, the residential furniture industry has been consolidating for several years. The result of this trend is fewer, but larger, customers for marketers of upholstery fabrics. Intense price competition continues to be an important consideration for both residential and commercial furniture.

## Products

As described above, our products include mattress fabrics and upholstery fabrics, which are our identified operating segments. These fabrics are sold in roll form and as sewn mattress covers by the mattress fabrics segment, and in roll form and as cut and sewn kits by the upholstery fabrics segment.

### Mattress Fabrics Segment

Mattress fabrics segment sales constituted 56% to 60% of our total net sales in each of the past three fiscal years. The company has emphasized fabrics that have broad appeal at prices generally ranging from \$1.50 to more than \$10.00 per yard.

### Upholstery Fabrics Segment

Upholstery fabrics segment sales totaled 40% to 44% of our sales for each of the past three fiscal years. The company has emphasized fabrics that have broad appeal at “good” and “better” prices, generally ranging from \$3.00 to \$10.00 per yard.

Culp Product Categories by Segment

We market products in most categories of fabric that manufacturers currently use for bedding and furniture. The following table indicates the product lines within each segment, and a brief description of their characteristics.

Mattress Fabrics

Woven jacquards      Various patterns and intricate designs. Woven on complex looms using a variety of synthetic and natural yarns.

Converted      Suedes, pile and embroidered fabrics, and other specialty type products are sourced to offer diversity for higher end mattresses.

Knitted fabric      Various patterns and intricate designs produced on special-width circular knit machines utilizing a variety of synthetic and natural yarns. Knitted mattress fabrics have inherent stretching properties and spongy softness, which conforms well with layered foam packages.

Sewn mattress covers      Covers for bedding (primarily non-inner spring), sewn from knitted, jacquard and other mattress fabrics produced by our facilities or sourced from others.

Upholstery Fabrics

Woven jacquards      Elaborate, complex designs such as florals and tapestries in traditional, transitional, and contemporary styles. Woven on intricate looms using a wide variety of synthetic and natural yarns.

Woven dobbies      Fabrics that use straight lines to produce geometric designs such as plaids, stripes, and solids in traditional and country styles. Woven on less complicated looms using a variety of weaving constructions and primarily synthetic yarns.

Velvets      Soft fabrics with a plush feel. Woven or knitted in basic designs, using synthetic yarns which are yarn dyed or piece dyed.

Suedes      Fabrics woven or knitted using microdenier polyester yarns, which are piece dyed and finished, usually by sanding. The fabrics are typically plain or small jacquard designs, with some being printed. These are sometimes referred to as microdenier suedes.

Faux leathers      Sueded or knitted base cloths which are overprinted with polyurethane, and composite products consisting of a base fabric which is coated with a top layer of polyurethane, which simulate the look and feel of leather.

Cut and sewn kits      Covers made from various types of upholstery fabrics and cut and sewn to specifications of furniture manufacturing customers for use on specific furniture frames.

## Manufacturing and Sourcing

### Mattress Fabrics Segment

Our mattress fabrics segment operates four manufacturing plants, with two located in Stokesdale, North Carolina, and one each in High Point, North Carolina, and St. Jerome, Quebec, Canada. Over the past ten fiscal years, we made capital expenditures of approximately \$56 million to consolidate all of our production of woven jacquards, or damask fabric, to these plants and to modernize both knit and weaving equipment, enhance and provide knit and woven finishing capabilities, and expand capacity in each of these facilities. The result has been an increase in manufacturing efficiency and reductions in operating costs, as well as expanded product offerings.

Jacquard mattress fabrics and knitted fabrics are produced at the St. Jerome plant, with further jacquard capacity at our main Stokesdale facility and knitting capacity at our High Point facility. Most finishing and inspection processes for mattress fabrics are conducted at the main Stokesdale plant. We have a joint marketing arrangement with a producer of sewn mattress covers for bedding. This arrangement includes an additional manufacturing facility in Stokesdale to produce and market sewn mattress covers.

In addition to the mattress fabrics we manufacture, we have important supply arrangements in place that allow us to source mattress fabric from strategic suppliers. A portion of our woven jacquard fabric and knitted fabric is obtained from a supplier located in Turkey, based on designs and a production schedule created by Culp. We are also sourcing some Culp-designed knitted fabrics using our Culp China platform, and we are also sourcing certain converted fabric products (such as suedes, pile fabrics and embroidered fabrics) through our China platform.

### Upholstery Fabrics Segment

We currently operate one upholstery manufacturing facility in the U.S. and three in China. The U.S. plant is located in Anderson, South Carolina, and mainly produces velvet upholstery fabrics with some production of certain decorative fabrics.

Our upholstery manufacturing facilities in China are all located within the same industrial area near Shanghai. At these facilities, we apply value-added finishing processes to fabrics sourced from a limited number of strategic suppliers in China, and we inspect sourced fabric there as well. In addition, the Shanghai operations include facilities where sourced fabric is cut and sewn to provide “kits” that are designed to be placed on specific furniture frames designated by our customers.

A large portion of our upholstery fabric products, as well as certain elements of our production processes, are being sourced from outside suppliers. Our facilities in China provide a base from which to access a variety of products, including certain fabrics (such as microdenier suedes and polyurethane fabrics) that are not produced anywhere within the U.S. We have found opportunities to develop significant relationships with key overseas suppliers in China that allow us to source products on a cost-effective basis, while limiting our investment of capital in manufacturing assets. We source unfinished and finished fabrics, as well as a portion of our cut and sewn kits, from a limited number of strategic suppliers in China who are willing to commit significant capacity to meet our needs while working with our product development team to meet the demands of our customers. We also source a portion of our yarns for our U.S. operation through our China facilities. The remainder of our yarn is obtained from other suppliers around the world.

## Product Design and Styling

Consumer tastes and preferences related to bedding and upholstered furniture change over time. The use of new fabrics and creative designs remains an important consideration for manufacturers to distinguish their products at retail and to capitalize on changes in preferred colors, patterns and textures. Culp's success is largely dependent on our ability to market fabrics with appealing designs and patterns. The process of developing new designs involves maintaining an awareness of broad fashion and color trends both in the United States and internationally.

### Mattress Fabrics Segment

Design innovation is a very important element of producing mattress fabrics. Price point delineation is accomplished through fabric quality as well as variation in design. Additionally, consumers are drawn to the mattress that is most visually appealing when walking into a retail showroom. Fiber differentiation also plays an important part in design. For example, rayon, organic cotton, and other special fibers are incorporated into the design process to allow the retailer to offer consumers additional benefits related to their sleeping experience. Similarly, many fabrics contain special production finishes that enhance fabric performance.

Mattress fabric designs are not routinely introduced on a scheduled season. Designs are typically introduced upon the request of the customer as they plan introduction to their retailers. Additionally, we work closely with our customers on new design offerings around the major furniture markets such as Las Vegas, Nevada, and High Point, North Carolina.

### Upholstery Fabrics Segment

The company has developed an upholstery fabrics design and product development team (with staff located in the U.S. and in China) with a focus on value in designing body cloths, while promoting style leadership with pillow fabrics and color. Our design staff travels regularly to international trade and design shows to maintain familiarity with current design and fashion trends. The team searches continually for new ideas and for the best sources of raw materials, yarns, and fabrics, utilizing a supply network located mostly in China. Using these design elements, they develop product offerings using ideas and materials that take both fashion trends and cost considerations into account to offer products designed to meet the needs of furniture manufacturers and ultimately the desires of consumers.

Upholstery fabric designs are introduced at major fabric trade conferences that occur twice a year in the United States (June and December). In recent years, we have become more aggressive in registering copyrights for popular fabric patterns and taking steps to discourage the illegal copying of our proprietary designs.

## Distribution

### Mattress Fabrics Segment

The vast majority of our shipments of mattress fabrics originate from our facilities in Stokesdale, North Carolina. Through arrangements with major customers and in accordance with industry practice, we maintain a significant inventory of mattress fabrics at our distribution facility in Stokesdale (“make to stock”), so that products may be shipped to customers with short lead times and on a “just in time” basis.

### Upholstery Fabrics Segment

A majority of our upholstery fabrics are marketed on a “make to order” basis and are shipped directly from our distribution facilities in Burlington, North Carolina, and Shanghai, China. In addition to “make to order” distribution, an inventory of a limited number of fabric patterns is held at our distribution facilities in Burlington and Shanghai from which our customers can obtain quick delivery of sourced fabrics through a program known as “Culp Express.” Beginning in fiscal 2010 and continuing through fiscal 2016, market share opportunities have been expanded through strategic selling partnerships.

## Sources and Availability of Raw Materials

### Mattress Fabrics Segment

Raw materials account for approximately 60%-70% of mattress fabric production costs. The mattress fabrics segment purchases synthetic yarns (polyester, polypropylene, and rayon), certain greige (unfinished) goods, latex adhesives, laminates, dyes, and other chemicals. Most of these materials are available from several suppliers, and prices fluctuate based on supply and demand, the general rate of inflation, and particularly on the price of petrochemical products. The mattress fabrics segment has generally not had significant difficulty in obtaining raw materials.

### Upholstery Fabrics Segment

Raw materials account for approximately 60%-70% of upholstery fabric manufacturing costs for products the company manufactures. This segment purchases synthetic yarns (polyester, acrylic, rayon, and polypropylene), acrylic staple fiber, latex adhesives, dyes, and other chemicals from various suppliers.

Increased reliance by both our U.S. and China upholstery operations on outside suppliers for basic production needs such as base fabrics, yarns, and finishing services has caused the upholstery fabrics segment to become more vulnerable to price increases, delays, or production interruptions caused by problems within businesses that we do not control.

### Both Segments

Many of our basic raw materials are petrochemical products or are produced from such products. For this reason, our material costs can be sensitive to changes in prices for petrochemicals and the underlying price of oil. During fiscal 2015 and 2016, our profitability was aided by lower raw material prices due to lower oil prices.



## Seasonality

### Mattress Fabrics Segment

The mattress fabrics business and the bedding industry in general are slightly seasonal, with sales being the highest in early spring and late summer, with another peak in mid-winter.

### Upholstery Fabrics Segment

The upholstery fabrics business is somewhat seasonal, with sales often higher during our first and fourth fiscal quarters. In the past, seasonality resulted from one-week closings of our manufacturing facilities and the facilities of most of our customers in the United States during our first and third fiscal quarters for the holiday weeks of July 4th and Christmas. This effect has become less pronounced as a larger portion of our fabrics are produced or sold in locations outside of the U.S. The timing of the Chinese National Holiday in October and the Chinese New Year (which occurs in January or February each year) now have a more significant impact on upholstery sales than the effects of U.S. holiday periods.

## Competition

Competition for our products is high and is based primarily on price, design, quality, timing of delivery, and service.

### Mattress Fabrics Segment

The mattress fabrics market is concentrated in a few relatively large suppliers. We believe our principal mattress fabric competitors are BekaertDeslee Textiles, Global Textile Alliance, and several smaller companies producing knitted and other fabric.

### Upholstery Fabrics Segment

In the upholstery fabrics market, we compete against a large number of companies, ranging from a few large manufacturers comparable in size to the company to small producers, and a growing number of “converters” of fabrics (companies who buy and re-sell, but do not manufacture fabrics). We believe our principal upholstery fabric competitors are Dorell Fabrics Co., Merrimack Fabrics, Morgan Fabrics, Richloom Fabrics and Specialty Textile, Inc. (or STI), plus a large number of smaller competitors (both manufacturers and converters).

The trend in the upholstery fabrics industry to greater overseas competition and the entry of more converters has caused the upholstery fabrics industry to become substantially more fragmented in recent years, with lower barriers to entry. This has resulted in a larger number of competitors selling upholstery fabrics, with an increase in competition based on price.

## Environmental and Other Regulations

We are subject to various federal and state laws and regulations, including the Occupational Safety and Health Act (“OSHA”) and federal and state environmental laws, as well as similar laws governing our manufacturing facilities in China and Canada. We periodically review our compliance with these laws and regulations in an attempt to minimize the risk of violations.

Our operations involve a variety of materials and processes that are subject to environmental regulation. Under current law, environmental liability can arise from previously owned properties, leased properties and properties owned by third parties, as well as from properties currently owned and leased by the company. Environmental liabilities can also be asserted by adjacent landowners or other third parties in toxic tort litigation.

In addition, under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, as amended (“CERCLA”), and analogous state statutes, liability can be imposed for the disposal of waste at sites targeted for cleanup by federal and state regulatory authorities. Liability under CERCLA is strict as well as joint and several.

The U.S. Congress is considering legislation to address climate change that is intended to reduce overall greenhouse gas emissions, including carbon dioxide. In addition, the U.S. Environmental Protection Agency has made a determination that greenhouse gas emissions may be a threat to human health and the environment. International agreements may also result in new regulations on greenhouse gas emissions. It is uncertain if, when, and in what form, a mandatory carbon dioxide emissions reduction program may be enacted either through legislation or regulation. However, if enacted, this type of program could materially increase our operating costs, including costs of raw materials, transportation, and electricity. It is difficult to predict the extent to which any new rules or regulations would affect our business, but we would expect the effect on our operations to be similar to that for other manufacturers, particularly those in our industry.

We are periodically involved in environmental claims or litigation and requests for information from environmental regulators. Each of these matters is carefully evaluated, and the company provides for environmental matters based on information presently available. Based on this information, we do not believe that environmental matters will have a material adverse effect on either the company’s financial condition or results of operations. However, there can be no assurance that the costs associated with environmental matters will not increase in the future.

#### Employees

As of May 1, 2016, we had 1,217 employees, compared with 1,188 at the end of fiscal 2015. Overall, our total number of employees has remained fairly steady over the past five years, with increases in the mattress fabrics segment and decreases in the upholstery segment during that period.

The hourly employees at our manufacturing facility in Canada (approximately 14% of the company’s workforce) are represented by a local, unaffiliated union. The collective bargaining agreement for these employees expires on February 1, 2017. We are not aware of any efforts to organize any more of our employees, and we believe our relations with our employees are good.

The following table illustrates the changes in the location of our workforce and number of employees, as of year-end, over the past five fiscal years.

	Number of Employees				
	Fiscal 2016	Fiscal 2015	Fiscal 2014	Fiscal 2013	Fiscal 2012
Mattress Fabrics Segment	682	631	592	577	492
Upholstery Fabrics Segment					
United States	134	129	129	121	113
Poland	-	-	4	5	8
China	397	424	438	464	497
Total Upholstery Fabrics Segment	531	553	571	590	618
Unallocated corporate	4	4	4	4	4
Total	1,217	1,188	1,167	1,171	1,114

#### Customers and Sales

##### Mattress Fabrics Segment

Major customers for our mattress fabrics include the leading bedding manufacturers: Serta- Simmons Bedding (SSB), Tempur + Sealy International (TSI), and Corsicana Bedding. Our two largest customers in the mattress fabrics segment are (1) Serta Simmons Holdings, LLC, accounting for approximately 23% of the company's overall sales in fiscal 2016, and (2) Tempur + Sealy International, Inc., accounting for approximately 11% of our overall sales in fiscal 2016. Our mattress fabrics customers also include many small and medium-size bedding manufacturers.

##### Upholstery Fabrics Segment

Our major customers for upholstery fabrics are leading manufacturers of upholstered furniture, including Ashley, Bassett, Best Home Furnishings, Flexsteel, Heritage Home Group (Broyhill and Lane), Jackson Furniture, Jonathan Louis, La-Z-Boy (La-Z-Boy Residential and England), and Southern Motion. Major customers for the company's fabrics for commercial furniture include HON Industries. Our largest customer in the upholstery fabrics segment is La-Z-Boy Incorporated, which accounted for 13% of the company's consolidated sales in fiscal 2016.

The following table sets forth our net sales by geographic area by amount and percentage of total net sales for the three most recent fiscal years.

Net Sales by Geographic Area  
(dollars in thousands)

	Fiscal 2016		Fiscal 2015		Fiscal 2014	
United States	\$ 244,930	78.3 %	\$ 242,833	78.3 %	\$ 232,078	80.8 %
North America (Excluding USA)(1)	\$ 31,667	10.1 %	\$ 30,758	10.0 %	\$ 15,556	5.4 %
Far East and Asia(2)	31,927	10.2 %	31,855	10.3 %	33,487	11.7 %
All other areas	4,336	1.4 %	4,720	1.4 %	6,041	2.1 %
Subtotal (International)	\$ 67,930	21.7 %	\$ 67,333	21.7 %	\$ 55,084	19.2 %
Total	\$ 312,860	100 %	\$ 310,166	100 %	\$ 287,162	100 %

(1) Of this amount, \$24.2 million are attributable to shipments to Mexico in fiscal 2016, with corresponding amounts of \$24.1 million in fiscal 2015 and \$9.3 million in fiscal 2014.

(2) Of this amount, \$23.1 million are attributable to shipments to China in fiscal 2016, with corresponding amounts of \$26.5 million in fiscal 2015 and \$32.2 million in fiscal 2014.

Sales are attributed to individual countries based upon the location that the company ships its products for delivery to customers.

For additional segment information, including the geographic location of long-lived assets, see Note 16 in the consolidated financial statements.

Backlog

Mattress Fabrics Segment

The backlog for mattress fabric is not a reliable predictor of future shipments because the majority of sales are on a just-in-time basis.

Upholstery Fabrics Segment

Although it is difficult to predict the amount of backlog that is “firm,” we have reported the portion of the upholstery fabric backlog from customers with confirmed shipping dates within five weeks of the end of the fiscal year. On May 1, 2016, the portion of the upholstery fabric backlog with confirmed shipping dates prior to June 6, 2016, was \$8.4 million, all of which are expected to be filled early during fiscal 2017, as compared to \$9.4 million as of the end of fiscal 2015 (for confirmed shipping dates prior to June 7, 2015).

## ITEM 1A. RISK FACTORS

Our business is subject to risks and uncertainties. In addition to the matters described above under “Cautionary Statement Concerning Forward-Looking Information,” set forth below are some of the risks and uncertainties that could cause a material adverse change in our results of operations or financial condition. The risks described below are not the only risks we face. Additional risks and uncertainties not presently known to us or not presently deemed material by us also may materially adversely affect our business, financial condition or results of operations in future periods.

Continued economic uncertainty could negatively affect our sales and earnings.

Overall demand for our products depends upon consumer demand for furniture and bedding, which is subject to variations in the general economy. Because purchases of furniture or bedding are discretionary purchases for most individuals and businesses, demand for these products is sometimes more easily influenced by economic trends than demand for other products. Economic downturns can affect consumer spending habits and demand for home furnishings, which reduces the demand for our products and therefore can cause a decrease in our sales and earnings. Economic uncertainty has caused a decrease in consumer spending and demand for home furnishings, including goods that incorporate our products. If these conditions persist, our business will be negatively affected.

It has been challenging to maintain and increase sales levels in the upholstery fabrics segment.

Increased competition and fragmentation of the upholstery fabrics business, including a dramatic shift to imported fabrics and resulting price deflation for upholstery fabrics, have led to a significant reduction in the size of our upholstery business. Opportunities for growth and profitability gains for this segment are encouraging, but there is no assurance that we will be able to maintain or consistently grow this business in the future.

Greater reliance on offshore operations and foreign sources of products or raw materials increases the likelihood of disruptions to our supply chain or our ability to deliver products to our customers on a timely basis.

We rely significantly on operations in distant locations, particularly China, and in addition we have been purchasing a significant share of our products and raw materials from offshore sources, particularly Asia and Turkey. At the same time, our domestic manufacturing capacity for the upholstery fabrics segment has been greatly reduced. These changes have caused us to rely on a much longer supply chain and on a larger number of suppliers that we do not control, both of which are inherently subject to greater risks of delay or disruption. In addition, operations and sourcing in foreign areas are subject to the risk of changing local governmental rules, taxes, changes in import rules or customs, potential political unrest, or other threats that could disrupt or increase the costs of operating in foreign areas or sourcing products overseas. Changes in the value of the U.S. dollar versus other currencies can affect our financial results because a significant portion of our operations are located outside the United States. Strengthening of the U.S. dollar against other currencies can have a negative impact on our sales of products produced in those countries. Any of the risks associated with foreign operations and sources could cause unanticipated increases in operating costs or disruptions in business, which could negatively impact our ultimate financial results.

We may have difficulty managing the outsourcing arrangements being used for products and services.

We rely on outside sources for various products and services, including yarn and other raw materials, greige (unfinished) fabrics, finished fabrics, and services such as weaving and finishing. Increased reliance on outsourcing lowers our capital investment and fixed costs, but it decreases the amount of control that we have over certain elements of our production capacity. Interruptions in our ability to obtain raw materials or other required products or services from our outside suppliers on a timely and cost effective basis, especially if alternative suppliers cannot be immediately obtained, could disrupt our production and damage our financial results.

Write-offs or write-downs of assets would result in a decrease in our earnings and shareholders' equity.

The company has long-lived assets, primarily consist of property, plant and equipment, and goodwill, and to a lesser extent other intangible assets. ASC Topic 360 establishes an impairment accounting model for long-lived assets such as property, plant, and equipment and requires the company to assess for impairment whenever events or changes in circumstances indicate that the carrying value of the asset may not be recovered. ASC Topic 350 requires that goodwill and other intangible assets be tested at least annually for impairment or whenever events or changes in circumstances indicate that the carrying value of the asset may not be recovered. Although no material write-downs were experienced in the past several fiscal years, there is no assurance that future write-downs of fixed assets or goodwill will not occur if business conditions deteriorate.

Changes in the price, availability, and quality of raw materials could increase our costs or cause production delays and sales interruptions, which would result in decreased earnings.

We depend upon outside suppliers for most of our raw material needs, and we rely upon outside suppliers for component materials such as yarn and unfinished fabrics, as well as for certain services such as finishing and weaving. Fluctuations in the price, availability, and quality of these goods and services could have a negative effect on our production costs and ability to meet the demands of our customers, which would affect our ability to generate sales and earnings. In many cases, we are not able to pass through increased costs of raw materials or increased production costs to our customers through price increases. In particular, many of our basic raw materials are petrochemical products or are produced from such products. For this reason, our material costs are especially sensitive to changes in prices for petrochemicals and the underlying price of oil. Increases in prices for oil, petrochemical products or other raw materials and services provided by outside suppliers could significantly increase our costs and negatively affect earnings. Although our raw material costs were lower during our most recent fiscal years, higher raw material prices could have a negative effect on our profits in the future.

Increases in energy costs would increase our operating costs and could adversely affect earnings.

Higher prices for electricity, natural gas, and fuel increase our production and shipping costs. A significant shortage, increased prices, or interruptions in the availability of these energy sources would increase the costs of producing and delivering products to our customers, and would be likely to adversely affect our earnings. In many cases, we are not able to pass along the full extent of increases in our production costs to customers through price increases. Energy costs have varied significantly during recent fiscal years, and remain a volatile element of our costs. Increases in energy costs could have a negative effect on our earnings.

Business difficulties or failures of large customers could result in a decrease in our sales and earnings.

We currently have several customers that account for a substantial portion of our sales. In the mattress fabrics segment, several large bedding manufacturers have large market shares and comprise a significant portion of our mattress fabric sales, with Serta Simmons Holdings, LLC accounting for approximately 23% of consolidated net sales, and Tempur Sealy International, Inc. accounting for approximately 11% of consolidated net sales, in fiscal 2016. In the upholstery fabrics segment, La-Z-Boy Incorporated accounted for approximately 13% of consolidated net sales during fiscal 2016, and several other large furniture manufacturers comprised a significant portion of sales. A business failure or other significant financial difficulty by one or more of our major customers, or the loss of one or more of these customers, could cause a significant loss in sales, an adverse effect on our earnings, and difficulty in collection of our trade accounts receivable.

Loss of market share due to competition would result in declines in sales and could result in losses or decreases in earnings.

Our business is highly competitive, and in particular the upholstery fabric industry is fragmented and is experiencing an increase in the number of competitors. As a result, we face significant competition from a large number of competitors, both foreign and domestic. We compete with many other manufacturers of fabric, as well as converters who source fabrics from various producers and market them to manufacturers of furniture and bedding. In many cases, these fabrics are sourced from foreign suppliers who have a lower cost structure than the company. The highly competitive nature of our business means we are constantly subject to the risk of losing market share. As a result of increased competition, there have been deflationary pressures on the prices for many of our products, which make it more difficult to pass along increased operating costs such as raw materials, energy or labor in the form of price increases and puts downward pressure on our profit margins. Also, the large number of competitors and wide range of product offerings in our business can make it more difficult to differentiate our products through design, styling, finish, and other techniques.

If we fail to anticipate and respond to changes in consumer tastes and fashion trends, our sales and earnings may decline.

Demand for various types of upholstery fabrics and mattress coverings changes over time due to fashion trends and changing consumer tastes for furniture and bedding. Our success in marketing our fabrics depends upon our ability to anticipate and respond in a timely manner to fashion trends in home furnishings. If we fail to identify and respond to these changes, our sales of these products may decline. In addition, incorrect projections about the demand for certain products could cause the accumulation of excess raw material or finished goods inventory, which could lead to inventory mark-downs and decreases in earnings.

Increasing dependence on information technology systems comes with specific risks, including cybersecurity breaches and data leaks, which could have an adverse effect on our business.

We increasingly rely on technology systems and infrastructure. Greater dependence on such systems heightens the risk of potential vulnerabilities from system failure and malfunction, breakdowns due to natural disasters, human error, unauthorized access, power loss, and other unforeseen events. Data privacy breaches by employees and others with or without authorized access to our systems poses risks that sensitive data may be permanently lost or leaked to the public or other unauthorized persons. With the growing use and rapid evolution of technology, not limited to cloud-based computing and mobile devices, there are additional risks of unintentional data leaks. There is also the risk of our exposure to theft of confidential information, intentional vandalism, industrial espionage, and a variety of cyber-attacks that could compromise our internal technology system and infrastructure, or result in data leakage in-house or at our third-party providers and business partners. Failures of technology or related systems, or an improper release of confidential information, could damage our business or subject us to unexpected liabilities.

We are subject to litigation and environmental regulations that could adversely impact our sales and earnings.

We have been, and in the future may be, a party to legal proceedings and claims, including environmental matters, product liability, and employment disputes, some of which claim significant damages. We face the continual business risk of exposure to claims that our business operations have caused personal injury or property damage. We maintain insurance against product liability claims and in some cases have indemnification agreements with regard to environmental claims, but there can be no assurance that these arrangements will continue to be available on acceptable terms or that such arrangements will be adequate for liabilities actually incurred. Given the inherent uncertainty of litigation, there can be no assurance that claims against the company will not have a material adverse impact on our earnings or financial condition. We are also subject to various laws and regulations in our business, including those relating to environmental protection and the discharge of materials into the environment. We could incur substantial costs as a result of noncompliance with or liability for cleanup or other costs or damages under environmental laws or other regulations.

We must comply with a number of governmental regulations applicable to our business, and changes in those regulations could adversely affect our business.

Our products and raw materials are and will continue to be subject to regulation in the United States by various federal, state, and local regulatory authorities. In addition, other governments and agencies in other jurisdictions regulate the manufacture, sale, and distribution of our products and raw materials. Also, rules and restrictions regarding the importation of fabrics and other materials, including custom duties, quotas and other regulations, are continually changing. Environmental laws, labor laws, tax regulations, and other regulations continually affect our business. All of these rules and regulations can and do change from time to time, which can increase our costs or require us to make changes in our manufacturing processes, product mix, sources of products and raw materials, or distribution. Changes in the rules and regulations applicable to our business may negatively impact our sales and earnings.



## ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

## ITEM 2. PROPERTIES

Our headquarters are located in High Point, North Carolina. As of the end of fiscal 2016, we leased our corporate headquarters and owned or leased thirteen manufacturing and distribution facilities. The following is a list of our principal administrative, manufacturing and distribution facilities. The manufacturing facilities and distribution centers are organized by segment.

<u>Location</u>	<u>Principal Use</u>	Approx. <u>Total Area</u> <u>(Sq. Ft.)</u>	<u>Expiration</u> <u>of Lease</u>
Administrative:			
High Point, North Carolina (1)	Upholstery fabric division offices and corporate headquarters	29,812	2025
Mattress Fabrics:			
Stokesdale, North Carolina	Manufacturing, distribution, and division offices	293,958	Owned
Stokesdale, North Carolina	Warehouse	56,950	2017
High Point, North Carolina (1)	Manufacturing	63,522	2023
High Point, North Carolina	Warehouse and offices	65,886	2017
Summerfield, North Carolina	Manufacturing	39,320	2017
St. Jerome, Quebec, Canada	Manufacturing	202,500	Owned
Upholstery Fabrics:			
Anderson, South Carolina	Manufacturing	99,000	Owned
Burlington, North Carolina (2)	Finished goods distribution	132,000	-
Shanghai, China	Manufacturing and offices	68,677	2018
Shanghai, China	Manufacturing and offices	89,857	2018
Shanghai, China	Manufacturing and warehousing	89,861	2017
Shanghai, China	Warehouse and offices	64,583	2017
Shanghai, China	Warehouse	48,610	2018

(1) Includes all options to renew.

(2) This lease agreement is currently on a month to month basis.

We believe that our facilities are in good condition, well-maintained and suitable and adequate for present utilization. In the upholstery fabrics segment, we have the ability to source upholstery fabric from outside suppliers to meet current and expected demand trends and further increase our output of finished goods. This ability to source upholstery fabric is part of our long-term strategy to have a low-cost platform that is scalable, but not capital intensive. In the mattress fabrics segment, management has estimated that it is currently performing at near capacity. Also, we have the ability to source additional mattress fabric from outside suppliers to further increase our ultimate output of finished goods.



ITEM 3. LEGAL PROCEEDINGS

Our legal proceedings are described more fully in Note 11 in the notes to the consolidated financial statements.

ITEM 4. MINE SAFETY DISCLOSURE

Not applicable.

PART II

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES

Registrar and Transfer Agent

Computershare Trust Company, N.A.  
c/o Computershare Investor Services  
Post Office Box 30170  
College Station, TX 77842  
(800) 254-5196  
(781) 575-2879 (Foreign shareholders)  
[www.computershare.com/investor](http://www.computershare.com/investor)

Stock Listing

Culp, Inc. common stock is traded on the New York Stock Exchange ("NYSE") under the symbol CFI. As of May 1, 2016, Culp, Inc. had approximately 3,120 shareholders based on the number of holders of record and an estimate of individual participants represented by security position listings.

Analyst Coverage

These analysts cover Culp, Inc.:

Raymond, James & Associates - Budd Bugatch, CFA

Value Line – Craig Sirois

Stifel Financial Corp - John A. Baugh, CFA

Stonegate Capital Partners, Inc. - Marco Rodriguez, CFA

## Dividends and Share Repurchases; Sales of Unregistered Securities

Share Repurchases

## ISSUER PURCHASES OF EQUITY SECURITIES

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (1)
February 1, 2016 to March 6, 2016	-	\$ -	-	\$1,859,274
March 7, 2016 to April 3, 2016	-	\$ -	-	\$1,859,274
April 4, 2016 to May 1, 2016	-	\$ -	-	\$1,859,274
Total	-	\$ -	-	\$1,859,274

(1) On February 25, 2014, we announced that our board of directors approved an authorization for us to acquire up to \$5.0 million of our common stock. During fiscal 2016, we purchased 100,776 shares of common stock at a cost of \$2.4 million, all of which were purchased during the third quarter. At May 1, 2016, we had \$1.9 million available for additional repurchases of common stock pursuant to the authorization by our board of directors dated February 25, 2014. On June 15, 2016, we announced that our board of directors increased the authorization for us to acquire up to \$5.0 million of our common stock.

Dividends

On June 15, 2016, we announced that our board of directors approved the payment of a special cash dividend of \$0.21 per share and a regular quarterly cash dividend payment of \$0.07 per share. These dividend payments are payable on July 15, 2016, to shareholders of record as of July 1, 2016.

During fiscal 2016, dividend payments totaled \$8.1 million, of which \$5.0 million represented a special cash dividend payment in the first quarter of \$0.40 per share, and \$3.1 million represented our regular quarterly cash dividend payments ranging from \$0.06 to \$0.07 per share.

During fiscal 2015, dividend payments totaled \$7.6 million, of which \$4.9 million represented a special cash dividend payment in the first quarter of \$0.40 per share, and \$2.7 million represented our regular quarterly cash dividend payments ranging from \$0.05 to \$0.06 per share.

During fiscal 2014, we paid regular quarterly cash dividends totaling \$2.2 million that ranged from \$0.04 to \$0.05 per share.

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

Sales of Unregistered Securities

There were no sales of unregistered securities during fiscal 2016, 2015, or 2014.

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### Performance Comparison

The following graph shows changes over the five fiscal years ending May 1, 2016 in the value of \$100 invested in (1) the common stock of the company, (2) the Hemscott Textile Manufacturing Group Index reported by Standard and Poor's, consisting of eight companies (including the company) in the textile industry, and (3) the Standard & Poor's 500 Index.

The graph assumes an initial investment of \$100 at the end of fiscal 2011 and the reinvestment of all dividends during the periods identified.

### Market Information

See Item 6, Selected Financial Data, and Selected Quarterly Data in Item 8, for market information regarding the company's common stock.

## ITEM 6. SELECTED FINANCIAL DATA

	fiscal	fiscal	fiscal	fiscal	fiscal	percent change	
(amounts in thousands, except per share, ratios & other, stock data)	2016	2015	2014	2013	2012	2016/2015	
<b>INCOME STATEMENT DATA</b>							
net sales	\$312,860	310,166	287,162	268,814	254,443	0.9	%
cost of sales	247,749	254,599	238,256	219,284	214,711	-2.7	%
gross profit	65,111	55,567	48,906	49,530	39,732	17.2	%
selling, general, and administrative expenses	36,773	32,778	28,657	28,445	25,026	12.2	%
income from operations	28,338	22,789	20,249	21,085	14,706	24.3	%
interest expense	-	64	427	632	780	-100.0	%
interest income	(176 )	(622 )	(482 )	(419 )	(508 )	-71.7	%
other expense	616	391	1,261	583	236	57.5	%
income before income taxes	27,898	22,956	19,043	20,289	14,198	21.5	%
income taxes	10,963	7,885	1,596	1,972	902	39.0	%
net income	\$16,935	15,071	17,447	18,317	13,296	12.4	%
depreciation	\$6,671	5,773	5,312	5,115	4,865	15.6	%
weighted average shares outstanding	12,302	12,217	12,177	12,235	12,711	0.7	%
weighted average shares outstanding, assuming dilution	12,475	12,422	12,414	12,450	12,866	0.4	%
<b>PER SHARE DATA</b>							
net income per share - basic	\$1.38	1.23	1.43	1.50	1.05	11.6	%
net income per share - diluted	1.36	1.21	1.41	1.47	1.03	11.9	%
dividends per share	\$0.66	0.62	0.18	0.62	-	6.5	%
book value	\$10.50	9.77	9.12	7.82	7.00	7.5	%
<b>BALANCE SHEET DATA</b>							
operating working capital (4)	\$45,794	41,829	41,120	39,228	30,596	9.5	%
property, plant and equipment, net	39,973	36,078	31,376	30,594	31,279	10.8	%
total assets	175,142	171,300	160,935	142,779	144,721	2.2	%
capital expenditures	10,708	11,174	5,310	4,457	5,919	-4.2	%
dividends paid	8,140	7,579	2,204	7,593	-	7.4	%
long-term debt, current maturities of long-term debt and line of credit	-	2,200	4,986	7,161	10,012	-100.0	%
shareholders' equity	128,812	119,427	111,744	95,583	89,000	7.9	%
capital employed (3)	90,357	83,225	80,038	74,747	69,630	8.6	%
<b>RATIOS &amp; OTHER DATA</b>							
gross profit margin	20.8	% 17.9	% 17.0	% 18.4	% 15.6	%	%
operating income margin	9.1	% 7.3	% 7.1	% 7.8	% 5.8	%	%
net income margin	5.4	% 4.9	% 6.1	% 6.8	% 5.2	%	%
effective income tax rate	39.3	% 34.3	% 8.4	% 9.7	% 6.4	%	%
debt to total capital employed ratio (1) (3)	0.0	% 2.6	% 6.2	% 9.6	% 14.4	%	%
operating working capital turnover (4)	7.0	7.7	7.0	7.4	8.9		
days sales in receivables	27	34	35	32	36		
inventory turnover	5.6	6.1	6.0	5.9	6.6		

## STOCK DATA

stock price					
high	\$35.23	29.19	21.10	18.15	11.81
low	22.72	16.60	14.93	9.00	7.05
close	26.24	26.02	18.61	16.25	11.05
P/E ratio (2)					
high	26	24	15	12	11
low	17	14	11	6	7
daily average trading volume (shares)	67.3	38.6	27.5	40.9	30.6

- (1) Debt includes long-term and current maturities of long-term debt and line of credit.
- (2) P/E ratios based on trailing 12-month diluted net income per share.
- (3) Capital employed does not include cash and cash equivalents, short-term investments, long-term investments, current maturities of long-term debt, long-term debt, line of credit, noncurrent deferred tax assets and liabilities, income taxes receivable and payable, and deferred compensation.
- (4) Operating working capital for this calculation is accounts receivable and inventories, offset by accounts payable-trade and account payable - capital expenditures.



## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following analysis of the financial condition and results of operations should be read in conjunction with the consolidated financial statements and notes and other exhibits included elsewhere in this report.

### General

Our fiscal year is the 52 or 53 week period ending on the Sunday closest to April 30. Fiscal 2016 and 2014 each included 52 weeks. Fiscal 2015 included 53 weeks. Our operations are classified into two business segments: mattress fabrics and upholstery fabrics. The mattress fabrics segment manufactures, sources and sells fabrics and mattress covers to bedding manufacturers. The upholstery fabrics segment sources, manufactures and sells fabrics primarily to residential furniture manufacturers.

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

### Executive Summary

#### Results of Operations

	Twelve Months Ended		
	May 1, 2016	May 3, 2015	Change
(dollars in thousands)			
Net sales	\$312,860	\$310,166	0.9 %
Gross profit	65,111	55,567	17.2 %
Gross profit margin	20.8 %	17.9 %	290 bp
SG&A expenses	36,773	32,778	12.2 %
Income from operations	28,338	22,789	24.3 %
Operating margin	9.1 %	7.3 %	180 bp
Income before income taxes	27,898	22,956	21.5 %
Income taxes	10,963	7,885	39.0 %
Net income	16,935	15,071	12.4 %

### Net Sales

Overall, our net sales were slightly higher in fiscal 2016 compared to a year ago. We have remained focused on our top strategic priorities of product innovation and creativity to provide a product mix that meets the demands of our customers. Our scalable and flexible manufacturing platform supports this strategy and we have made significant capital investments to improve our operating efficiencies and overall capacity.

Our overall net sales for fiscal 2016 were also affected by the fact that fiscal 2016 contained one less week of operations compared to a year ago.

## Income Before Income Taxes

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

## Income Taxes

We recorded income tax expense of \$11.0 million, or 39.3% of income before income tax expense, in fiscal 2016 compared with income tax expense of \$7.9 million, or 34.3% of income before income tax expense, in fiscal 2015. This increase was primarily due to the increase in taxable foreign currency exchange gains associated with our operations located in China in fiscal 2016 compared with fiscal 2015.

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

## Liquidity

At May 1, 2016, our cash and cash equivalents and short-term investments totaled \$42.1 million compared with \$39.7 million at May 3, 2015. This year over year increase was achieved despite spending \$11.5 million on capital expenditures mostly associated with our mattress fabrics segment, \$8.1 million on dividend payments, \$2.4 million on common stock repurchases, \$2.2 million on a long-term debt payment, and \$1.6 million on long-term investment purchases associated with our Rabbi Trust. This spending was more than offset by net cash provided by operating activities of \$26.8 million.

Our net cash provided by operating activities of \$26.8 million was slightly higher than the same period a year ago.

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

On March 10, 2016, we amended our Credit Agreement with Wells Fargo Bank, N.A. (Wells Fargo) to increase our borrowing capacity from \$10 million to \$30 million. The purpose of the increase in our revolving credit line with Wells Fargo is to support potential short-term cash needs in different jurisdictions within our global operations, mitigate our risk associated with foreign currency exchange rate fluctuations, and support repatriation of earnings and profits from our foreign subsidiaries to the U.S. for strategic purposes.

## Dividend Program

On June 15, 2016, we announced that our board of directors approved the payment of a special cash dividend of \$0.21 per share and a regular quarterly cash dividend payment of \$0.07 per share. These dividend payments are payable on July 15, 2016, to shareholders of record as of July 1, 2016.

During fiscal 2016, dividend payments totaled \$8.1 million, of which \$5.0 million represented a special cash dividend payment in the first quarter of \$0.40 per share, and \$3.1 million represented our regular quarterly cash dividend payments ranging from \$0.06 to \$0.07 per share.

During fiscal 2015, dividend payments totaled \$7.6 million, of which \$4.9 million represented a special cash dividend payment in the first quarter of \$0.40 per share, and \$2.7 million represented our regular quarterly cash dividend payments ranging from \$0.05 to \$0.06 per share.

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

## Common Stock Repurchases

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

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

At May 1, 2016, we had \$1.9 million available for additional repurchases of our common stock pursuant to the authorization by our board of directors dated February 25, 2014. On June 15, 2016, we announced that our board of directors increased the authorization for us to acquire up to \$5.0 million of our common stock.

## Results of Operations

The following table sets forth certain items in our consolidated statements of net income as a percentage of net sales.

	Fiscal 2016	Fiscal 2015	Fiscal 2014
Net sales	100.0%	100.0%	100.0%
Cost of sales	79.2	82.1	83.0
Gross profit	20.8	17.9	17.0
Selling, general and administrative expenses	11.7	10.6	9.9
Income from operations	9.1	7.3	7.1
Interest income, net	0.0	0.2	0.0
Other expense, net	(0.2 )	(0.1 )	(0.5 )
Income before income taxes	8.9	7.4	6.6
Income taxes *	39.3	34.3	8.4
Net income	5.4 %	4.9 %	6.1 %

\* Calculated as a percentage of income before income taxes.

2016 compared with 2015

## Segment Analysis

Mattress Fabrics Segment

(dollars in thousands)	Twelve Months Ended			Change
	May 1, 2016	May 3, 2015		
Net sales	\$186,419	\$179,739		3.7 %
Gross profit	38,718	32,877		17.8%
Gross profit margin	20.8 %	18.3 %		250 bp
SG&A expenses	12,223	11,206		9.1 %
Income from operations	26,496	21,671		22.3%
Operating margin	14.2 %	12.1 %		210 bp

## Net Sales

Our steady sales growth this fiscal year, outperformed overall industry trends. Our focus on design and innovation has allowed us to create a diversified product mix of mattress fabrics and sewn covers across most price points. We also achieved significant progress this year in our mattress cover business. This has allowed us to reach new customers and additional market segments, especially the internet bedding space. Our scalable manufacturing platform and reactive capacity supports our ability to deliver a diverse product mix in line with customer demand.

Our mattress fabric net sales also were affected somewhat by increased customer pricing pressures and the fact that fiscal 2016 contained one less week of operations compared with fiscal 2015.

## Gross Profit and Operating Income

Our increases in gross profit and operating income reflect the benefits of our capital investments that were placed into service in the last half of fiscal 2015, which include increased production capacity via newer and more efficient equipment, enhanced finishing capabilities, and improved overall efficiency and throughput. During the last half of fiscal 2016, we completed the first phase of our expansion project at our facility located in Canada, which primarily included the installation of additional new equipment and other technological improvements to our manufacturing platform. In early fiscal 2017, we will commence the second phase of our expansion project, which includes additional equipment, finishing capabilities, and a new distribution platform that we expect will improve our service to customers located in Canada. Also, we have already commenced work on additional expansion projects associated with our facilities located in North Carolina, which will add more capacity, expand our design facilities, and enhance our distribution capabilities.

The increases in our gross profit and operating income for this segment were also due to lower raw material costs and lower operating expenses due to more favorable exchange rates in Canada.

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

#### Segment Assets

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

	May 1, 2016	May 3, 2015	% Change
(dollars in thousands)			
Accounts receivable and inventory	\$43,472	\$41,328	5.2 %
Property, plant & equipment	37,480	33,773	11.0 %
Goodwill	11,462	11,462	0.0 %
Non-compete agreement	903	979	(7.8)%
Customer Relationships	715	766	(6.7)%

#### Accounts Receivable & Inventory

The increase in accounts receivable and inventory are due to an increase in inventory of \$4.6 million, as a result of customers requiring us to hold higher inventory levels of key products. This was partially offset by a decrease in accounts receivable of \$2.5 million due to improved cash collections in the fourth quarter of fiscal 2016 compared with the fourth quarter fiscal 2015.

#### Property, Plant & Equipment

The \$37.5 million at May 1, 2016, represents property, plant and equipment of \$24.8 million and \$12.7 million located in the U.S. and Canada, respectively. The \$33.8 million at May 3, 2015, represents property, plant, and equipment of \$23.8 million and \$10.0 million located in the U.S. and Canada, respectively.

The increase in property, plant, and equipment for this segment is due to the capital expansion projects noted above, offset by depreciation expense.

#### Non-Compete Agreement and Customer Relationships

The decreases in carrying values of our non-compete agreement and customer relationships at May 1, 2016, are primarily due to amortization expense in fiscal 2016.

Upholstery Fabrics Segment

## Net Sales

(dollars in thousands)	Twelve Months Ended			% Change
	May 1, 2016	May 3, 2015		
Non U.S. Produced	\$115,167	\$119,177	92 %	(3.4)%
U.S Produced	11,274	11,250	8 %	0.2 %
Total	\$126,441	\$130,427	100%	(3.1)%

Our decrease in net sales reflects softer retail demand for home furnishings and our strategy to enhance both our customer and product mix to improve our profitability. Our upholstery fabric net sales were also affected by the fact that fiscal 2016 contained one less week of operations compared with the same period a year ago and by the closure of our finished goods warehouse and distribution facility located in Poland during the third quarter of fiscal 2015.

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

## Gross Profit and Operating Income

(dollars in thousands)	Twelve Months Ended			Change
	May 1, 2016	May 3, 2015		
Gross profit	\$26,393	\$22,690		16.3 %
Gross profit margin	20.9 %	17.4 %		350 bp
SG&A expenses	15,094	14,562		3.7 %
Income from operations	11,298	8,128		39.0 %
Operating margin	8.9 %	6.2 %		270 bp

The increases in this segment's gross profit and operating income reflect the benefits of our strategic focus on product innovation and sales diversification. The benefits include an enhanced product mix that has resulted in greater operating efficiency and capacity utilization. We also experienced lower raw material costs and operating expenses due to more favorable foreign exchange rates in China.

Partially offsetting the improvement in income from operations was an increase in SG&A expenses due primarily to higher incentive compensation expense reflecting stronger financial results in relation to pre-established performance targets, and some pricing pressures from key customers.

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

#### Culp Europe

At the end of the third quarter of fiscal 2015, we closed our finished goods warehouse and distribution facility located in Poznan, Poland, primarily as a result of ongoing economic weakness in Europe. Currently, we remain very interested in developing business in Europe, and we are assessing the best strategy for selling upholstery fabric into this market as business conditions improve.

#### Segment Assets

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

	May 1, 2016	May 3, 2015	% Change
(dollars in thousands)			
Accounts receivable and inventory	\$26,540	\$29,905	(11.3)%
Property, plant & equipment	1,564	1,467	6.6 %

#### Accounts Receivable & Inventory

The decrease in accounts receivable and inventory are primarily due to a decrease in this segment's accounts receivable as a result of lower net sales and improved cash collections in the fourth quarter of fiscal 2016 compared with the fourth quarter of fiscal 2015.

#### Property, Plant & Equipment

The \$1.6 million at May 1, 2016, represents property, plant, and equipment located in the U.S. of \$893,000 and located in China of \$671,000. The \$1.5 million at May 3, 2015, represents property, plant, and equipment located in the U.S. of \$848,000 and located in China of \$619,000.



Other Income Statement Categories

(dollars in thousands)	Twelve Months Ended		
	May 1, 2016	May 3, 2015	% Change
SG&A expenses	\$36,773	\$32,778	12.2 %
Interest expense	-	64	(100.0)%
Interest income	176	622	(71.7 )%
Other expense	616	391	57.5 %

## Selling, General and Administrative Expenses

The increase in SG&A expenses is primarily due to higher incentive compensation expense reflecting stronger financial results in relation to pre-established performance targets in fiscal 2016 compared to fiscal 2015.

## Interest Expense

Interest expense decreased in fiscal 2016 compared with fiscal 2015. This trend primarily reflects lower outstanding balances of long-term debt and interest costs that were capitalized in connection with our capital investments associated with our mattress fabrics segment. Interest costs charged to operations and incurred on our long-term debt and lines of credit were \$58,000 and \$235,000 for fiscal 2016 and 2015, respectively. Interest costs charged to operations were reduced by \$58,000 and \$171,000 for capitalized interest costs for fiscal 2016 and 2015, respectively. These capitalized interest costs will be amortized over the related assets' useful lives.

## Interest Income

Interest income decreased in fiscal 2016 compared with fiscal 2015. This trend reflects higher cash and cash equivalents and short-term investment balances held in U.S. dollar denominated account balances during fiscal 2016 compared with fiscal 2015. Cash and cash equivalents and short-term investment balances held in U.S. dollar denominated account balances earn lower interest rates as compared to our cash and cash equivalents and short-term investment balances denominated in the local currency of our foreign subsidiaries.

During fiscal 2016, we implemented a strategy of substantially reducing the amount of cash we hold in Chinese Yuan Renminbi. Although this action resulted in lower interest income as compared to last year, the strategy has mitigated our foreign currency exchange rate exposure in China. See discussion in "Other Expense" below.

## Other Expense

The increase in other expense was primarily due to foreign exchange rate fluctuations associated with our subsidiaries domiciled in Canada and China. Our operations located in Canada and China reported a foreign exchange gain of \$6,000 in fiscal 2016 compared to \$131,000 in fiscal 2015.

Our foreign exchange gain of \$6,000 in fiscal 2016 reflects our ability to mitigate the effects of foreign currency exchange rate fluctuations through the maintenance of a natural hedge by keeping a balance of assets and liabilities denominated in foreign currencies other than the U.S. dollar. As noted above, we made a concerted effort in fiscal 2016 to transfer significant amounts of cash we hold in Chinese Yuan Renminbi to accounts denominated in U.S. dollars.

Income Taxes

Significant judgment is required in determining the provision for income taxes. During the ordinary course of business, there are many transactions and calculations for which the ultimate tax determination is uncertain. We account for income taxes using the asset and liability approach as prescribed by ASC Topic 740, "Income Taxes." This approach requires recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the consolidated financial statements or income tax returns. Using the enacted tax rates in effect for the fiscal year in which differences are expected to reverse, deferred tax assets and liabilities are determined based on the differences between financial reporting and tax basis of an asset or liability. If a change in the effective tax rate to be applied to a timing difference is determined to be appropriate, it will affect the provision for income taxes during the period that the determination is made.

## Effective Income Tax Rate

We recorded income tax expense of \$11.0 million, or 39.3% of income before income tax expense, in fiscal 2016 compared with income tax expense of \$7.9 million, or 34.3% of income before income tax expense, in fiscal 2015. The following schedule summarizes the principal differences between income tax expense at the federal income tax rate and the effective income tax rate reflected in the consolidated financial statements:

	2016	2015
federal income tax rate	34.0%	34.0%
tax effects of Chinese foreign exchange gains	4.4	0.3
change in valuation allowance	(1.2 )	(0.2 )
change in North Carolina income tax rates	0.7	-
other	1.4	0.2
	39.3%	34.3%

## Deferred Income Taxes – Valuation Allowance

Summary

In accordance with ASC Topic 740, we evaluate our deferred income taxes to determine if a valuation allowance is required. ASC Topic 740 requires that companies assess whether a valuation allowance should be established based on the consideration of all available evidence using a "more likely than not" standard with significant weight being given to evidence that can be objectively verified. Since the company operates in multiple jurisdictions, we assess the need for a valuation allowance on a jurisdiction- by-jurisdiction basis, taking into account the effects of local tax law. Based on our assessment at May 1, 2016, we recorded a partial valuation allowance of \$590,000, of which \$518,000 pertained to certain U.S. state net operating loss carryforwards and credits and \$72,000 pertained to loss carryforwards associated with our Culp Europe operation located in Poland. Based on our assessment at May 3, 2015, we recorded a partial valuation allowance of \$922,000, of which \$561,000 pertained to certain U.S. state net operating loss carryforwards and credits and \$361,000 pertained to loss carryforwards associated with our Culp Europe operation located in Poland.

No valuation allowance was recorded against our net deferred tax assets associated with our operations located in China and Canada at May 1, 2016 and May 3, 2015, respectively.

### United States

Our partial valuation allowance against our U.S. net deferred assets totaled \$518,000 and \$561,000 at May 1, 2016 and May 3, 2015, respectively. These valuation allowances pertain to U.S. state net operating loss carryforwards and credits in which it is “more likely than not” that these U.S. state net operating loss carryforwards and credits would not be realized prior to their respective expiration dates. We recorded income tax benefits of \$43,000 and \$105,000 that reduced our valuation allowance against our U.S. net deferred tax assets in fiscal years 2016 and 2015, respectively. These income tax benefits pertain to a change in estimate of the recoverability of our U.S. state net loss operating carryforwards at the end of the respective prior fiscal year.

### Poland

During the third quarter of fiscal 2011, we established Culp Europe, a wholly-owned subsidiary located in Poland. Due to the initial start-up costs of setting up this operation and the current state of the European economy, this operation had a history of cumulative pre-tax losses.

Based on the negative evidence, as supported by our cumulative pre-tax loss history and the short carryforward period of five years imposed by the Polish government, we established a full valuation allowance against Culp Europe’s net deferred tax assets during fiscal 2013.

Our partial valuation allowance against our loss carryforwards associated with our Culp Europe operation located in Poland totaled \$72,000 at May 1, 2016. Our full valuation allowance against our loss carryforwards associated with our Culp Europe operation located in Poland totaled \$361,000 at May 3, 2015. These valuation allowances pertain to net operating loss carryforwards in which it is “more likely than not” that these net operating loss carryforwards would not be realized prior to their respective expiration dates.

During fiscal 2016, we recorded an income tax benefit of \$289,000 for a change in estimate of the recoverability of our net loss operating carryforwards at the end of the respective prior fiscal year. During fiscal 2015, we recorded an income tax charge of \$50,000 for an increase in the full valuation allowance against our net deferred tax assets associated with our Culp Europe operations.

### Deferred Income Taxes – Undistributed Earnings from Foreign Subsidiaries

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

At May 1, 2016, we had accumulated earnings and profits from our foreign subsidiaries totaling \$129.6 million. At the same date, the deferred tax liability associated with our undistributed earnings from our foreign subsidiaries totaled \$604,000, which included U.S. income and foreign withholding taxes totaling \$38.5 million, offset by U.S. foreign income tax credits of \$37.9 million.

At May 3, 2015, we had accumulated earnings and profits from our foreign subsidiaries totaling \$85.2 million. At the same date, the deferred tax liability associated with our undistributed earnings from our foreign subsidiaries totaled \$1.7 million, which included U.S. income and foreign withholding taxes totaling \$32.4 million, offset by U.S. foreign

income tax credits of \$30.7 million.

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## Income Taxes Paid

We reported income tax expense of \$11.0 million and \$7.9 million in fiscal 2016 and 2015, respectively. Currently, we are not paying income taxes in the United States as we have an estimated \$18.0 million in operating loss carryforwards at May 1, 2016. However, we did have income tax payments of \$6.7 million in fiscal 2016 and \$4.8 million in fiscal 2015. Our income tax payments are associated with our subsidiaries located in China and Canada.

2015 compared with 2014

## Segment Analysis

Mattress Fabrics Segment

(dollars in thousands)	Twelve Months Ended			Change
	May 3, 2015	April 27, 2014		
Net sales	\$179,739	\$160,705		11.8%
Gross profit	32,877	27,477		19.7%
Gross profit margin	18.3 %	17.1 %		120 bp
SG&A expenses	11,206	9,962		12.5%
Income from operations	21,671	17,515		23.7%
Operating margin	12.1 %	10.9 %		120 bp

## Net Sales

The increase in mattress fabric net sales reflected our ability to capitalize on the growing consumer demand for better designed bedding products. In response to this demand trend, design and innovation were our top strategic priorities, which allowed us to keep pace with latest fashion trends and meet customer style preferences.

Also contributing to this increase in net sales as compared to the prior year was the fact that fiscal 2015 included 53 weeks compared to 52 weeks in fiscal 2014.

## Gross Profit and Operating Income

The increases in gross profit and operating income for the mattress fabric segment reflected the increase in net sales noted above, as well as improvement in operating efficiencies as compared to the prior year. The year over year operational improvement resulted largely from the benefits of our \$9.5 million capital expansion project that increased our production capacity, added finishing capabilities, and improved our overall efficiency and throughput. We also benefited from lower input costs, primarily in the second half of fiscal 2015. Another factor contributing to the increased operating profit in our mattress fabrics segment, especially in the last half of fiscal 2015, was significant operational improvement in the mattress cover business. The significant labor inefficiencies and unfavorable product mix, along with severe weather conditions, that pressured performance in the last half of fiscal 2014 did not impact the last half of fiscal 2015.

Partially offsetting this gross profit improvement was an increase in SG&A expenses in fiscal 2015 compared to fiscal 2014. The increase was primarily due to the increase in net sales noted above and higher incentive compensation expense reflecting stronger financial results in relation to pre-established performance targets in fiscal 2015 compared to fiscal 2014.

#### Fiscal 2014 Acquisition

On May 8, 2013, we entered into an asset purchase and consulting agreement with Bodet & Horst GMBH & Co. KG and certain affiliates (“Bodet & Horst”) that provided for, among other things, the purchase of equipment and certain other assets from Bodet & Horst and the restructuring of prior consulting and non- compete agreements pursuant to an earlier asset purchase and consulting agreement with Bodet & Horst dated August 11, 2008. This agreement was accounted for as a business combination in accordance with ASC Topic 805, Business Combinations. We agreed with Bodet & Horst to replace the prior non-compete agreement that prevented us from selling certain mattress fabrics and products to a leading manufacturer, which now allows us to make such sales. In addition, the prior consulting and non-compete agreement, under which Bodet & Horst agreed not to sell most mattress fabrics in North America, was replaced, expanded and extended pursuant to the new asset purchase and consulting agreement.

The purchase price for the equipment and the certain other assets noted below was \$2.6 million in cash.

The following table presents the allocation of the acquisition cost to the assets acquired based on their fair values:

(dollars in thousands)	Fair Value
Equipment	\$890
Non-compete agreement	882
Customer relationships	868
	\$2,640

The company recorded its non-compete at its fair value based on a discounted cash flow valuation model. The company recorded its customer relationships at its fair value based on a multi-period excess earnings valuation model. This non-compete agreement is being amortized on a straight line basis over the fifteen year life of the agreement. The customer relationships are being amortized on a straight line basis over their useful life of seventeen years. The equipment is being amortized on a straight line basis over its useful life of seven years.

#### Segment Assets

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

(dollars in thousands)	May 3, 2015	April 27, 2014	% Change
Accounts receivable and inventory	\$41,328	\$36,229	14.1 %
Property, plant & equipment	33,773	29,040	16.3 %
Goodwill	11,462	11,462	0.0 %
Non-compete agreement	979	1,041	(6.0 )%
Customer Relationships	766	817	(6.2 )%



### Accounts Receivable & Inventory

Accounts receivable and inventory increased due to the increased business volume in the fourth quarter of fiscal 2015 compared to the same period a year ago. Net sales for the mattress fabric segment increased 10.4% in the fourth quarter of fiscal 2015 compared to the fourth quarter of fiscal 2014.

### Property, Plant & Equipment

The \$33.8 million at May 3, 2015, represented property, plant and equipment of \$23.8 million and \$10.0 million located in the U.S. and Canada, respectively. The \$29.0 million at April 27, 2014, represented property, plant, and equipment of \$20.6 million and \$8.4 million located in the U.S. and Canada, respectively.

The increase in property, plant, and equipment for this segment was due to the capital expansion project noted above, offset by depreciation expense.

### Non-Compete Agreement and Customer Relationships

The decreases in carrying values of our non-competes agreement and customer relationships were primarily due to amortization expense in fiscal 2015.

### Upholstery Fabrics Segment

#### Net Sales

	Twelve Months Ended					
	May 3, 2015		April 27, 2014		% Change	
(dollars in thousands)						
Non U.S. Produced	\$119,177	92 %	\$115,991	92 %	2.7 %	
U.S Produced	11,250	8 %	10,466	8 %	7.5 %	
Total	\$130,427	100 %	\$126,457	100 %	3.1 %	

The increase in net sales for our upholstery fabrics segment reflected our strategic focus on design and product innovation. Our 100% owned China platform provided significant manufacturing flexibility to produce a diverse product mix of fabric styles and price points, which allowed us to meet changing customer demand in line with current furniture style trends. As a result, we were able to diversify our customer base, including the hospitality market and the lifestyle retail category. Additionally, we experienced higher demand for cut and sewn kits in fiscal 2015, which further supported our net sales for the year.

Also contributing to this increase in net sales as compared to the prior year was the fact that fiscal 2015 included 53 weeks compared to 52 weeks in fiscal 2014.



## Gross Profit and Operating Income

(dollars in thousands)	Twelve Months Ended		
	May 3, 2015	April 27, 2014	Change
Gross profit	\$22,690	\$21,429	5.9 %
Gross profit margin	17.4 %	16.9 %	50 bp
SG&A expenses	14,562	13,393	8.7 %
Income from operations	8,128	8,036	1.1 %
Operating margin	6.2 %	6.4 %	(20)bp

Our upholstery segment's gross profit and gross profit margin increased compared to the same period a year ago due primarily to the increase in net sales noted above and higher profit margins achieved on certain product introductions. We also benefited from lower input costs, especially in the second half of fiscal 2015. These lower input costs helped partially offset higher operational costs associated with our operations in China.

This business segment's operating income slightly increased and operating margins slightly decreased in fiscal 2015 compared to fiscal 2014. These trends were due to the increase in gross profit noted above and the increase in SG&A expenses in fiscal 2015 compared to fiscal 2014. The increase in SG&A expenses in fiscal 2015 was primarily due to the increase in net sales.

At the end of the third quarter of fiscal 2015 we closed our finished goods warehouse and distribution facility located in Poznan, Poland, primarily as a result of ongoing economic weakness in Europe. As a result, we incurred a charge of approximately \$200,000 for closing related costs during fiscal 2015. No corresponding charge was incurred in fiscal 2014.

## Segment Assets

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

(dollars in thousands)	April		
	May 3, 2015	27, 2014	% Change
Accounts receivable and inventory	\$29,905	\$31,854	(6.1 )%
Property, plant & equipment	1,467	1,573	(6.7 )%

## Accounts Receivable &amp; Inventory

At May 3, 2015, accounts receivable for this segment was \$11.9 million compared with \$12.8 million as of April 27, 2014. This decrease was due to increased sales with customers with discounted payment terms in fiscal 2015 compared with fiscal 2014, which resulted in customers paying off receivables more quickly.

At May 3, 2015, inventory for this segment was \$18.0 million compared with \$19.0 million as of April 27, 2014. This decrease is primarily due to improved inventory management and the reduction of inventory associated with the closure of our Culp Europe operation located in Poland.

## Property, Plant & Equipment

The \$1.5 million at May 3, 2015, represented property, plant, and equipment located in the U.S. of \$848,000 and located in China of \$619,000. The \$1.6 million at April 27, 2014, represented property, plant, and equipment located in the U.S. of \$957,000, located in China of \$572,000, and located in Poland of \$44,000.

## Other Income Statement Categories

	Twelve Months Ended		
	May 3, 2015	April 27, 2014	% Change
(dollars in thousands)			
SG&A expenses	\$32,778	\$28,657	14.4 %
Interest expense	64	427	(850.1 )%
Interest income	622	482	29.0 %
Other expense	391	1,261	(690.0 )%

## Selling, General and Administrative Expenses

The increase in SG&A expenses was primarily due to the increase in net sales noted above and higher incentive compensation expense that reflected stronger financial results in relation to pre-established performance targets in fiscal 2015 compared to fiscal 2014.

## Interest Expense

Interest expense reflected lower outstanding balances of long-term debt in fiscal 2015 compared with fiscal 2014. Also, interest expense was reduced by \$171,000 for interest costs associated with the mattress fabric segment capital expansion project that were capitalized during fiscal 2015. These interest costs will be depreciated over the related assets' useful lives. No interest costs were capitalized in fiscal 2014.

## Interest Income

The increase in interest income reflected higher cash and cash equivalent and short-term investment balances held with foreign subsidiaries during fiscal 2015 compared to fiscal 2014. Cash and cash equivalents and short-term investment balances held by our foreign subsidiaries earned higher interest rates as compared to funds held in the United States.

## Other Expense

The decrease in other expense was primarily due to more favorable foreign currency exchange rates associated with operations located in China for fiscal 2015 compared with the same period a year ago. We recorded a foreign currency exchange gain of \$241,000 in fiscal 2015 compared to a foreign currency exchange loss of \$571,000 in fiscal 2014 regarding our operations located in China.

Also, a non-recurring charge of \$206,000 was recorded in the first quarter of fiscal 2014 for the settlement of litigation relating to the environmental claims associated with a closed facility, and there was no comparable charge recorded in fiscal 2015.

Income Taxes

We recorded income tax expense of \$7.9 million, or 34.3% of income before income tax expense, in fiscal 2015 compared with income tax expense of \$1.6 million, or 8.4% of income before income tax expense, in fiscal 2014. The following schedule summarizes the principal differences between income tax expense at the federal income tax rate and the effective income tax rate reflected in the consolidated financial statements:

	2015	2014
federal income tax rate	34.0%	34.0 %
tax effects of Chinese foreign exchange gains (losses)	0.3	(1.3 )
change in valuation allowance	(0.2 )	0.1
change in North Carolina income tax rates	-	1.8
undistributed earnings from foreign subsidiaries	-	(26.3)
other	0.2	0.1
	34.3%	8.4 %

## Fiscal 2014 - Discrete Event

During the third quarter of fiscal 2014, our operations in China achieved positive accumulated earnings and profits for both U.S. income tax and financial reporting purposes for the first time since we determined our undistributed earnings from foreign subsidiaries would not be reinvested indefinitely in the second quarter of fiscal 2013. As a result, we recorded an income tax benefit of \$5.4 million to recognize U.S. foreign income tax credits of \$9.9 million offset by the U.S. income tax effects of the undistributed earnings from our China operations and foreign withholding taxes totaling \$4.5 million. This \$5.4 million income tax benefit was treated as a discrete event in which the full income tax benefits of this adjustment were recorded in the third quarter and full fiscal year 2014, as it pertained to a change in judgment on prior periods' accumulated earnings and profits associated with our subsidiaries located in China.

In addition, an income tax charge of \$352,000 was recorded during fiscal 2014 for the U.S. income tax effects of the undistributed earnings and foreign withholding taxes incurred in fiscal 2014 from our Canadian operations and the fourth quarter of fiscal 2014 from our China operations.

## Liquidity and Capital Resources

## Liquidity

Currently, our sources of liquidity include cash and cash equivalents, short-term investments, cash flow from operations, and amounts available under our revolving credit lines. These sources have been adequate for day-to-day operations, capital expenditures, long-term debt and line of credit payments, common stock repurchases, and dividend payments. We believe our present cash and cash equivalents and short-term investment balance of \$42.1 million at May 1, 2016, cash flow from operations, and current availability under our revolving credit lines will be sufficient to fund our business needs and our contractual obligations (see commitments table below).

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

On March 10, 2016, we amended our Credit Agreement with Wells Fargo Bank, N.A. (Wells Fargo) to increase our borrowing capacity from \$10 million to \$30 million. The purpose of the increase in our revolving credit line with Wells Fargo is to support potential short term cash needs in different jurisdictions within our global operations, mitigate our risk associated with foreign currency exchange rate fluctuations, and support repatriation of earnings and

profits from our foreign subsidiaries to the U.S. for strategic purposes.

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

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

	May 1, 2016	May 3, 2015
(dollars in thousands)		
Cayman Islands	\$25,762	8,591
China	8,454	14,630
Canada	6,844	12,511
United States	1,086	3,977
Poland	-	20
	\$42,146	39,729

At May 1, 2016, our cash and cash equivalents and short-term investments totaled \$42.1 million compared with \$39.7 million at May 3, 2015. This year over year increase was achieved despite spending \$11.5 million on capital expenditures mostly associated with our mattress fabrics segment, \$8.1 million on dividend payments, \$2.4 million on common stock repurchases, \$2.2 million on a long-term debt payment, and \$1.6 million on long-term investment purchases associated with our Rabbi Trust. This spending was more than offset by net cash provided by operating activities of \$26.8 million.

Our net cash provided by operating activities of \$26.8 million was slightly higher than the same period a year ago.

During fiscal 2016, we had a significant increase in cash and cash equivalents held in the Cayman Islands. Since April 2015 and through the end of fiscal 2016, we distributed earnings and profits totaling \$28.9 million from our subsidiaries located in China to our international holding company located in the Cayman Islands. In addition, we distributed another \$10.3 million in earnings and profits from China to the Cayman Islands during the first quarter of fiscal 2017. This shift is primarily due to our strategy of ultimately repatriating earnings and profits from our subsidiaries located in China to the U.S. (\$3.1 million during fiscal 2016) and mitigating our risk to foreign currency exchange rate fluctuations for assets and liabilities denominated in Chinese Yuan Renminbi. By reducing the amount of cash and cash equivalents held in Chinese Yuan Renminbi, we are able to obtain a better balance of assets and liabilities denominated in Chinese Yuan Renminbi, and therefore mitigate the risk in foreign currency exchange rate fluctuations in China. In addition, transferring earnings and profits from China to the Cayman Islands will provide increased flexibility to repatriate these earnings and profits to the U.S. for various strategic purposes.

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

#### Dividend Program

On June 15, 2016, we announced that our board of directors approved the payment of a special cash dividend of \$0.21 per share and a regular quarterly cash dividend payment of \$0.07 per share. These dividend payments are payable on July 15, 2016, to shareholders of record as of July 1, 2016.

During fiscal 2016, dividend payments totaled \$8.1 million, of which \$5.0 million represented a special cash dividend payment in the first quarter of \$0.40 per share, and \$3.1 million represented our regular quarterly cash dividend payments ranging from \$0.06 to \$0.07 per share.



During fiscal 2015, dividend payments totaled \$7.6 million, of which \$4.9 million represented a special cash dividend payment in the first quarter of \$0.40 per share, and \$2.7 million represented our regular quarterly cash dividend payments ranging from \$0.05 to \$0.06 per share.

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

#### Common Stock Repurchases

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

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

At May 1, 2016, we had \$1.9 million available for additional repurchases of our common stock pursuant to the authorization by our board of directors dated February 25, 2014. On June 15, 2016, we announced that our board of directors increased the authorization for us to acquire up to \$5.0 million of our common stock.

#### Working Capital

Accounts receivable at May 1, 2016, were \$23.5 million, a decrease of 18% compared with \$28.7 million at May 3, 2015. This decrease is primarily due to improved cash collections with customers associated with both our business segments in the fourth quarter of fiscal 2016 compared with the fourth quarter of fiscal 2015. Days' sales in receivables were 28 days and 33 days during the fourth quarters of fiscal 2016 and 2015, respectively.

Inventories at May 1, 2016 were \$46.5 million, an increase of 9% compared with \$42.5 million at May 3, 2015. This increase is mostly associated with our mattress fabrics segment and is due to customers requiring us to hold higher inventory levels of key products. Inventory turns were 5.3 and 6.4 during the fourth quarters of fiscal 2016 and 2015, respectively.

Accounts payable-trade as of May 1, 2016, was \$24.0 million, a decrease of 15% compared with \$28.4 million at May 3, 2015. This decrease is due to the timing of payments to suppliers in the fourth quarter of fiscal 2016 compared to the fourth quarter of fiscal 2015.

Operating working capital (accounts receivable and inventories, less accounts payable – trade and capital expenditures) was \$45.8 million at May 1, 2016, compared with \$41.8 million at May 3, 2015. Operating working capital turnover was 7.0 in fiscal 2016 compared to 7.7 in fiscal 2015.

#### Financing Arrangements

##### Unsecured Term Notes

We entered into a note agreement dated August 11, 2008 that provided for the issuance of \$11.0 million of unsecured term notes with a fixed interest rate of 8.01% and a term of seven years. On August 11, 2015, we paid our last annual

payment of \$2.2 million and this agreement has been paid in full.

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#### Revolving Credit Agreement –United States

At May 3, 2015, our Credit Agreement with Wells Fargo provided for an unsecured revolving loan commitment of \$10.0 million to be used to finance working capital and general corporate purposes. Interest was charged at a rate (applicable interest rate of 1.78% at May 3, 2015) equal to the one-month LIBOR rate plus a spread based on the ratio of debt to EBITDA as defined in the agreement. The Credit Agreement contained customary financial and other covenants as defined in the agreement and was set to expire August 31, 2015.

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

We entered into a Second Amendment to our Credit Agreement dated March 10, 2016. The terms of the Second Amendment include, among other things, provisions that (i) increase our line of credit under the Credit Agreement to \$30 million, (ii) increase the annual limit on capital expenditures by the company to \$15 million, (iii) add a new financial covenant to establish a minimum level of unencumbered liquid assets, (iv) eliminate certain financial covenants, (v) amend the pricing matrix that provides for interest payable on obligations under the agreement as a variable spread over LIBOR, based on the company's ratio of debt to EBITDA (applicable interest rate of 1.89% at May 1, 2016), and (vi) provide that obligations under the Credit Agreement are to be secured by a pledge of 65% of the common stock of Culp International Holdings Ltd, our subsidiary located in the Cayman Islands.

The purpose of the increase in our revolving credit line with Wells Fargo is to support potential short term cash needs in different jurisdictions within our global operations, mitigate our risk associated with foreign currency exchange rate fluctuations, and support repatriation of earnings and profits from our foreign subsidiaries to the U.S. for various strategic purposes.

At May 1, 2016, and May 3, 2015, there were \$250,000 in outstanding letters of credit (all of which related to workers compensation) provided by the Credit Agreement. There were no borrowings outstanding under the agreement at May 1, 2016, and May 3, 2015.

#### Revolving Credit Agreement - China

At May 3, 2015, we had an unsecured credit agreement associated with our operations in China that provided for a line of credit up to 40 million RMB and was set to expire on February 9, 2016. On March 8, 2016, we renewed this credit agreement. This renewal extended the expiration date to March 8, 2017 and maintained the existing available line of credit of 40 million RMB (\$6.2 million USD). This agreement has an interest rate determined by the Chinese government and there were no outstanding borrowings as of May 1, 2016 and May 3, 2015.

#### Overall

Our loan agreements require, among other things, that we maintain compliance with certain financial covenants. At May 1, 2016, the company was in compliance with these financial covenants.

## Commitments

The following table summarizes our contractual payment obligations and commitments for each of the next five fiscal years and thereafter (in thousands):

	2017	2018	2019	2020	2021	Thereafter	Total
Capital expenditures	\$5,623	3,750	1,240	-	-	-	10,613
Accounts payable – capital expenditures	224	-	-	-	-	-	224
Operating leases	2,567	1,178	405	48	18	-	4,216
Interest expense	-	-	-	-	-	-	-
Line of credit	-	-	-	-	-	-	-
Long-term debt – principal	-	-	-	-	-	-	-
Total (1)	\$8,414	4,928	1,645	48	18	-	15,053

## Note: Payment Obligations by End of Each Fiscal Year

(1) At May 1, 2016, we had \$14.9 million of total gross unrecognized tax benefits, of which \$11.1 million and \$3.8 million were classified as net non-current deferred income taxes and income taxes payable – long-term, respectively. 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 a result of these inherent uncertainties, the company cannot reasonably estimate the timing of payment of these amounts. Of the \$14.9 million in total gross unrecognized tax benefits, \$6.9 million would not be subject to cash payments due to the company's U.S. federal and state net operating loss carryforwards.

## Capital Expenditures

Capital expenditures on a cash basis were \$11.5 million and \$10.5 million for fiscal 2016 and 2015, respectively. These capital expenditures primarily pertained to our mattress fabrics segment. Depreciation expense was \$6.7 million and \$5.8 million for fiscal 2016 and 2015, respectively, and primarily pertained to our mattress fabrics segment.

For fiscal 2017, we are projecting capital expenditures for the company as a whole to approximate the \$11.5 million spent in fiscal 2016. Depreciation expense for the company as a whole is projected to be \$7.0 million in fiscal 2017. The estimated capital expenditures and depreciation expense primarily relate to the mattress fabrics segment. These are management's current expectations only, and changes in our business needs could cause changes in plans for capital expenditures and expectations for related depreciation expense. Funding for capital expenditures is expected to be primarily from cash provided by our operations.

## Accounts Payable – Capital Expenditures

At May 1, 2016, we had total amounts due regarding capital expenditures totaling \$224,000, which pertain to outstanding vendor invoices, none of which are financed. This amount due of \$224,000 is required to be paid in full during fiscal 2017.

## Purchase Commitments – Capital Expenditures

At May 1, 2016, we had open purchase commitments to acquire a building and equipment for our mattress fabrics segment totaling \$10.6 million. The \$10.6 million open purchase commitments include \$9.3 million associated with

the construction of a new building noted below.

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Effective May 16, 2016, we entered into an agreement with a contractor to construct a new building located in North Carolina that will expand our distribution capabilities and office space at a current estimated cost of \$11.2 million. This agreement required an installment payment of \$1.9 million in April 2016 and requires remaining installment payments to be made in the next three fiscal years as follows: Fiscal 2017- \$4.3 million; Fiscal 2018- \$3.8 million; and Fiscal 2019- \$1.2 million. Interest will be charged on the outstanding installment payments at a rate of 2.25% plus the current 30 day LIBOR rate. Also, we are required to issue a letter of a credit totaling \$5.0 million with the contractor being the beneficiary. In addition to the interest that will be charged on the outstanding installment payments, there will be 0.1% unused fee calculated on the balance of the \$5.0 million letter of credit less the amount outstanding per month.

The construction of this new building is currently expected to be completed in December 2016.

#### Handling Costs

We record warehousing costs in SG&A expenses. These costs were \$4.2 million, \$3.8 million, and \$3.5 million, in fiscal 2016, 2015, and 2014 respectively. Warehousing costs include the operating expenses of our various finished goods distribution centers, such as personnel costs, utilities, building rent and material handling equipment, and lease expense. Had these costs been included in cost of sales, gross profit would have been \$60.9 million or 19.5% of net sales, in fiscal 2016, \$51.8 million or 16.7% of net sales, in fiscal 2015, and \$45.4 million, or 15.8% of net sales, in fiscal 2014.

#### Inflation

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

#### Critical Accounting Policies

U.S. generally accepted accounting principles require us to make estimates and assumptions that affect our reported amounts in the consolidated financial statements and accompanying notes. Some of these estimates require difficult, subjective and/or complex judgments about matters that are inherently uncertain, and as a result actual results could differ significantly from those estimates. Due to the estimation processes involved, management considers the following summarized accounting policies and their application to be critical to understanding the company's business operations, financial condition and results of operations.

**Accounts Receivable - Allowance for Doubtful Accounts.** Substantially all of our accounts receivable are due from residential furniture and bedding manufacturers. As of May 1, 2016, accounts receivable from furniture manufacturers totaled approximately \$9.1 million, and accounts receivable from bedding manufacturers totaled approximately \$14.4 million. Additionally, as of May 1, 2016, the aggregate accounts receivable balance of our ten largest customers was \$12.8 million, or 55% of trade accounts receivable. No customers within the upholstery fabrics segment accounted for 10% or more of consolidated accounts receivable as of May 1, 2016. One customer within the mattress fabrics segment represented 16% of consolidated accounts receivable at May 1, 2016.

We continuously perform credit evaluations of our customers, considering numerous inputs including customers' financial position, past payment history, cash flows and management capability; historical loss experience; and economic conditions and prospects. Once evaluated, each customer is assigned a credit grade. Credit grades are adjusted as warranted. Significant management judgment and estimates must be used in connection with establishing the reserve for allowance for doubtful accounts. While management believes that adequate allowances for doubtful accounts have been provided in the consolidated financial statements, it is possible that we could experience

additional unexpected credit losses.

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The reserve balance for doubtful accounts was \$1.1 million and \$851,000 at May 1, 2016, and May 3, 2015, respectively.

**Inventory Valuation.** We operate as a “make-to-order” and “make-to-stock” business. Although management closely monitors demand in each product area to decide which patterns and styles to hold in inventory, the increasing availability of low cost imports and the gradual shifts in consumer preferences expose the company to markdowns of inventory.

Management continually examines inventory to determine if there are indicators that the carrying value exceeds its net realizable value. Experience has shown that the most significant indicator of the need for inventory markdowns is the age of the inventory and the planned discontinuance of certain patterns. As a result, the company provides inventory valuation markdowns based upon set percentages for inventory aging categories, generally using six, nine, twelve and fifteen month categories. We also provide inventory valuation write-downs based on the planned discontinuance of certain products based on the current market values at that time as compared to their current carrying values. While management believes that adequate markdowns for excess and obsolete inventory have been made in the consolidated financial statements, significant unanticipated changes in demand or changes in consumer tastes and preferences could result in additional excess and obsolete inventory in the future.

The reserve for inventory markdowns was \$3.1 million and \$2.6 million at May 1, 2016, and May 3, 2015, respectively.

**Goodwill.** Management assesses goodwill for impairment at the end of each fiscal year or between annual tests if an event that occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying values. In accordance with ASU No. 2011-08, Intangibles – Goodwill and Other, we performed our annual impairment test on a qualitative basis. Based on our qualitative assessment, we determined that our goodwill is not impaired using a more likely than not standard.

The company’s goodwill of \$11.5 million at May 1, 2016, relates to the mattress fabrics segment.

Although we believe we have based the impairment testing on reasonable estimates and assumptions, the use of different estimates and assumptions could result in materially different results.

**Income Taxes.** Income taxes are accounted for under the asset and liability method. Deferred income taxes are recognized for temporary differences between the financial statement carrying amounts and the tax bases of the company’s assets and liabilities and operating loss and tax credit carryforwards at income tax rates expected to be in effect when such amounts are realized or settled. The effect on deferred income taxes of a change in tax rates is recognized in income (loss) in the period that includes the enactment date.

In accordance with ASC Topic 740, we evaluate our deferred income taxes to determine if a valuation allowance is required. ASC Topic 740 requires that companies assess whether a valuation allowance should be established based on the consideration of all available evidence using a “more likely than not” standard with significant weight being given to evidence that can be objectively verified. Since the company operates in multiple jurisdictions, we assess the need for a valuation allowance on a jurisdiction- by-jurisdiction basis, taking into account the effects of local tax law. Based on this assessment, we recorded a partial valuation allowance of \$590,000 and \$922,000 million against our net deferred tax assets at May 1, 2016 and May 3, 2015, respectively. Our valuation allowance of \$590,000 at May 1, 2016, represents a \$518,000 valuation allowance against certain U.S. state net operating loss carryforwards and credits and a valuation allowance of \$72,000 against our loss carryforwards associated with our Culp Europe operation located in Poland. Our valuation allowance of \$922,000 at May 3, 2015, represents a \$561,000 valuation allowance against certain U.S. state net operating loss carryforwards and credits and a valuation allowance of \$361,000 against our loss carryforwards associated with our Culp Europe operation located in Poland.



Refer to Note 9 located in the notes to the consolidated statements for disclosures regarding our assessment of our recorded valuation allowance as of May 1, 2016 and May 3, 2015, respectively.

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

At May 1, 2016, we had accumulated earnings and profits from our foreign subsidiaries totaling \$129.6 million. At the same date, the deferred tax liability associated with our undistributed earnings from our foreign subsidiaries totaled \$604,000, which included U.S. income and foreign withholding taxes totaling \$38.5 million, offset by U.S. foreign income tax credits of \$37.9 million.

In accordance with ASC Topic 740, we must recognize the income tax impact from an uncertain income tax position only if it is more likely than not that the income tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The income tax impact recognized in the financial statements from such a position is measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate resolution. Penalties and interest related to uncertain income tax positions are recorded as income tax expense. Significant judgment is required in the identification of uncertain income tax positions and in the estimation of penalties and interest on uncertain income tax positions.

At May 1, 2016, we had \$14.9 million of total gross unrecognized tax benefits, of which \$11.1 million and \$3.8 million were classified as net non-current deferred income taxes and income taxes payable – long-term, respectively, in the accompanying consolidated balance sheets.

**Stock-Based Compensation.** ASC Topic 718, “Compensation-Stock Compensation”, requires that all stock-based compensation be recognized as compensation expense in the financial statements and that such cost be measured at the grant date for awards issued to employees and our board of directors. Equity awards issued to non-employees are measured at the earlier date of when the performance criteria are met or at the end of each reporting period.

Compensation expense for unvested incentive stock options and time vested stock awards are amortized on a straight-line basis over the remaining vesting periods. At May 1, 2016, there were no unvested incentive stock options or time vested restricted stock awards. Therefore, there was no unrecognized compensation cost related to these types of equity based awards at May 1, 2016. Our common stock awards issued to our board of directors vest immediately, and therefore, compensation cost was measured at the closing price of our common stock on the date of grant and recognized in full at that time. Compensation expense for performance based restricted stock units are recorded based on an assessment each reporting period of the probability if certain performance goals will be met during the contingent vesting period. If performance goals are not probable of occurrence, no compensation expense will be recognized. Performance goals that were previously deemed probable and were not or expected to be met, previously recognized compensation cost will be reversed. At May 1, 2016, the remaining compensation cost related to the performance based restricted stock units was \$3.7 million.

We recorded \$2.7 million, \$786,000, and \$710,000 of compensation expense within selling, general, and administrative expense for our equity based awards in fiscal 2016, 2015, and 2014, respectively.





Excess income tax benefits related to our equity incentive plans are reflected as financing cash inflows on the Statement of Cash Flows. We have elected to record the additional excess tax benefits associated with our equity incentive awards as a reduction in current income tax payable prior to utilizing any net operating loss carryforward.

Our equity incentive plans are described more fully in Note 12 in the notes to the consolidated financial statements.

#### Adoption of New Accounting Pronouncements

Refer to Note 1 located in the notes to the consolidated statements for recently adopted accounting pronouncements for fiscal 2016.

#### Recently Issued Accounting Standards

Refer to Note 1 located in the notes to the consolidated statements for recently issued accounting pronouncements for fiscal 2017 and beyond.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES  
ABOUT MARKET RISK

We are exposed to market risk from changes in interest rates on our revolving credit lines.

At May 1, 2016, our U.S. revolving credit agreement had an interest rate equal to the one-month LIBOR rate plus a spread based on our ratio of debt to EBITDA as defined in the agreement. Our revolving credit line associated with our China subsidiaries bears interest at a rate determined by the Chinese government. At May 1, 2016, there were no borrowings outstanding under any of our revolving credit lines.

We are exposed to market risk from changes in the value of foreign currencies for our subsidiaries domiciled in Canada and China. We try to maintain a natural hedge by keeping a balance of our assets and liabilities denominated in the local currency of our subsidiaries domiciled in Canada and China, although there is no assurance that we will be able to continually maintain this natural hedge. Our foreign subsidiaries use the United States dollar as their functional currency. A substantial portion of the company's imports purchased outside the United States are denominated in U.S. dollars. A 10% change in the above exchange rates at May 1, 2016, would not have had a significant impact on our results of operations or financial position.

ITEM 8. CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders Culp, Inc.:

We have audited the accompanying consolidated balance sheets of Culp, Inc. (a North Carolina Corporation) and Subsidiaries (the “Company”) as of May 1, 2016 and May 3, 2015, and the related consolidated statements of net income, comprehensive income, shareholders’ equity, and cash flows for each of the three years in the period ended May 1, 2016. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Culp, Inc. and Subsidiaries as of May 1, 2016 and May 3, 2015 and the results of their operations and their cash flows for each of the three years in the period ended May 1, 2016 in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company’s internal control over financial reporting as of May 1, 2016, based on criteria established in the 2013 Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated July 15, 2016 expressed an unqualified opinion.

As discussed in Note 1 to the consolidated financial statements, the Company adopted new accounting guidance in fiscal 2016 and 2015, related to the presentation of deferred income taxes.

/s/ GRANT THORNTON LLP

Raleigh, North Carolina  
July 15, 2016

## CONSOLIDATED BALANCE SHEETS

(dollars in thousands, except per share data and preferred and common stock shares)

May 1, 2016 and May 3, 2015	2016	2015
<b>ASSETS</b>		
current assets:		
cash and cash equivalents	\$37,787	\$29,725
short-term investments	4,359	10,004
accounts receivable, net	23,481	28,749
inventories	46,531	42,484
income taxes receivable	155	229
other current assets	2,477	2,440
<b>total current assets</b>	<b>114,790</b>	<b>113,631</b>
property, plant and equipment, net	39,973	36,078
goodwill	11,462	11,462
deferred income taxes	2,319	5,169
long-term investments	4,025	2,415
other assets	2,573	2,545
<b>total assets</b>	<b>\$175,142</b>	<b>\$171,300</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
current liabilities:		
current maturities of long-term debt	\$-	\$2,200
accounts payable - trade	23,994	28,414
accounts payable - capital expenditures	224	990
accrued expenses	11,922	11,129
income taxes payable	180	325
<b>total current liabilities</b>	<b>36,320</b>	<b>43,058</b>
income taxes payable - long-term	3,841	3,792
deferred income taxes	1,483	982
deferred compensation	4,686	4,041
<b>total liabilities</b>	<b>46,330</b>	<b>51,873</b>
commitments and contingencies (notes 10 and 11)		
shareholders' equity:		
preferred stock, \$.05 par value, authorized 10,000,000 shares	-	-
common stock, \$.05 par value, authorized 40,000,000 shares, issued and outstanding 12,265,489 at May 1, 2016 and 12,219,121 at May 3, 2015	614	611
capital contributed in excess of par value	43,795	43,159
accumulated earnings	84,547	75,752
accumulated other comprehensive loss	(144 )	(95 )
<b>total shareholders' equity</b>	<b>128,812</b>	<b>119,427</b>

total liabilities and shareholders' equity	\$175,142	\$171,300
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The accompanying notes are an integral part of these consolidated financial statements.

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## CONSOLIDATED STATEMENTS OF NET INCOME

For the years ended May 1, 2016, May 3, 2015 and April 27, 2014

(dollars in thousands, except per share data)	2016	2015	2014
net sales	\$312,860	\$310,166	\$287,162
cost of sales	247,749	254,599	238,256
gross profit	65,111	55,567	48,906
selling, general and administrative expenses	36,773	32,778	28,657
income from operations	28,338	22,789	20,249
interest expense	-	64	427
interest income	(176 )	(622 )	(482 )
other expense, net	616	391	1,261
income before income taxes	27,898	22,956	19,043
income tax expense (note 9)	10,963	7,885	1,596
net income	\$16,935	\$15,071	\$17,447
net income per share-basic	\$1.38	\$1.23	\$1.43
net income per share-diluted	\$1.36	\$1.21	\$1.41

The accompanying notes are an integral part of these consolidated financial statements.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

For the years ended May 1, 2016, May 3, 2015 and April 27, 2014

	2016	2015	2014
Net income	\$16,935	\$15,071	\$17,447
Other comprehensive loss			
Unrealized losses on investments			
Unrealized holding losses on investments	(176 )	(35 )	(114 )
Reclassification adjustment for realized loss included in net income	127	-	-
Total other comprehensive loss	(49 )	(35 )	(114 )
Comprehensive income	\$16,886	\$15,036	\$17,333

The accompanying notes are an integral part of the consolidated financial statements.



## CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(dollars in thousands, except common stock shares)	common	common	capital		accumulated	
	stock	stock	contributed	of	other	total
For the years ended May 1, 2016,	shares	amount	in excess	of	comprehensive	shareholders'
May 3, 2015 and April 27, 2014	shares	amount	par value	earnings	income	equity
balance, April 28, 2013	12,224,894	\$ 611	\$ 41,901	\$ 53,017	\$ 54	\$ 95,583
net income	-	-	-	17,447	-	17,447
stock-based compensation	-	-	710	-	-	710
unrealized loss on investments	-	-	-	-	(114 )	(114 )
excess tax benefit related to stock-based compensation	-	-	143	-	-	143
fully vested common stock award	3,000	-	-	-	-	-
common stock issued in connection with exercise of stock options	23,125	1	193	-	-	194
common stock issued surrendered for withholding taxes payable	(989 )	-	(15 )	-	-	(15 )
dividends paid	-	-	-	(2,204 )	-	(2,204 )
balance, April 27, 2014	12,250,030	612	42,932	68,260	(60 )	111,744
net income	-	-	-	15,071	-	15,071
stock-based compensation	-	-	786	-	-	786
unrealized loss on investments	-	-	-	-	(35 )	(35 )
excess tax benefit related to stock-based compensation	-	-	109	-	-	109
common stock repurchased	(43,014 )	(2 )	(743 )	-	-	(745 )
fully vested common stock award	3,000	-	-	-	-	-
common stock issued in connection with exercise of stock options	10,100	1	93	-	-	94
common stock issued surrendered for withholding taxes payable	(995 )	-	(18 )	-	-	(18 )
dividends paid	-	-	-	(7,579 )	-	(7,579 )
balance, May 3, 2015	12,219,121	611	43,159	75,752	(95 )	119,427
net income	-	-	-	16,935	-	16,935
stock-based compensation	-	-	2,742	-	-	2,742
unrealized loss on investments	-	-	-	-	(49 )	(49 )
excess tax benefit related to stock-based compensation	-	-	841	-	-	841
common stock repurchased	(100,776 )	(5 )	(2,392 )	-	-	(2,397 )
common stock issued in connection with vesting of performance-based restricted stock units	115,855	6	(6 )	-	-	-
fully vested common stock award	3,000	-	-	-	-	-
common stock issued in connection with exercise of stock options	54,500	3	197	-	-	200
common stock issued surrendered for withholding taxes payable	(26,211 )	(1 )	(746 )	-	-	(747 )

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dividends paid				(8,140	)		(8,140	)
balance, May 1, 2016	12,265,489	\$ 614	\$ 43,795	\$ 84,547	\$ (144	)	\$ 128,812	

The accompanying notes are an integral part of these consolidated financial statements.

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## CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended May 1, 2016, May 3, 2015, and April 27, 2014  
(dollars in thousands)

	2016	2015	2014
cash flows from operating activities:			
net income	\$16,935	\$15,071	\$17,447
adjustments to reconcile net income to net cash provided by operating activities:			
depreciation	6,671	5,773	5,312
amortization of other assets	170	187	169
stock-based compensation	2,742	786	710
excess tax benefit related to stock-based compensation	(841 )	(109 )	(143 )
deferred income taxes	4,192	3,179	(1,727 )
gain on sale of equipment	(35 )	(78 )	(283 )
realized loss on sale of short-term investments	127	-	-
foreign currency exchange (gains) losses	(40 )	(84 )	626
changes in assets and liabilities, net of effects of acquisition of assets:			
accounts receivable	4,476	(1,636 )	(3,857 )
inventories	(4,407 )	(1,883 )	(2,200 )
other current assets	(206 )	(151 )	(270 )
other assets	(46 )	(117 )	(72 )
accounts payable-trade	(3,785 )	1,964	4,131
accrued expenses and deferred compensation	751	3,372	34
income taxes	91	(163 )	342
net cash provided by operating activities	26,795	26,111	20,219
cash flows from investing activities:			
capital expenditures	(11,475)	(10,461)	(5,258 )
net cash paid for acquisition of assets (notes 2 and 13)	-	-	(2,640 )
purchase of short-term investments	(104 )	(5,355 )	(1,945 )
proceeds from the sale of short-term investments	5,612	1,628	810
purchase of long-term investments	(1,649 )	(1,650 )	(765 )
proceeds from life insurance policies	-	320	-
payments on life insurance policies	(18 )	(18 )	(30 )
proceeds from the sale of buildings and equipment	233	727	407
net cash used in investing activities	(7,401 )	(14,809)	(9,421 )
cash flows from financing activities:			
proceeds from lines of credit	7,000	-	-
payments on lines of credit	(7,000 )	(538 )	-
payments on long-term debt	(2,200 )	(2,200 )	(2,200 )
debt issuance costs	(134 )	-	(83 )
repurchases of common stock	(2,397 )	(745 )	-
dividends paid	(8,140 )	(7,579 )	(2,204 )
proceeds from common stock issued	200	94	194
excess tax benefit related to stock options exercised	841	109	143
net cash used in financing activities	(11,830)	(10,859)	(4,150 )
effect of exchange rate changes on cash and cash equivalents	498	(21 )	(875 )

increase in cash and cash equivalents	8,062	422	5,773
cash and cash equivalents at beginning of year	29,725	29,303	23,530
cash and cash equivalents at end of year	\$37,787	\$29,725	\$29,303

The accompanying notes are an integral part of these consolidated financial statements.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## 1. GENERAL AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business – Our operations are classified into two business segments: mattress fabrics and upholstery fabrics. The mattress fabrics segment manufactures, sources, and sells fabrics and mattress covers to bedding manufacturers. The upholstery fabrics segment sources, manufactures, and sells fabrics primarily to residential furniture manufacturers. The majority of our revenues are derived in North America. The company has mattress fabric operations located in Stokesdale, NC, High Point, NC, and Quebec, Canada. The company has upholstery fabric operations located in Shanghai, China, Burlington, NC and Anderson, SC.

At the end of our third quarter of fiscal 2015, we closed our finished goods warehouse and distribution facility located in Poznan, Poland, primarily as a result of the ongoing economic concerns in Europe. Currently, we remain interested in developing business in Europe, and we are assessing the best strategy for selling upholstery fabric into this market as business conditions improve.

Basis of Presentation – The consolidated financial statements of the company have been prepared in accordance with U.S. generally accepted accounting principles.

Principles of Consolidation – The consolidated financial statements include the accounts of the company and its subsidiaries, which are wholly-owned. All significant intercompany balances and transactions have been eliminated in consolidation. The accounts of our subsidiaries located in Shanghai, China and Poznan, Poland are consolidated as of April 30, a calendar month end, which is required by the Chinese and Polish governments, respectively. No events occurred related to the difference between our fiscal year end on the Sunday closest to April 30 and our China and Polish subsidiaries year end of April 30 that materially affected the company's financial position, results of operations, or cash flows for fiscal years 2016, 2015, and 2014.

Fiscal Year – Our fiscal year is the 52 or 53 week period ending on the Sunday closest to April 30. Fiscal 2016 and 2014 each included 52 weeks. Fiscal 2015 included 53 weeks.

Use of Estimates – The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents – Cash and cash equivalents include demand deposit and money market accounts. We consider all highly liquid instruments with original maturities of three months or less to be cash equivalents.

A summary of our cash and cash equivalents by geographic area follows:

	<i>May 1,</i>	<i>May 3,</i>
(dollars in thousands)	2016	2015
Cayman Islands	\$25,762	8,591
China	8,454	13,018
Canada	3,550	5,178
United States	21	2,918
Poland	-	20
	\$37,787	29,725

Throughout the year, we have cash balances regarding our U.S. operations in excess of federally insured amounts on deposit with a financial institution. We have not experienced any losses in such accounts. Management believes we are not exposed to any significant credit risk related to cash and cash equivalents.

**Short-Term Investments** – Our short-term investments consist of bond funds that are classified as available-for-sale and a deposit account with a maturity in excess of more than three months. Our short term investments had an accumulated unrealized loss totaling \$100,000 and \$95,000 at May 1, 2016 and May 3, 2015, respectively. Our short-term investments were recorded at its fair value of \$4.4 million and \$10.0 million at May 1, 2016 and May 3, 2015, respectively. The fair value of our short-term investments approximates its cost basis.

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

	<i>May 1,</i>	<i>May 3,</i>
(dollars in thousands)	2016	2015
Canada	\$3,294	7,333
China	-	1,612
United States	1,065	1,059
	\$4,359	10,004

**Long-Term Investments** – Effective January 1, 2014, we established a Rabbi Trust to set aside funds for participants of our deferred compensation plan (the “Plan”) and enable the participants to credit their contributions to various investment options of the Plan. The investments associated with the Rabbi Trust consist of investments in a money market fund and various mutual funds that are classified as available for sale.

Our long-term investments are classified as available for sale and were recorded at its fair value of \$4.0 million and \$2.4 million at May 1, 2016 and May 3, 2015, respectively. Our long-term investments had an accumulated unrealized loss totaling \$44,000 at May 1, 2016. At May 3, 2015, our accumulated gains or losses regarding our long-term investments were immaterial. The fair value of long-term investments approximates its cost basis.

**Accounts Receivable** – Substantially all of our accounts receivable are due from manufacturers in the bedding and furniture industries. We grant credit to customers, a substantial number of which are located in North America and generally do not require collateral. We record an allowance for doubtful accounts that reflects estimates of probable credit losses. Management continuously performs credit evaluations of our customers, considering numerous inputs including financial position, past payment history, cash flows, management ability, historical loss experience and economic conditions and prospects. We do not have any off-balance sheet credit exposure related to our customers.

**Inventories** – We account for inventories at the lower of first-in, first-out (FIFO) cost or market. Management continually examines inventory to determine if there are indicators that the carrying value exceeds its net realizable value. Experience has shown that the most significant indicators of the need for inventory markdowns are the age of the inventory and the planned discontinuance of certain patterns. As a result, we provide inventory valuation write-downs based upon established percentages based on the age of the inventory that are continually evaluated as events and market conditions require. Our inventory aging categories are six, nine, twelve, and fifteen months. We also provide inventory valuation write-downs based on the planned discontinuance of certain products based on the current market values at that time as compared to their current carrying values.

Property, Plant and Equipment – Property, plant and equipment are recorded at cost and depreciated over their estimated useful lives using the straight-line method. Major renewals and betterments are capitalized. Maintenance, repairs and minor renewals are expensed as incurred. When properties or equipment are retired or otherwise disposed of, the related cost and accumulated depreciation are removed from the accounts. Amounts received on disposal less the book value of assets sold are charged or credited to income from operations.

Management reviews long-lived assets, which consist principally of property, plant and equipment, for impairment whenever events or changes in circumstances indicate that the carrying value of the asset may not be recovered. Recoverability of long-lived assets to be held and used is measured by a comparison of the carrying amount of the asset to future net undiscounted cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, the related cost and accumulated depreciation are removed from the accounts and an impairment charge is recognized for the excess of the carrying amount over the fair value of the asset. After the impairment loss is recognized, the adjusted carrying amount is the new accounting basis. Assets to be disposed of by sale are reported at the lower of the carrying value or fair value less cost to sell when the company has committed to a disposal plan, and are reported separately as assets held for sale in the Consolidated Balance Sheets.

Interest Costs – We charge interest costs incurred on our long-term debt and lines of credit to operations. Interest costs charged to operations were \$58,000, \$235,000, and \$427,000 in fiscal years 2016, 2015, and 2014, respectively.

We capitalize interest costs incurred on funds used to construct property, plant, and equipment. The capitalized interest is recorded as part of the asset to which it relates and is amortized over the asset's estimated useful life. Interest costs of \$58,000 and \$171,000 were capitalized for the construction of qualifying fixed assets for fiscal 2016 and 2015, respectively. No interest costs were capitalized for the construction of property, plant, and equipment during fiscal 2014.

Foreign Currency Adjustments – The United States dollar is the functional currency for the company's Canadian, Chinese, and Polish subsidiaries. All monetary foreign currency asset and liability accounts are remeasured into U.S. dollars at year-end exchange rates. Non-monetary asset and liabilities such as property, plant, and equipment are recorded at historical exchange rates. Foreign currency revenues and expenses are remeasured at average exchange rates in effect during the year, except for certain expenses related to balance sheet amounts remeasured at historical exchange rates. Exchange gains and losses from remeasurement of foreign currency denominated monetary assets and liabilities are recorded in the other expense, net line item in the Consolidated Statements of Net Income in the period in which they occur.

A summary of our foreign currency exchange gains (losses) by geographic area follows:

(dollars in thousands)	2016	2015	2014
China	\$(70)	241	(571)
Canada	76	(108)	(44)
Poland	-	(2)	(50)
	\$6	131	(665)

Goodwill – Management assesses goodwill for impairment at the end of each fiscal year or between annual tests if an event that occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying values. In accordance with ASU No. 2011-08, Intangibles-Goodwill and Other (ASC Topic 350), we performed our annual impairment test on a qualitative basis. Based on our qualitative assessments as of May 1, 2016 and May 3, 2015, we determined that our goodwill was not impaired using a more likely than not standard.

Our goodwill of \$11.5 million at May 1, 2016 and May 3, 2015, respectively, relates to our mattress fabrics segment.





**Income Taxes** – Income taxes are accounted for under the asset and liability method. Deferred income taxes are recognized for temporary differences between the financial statement carrying amounts and the tax bases of our assets and liabilities and operating loss and tax credit carryforwards at income tax rates expected to be in effect when such amounts are realized or settled. The effect on deferred income taxes of a change in tax rates is recognized in income (loss) in the period that includes the enactment date.

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

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

We recognize the tax impact from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax impact recognized in the financial statements from such a position is measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate resolution. Penalties and interest related to uncertain tax positions are recorded as income tax expense. Significant judgment is required in the identification of uncertain tax positions and in the estimation of penalties and interest on uncertain tax positions.

**Revenue Recognition** – Revenue is primarily recognized upon shipment and when title and risk of loss pass to the customer. Provision is currently made for estimated product returns, claims and allowances. Management considers historical claims and return experience, among other things, when establishing the allowance for returns and allowances.

**Shipping and Handling Costs** – Revenue received for shipping and handling costs, which is immaterial for all periods presented, is included in net sales. Shipping costs, principally freight, that comprise payments to third-party shippers are classified as cost of sales. Handling costs represent finished goods warehousing costs incurred to store, move, and prepare products for shipment in the company’s various distribution facilities. Handling costs were \$4.2 million, \$3.8 million and \$3.5 million in fiscal 2016, 2015, and 2014, respectively, and are included in selling, general and administrative expenses.

**Sales and Other Taxes** – Sales and other taxes collected from customers and remitted to governmental authorities are presented on a net basis and, as such, are excluded from revenues.

**Stock-Based Compensation** – Our equity incentive plans are described more fully in Note 12. ASC 718, “Compensation – Stock Compensation”, requires that all stock-based compensation be recognized as compensation expense in the financial statements and that such cost be measured at the grant date for awards issued to employees and the company’s board of directors. Equity awards issued to non-employees are measured at the earlier date of when the performance criteria are met or at the end of each reporting period. Compensation expense for unvested stock options and time vested restricted stock awards are amortized on a straight-line basis over the remaining vesting periods. Compensation expense for performance based restricted stock units were recorded based on an assessment each reporting period of the probability if certain performance goals were to be met during the contingent vesting period. If

performance goals were not probable of occurrence, no compensation expense was recognized. Performance goals that were previously deemed probable and were not or expected to be met, previously recognized compensation cost was reversed. Excess tax benefits related to our equity incentive plans are reflected as financing cash inflows on the Statements of Cash Flows. We have elected to record the additional excess tax benefits associated with our equity incentive awards as a reduction in current income tax payable prior to utilizing any net operating loss carryforwards.

Fair Value of Financial Instruments – The accompanying consolidated financial statements include certain financial instruments, and the fair market value of such instruments may differ from amounts reflected on a historical basis. These financial instruments include our long-term debt and short-term and long-term investments. The fair value measurements of our financial instruments are described more fully in Note 13.

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

#### Recently Adopted Accounting Pronouncements

In November 2015, the FASB issued ASU No. 2015-17, Balance Sheet Classification of Deferred Taxes, an amendment to FASB ASC Topic 740, which simplifies the presentation of deferred income taxes on an entity's classified balance sheet. Currently, entities that are required to issue a classified balance sheet present a net current and net noncurrent deferred income tax asset or liability for each tax jurisdiction. The amendments in this ASU require entities to offset all deferred income tax assets and liabilities for each tax jurisdiction and present a net deferred income tax asset or liability as a single noncurrent amount. The recognition and measurement guidance for deferred income tax assets and liabilities are not affected by this amendment. This amended guidance is effective for fiscal years and interim periods within those fiscal years, beginning after December 15, 2016. Early adoption is permitted and the standard may be applied either retrospectively or on a prospective basis to all deferred income tax assets and liabilities.

We adopted this amendment during fiscal 2016 on a retrospective basis. Accordingly, we reclassified our current deferred income taxes to noncurrent on our May 3, 2015 Consolidated Balance Sheet, which increased noncurrent deferred income taxes \$4.7 million and decreased noncurrent deferred tax liabilities \$68,000.

#### Recently Issued Accounting Pronouncements

In June 2014, the Financial Accounting Standards Board ("FASB") amended its authoritative guidance on accounting for certain share-based payment awards. The amended guidance requires that share-based compensation awards with terms of a performance target that affects vesting, and that could be achieved after the requisite service period, be treated as a performance condition. As such, the performance target should not be reflected in estimating the grant-date fair value of the award and compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved. The guidance will be effective in our fiscal 2017 first quarter. The guidance will permit an entity to apply the amendments in the update either (a) prospectively to all awards granted or modified after the effective date or (b) retrospectively to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented in the consolidated financial statements and to all new or modified awards thereafter. Currently, we do not have any share-based payment awards with terms of a performance target that affects vesting and could be achieved after the requisite service period. We are currently assessing the impact that this guidance will have on our consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, which amends ASC Topic 606, Revenue from Contracts with Customers. The amendments in this ASU are intended to enhance the comparability of revenue recognition practices and will be applied to all contracts with customers. Improved disclosures related to the nature, amount, timing, and uncertainty of revenue that is recognized are requirements under the amended guidance. In April 2015, the FASB issued ASU 2015-24, Revenue from Contracts with Customers: Deferral of the Effective Date which proposed a deferral of the effective date by one year, and on July 7, 2015, the FASB decided to delay the effective date by one year. The deferral results in the new revenue standard being effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. We are therefore required to apply the new revenue guidance in our fiscal 2019 interim and annual financial statements. This ASU can be adopted either retrospectively or as a

cumulative-effect adjustment as of the date of adoption. We are currently assessing the impact that this guidance will have on our consolidated financial statements.

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In July 2015, the FASB issued ASU No. 2015-11, Simplifying the Measurement of Inventory, which changed the measurement principle for inventory from the lower of cost or market to lower of cost and net realizable value. This ASU is effective for fiscal years and interim periods within those fiscal years, beginning after December 15, 2016. We are therefore required to apply this guidance in our fiscal 2018 interim and annual financial statements. We are currently assessing the impact that this guidance will have on our consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), which increases transparency and comparability among companies accounting for lease transactions. The most significant change of this update will require the recognition of lease assets and liabilities on the balance sheet for operating lease arrangements with lease terms greater than twelve months for lessees. This update will require a modified retrospective application which includes a number of optional practical expedients related to the identification and classification of leases commenced before the effective date. This ASU is effective for fiscal years and interim periods within those fiscal years, beginning after December 18, 2018. We are therefore required to apply this guidance in our fiscal 2020 interim and annual financial statements. We are currently assessing the impact that this guidance will have on our consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-09, "Compensation - Stock Compensation (Topic 718): Improvements to Employee Shares-Based Payment Accounting." ASU 2016-09 is intended to improve the accounting for share-based payment transactions as part of the FASB's simplification initiative. ASU 2016-09 changes several aspects of the accounting for share-based payment award transactions, including: (1) accounting for income taxes; (2) classification of excess tax benefits on the statement of cash flows; (3) forfeitures; (4) minimum statutory tax withholding requirements; and (5) classification of employee taxes paid on the statement of cash flows when an employer withholds shares for tax-withholding purposes. ASU 2016-09 is effective for fiscal years beginning after December 15, 2016, and interim periods within those years for public companies. We are therefore required to apply this guidance in our fiscal 2018 interim and annual financial statements. We are currently assessing the impact that ASU 2016-09 will have on its consolidated financial statements.

There are no other new accounting pronouncements that are expected to have a significant impact on our consolidated financial statements.

## 2. BUSINESS COMBINATIONS – MATTRESS FABRIC SEGMENT

On May 8, 2013, we entered into an asset purchase and consulting agreement with Bodet & Horst GMBH & Co. KG and certain affiliates ("Bodet & Horst") that provided for, among other things, the purchase of equipment and certain other assets from Bodet & Horst and the restructuring of prior consulting and non-compete agreements pursuant to an earlier asset purchase and consulting agreement with Bodet & Horst dated August 11, 2008. This agreement was accounted for as a business combination in accordance with ASC Topic 805, Business Combinations. We agreed with Bodet & Horst to replace the prior non-compete agreement that prevented us from selling certain mattress fabrics and products to a leading manufacturer, with a non-compete agreement that now allows us to make such sales. In addition, the prior consulting and non-compete agreement, under which Bodet & Horst agreed not to sell most mattress fabrics in North America, was replaced, expanded, and extended pursuant to the new asset purchase and consulting agreement.

The purchase price for the equipment and the certain other assets noted below was \$2.6 million in cash.

The following table presents the allocation of the acquisition cost to the assets acquired based on their fair values:

(dollars in thousands)	Fair Value
Equipment (Note 13)	\$890
Non-compete agreement (Notes 7 and 13)	882
Customer relationships (Notes 7 and 13)	868
	\$2,640

The company recorded its non-compete at its fair value based on a discounted cash flow valuation model. The company recorded its customer relationships at its fair value based on a multi-period excess earnings valuation model. This non-compete agreement is being amortized on a straight line basis over the fifteen year life of the agreement. The customer relationships are being amortized on a straight line basis over their useful life of seventeen years. The equipment is being amortized on a straight line basis over its useful life of seven years.

### 3. ACCOUNTS RECEIVABLE

A summary of accounts receivable follows:

(dollars in thousands)	May 1, 2016	May 3, 2015
customers	\$25,531	30,338
allowance for doubtful accounts	(1,088 )	(851 )
reserve for returns and allowances and discounts	(962 )	(738 )
	\$23,481	28,749

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

(dollars in thousands)	2016	2015	2014
beginning balance	\$(851 )	(573 )	(780 )
provision for bad debts	(363 )	(421 )	139
write-offs, net of recoveries	126	143	68
ending balance	\$(1,088 )	(851 )	(573 )

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

(dollars in thousands)	2016	2015	2014
beginning balance	\$(738 )	(479 )	(543 )
provision for returns and allowances and discounts	(2,825 )	(2,733 )	(2,094 )
credits issued	2,601	2,474	2,158
ending balance	\$(962 )	(738 )	(479 )

#### 4. INVENTORIES

A summary of inventories follows:

	May 1, 2016	May 3, 2015
(dollars in thousands)		
raw materials	\$5,462	5,374
work-in-process	2,972	2,766
finished goods	38,097	34,344
	\$46,531	42,484

#### 5. PROPERTY, PLANT AND EQUIPMENT

A summary of property, plant and equipment follows:

	depreciable lives (in years)	May 1, 2016	May 3, 2015
(dollars in thousands)			
land and improvements	0-10	\$836	741
buildings and improvements	7-40	16,126	15,312
leasehold improvements	**	1,340	1,320
machinery and equipment	3-12	64,114	57,286
office furniture and equipment	3-10	8,212	7,340
capital projects in progress		2,896	1,966
		93,524	83,965
accumulated depreciation and amortization		(53,551)	(47,887)
		\$39,973	36,078

\*\* Shorter of life of lease or useful life.

At May 1, 2016, we had total amounts due regarding capital expenditures totaling \$224,000, which pertain to outstanding vendor invoices, none of which are financed. The total outstanding amount of \$224,000 is required to be paid in full in fiscal 2017.

At May 3, 2015, we had total amounts due regarding capital expenditures totaling \$990,000, which pertained to outstanding vendor invoices, none of which are financed.

We did not finance any of our capital expenditures in fiscal 2016, 2015, and 2014.

#### 6. GOODWILL

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

(dollars in thousands)	2016	2015	2014
beginning balance	\$11,462	11,462	11,462
loss on impairment	-	-	-
acquisitions	-	-	-
ending balance	\$11,462	11,462	11,462

The goodwill balance relates to the mattress fabrics segment.





## 7. OTHER ASSETS

A summary of other assets follows:

	May	
(dollars in thousands)	May 1, 2016	3, 2015
cash surrender value – life insurance	\$357	339
non-compete agreement, net	903	979
customer relationships, net	715	766
other	598	461
	\$2,573	2,545

### Non-Compete Agreement

In connection with the asset purchase and consulting agreement with Bodet & Horst on May 8, 2013 (see note 2), we restructured our prior non-compete agreement pursuant to our asset purchase and consulting agreement dated August 11, 2008. We agreed with Bodet & Horst to replace the prior non-compete agreement that prevented us from selling certain mattress fabrics and products to a leading manufacturer, with a non-compete agreement that will now allow us to make such sales. In addition, the prior consulting and non-compete agreement, under which Bodet & Horst agreed not to sell mattress fabrics in North America, was replaced, expanded, and extended pursuant to the new asset purchase and consulting agreement. We recorded this non-compete agreement at its fair value based on a discounted cash flow valuation model. This non-compete agreement is amortized on a straight line basis over the fifteen year life of the agreement.

The gross carrying amount of this non-compete agreement was \$2.0 million at May 1, 2016 and May 3, 2015, respectively. Accumulated amortization for this non-compete agreement was \$1.1 million at May 1, 2016 and May 3, 2015, respectively.

Amortization expense for this non-compete agreement was \$75,000 in fiscal years 2016, 2015, and 2014, respectively. The remaining amortization expense for the next five years and thereafter follows: FY 2017 - \$75,000; FY 2018 - \$75,000; FY 2019 - \$75,000; FY 2020 - \$75,000; FY 2021 - \$75,000, and Thereafter - \$528,000.

The weighted average amortization period for the non-compete agreement is 12 years as of May 1, 2016.

### Customer Relationships

In connection with the asset purchase and consulting agreement with Bodet & Horst noted above, we purchased certain customer relationships. We recorded the customer relationships at their fair value based on a multi-period excess earnings valuation model. The gross carrying amount of these customer relationships was \$868,000 at May 1, 2016 and May 3, 2015, respectively. Accumulated amortization for these customer relationships was \$153,000 and \$102,000 at May 1, 2016 and May 3, 2015, respectively.

The customer relationships are amortized on a straight-line basis over their seventeen year useful life. Amortization expense for the customer relationships was \$51,000 for fiscal years 2016, 2015, and 2014, respectively. The remaining amortization expense for the next five fiscal years and thereafter follows: FY 2017 - \$51,000; FY 2018 - \$51,000; FY 2019 - \$51,000; FY 2020 - \$51,000; FY 2021 - \$51,000; and Thereafter - \$460,000.

The weighted average amortization period for our customer relationships is 14 years as of May 1, 2016.

Cash Surrender Value - Life Insurance

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

We had one life insurance contract with a death benefit of \$1.4 million at May 1, 2016 and May 3, 2015, respectively. Our cash surrender value - life insurance balance of \$357,000 and \$339,000 at May 1, 2016 and May 3, 2015, respectively, are collectible upon death of the respective insured.

## 8. ACCRUED EXPENSES

A summary of accrued expenses follows:

(dollars in thousands)	May 1, 2016	May 3, 2015
compensation, commissions and related benefits	\$10,011	9,081
advertising rebates	870	1,002
interest	-	37
other	1,041	1,009
	\$11,922	11,129

## 9. INCOME TAXES

### Income Tax Expense and Effective Income Tax Rate

Total income tax expense was allocated as follows:

(dollars in thousands)	<i>2016</i>	<i>2015</i>	<i>2014</i>
income from operations	\$10,963	7,885	1,596
shareholders' equity, related to the tax benefit arising from stock based compensation	(841 )	(109 )	(143 )
	\$10,122	7,776	1,453

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Income tax expense attributable to income from operations consists of:

(dollars in thousands)	2016	2015	2014
current			
federal	\$-	-	-
state	6	(7 )	-
foreign	6,765	4,713	3,323
	6,771	4,706	3,323
deferred			
federal	(1,205 )	(849 )	1,065
state	305	(52 )	416
undistributed earnings – foreign subsidiaries	(1,129 )	(260 )	(5,018)
U.S. operating loss carryforwards	5,467	4,487	1,838
foreign	1,086	(92 )	(42 )
valuation allowance	(332 )	(55 )	14
	4,192	3,179	(1,727)
	\$10,963	7,885	1,596

Income (loss) before income taxes related to the company's foreign and U.S. operations consists of:

(dollars in thousands)	2016	2015	2014
Foreign			
China	\$14,130	12,531	11,512
Canada	3,647	2,695	2,149
Poland	(62 )	(260 )	(370 )
Total Foreign	17,715	14,966	13,291
United States	10,183	7,990	5,752
	\$27,898	22,956	19,043

The following schedule summarizes the principal differences between the income tax expense at the federal income tax rate and the effective income tax rate reflected in the consolidated financial statements:

	2016	2015	2014
federal income tax rate	34.0%	34.0%	34.0 %
tax effects of Chinese foreign exchange gains	4.4	0.3	(1.3 )
change in valuation allowance	(1.2 )	(0.2 )	0.1
change in North Carolina income tax rates	0.7	-	1.8
undistributed earnings from foreign subsidiaries	-	-	(26.3)
other	1.4	0.2	0.1
	39.3%	34.3%	8.4 %

## Deferred Income Taxes

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and liabilities consist of the following:

(dollars in thousands)	2016	2015
deferred tax assets:		
accounts receivable	\$545	444
inventories	2,660	2,251
compensation	5,311	4,497
liabilities and other	1,173	1,155
foreign income tax credits - U.S.	1,436	-
alternative minimum tax credit - U.S.	1,320	1,320
property, plant and equipment (1)	326	447
loss carryforwards – U.S.	6,888	12,133
loss carryforwards – foreign	147	361
unrecognized tax benefits – U.S.	(6,888 )	(10,349)
valuation allowances	(590 )	(922 )
total deferred tax assets	12,328	11,337
deferred tax liabilities:		
undistributed earnings on foreign subsidiaries	(604 )	(1,733)
unrecognized tax benefits – U.S.	(4,168 )	-
property, plant and equipment (2)	(5,210 )	(4,022)
goodwill	(1,325 )	(1,197)
other	(185 )	(198 )
total deferred tax liabilities	(11,492)	(7,150)
Net deferred tax asset	\$836	4,187

(1)Pertains to the company's operations located in China.

(2)Pertains to the company's operations located in the U.S. and Canada.

Federal and state net operating loss carryforwards were approximately \$18.0 million with related future tax benefits of \$6.9 million at May 1, 2016. These carryforwards principally expire in 10-19 years, fiscal 2026 through fiscal 2035. Our U.S. foreign income tax credits of \$1.4 million expire in 10 years, fiscal 2026. Our alternative minimum tax credit carryforward of approximately \$1.3 million for federal income tax purposes does not expire.

At May 1, 2016, our non-current deferred income tax asset of \$2.3 million represents \$1.7 million and \$572,000 from our operations located in the U.S. and China, respectively. At May 3, 2015, our non-current deferred income tax asset of \$5.2 million represents \$4.3 million and \$868,000 from our operations located in the U.S. and China, respectively.

Our non-current deferred income tax liability balances of \$1.5 million and \$982,000 at May 1, 2016 and May 3, 2015, respectively, pertain to our operations located in Canada.

## Deferred Income Taxes – Valuation Allowance

Summary

In accordance with ASC Topic 740, we evaluate our deferred income taxes to determine if a valuation allowance is required. ASC Topic 740 requires that companies assess whether a valuation allowance should be established based

on the consideration of all available evidence using a “more likely than not” standard with significant weight being given to evidence that can be objectively verified. Since the company operates in multiple jurisdictions, we assess the need for a valuation allowance on a jurisdiction-by-jurisdiction basis, taking into account the effects of local tax law. Based on our assessment at May 1, 2016, we recorded a partial valuation allowance of \$590,000, of which \$518,000 pertained to certain U.S. state net operating loss carryforwards and credits and \$72,000 pertained to loss carryforwards associated with our Culp Europe operation located in Poland. Based on our assessment at May 3, 2015, we recorded a partial valuation allowance of \$922,000, of which \$561,000 pertained to certain U.S. state net operating loss carryforwards and credits and \$361,000 pertained to loss carryforwards associated with our Culp Europe operation located in Poland.

No valuation allowance was recorded against our net deferred tax assets associated with our operations located in China and Canada at May 1, 2016 and May 3, 2015, respectively.

#### United States

Our partial valuation allowance against our U.S. net deferred assets totaled \$518,000, \$561,000, and \$666,000 at May 1, 2016, May 3, 2015, and April 27, 2014, respectively. These valuation allowances pertain to U.S. state net operating loss carryforwards and credits in which it is “more likely than not” that these U.S. state net operating loss carryforwards and credits would not be realized prior to their respective expiration dates. We recorded income tax benefits of \$43,000, \$105,000, and \$56,000 that reduced our valuation allowance against our U.S. net deferred tax assets in fiscal years 2016, 2015, and 2014, respectively. These income tax benefits pertain to a change in estimate of the recoverability of our U.S. state net loss operating carryforwards at the end of the respective prior fiscal year.

#### Poland

During the third quarter of fiscal 2011, we established Culp Europe, a wholly-owned subsidiary located in Poland. Due to the initial start-up costs of setting up this operation and the current state of the European economy, this operation had a history of cumulative pre-tax losses.

Based on the negative evidence, as supported by our cumulative pre-tax loss history and the short carryforward period of five years imposed by the Polish government, we recorded an income tax charge of \$241,000 during fiscal 2013 to establish a full valuation allowance against Culp Europe’s net deferred tax assets.

Our partial valuation allowance against our loss carryforwards associated with our Culp Europe operation located in Poland totaled \$72,000 at May 1, 2016. Our full valuation allowance against our loss carryforwards associated with our Culp Europe operation located in Poland totaled \$361,000 and \$311,000 at May 3, 2015 and April 27, 2014, respectively. These valuation allowances pertain to net operating loss carryforwards in which it is “more likely than not” that these net operating loss carryforwards would not be realized prior to their respective expiration dates.

During fiscal 2016, we recorded an income tax benefit of \$289,000 for a change in estimate of the recoverability of our net loss operating carryforwards at the end of the respective prior fiscal year. During fiscal 2015 and 2014, we recorded an income tax charge of \$50,000 and \$70,000, respectively, for an increase in the full valuation allowance against our net deferred tax assets associated with our Culp Europe operations.

#### Deferred Income Taxes – Undistributed Earnings from Foreign Subsidiaries

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

At May 1, 2016, we had accumulated earnings and profits from our foreign subsidiaries totaling \$129.6 million. At the same date, the deferred tax liability associated with our undistributed earnings from our foreign subsidiaries totaled \$604,000, which included U.S. income and foreign withholding taxes totaling \$38.5 million, offset by U.S. foreign income tax credits of \$37.9 million.

At May 3, 2015, we had accumulated earnings and profits from our foreign subsidiaries totaling \$85.2 million. At the same date, the deferred tax liability associated with our undistributed earnings from our foreign subsidiaries totaled \$1.7 million, which included U.S. income and foreign withholding taxes totaling \$32.4 million, offset by U.S. foreign income tax credits of \$30.7 million.

#### Fiscal 2014 - Discrete Event

During the third quarter of fiscal 2014, our operations in China achieved positive accumulated earnings and profits for both U.S. income tax and financial reporting purposes for the first time since we determined our undistributed earnings from foreign subsidiaries would not be reinvested indefinitely in the second quarter of fiscal 2013. As a result, we recorded an income tax benefit of \$5.4 million to recognize U.S. foreign income tax credits of \$9.9 million offset by the U.S. income tax effects of the undistributed earnings from our China operations and foreign withholding taxes totaling \$4.5 million. This \$5.4 million income tax benefit was treated as a discrete event in which the full income tax benefits of this adjustment were recorded in the third quarter and full fiscal year 2014, as it pertained to a change in judgment on prior periods' accumulated earnings and profits associated with our subsidiaries located in China.

In addition, an income tax charge of \$352,000 was recorded during fiscal 2014 for the U.S. income tax effects of the undistributed earnings and foreign withholding taxes incurred in fiscal 2014 from our Canadian operations and the fourth quarter of fiscal 2014 from our China operations.

#### Uncertainty in Income Taxes

The following table sets forth the change in the company's unrecognized tax benefit:

(dollars in thousands)	2016	2015	2014
beginning balance	\$14,141	13,740	13,166
increases from prior period tax positions	454	588	756
decreases from prior period tax positions	(77 )	(187 )	(182 )
increases from current period tax positions	379	-	-
ending balance	\$14,897	14,141	13,740

At May 1, 2016, we had \$14.9 million of total gross unrecognized tax benefits, of which \$3.8 million would favorably affect the income tax rate in future periods. At May 3, 2015, we had \$14.1 million of total gross unrecognized tax benefits, of which \$3.8 million would favorably affect the income tax rate in future periods.

As of May 1, 2016, we had \$14.9 million of total gross unrecognized tax benefits, of which \$11.1 million and \$3.8 million were classified as net non-current deferred income taxes and income taxes payable-long-term, respectively, in the accompanying consolidated balance sheets. As of May 3, 2015, we had \$14.1 million of total gross unrecognized tax benefits, of which \$10.3 million and \$3.8 million were classified as net non-current deferred income taxes and income taxes payable- long-term, respectively, in the accompanying consolidated balance sheets.



We elected to classify interest and penalties as part of income tax expense. At May 1, 2016 and May 3, 2015, the gross amount of interest and penalties due to unrecognized tax benefits was \$978,000 and \$844,000, respectively.

The liability for uncertain tax positions at May 1, 2016, includes \$14.9 million related to tax positions for which significant change is reasonably possible in fiscal 2017. This amount relates to double taxation under applicable tax treaties with foreign tax jurisdictions. United States federal and state income tax returns filed by the company remain subject to examination for tax years 2005 and subsequent due to loss carryforwards. Canadian federal returns remain subject to examination for tax years 2009 and subsequent. Canadian provincial (Quebec) returns remain subject to examination for tax years 2012 and subsequent. Income tax returns for the company's China subsidiaries are subject to examination for tax years 2011 and subsequent.

#### Income Taxes Paid

Income tax payments, net of income tax refunds, were \$6.7 million in fiscal 2016, \$4.8 million in 2015, and \$3.0 million in 2014.

#### 10. LONG-TERM DEBT AND LINES OF CREDIT

A summary of long-term debt follows:

	May	
(dollars in thousands)	1, 2016	May 3, 2015
unsecured senior term notes	\$ -	2,200
current maturities of long-term debt	-	(2,200)
long-term debt, less current maturities	\$ -	-

#### Unsecured Term Notes

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

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

#### Revolving Credit Agreement –United States

At May 3, 2015, our Credit Agreement with Wells Fargo provided for an unsecured revolving loan commitment of \$10.0 million to be used to finance working capital and general corporate purposes. Interest was charged at a rate (applicable interest rate of 1.78% at May 3, 2015) equal to the one-month LIBOR rate plus a spread based on the ratio of debt to EBITDA as defined in the agreement. The Credit Agreement contained customary financial and other covenants as defined in the agreement and was set to expire August 31, 2015.

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

We entered into a Second Amendment to our Credit Agreement dated March 10, 2016. The terms of the Second Amendment include, among other things, provisions that (i) increase our line of credit under the Credit Agreement to \$30 million, (ii) increase the annual limit on capital expenditures by the company to \$15 million, (iii) add a new financial covenant to establish a minimum level of unencumbered liquid assets, (iv) eliminate certain financial covenants, (v) amend the pricing matrix that provides for interest payable on obligations under the agreement as a variable spread over LIBOR, based on the company's ratio of debt to EBITDA (applicable interest rate of 1.89% at May 1, 2016), and (vi) provide that obligations under the Credit Agreement are to be secured by a pledge of 65% of the common stock of Culp International Holdings Ltd, our subsidiary located in the Cayman Islands.

The purpose of the increase in our revolving credit line with Wells Fargo is to support potential short term cash needs in different jurisdictions within our global operations, mitigate our risk associated with foreign currency exchange rate fluctuations, and support repatriation of earnings and profits from our foreign subsidiaries to the U.S. for various strategic purposes.

At May 1, 2016, and May 3, 2015, there were \$250,000 in outstanding letters of credit (all of which related to workers compensation) provided by the Credit Agreement. There were no borrowings outstanding under the agreement at May 1, 2016, and May 3, 2015.

#### Revolving Credit Agreement - China

At May 3, 2015, we had an unsecured credit agreement associated with our operations in China that provided for a line of credit up to 40 million RMB and was set to expire on February 9, 2016. On March 8, 2016, we renewed this credit agreement. This renewal extended the expiration date to March 8, 2017 and maintained the existing available line of credit of 40 million RMB (\$6.2 million USD). This agreement has an interest rate determined by the Chinese government and there were no outstanding borrowings as of May 1, 2016 and May 3, 2015.

#### Overall

Our loan agreements require, among other things, that we maintain compliance with certain financial covenants. At May 1, 2016, the company was in compliance with these financial covenants.

Interest paid during 2016, 2015, and 2014 totaled \$95,000, \$268,000, and \$466,000, respectively.

## 11. COMMITMENTS AND CONTINGENCIES

### Operating Leases

We lease certain office, manufacturing and warehouse facilities and equipment under noncancellable operating leases. Lease terms related to real estate primarily range from three to five years with renewal options for additional periods ranging up to nine years. The leases generally require the company to pay real estate taxes, maintenance, insurance and other expenses. Rental expense for operating leases was \$3.0 million in fiscal 2016, \$2.9 million in fiscal 2015, and \$2.7 million in fiscal 2014. Future minimum rental commitments for noncancellable operating leases are \$2.6 million in fiscal 2017; \$1.2 million in fiscal 2018; \$405,000 in fiscal 2019; \$48,000 in fiscal 2020; and \$18,000 in fiscal 2021. Management expects that in the normal course of business, these leases will be renewed or replaced by other operating leases.

We lease a plant facility associated with our mattress fabrics segment from a partnership owned by certain shareholders and officers of the company and their immediate families. During fiscal 2014, this lease was on a month to month basis at an amount of \$12,704 per month. Effective October 1, 2014, we entered into a new lease agreement with the partnership noted above. The new lease agreement requires monthly payments of \$13,000 for a three year

term commencing on October 1, 2014 through September 30, 2017. This lease contains two successive options to renew the lease with each renewal period being three years. The first and second renewal terms would require monthly payments of \$13,100 and \$13,200, respectively.

Rents paid to entities owned by certain shareholders and officers of the company and their immediate families totaled \$156,000 in fiscal 2016; \$155,000 in fiscal 2015; and \$152,000 in fiscal 2014.

### Chromatex Environmental Claim

A lawsuit was filed against us and other defendants (Chromatex, Inc., Rossville Industries, Inc., Rossville Companies, Inc. and Rossville Investments, Inc.) on February 5, 2008 in the United States District Court for the Middle District of Pennsylvania. The plaintiffs were Alan Shulman, Stanley Siegel, Ruth Cherenson as Personal Representative of Estate of Alan Cherenson, and Adrienne Rolla and M.F. Rolla as Executors of the Estate of Joseph Byrnes. The plaintiffs were partners in a general partnership that formerly owned a manufacturing plant in West Hazleton, Pennsylvania (the "Site"). Approximately two years after this general partnership sold the Site to defendants Chromatex, Inc. and Rossville Industries, Inc., we leased and operated the Site as part of our Rossville/Chromatex division. The lawsuit involved court judgments that have been entered against the plaintiffs and against defendant Chromatex, Inc. requiring them to pay costs incurred by the United States Environmental Protection Agency ("USEPA") responding to environmental contamination at the Site, in amounts approximating \$14 million, plus unspecified future environmental costs. Neither USEPA nor any other governmental authority asserted any claim against us on account of these matters. The plaintiffs sought contribution from us and other defendants and a declaration that the company and the other defendants were responsible for environmental response costs under environmental laws and certain agreements. The plaintiffs also asserted that we tortiously interfered with contracts between them and other defendants in the case and diverted assets to prevent the plaintiffs from being paid monies owed to them. We have defended ourselves vigorously with regards to the matters described in this litigation. In addition, we had an indemnification agreement with certain other defendants in this litigation pursuant to which the other defendants agreed to indemnify us for any damages we would incur as a result of the environmental matters that are the subject of this litigation, although it was unclear whether the indemnitors had significant assets.

In the first quarter of fiscal 2014, the parties to this lawsuit reached a tentative settlement of all matters, which required us to contribute cash to a global settlement fund. Consequently, we recorded a charge of \$206,000 to other expense in the fiscal 2014 Consolidated Statement of Net Income. In the fourth quarter of fiscal 2014, we paid the \$206,000 tentative settlement amount. Subsequently, the settlement was reviewed by the government and during the first quarter of fiscal 2015 the court approved the final agreement by the parties involved. The lawsuit was dismissed on June 5, 2014.

### Other Litigation

The company is involved in legal proceedings and claims which have arisen in the ordinary course of business. Management has determined that it is not reasonably possible that these actions, when ultimately concluded and settled, will have a material adverse effect upon the financial position, results of operations, or cash flows of the company.

### Purchase Commitments

At May 1, 2016, and May 3, 2015, we had open purchase commitments to acquire a building and equipment for our mattress fabrics segment totaling \$10.6 million and \$2.3 million, respectively. The \$10.6 million open purchase commitments as of May 1, 2016, include \$9.3 million associated with the construction of a new building noted below.

Effective May 16, 2016, we entered into an agreement with a contractor to construct a new building located in North Carolina that will expand our distribution capabilities and office space at a current estimated cost of \$11.2 million. This agreement required an installment payment of \$1.9 million in April 2016 and requires remaining installment payments to be made in the next three fiscal years as follows: Fiscal 2017- \$4.3 million; Fiscal 2018- \$3.8 million; and Fiscal 2019- \$1.2 million. Interest will be charged on the outstanding installment payments at a rate of 2.25% plus the current 30 day LIBOR rate. Also, we are required to issue a letter of a credit totaling \$5.0 million with the contractor being the beneficiary. In addition to the interest that will be charged on the outstanding installment payments, there will be 0.1% unused fee calculated on the balance of the \$5.0 million letter of credit less the amount outstanding per month.

The construction of this new building is currently expected to be completed in December 2016.

## 12. STOCK-BASED COMPENSATION

### Equity Incentive Plan Description

On September 16, 2015, our shareholders approved an equity incentive plan entitled the Culp, Inc. 2015 Equity Incentive Plan (the "2015 Plan"). The 2015 Plan is intended to update and replace our 2007 Equity Incentive Plan (the "2007 Plan") as the vehicle for granting new equity based awards substantially similar to those authorized under the 2007 Plan. In general, the 2015 Plan authorizes the grant of stock options intended to qualify as incentive stock options, nonqualified stock options, stock appreciation rights, restricted stock, restricted stock units, performance units, and other equity and cash related awards as determined by our Compensation Committee. An aggregate of 1,200,000 shares of common stock were authorized for issuance under the 2015 Plan, with certain sub-limits that would apply with respect to specific types of awards that may be issued as defined in the 2015 Plan. In connection with the approval of the 2015 Plan, no further awards will be granted under the 2007 Plan, but outstanding awards under the 2007 Plan will be settled in accordance with their terms.

At May 1, 2016, there were 1,079,809 shares available for future equity based grants under the company's 2015 Plan.

### Stock Options

Under our 2007 Plan, employees, outside directors, and others associated with the company were granted options to purchase shares of common stock at the fair market value on the date of grant.

No incentive or non-qualified stock options were granted in fiscal 2016, 2015 or 2014, respectively.

No compensation expense was recorded for incentive or non-qualified stock options in fiscal 2016 and 2015 as all incentive stock option awards were fully vested at the end of fiscal 2014. The company recorded compensation expense of \$10,000 within selling, general, and administrative expense for incentive stock options in fiscal 2014.

The following tables summarize stock option activity for fiscal 2016, 2015, and 2014:

	2016		2015		2014	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
outstanding at beginning of year	140,100	\$ 6.49	153,950	\$ 6.70	182,825	\$ 6.99
granted	-	-	-	-	-	-
exercised	(54,500 )	3.68	(10,100 )	9.31	(23,125 )	8.40

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canceled/expired	(2,000 )	4.59	(3,750 )	7.27	(5,750 )	9.28
outstanding at end of year	83,600	8.37	140,100	6.49	153,950	6.70

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Range of Exercise Prices	Options Outstanding			Options Exercisable		
	Number Outstanding at 5/01/16	Weighted-Avg. Remaining Contractual Life	Weighted-Avg. Exercise Price	Number Exercisable at 5/01/16	Weighted-Avg. Exercise Price	
\$4.59 - \$5.41	2,000	0.4	\$ 5.41	2,000	\$ 5.41	
\$7.08 - \$9.57	81,600	1.3	\$ 8.44	81,600	\$ 8.44	
	83,600	1.3	\$ 8.37	83,600	\$ 8.37	

At May 1, 2016, the aggregate intrinsic value for options outstanding and exercisable was \$1.5 million.

The aggregate intrinsic value for options exercised was \$1.3 million, \$87,000, and \$224,000, in fiscal 2016, 2015, and 2014, respectively.

At May 1, 2016, there were no unvested incentive stock option awards. Therefore, there was no unrecognized compensation cost related to the incentive stock option awards at May 1, 2016.

#### Time Vested Restricted Stock Awards

On July 1, 2009 (fiscal 2010), two executive officers were granted 80,000 shares of time vested restricted common stock. This time vested restricted stock award vested in equal one-third installments on July 1, 2012, 2013, and 2014. The fair value (the closing price of the company's common stock) of this restricted stock award is measured at the date of grant (July 1, 2009) and was \$5.08 per share.

On January 7, 2009 (fiscal 2009), certain key management employees and a non-employee were granted 115,000 shares of time vested restricted common stock. Of these 115,000 shares, 105,000 and 10,000 were granted to employees and a non-employee, respectively. This time vested restricted stock award vested in equal one-third installments on May 1, 2012, 2013, and 2014. The fair value (the closing price of the company's common stock) of this restricted stock award for key management employees was measured at the date of grant (January 7, 2009) and was \$1.88 per share. The fair value (the closing price of the company's common stock) of this restricted stock award for the non-employee is measured at the earlier date when the service period is met or the end of each reporting period. The fair value of the one-third installment that vested on May 1, 2012, May 1, 2013, and May 1, 2014 was \$11.05, \$16.25, and \$18.61, respectively.

The following table summarizes the time vested restricted stock activity for fiscal 2016, 2015, and 2014:

	2016	2015	2014
	Shares	Shares	Shares
outstanding at beginning of year	-	61,668	123,335
granted	-	-	-
vested	-	(61,668)	(61,667)
outstanding at end of year	-	-	61,668

During fiscal 2015, 61,668 shares of time vested restricted stock vested and had a weighted average fair value of \$257,000 or \$4.17 per share. During fiscal 2014, 61,667 shares of time vested restricted stock vested and had a weighted average fair value of \$249,000 or \$4.04 per share.

At April 27, 2014, there were 61,668 shares of time vested restricted stock outstanding and unvested. Of the 61,668 shares outstanding and unvested, 35,000 shares were granted on January 7, 2009 and 26,668 shares were granted on July 1, 2009. At April 27, 2014, the weighted average fair value of these outstanding and unvested shares was \$4.17

per share.

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At May 1, 2016, there were no outstanding and unvested shares of time vested restricted stock. Therefore, there was no unrecognized compensation cost related to time vested restricted stock awards at May 1, 2016.

No compensation expense was recorded for time vested restricted stock awards in fiscal 2016 as all time vested restricted stock awards were fully vested at the end of fiscal 2015. We recorded compensation expense of \$4,000 and \$62,000 within selling, general, and administrative expense for time vested restricted stock awards in fiscal 2015 and 2014, respectively.

#### Performance Based Restricted Stock Units

##### Fiscal 2016 Grant

On July 15, 2015, certain key members of management were granted performance based restricted stock units which could earn up to 107,554 shares of common stock if certain performance targets are met as defined in the related restricted stock unit agreements. These awards were valued based on the fair market value on the date of grant. The fair value of these awards was \$32.23 per share, which represents the closing price of our common stock on the date of grant. The vesting of these awards is over the requisite service period of three years.

On July 15, 2015, a non-employee was granted performance based restricted stock units which could earn up to 10,364 shares of common stock if certain performance targets are met as defined in the related restricted stock unit agreement. The fair value of this award is measured at the earlier date of when the performance criteria are met or the end of the reporting period. At May 1, 2016, this grant was unvested and was measured at \$26.24 per share, which represents the closing price of our common stock at the end of the reporting period. The vesting of this award is over the requisite service period of three years.

##### Fiscal 2015

On June 24, 2014, certain key members of management were granted performance based restricted common stock units which could earn up to 102,845 shares of common stock if certain performance targets are met as defined in the related restricted stock unit agreements. These awards were valued based on the fair market value on the date of grant. The fair value of these awards was \$17.70 per share, which represents the closing price of our common stock on the date of grant. The vesting of these awards is over the requisite service period of three years.

On March 3, 2015, a non-employee was granted performance based restricted stock units which could earn up to 28,000 shares of common stock if certain performance targets are met as defined in the related restricted stock unit agreements. The fair value of this award is measured at the earlier date of when the performance criteria are met or the end of the reporting period. At May 1, 2016, this grant was unvested and was measured at \$26.24 per share, which represents the closing price of the company's common stock at the end of the reporting period. The vesting of these awards is over the requisite service period of 16 months and 28 months for performance based restricted stock units which could earn up to 12,000 and 16,000 shares of common stock, respectively.

During the first quarter of fiscal 2017, 12,000 shares of common stock associated with this grant vested and had a weighted average fair value of \$345,000 or \$28.77 per share.

#### Fiscal 2014

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

During the first quarter of fiscal 2017, 37,192 shares of common stock associated with this grant vested and had a weighted average fair value of \$637,000 or \$17.12 per share.

#### Fiscal 2013

On July 11, 2012, certain key members of management were granted performance based restricted common stock units which could earn up to 120,000 shares of common stock if certain performance targets are met as defined in the related restricted stock unit agreements. These awards were valued based on the fair market value on the date of grant. The fair value of these awards was \$10.21 per share, which represents the closing price of our common stock on the date of grant. The vesting of these awards is over the requisite service period of three years.

During the first quarter of fiscal 2016, 115,855 shares of common stock associated with this grant vested and had a weighted average fair value of \$1.2 million or \$10.21 per share

#### Overall

We recorded compensation expense of \$2.6 million, \$727,000, and \$581,000 within selling, general, and administrative expense for performance based restricted stock units in fiscal 2016, 2015 and 2014, respectively. Compensation cost is recorded based on an assessment each reporting period of the probability that certain performance goals will be met during the vesting period. If performance goals are not probable of occurrence, no compensation cost will be recognized and any recognized compensation cost would be reversed.

At May 1, 2016, the remaining unrecognized compensation cost related to the performance based restricted stock units was \$3.7 million, which is expected to be recognized over a weighted average vesting period of 1.9 years.

#### Common Stock Awards

On October 1, 2015, we granted a total of 3,000 shares of common stock to our outside directors. These shares of common stock vested immediately and were measured at \$31.77 per share, which represents the closing price of the company's common stock at the date of grant.

On October 1, 2014, we granted a total of 3,000 shares of common stock to our outside directors. These shares of common stock vested immediately and were measured at \$17.95 per share, which represents the closing price of the company's common stock at the date of grant.

On October 1, 2013, we granted a total of 3,000 shares of common stock to our outside directors. These shares of common stock vested immediately and were measured at \$18.84 per share, which represents the closing price of the company's common stock at the date of grant.

We recorded \$95,000, \$55,000, and \$57,000, of compensation expense within selling, general, and administrative expense for these common stock awards for fiscal 2016, 2015, and 2014, respectively.



## 13. Fair Value of Financial Instruments

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

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

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

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

## Recurring Basis

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

Fair value measurements at May 1, 2016 using:

(amounts in thousands)	Quoted prices in active markets for identical assets	Significant other observable inputs	Significant unobservable inputs	Total
	Level 1	Level 2	Level 3	
Assets:				
Premier Money Market Fund	\$3,404	N/A	N/A	\$3,404
Low Duration Bond Fund	1,604	N/A	N/A	1,604
Intermediate Term Bond Fund	1,154	N/A	N/A	1,154
Strategic Income Fund	999	N/A	N/A	999
Limited Term Bond Fund	602	N/A	N/A	602
Large Blend Fund	289	N/A	N/A	289
Growth Allocation Fund	148	N/A	N/A	148
Mid Cap Value Fund	102	N/A	N/A	102
Other	82	N/A	N/A	82

Fair value measurements at May 3, 2015 using:

Quoted prices in	Significant other	Significant unobservable inputs
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active observable  
markets inputs  
for  
identical  
assets

(amounts in thousands)	Level			Total
	1	Level 2	Level 3	
Assets:				
Limited Term Bond Fund	\$3,107	N/A	N/A	\$3,107
Premier Money Market Fund	2,285	N/A	N/A	2,285
Intermediate Term Bond Fund	2,181	N/A	N/A	2,181
Low Duration Bond Fund	2,096	N/A	N/A	2,096
Strategic Income Fund	1,008	N/A	N/A	1,008
Growth Allocation Fund	85	N/A	N/A	85
Other	45	N/A	N/A	45

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

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

#### Nonrecurring Basis

During fiscal 2016 and 2015, we did not have any financial assets that were required to be measured at fair value on a nonrecurring basis.

During fiscal 2014, we had no assets that are required to be measured at fair value on a nonrecurring basis other than the assets acquired from Bodet & Horst (see note 2) that were acquired at fair value.

Fair value measurements during fiscal 2014 using:

(amounts in thousands)	Quoted prices in active markets for identical assets			Total
	Level 1	Level 2	Level 3	
Assets:				
Equipment	\$-	\$ 890	\$ -	\$890
Non-compete Agreement	-	-	882	882
Customer Relationships	-	-	868	868

The equipment was classified as level 2 as the fair value was determined using quoted market prices from a third party. The non-compete agreement was recorded at its fair value using a discounted cash flow valuation model that used significant unobservable inputs and was classified as level 3. The customer relationships were recorded at fair value using a multi-period excess earnings valuation model that used significant unobservable inputs and was classified as level 3.

#### 14. NET INCOME PER SHARE

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

(in thousands)	2016	2015	2014
weighted-average common shares outstanding, basic	12,302	12,217	12,177
dilutive effect of stock-based compensation	173	205	237
weighted-average common shares outstanding, diluted	12,475	12,422	12,414

All options to purchase shares of common stock were included in the computation of diluted net income for fiscal years 2016, 2015 and 2014, as the exercise price of the options was less than the average market price of common shares.

At May 1, 2016 and May 3, 2015, there were no outstanding and unvested shares of time vested restricted common stock and therefore, the computation of basic net income per share was not affected. The computation of basic net income did not include 61,668 shares of time vested restricted common stock as these shares were unvested for fiscal 2014.

## 15. BENEFIT PLANS

### Defined Contribution Plans

The company has defined contribution plans which cover substantially all employees and provides for participant contributions on a pre-tax basis and matching contributions by the company for its U.S. and Canadian operations. Our contributions to the plan were \$843,000, \$798,000, and \$696,000 in fiscal years 2016, 2015, and 2014, respectively.

### Deferred Compensation Plan

We have a nonqualified deferred compensation plan (the "Plan") covering officers and certain key members of management. The Plan provides for participant deferrals on a pre-tax basis that are subject to annual deferral limits by the IRS and non-elective contributions made by the company. Participant deferrals and non-elective contributions made by the company are immediately vested.

Our contributions to the Plan were \$180,000, \$174,000 and \$166,000 in fiscal years 2016, 2015, and 2014, respectively. Our nonqualified deferred compensation plan liability of \$4.7 million and \$4.0 million at May 1, 2016 and May 3, 2015, were recorded in deferred compensation in the 2016 and 2015 Consolidated Balance Sheets, respectively.

Effective January 1, 2014, we established a Rabbi Trust (the "Trust") to set aside funds for the participants of the Plan and enable the participants to direct their contributions to various investment options in the Plan. The investment options of the Plan consist of a money market fund and various mutual funds. The funds set aside in the Trust are subject to the claims of our general creditors in the event of the company's insolvency as defined in the Plan.

The investment assets of the Trust are recorded at their fair value of \$4.0 million and \$2.4 million at May 1, 2016 and May 3, 2015, and were recorded in long-term investments in the 2016 and 2015 Consolidated Balance Sheets, respectively. The investment assets of the Trust are classified as available for sale and accordingly, changes in their fair values are recorded in other comprehensive income (loss).

## 16. SEGMENT INFORMATION

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

Net sales denominated in U.S. dollars accounted for 93%, 92% and 88% of total consolidated net sales in 2016, 2015, and 2014, respectively. International sales accounted for 22%, 22% and 19% of net sales in 2016, 2015, and 2014, respectively, and are summarized by geographic area as follows:

(dollars in thousands)	2016	2015	2014
north america (excluding USA) (1)	\$31,667	30,758	15,556
far east and asia (2)	31,927	31,855	33,487
all other areas	4,336	4,720	6,041
	\$67,930	67,333	55,084



(1) Of this amount, \$24.2 million, \$24.1 million, and \$9.3 million are attributable to shipments to Mexico in fiscal 2016, 2015, and 2014, respectively.

(2) Of this amount \$23.1 million, \$26.5 million, and \$32.2 million are attributable to shipment to China in fiscal 2016, 2015, and 2014, respectively.

Sales are attributed to individual countries based upon location that the company ships its products to for delivery to customers.

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

Statements of operations for the company's operating segments are as follows:

(dollars in thousands)	2016	2015	2014
net sales:			
upholstery fabrics	\$126,441	130,427	126,457
mattress fabrics	186,419	179,739	160,705
	\$312,860	310,166	287,162
gross profit:			
upholstery fabrics	\$26,393	22,690	21,429
mattress fabrics	38,718	32,877	27,477
	\$65,111	55,567	48,906

(dollars in thousands)	2016	2015	2014
selling, general, and administrative expenses:			
upholstery fabrics	\$15,094	14,562	13,393
mattress fabrics	12,223	11,206	9,962
unallocated corporate	9,456	7,010	5,302
total selling, general, and administrative expenses	\$36,773	32,778	28,657

Income from operations:			
upholstery fabrics	\$11,298	8,128	8,036
mattress fabrics	26,496	21,671	17,515
total segment income from operations	37,794	29,799	25,551
unallocated corporate expenses	(9,456 )	(7,010 )	(5,302 )
total income from operations	28,338	22,789	20,249
interest expense	-	(64 )	(427 )
interest income	176	622	482
other expense	(616 )	(391 )	(1,261 )
income before income taxes	\$27,898	22,956	19,043



One customer within the upholstery fabrics segment represented 13% of consolidated net sales in fiscal years 2016, 2015, and 2014, respectively. Two customers within the mattress fabrics segment represented 22%, 20%, and 21% of consolidated net sales in fiscal 2016, 2015, and 2014, respectively. No customers within the upholstery fabrics segment accounted for 10% or more of net accounts receivable as of May 1, 2016 and May 3, 2015, respectively. One customer within the mattress fabrics segment accounted for 16% and 10% of net accounts receivable balance as of May 1, 2016 and May 3, 2015, respectively.

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

(dollars in thousands)	2016	2015	2014
segment assets			
mattress fabrics			
current assets (1)	\$43,472	41,328	36,229
non-compete agreements, net	903	979	1,041
customer relationships	715	766	817
goodwill	11,462	11,462	11,462
property, plant, and equipment	37,480 (2)	33,773 (3)	29,040 (4)
total mattress fabrics assets	\$94,032	88,308	78,589
upholstery fabrics			
current assets (1)	\$26,540	29,905	31,854
property, plant, and equipment	1,564 (5)	1,467 (6)	1,573 (7)
total upholstery fabrics assets	\$28,104	31,372	33,427
total segment assets	122,136	119,680	112,016
non-segment assets			
cash and cash equivalents	37,787	29,725	29,303
short-term investments	4,359	10,004	6,294
income taxes receivable	155	229	121
deferred income taxes	2,319	5,169	8,270
other current assets	2,477	2,440	2,344
property, plant, and equipment	929 (8)	838 (8)	763 (8)
long-term investments	4,025	2,415	765
other assets	955	800	1,059
total assets	\$175,142	171,300	160,935
capital expenditures (9):			
mattress fabrics	\$9,666	10,454	4,380
upholstery fabrics	626	468	827
unallocated corporate	416	252	103
	\$10,708	11,174	5,310
depreciation expense			
mattress fabrics	\$5,837	5,034	4,694
upholstery fabrics	834	739	618
total segment depreciation expense	\$6,671	5,773	5,312

(1) Current assets represent accounts receivable and inventory.

(2)

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The \$37.5 million at May 1, 2016, represents property, plant, and equipment located in the U.S. of \$24.8 million and located in Canada of \$12.7 million.

(3) The \$33.8 million at May 3, 2015, represents property, plant, and equipment located in the U.S. of \$23.8 million and located in Canada of \$10.0 million.

(4) The \$29.0 million at April 27, 2014, represents property, plant, and equipment located in the U.S. of \$20.6 million and located in Canada of \$8.4 million.

(5) The \$1.6 million at May 1, 2016, represents property, plant, and equipment located in the U.S. of \$893 and located in China of \$671.

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(6) The \$1.5 million at May 3, 2015, represents property, plant, and equipment located in the U.S. of \$848 and located in China of \$619.

(7) The \$1.6 million at April 27, 2014, represents property, plant, and equipment located in the U.S. of \$957, China of \$572, and located in Poland of \$44.

The \$929, \$838, and \$763 balance at May 1, 2016, May 3, 2015, and April 27, 2014, represent property, plant, and (8) equipment associated with unallocated corporate departments and corporate departments shared by both the mattress and upholstery fabric segments.

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

## 17. 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 distributions of any dividend to shareholders. As of May 1, 2016, the company's statutory surplus reserve was \$4.8 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.

The company's subsidiaries located in China can transfer funds to the parent company with the exception of the statutory surplus reserve of \$4.8 million to assist with debt repayment, capital expenditures, and other expenses of the company's business.

## 18. COMMON STOCK REPURCHASE PROGRAM

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

During fiscal 2016, we purchased 100,776 shares of our common stock at a cost of \$2.4 million, all of which was purchased during the third quarter. During fiscal 2015, we purchased 43,014 shares of our common stock at a cost of \$745,000, all of which were purchased in the first and second quarters. During fiscal 2014, there were no repurchases of our common stock.

At May 1, 2016, we had \$1.9 million available for additional repurchases of our common stock pursuant to the authorization by our board of directors dated February 25, 2014. On June 15, 2016, we announced that our board of directors increased the authorization for us to acquire up to \$5.0 million of our common stock.

## 19. DIVIDEND PROGRAM

On June 15, 2016, we announced that our board of directors approved the payment of a special cash dividend of \$0.21 per share and a regular quarterly cash dividend payment of \$0.07 per share. These dividend payments are payable on July 15, 2016, to shareholders of record as of July 1, 2016.

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During fiscal 2016, dividend payments totaled \$8.1 million, of which \$5.0 million represented a special cash dividend payment in the first quarter of \$0.40 per share, and \$3.1 million represented our regular quarterly cash dividend payments ranging from \$0.06 to \$0.07 per share.

During fiscal 2015, dividend payments totaled \$7.6 million, of which \$4.9 million represented a special cash dividend payment in the first quarter of \$0.40 per share, and \$2.7 million represented our regular quarterly cash dividend payments ranging from \$0.05 to \$0.06 per share.

During fiscal 2014, we paid regular quarterly cash dividends totaling \$2.2 million that ranged from \$0.04 to \$0.05 per share.

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

## SELECTED QUARTERLY DATA (UNAUDITED)

	fiscal 2016	fiscal 2016	fiscal 2016	fiscal 2016	fiscal 2015	fiscal 2015	fiscal 2015	fiscal 2015
(amounts in thousands except per share, ratios & other, stock data)	4th quarter	3rd quarter	2nd quarter	1st quarter	4th quarter	3rd quarter	2nd quarter	1st quarter
<b>INCOME STATEMENT DATA</b>								
net sales	\$77,253	78,466	76,956	80,185	78,846	81,269	73,991	76,060
cost of sales	60,640	61,903	61,223	63,983	62,674	66,867	61,713	63,345
gross profit	16,613	16,563	15,733	16,202	16,172	14,402	12,278	12,715
selling, general and administrative expenses	9,261	9,337	9,433	8,741	9,605	8,375	7,379	7,419
income from operations	7,352	7,226	6,300	7,461	6,567	6,027	4,899	5,296
interest expense	-	-	-	24	15	-	-	68
interest income	(26 )	(38 )	(69 )	(66 )	(143 )	(202 )	(153 )	(142 )
other expense (income)	211	85	225	95	10	307	162	(89 )
income before income taxes	7,167	7,179	6,144	7,408	6,685	5,922	4,890	5,459
income taxes	3,566	2,317	2,373	2,707	1,772	2,110	1,889	2,115
net income	\$3,601	4,862	3,771	4,701	4,913	3,812	3,001	3,344
depreciation	\$1,782	1,705	1,629	1,555	1,528	1,432	1,414	1,399
weighted average shares outstanding	12,257	12,331	12,343	12,277	12,219	12,219	12,218	12,212
weighted average shares outstanding, assuming dilution	12,434	12,486	12,484	12,456	12,440	12,417	12,401	12,404
<b>PER SHARE DATA</b>								
net income per share - basic	\$0.29	0.39	0.31	0.38	0.40	0.31	0.25	0.27
net income per share - diluted	0.29	0.39	0.30	0.38	0.39	0.31	0.24	0.27
dividends per share	0.07	0.07	0.06	0.46	0.06	0.06	0.05	0.45
book value	10.50	10.21	9.96	9.62	9.77	9.41	9.14	8.93
<b>BALANCE SHEET DATA</b>								
operating working capital (3)	\$45,794	49,288	43,303	43,405	41,829	39,371	37,645	41,265
property, plant and equipment, net	39,973	38,157	38,319	37,480	36,078	35,269	33,204	31,891
total assets	175,142	173,551	168,947	166,880	171,300	165,358	156,162	154,219
	3,631	1,542	2,575	2,960	2,490	3,696	2,728	2,260



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capital expenditures																
dividends paid	859	864	741	5,676	733	733	611	5,502								
long-term debt, current maturities of long-term debt, and line of credit (1)	-	-	-	2,200	2,200	2,200	2,200	4,969								
shareholders' equity	128,812	125,074	122,975	118,725	119,427	114,972	111,674	109,147								
capital employed (2)	90,357	90,983	88,297	90,593	83,225	81,645	79,430	83,148								
<b>RATIOS &amp; OTHER DATA</b>																
gross profit margin	21.5	%	21.1	%	20.4	%	20.2	%	20.5	%	17.7	%	16.6	%	16.7	%
operating income margin	9.5		9.2		8.2		9.3		8.3		7.4		6.6		7.0	
net income margin	4.7		6.2		4.9		5.9		6.2		4.7		4.1		4.4	
effective income tax rate	49.8		32.3		38.6		36.5		26.5		35.6		38.6		38.7	
Debt-to-total capital employed ratio (1)	0.0		0.0		0.0		2.4		2.6		2.7		2.8		6.0	
operating working capital turnover (3)	7.0		7.2		7.7		7.7		7.7		7.5		7.2		7.1	
days sales in receivables	28		31		28		29		33		32		31		31	
inventory turnover	5.3		5.1		5.3		5.6		6.4		7.0		6.4		6.0	
<b>STOCK DATA</b>																
stock price high	\$28.53		31.15		35.23		33.64		29.19		22.74		19.24		19.05	
low	22.72		22.61		29.13		25.22		19.22		18.50		16.60		17.11	
close	26.24		25.32		30.01		30.25		26.02		20.09		18.97		17.87	
daily average trading volume (shares)	33.5		68.8		76.2		90.5		64.9		26.8		29.7		33.7	

(1) Debt includes long-term debt, current maturities of long-term debt, and line of credit.

(2) Capital employed does not include cash and cash equivalents, short-term investments, long-term investments, current maturities of long-term debt, long-term debt, line of credit, noncurrent deferred tax assets and liabilities, income taxes receivable and payable, and deferred compensation.

(3) Operating working capital for this calculation is accounts receivable and inventories, offset by accounts payable-trade  
accounts payable - capital expenditures.

## ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

During the three years ended May 1, 2016, there were no disagreements on any matters of accounting principles or practices or financial statement disclosures.

### ITEM 9A. CONTROLS AND PROCEDURES

#### Evaluation of Disclosure Controls and Procedures

We have conducted an evaluation of the effectiveness of our disclosure controls and procedures as of May 1, 2016. This evaluation was conducted under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer. Based upon that evaluation, we have concluded that these disclosure controls and procedures were effective, in all material respects, to ensure that information required to be disclosed in the reports filed by us and submitted under the Securities Exchange Act of 1934, as amended (the "Exchange Act") is recorded, processed, summarized, and reported as and when required. Further we concluded that our disclosure controls and procedures have been designed to ensure that information required to be disclosed in reports filed by us under the Exchange Act is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, in a manner to allow timely decisions regarding the required disclosure.

#### Management's Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is a process to provide reasonable assurance regarding the reliability of our financial reporting for external purposes in accordance with generally accepted accounting principles. Internal control over financial reporting includes: (1) maintaining records that in reasonable detail accurately and fairly reflect the transactions and disposition of assets; (2) providing reasonable assurance that the transactions are recorded as necessary for preparation of financial statements, and that receipts and expenditures are made in accordance with authorizations of management and directors; and (3) providing reasonable assurance that unauthorized acquisition, use, disposition of assets that could have a material effect on financial statements would be prevented or detected on a timely basis. Because of its inherent limitations, internal control over financial reporting is not intended to provide absolute assurance that a misstatement of financial statements would be prevented or detected. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of our internal control over financial reporting based on the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in the 2013 Internal Control – Integrated Framework. Based on this assessment, management concluded that our internal control over financial reporting was effective at May 1, 2016.

Grant Thornton LLP, an independent registered public accounting firm, has audited the consolidated financial statements as of and for the years ended May 1, 2016, May 3, 2015 and April 27, 2014 and has audited the company's effectiveness of internal controls over financial reporting as of May 1, 2016, as stated in their report, which is included in Item 8 hereof.

During the quarter ended May 1, 2016, there were no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders Culp, Inc.:

We have audited the internal control over financial reporting of Culp, Inc. (a North Carolina corporation) and Subsidiaries (the “Company”) as of May 1, 2016, based on criteria established in the 2013 Internal Control— Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company’s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying on internal control over financial reporting. Our responsibility is to express an opinion on the Company’s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of May 1, 2016, based on criteria established in the 2013 Internal Control—Integrated Framework issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements of the Company as of and for the year ended May 1, 2016, and our report dated July 15, 2016 expressed an unqualified opinion those financial statements.

/s/ GRANT THORNTON LLP

Raleigh, North Carolina  
July 15, 2016



ITEM 9B. OTHER INFORMATION

None

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE

Information with respect to executive officers and directors of the company is included in the company's definitive Proxy Statement to be filed within 120 days after the end of the company's fiscal year pursuant to Regulation 14A of the Securities and Exchange Commission, under the captions "Nominees, Directors and Executive Officers," "Section 16(a) Beneficial Ownership Reporting Compliance," "Corporate Governance – Code of Business Conduct and Ethics," "Board Committees and Attendance – Audit Committee" which information is herein incorporated by reference.

ITEM 11. EXECUTIVE COMPENSATION

Information with respect to executive compensation is included in the company's definitive Proxy Statement to be filed within 120 days after the end of the company's fiscal year pursuant to Regulation 14A of the Securities and Exchange Commission, under the captions "Executive Compensation" and "Compensation Committee Interlocks and Insider Participation" which information is herein incorporated by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Information with respect to the security ownership of certain beneficial owners and management is included in the company's definitive Proxy Statement to be filed within 120 days after the end of the company's fiscal year pursuant to Regulation 14A of the Securities and Exchange Commission, under the captions "Executive Compensation Plan Information" and "Voting Securities," which information is herein incorporated by reference.

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The following table sets forth information as of the end of fiscal 2016 regarding shares of the our common stock that may be issued upon the exercise of equity awards previously granted and currently outstanding equity awards under the company's equity incentive and stock option plans, as well as the number of shares available for the grant of equity awards that had not been granted as of that date.

## EQUITY COMPENSATION PLAN INFORMATION

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plan (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	83,600	\$8.37	1,079,809
Equity compensation plans not approved by security holders	-		