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CULP INC  
Form 10-Q  
September 10, 2008

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended August 3, 2008

Commission File No. 0-12781

CULP, INC.

(Exact name of registrant as specified in its charter)

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

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

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

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

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

Large accelerated filer [ ] Accelerated filer [X] 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 Exchange Act). [ ] YES NO [X]

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

Common shares outstanding at August 3, 2008: 12,648,027  
Par Value: \$0.05 per share

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For the period ended August 3, 2008

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CULP, INC.  
CONSOLIDATED STATEMENTS OF NET INCOME  
FOR THE THREE MONTHS ENDED AUGUST 3, 2008 AND JULY 29, 2007  
UNAUDITED  
(Amounts in Thousands, Except for Per Share Data)

	THREE MONTHS ENDED			
	Amounts			
	August 3, 2008	July 29, 2007	% Over (Under)	Aug 2
Net sales	\$ 59,321	65,230	(9.1)%	
Cost of sales	51,919	56,174	(7.6)%	
Gross profit	7,402	9,056	(18.3)%	
Selling, general and administrative expenses	5,384	6,321	(14.8)%	
Restructuring expense	402	432	(6.9)%	
Income from operations	1,616	2,303	(29.8)%	
Interest expense	431	818	(47.3)%	
Interest income	(34)	(58)	(41.4)%	
Other expense	14	232	(94.0)%	
Income before income taxes	1,205	1,311	(8.1)%	
Income taxes *	424	460	(7.8)%	
Net income	\$ 781	851	(8.2)%	
Net income per share, basic	\$ 0.06	0.07	(14.3)%	
Net income per share, diluted	0.06	0.07	(14.3)%	
Average shares outstanding, basic	12,648	12,583	0.5 %	
Average shares outstanding, diluted	12,736	12,728	0.1 %	

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

See accompanying notes to consolidated financial statements.

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CULP, INC.  
CONSOLIDATED BALANCE SHEETS  
AUGUST 3, 2008, JULY 29, 2007 AND APRIL 27, 2008  
UNAUDITED  
(Amounts in Thousands)

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	Amounts		Increase (Decrease)
	August 3, 2008	July 29, 2007	Dollars
<b>Current assets:</b>			
Cash and cash equivalents	\$ 6,352	9,017	(2,665)
Accounts receivable	20,164	23,903	(3,739)
Inventories	34,862	42,159	(7,297)
Deferred income taxes	4,472	5,376	(904)
Assets held for sale	5,610	1,906	3,704
Income taxes receivable	160	-	160
Other current assets	1,627	1,649	(22)
<b>Total current assets</b>	<b>73,247</b>	<b>84,010</b>	<b>(10,763)</b>
Property, plant and equipment, net	33,950	36,901	(2,951)
Goodwill	4,114	4,114	-
Deferred income taxes	29,144	26,220	2,924
Other assets	2,335	2,831	(496)
<b>Total assets</b>	<b>\$ 142,790</b>	<b>154,076</b>	<b>(11,286)</b>
<b>Current liabilities:</b>			
Current maturities of long-term debt	\$ 7,378	13,849	(6,471)
Current portion of obligation under a capital lease	692	-	692
Lines of credit	-	2,641	(2,641)
Accounts payable-trade	17,249	16,776	473
Accounts payable - capital expenditures	1,020	1,219	(199)
Accrued expenses	5,534	8,484	(2,950)
Accrued restructuring costs	1,495	3,047	(1,552)
Income taxes payable - current	33	856	(823)
<b>Total current liabilities</b>	<b>33,401</b>	<b>46,872</b>	<b>(13,471)</b>
Accounts payable - capital expenditures	1,275	-	1,275
Income taxes payable - long-term	5,069	3,765	1,304
Deferred income taxes	1,363	-	1,363
Obligation under capital lease	458	-	458
Long-term debt, less current maturities	13,980	22,094	(8,114)
<b>Total liabilities</b>	<b>55,546</b>	<b>72,731</b>	<b>(17,185)</b>
Shareholders' equity	87,244	81,345	5,899
<b>Total liabilities and shareholders' equity</b>	<b>\$ 142,790</b>	<b>154,076</b>	<b>(11,286)</b>
Shares outstanding	12,648	12,635	13

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\* Derived from audited financial statements.

See accompanying notes to consolidated financial statements.

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CULP, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
FOR THE THREE MONTHS ENDED AUGUST 3, 2008 AND JULY 29, 2007  
UNAUDITED  
(Amounts in Thousands)

	THREE MONTHS ENDED	
	Amounts	
	August 3, 2008	July 29, 2007
Cash flows from operating activities:		
Net income	\$ 781	851
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	1,258	1,447
Amortization of other assets	79	90
Stock-based compensation	98	140
Excess tax benefit related to stock options exercised	-	(21)
Deferred income taxes	90	(518)
Restructuring expenses, net of gain on sale of related assets	-	160
Changes in assets and liabilities:		
Accounts receivable	6,909	5,387
Inventories	532	(1,529)
Other current assets	(299)	175
Other assets	(5)	(327)
Accounts payable - trade	(3,854)	(5,251)
Accrued expenses	(2,757)	(186)
Accrued restructuring	63	(235)
Income taxes payable	428	889
Net cash provided by operating activities	3,323	1,072
Cash flows from investing activities:		
Capital expenditures	(986)	(1,113)
Proceeds from the sale of buildings and equipment	-	702
Net cash used in investing activities	(986)	(411)
Cash flows from financing activities:		
Payments on vendor-financed capital expenditures	(599)	(70)
Payments on long-term debt	(65)	(2,169)

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Payments on capital lease obligation	(235)	-
Proceeds from common stock issued	-	405
Excess tax benefit related to stock option exercises	-	21
	-----	-----
Net cash used in financing activities	(899)	(1,813)
	-----	-----
Increase (decrease) in cash and cash equivalents	1,438	(1,152)
Cash and cash equivalents at beginning of period	4,914	10,169
	-----	-----
Cash and cash equivalents at end of period	\$ 6,352	9,017
	=====	=====

See accompanying notes to consolidated financial statements.

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

	Common Stock		Capital Contributed in Excess of Par Value	Retained Earnings	Acco O Comp
	Shares	Amount			
	-----	-----	-----	-----	-----
Balance, April 29, 2007	12,569,291	\$ 629	46,197	32,255	
Cumulative effect of adopting FASB Interpretation No. 48	-	-	-	847	
Net income	-	-	-	5,385	
Stock-based compensation	-	-	618	-	
Loss on cash flow hedge, net of taxes	-	-	-	-	
Excess tax benefit related to stock options exercised	-	-	17	-	
Common stock issued in connection with stock option plans	78,736	3	456	-	
	-----	-----	-----	-----	-----
Balance, April 27, 2008	12,648,027	632	47,288	38,487	
Net income	-	-	-	781	
Stock-based compensation	-	-	98	-	
Gain on cash flow hedge, net of taxes	-	-	-	-	
	-----	-----	-----	-----	-----
Balance, August 3, 2008	12,648,027	\$ 632	47,386	39,268	
	=====	=====	=====	=====	=====

See accompanying notes to consolidated financial statements.

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

## 1. Basis of Presentation

The accompanying unaudited consolidated financial statements of Culp, Inc. and subsidiaries (the "company") include all adjustments, which are, in the opinion of management, necessary for fair presentation of the results of operations and financial position. All of these adjustments are of a normal recurring nature except as disclosed in note 14 to the consolidated financial statements. Results of operations for interim periods may not be indicative of future results. The unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements, which are included in the company's annual report on Form 10-K filed with the Securities and Exchange Commission on July 9, 2008 for the fiscal year ended April 27, 2008.

The company's three months ended August 3, 2008 and July 29, 2007 represent 14 and 13 week periods, respectively.

## 2. Significant Accounting Policies

Significant accounting policies adopted by the company in fiscal 2009 are as follows:

### Fair Value Measurements:

The company adopted SFAS No. 157, Fair Value Measurements ("SFAS 157") and SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities ("SFAS 159"), on April 28, 2008. SFAS 157 (1) creates a single definition of fair value, (2) establishes a framework for measuring fair value, and (3) expands disclosure requirements about items measured at fair value. SFAS 157 applies to both items recognized and reported at fair value in the financial statements and items disclosed at fair value in the notes to the financial statements. SFAS 157 does not change existing accounting rules governing what can or what must be recognized and reported at fair value in the company's financial statements, or disclosed at fair value in the company's notes to the financial statements. Additionally, SFAS 157 does not eliminate practicability exceptions that exist in accounting pronouncements amended by SFAS 157 when measuring fair value. As a result, the company will not be required to recognize any new assets or liabilities at fair value.

Prior to SFAS 157, certain measurements of fair value were based on the price that would be paid to acquire an asset, or received to assume a liability (an entry price). SFAS 157 clarifies the definition of fair value as the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date (that is, an exit price). The exit price is based on the amount that the holder of the asset or liability would receive or need to pay in an actual transaction (or in a hypothetical transaction if an actual transaction does not exist) at the measurement date. In some circumstances, the entry and exit price may be the same; however, they are conceptually different.

Fair value is generally determined based on quoted market prices in active markets for identical assets or liabilities. If quoted market prices are not available, the company uses valuation techniques that place greater reliance on observable inputs and less reliance on unobservable inputs. In measuring fair value, the company may make adjustments for risks and uncertainties, if a market participant would include such an adjustment in its pricing.

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

SFAS 157 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 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.

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

Fair value measurements at August 3, 2008 using:

	Quoted prices in active markets for identical assets	Significant other observable inputs	Significant unobservable inputs	
(amounts in thousands)	Level 1	Level 2	Level 3	
Assets:				
None	Not applicable	Not applicable	Not applicable	No
Liabilities:				
Interest Rate Swap Agreement	Not applicable	66	Not applicable	

As shown above, the interest rate swap derivative is valued based on fair value provided by the company's bank and is classified within level 2 of the fair value hierarchy. The determination of where an asset or liability falls in the hierarchy requires significant judgment. The company evaluates its 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, the company expects that changes in classifications between different levels will be rare.

Most derivative contracts are not listed on an exchange and require the use of valuation models. Consistent with SFAS 157, the company attempts to maximize the use of observable market inputs in its models. When observable inputs are not available, the company defaults to unobservable inputs. Derivatives valued based



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on models with significant unobservable inputs and that are not actively traded, or trade activity is one way, are classified within level 3 of the fair value hierarchy.

Some financial statement preparers have reported difficulties in applying SFAS 157 to certain nonfinancial assets and nonfinancial liabilities, particularly those acquired in business combinations and those requiring a determination of impairment. To allow the time to consider the effects of the implementation issues that have arisen, the FASB issued FSP FAS 157-2 ("FSP 157-2") on February 12, 2008 to provide a one-year deferral of the effective date of SFAS 157 for

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

nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed in financial statements at fair value on a recurring basis (that is, at least annually). As a result of FSP 157-2, the company has not yet adopted SFAS 157 for nonfinancial assets and liabilities that are valued at fair value on a non-recurring basis. FSP 157-2 is effective for the company in fiscal 2010 and the company is evaluating the impact that the application of SFAS 157 to those nonfinancial assets and liabilities will have on its financial statements.

In February 2007, the FASB issued SFAS 159, The Fair Value Option for Financial Assets and Financial Liabilities. SFAS 159 provides the company with an option to elect fair value as the initial and subsequent measurement attribute for most financial assets and liabilities and certain other items. The fair value option election is applied on an instrument-by-instrument basis (with some exceptions), is irrevocable, and is applied to an entire instrument. The election may be made as of the date of initial adoption for existing eligible items. Subsequent to initial adoption, the company may elect the fair value option at initial recognition of eligible items, on entering into an eligible firm commitment, or when certain specified reconsideration events occur. Unrealized gains and losses on items for which the fair value option has been elected will be reported in earnings.

Upon adoption of SFAS 159 on April 28, 2008, the company did not elect to account for any assets and liabilities under the scope of SFAS 159 at fair value.

#### 3. Asset Acquisition - Mattress Fabric Segment

Pursuant to an Asset Purchase Agreement among the company, Bodet & Horst USA, LP and Bodet & Horst GMBH & Co. KG (collectively "Bodet & Horst") dated August 11, 2008, the company purchased certain assets and assumed certain liabilities of the knitted mattress fabric operation of Bodet & Horst, including its manufacturing operation in High Point, North Carolina. The purchase involves the equipment, inventory, and intellectual property associated with the High Point manufacturing operation, which has served as the company's primary source of knitted mattress fabric for six years. Demand for this product line has grown significantly, as knits are increasingly being utilized on mattresses at volume retail price points. The company is assuming the lease of the building where the operation is located and intends to continue operating the business in that location. The purchase price for the assets is cash in the amount of \$10.5 million, plus the assumption of certain liabilities, subject to adjustment after closing for changes in working capital through the date of closing. Also, in connection with the purchase, the company entered into a six-year consulting and

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non-compete agreement with the principal owner of Bodet & Horst, providing for payments to the owner in the amount of \$75,000 per year for the agreement's full six-year term.

The acquisition was financed by \$11.0 million of unsecured notes pursuant to a Note Purchase Agreement ("2008 Note Agreement") dated August 11, 2008. The 2008 Note Agreement has a fixed interest rate of 8.01% and a term of seven years. Principal payments of \$2.2 million per year are due on the notes beginning three years from the date of the 2008 Note Agreement. The 2008 Note Agreement contains customary financial and other covenants as defined in the 2008 Note Agreement.

In connection with the 2008 Note Agreement, the company entered into a Consent and Fifth Amendment (the "Consent and Amendment") that amends the previously existing unsecured note purchase agreements. The purpose of the Consent and Amendment is for the existing note holders to consent to the 2008 Note Agreement

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

and to provide that certain financial covenants in favor of the existing note holders will be on the same terms as those contained in the 2008 Note Agreement.

#### 4. Stock-Based Compensation

On June 17, 2008, the company granted two employees 25,000 options to purchase shares of common stock at the fair market value on the date of grant. These options will vest over five years and expire ten years after the date of grant. The fair value of these option awards were estimated on the date of grant using the Black-Scholes option-pricing model. The fair value of stock options granted to these two employees during the three-month period ended August 3, 2008, was \$5.00 per share using the following assumptions:

Grant on June 17, 2008

Risk-free interest rate	4.23%
Dividend yield	0.00%
Expected volatility	66.18%
Expected term (in years)	8.0

The assumptions utilized in the model are evaluated and revised, as necessary, to reflect market conditions, actual historical experience, and groups of employees that have similar exercise patterns that are considered separately for valuation purposes. The risk-free interest rate for periods within the contractual life of the option was based on the U.S. Treasury yield curve in effect at the time of grant. The company does not plan to issue any dividends, and, therefore, the yield is 0.00%. The expected volatility was derived using a term structure based on historical volatility and the volatility implied by exchange-traded options on the company's common stock. The expected term of the options is the contractual term of the stock options and expected employee exercise and post-vesting employment termination trends.

The company recorded \$98,000 and \$140,000 of compensation expense for stock options within selling, general, and administrative expense for the three-month periods ended August 3, 2008 and July 29, 2007, respectively. The remaining unrecognized compensation costs related to unvested awards at August 3, 2008 was

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\$894,562 which is expected to be recognized over a weighted average period of 3.0 years.

5. Accounts Receivable

A summary of accounts receivable follows:

(dollars in thousands)	August 3, 2008	April 27, 2008
Customers	\$ 22,044	\$ 28,830
Allowance for doubtful accounts	(1,381)	(1,350)
Reserve for returns and allowances and discounts	(499)	(407)
	\$ 20,164	\$ 27,073

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

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

(dollars in thousands)	Three months ended	
	August 3, 2008	July 29, 2007
Beginning balance	\$ (1,350)	\$ (1,332)
Provision (recovery) of bad debt expense	(94)	17
Net write-offs	63	155
Ending balance	\$ (1,381)	\$ (1,160)

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

(dollars in thousands)	Three months ended	
	August 3, 2008	July 29, 2007
Beginning balance	\$ (407)	\$ (570)
Provision for returns and allowances and discounts	(632)	(762)
Discounts taken	540	690
Ending balance	\$ (499)	\$ (642)

6. Inventories

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

A summary of inventories follows:

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(dollars in thousands)	August 3, 2008	April 27, 2008
Raw materials	\$ 10,083	\$ 9,939
Work-in-process	1,227	1,682
Finished goods	23,552	23,773
	\$ 34,862	\$ 35,394

7. Other Assets

A summary of other assets follows:

(dollars in thousands)	August 3, 2008	April 27, 2008
Cash surrender value - life insurance	\$ 1,269	\$ 1,269
Non-compete agreement, net	717	789
Other	349	351
	\$ 2,335	\$ 2,409

The company recorded a non-compete agreement related to the ITG asset purchase agreement at its fair value based on valuation techniques. At August 3, 2008 and April 27, 2008, the gross carrying amount of this non-compete agreement was \$1.1

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Culp, Inc.  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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million. At August 3, 2008 and April 27, 2008 accumulated amortization for this non-compete agreement was \$431,000 and \$359,000, respectively. The non-compete agreement is amortized on a straight-line basis over the four year life of the agreement. Amortization expense for this non-compete agreement for the three-month period ended August 3, 2008 and July 29, 2007 was \$72,000. Amortization expense during the next three fiscal years follows: FY 2009 - \$215,000; FY 2010 - \$287,000; and FY 2011 - 215,000.

8. Accounts Payable - Capital Expenditures

The company has certain vendor financed arrangements regarding capital expenditures that bear interest with fixed interest rates ranging from 6% to 7.14%. At August 3, 2008 and April 27, 2008, the company had total amounts due regarding capital expenditures totaling \$2.3 million and \$3.0 million, respectively. The payment requirements of these arrangements during the next three years are: Year 1 - \$1.0 million; Year 2 - \$725,000; and Year 3 - \$550,000.

9. Accrued Expenses

A summary of accrued expenses follows:

(dollars in thousands)	August 3, 2008	April 27, 2008
Compensation, commissions and related benefits	\$ 2,990	\$ 5,690
Interest	500	186

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Accrued rebates	144	241
Other	1,900	2,183
	\$ 5,534	\$ 8,300

10. Long-Term Debt and Lines of Credit

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

(dollars in thousands)	August 3, 2008	April 27, 2008
Unsecured term notes	\$ 14,307	\$ 14,307
Real estate loan - I	3,773	3,828
Real estate loan - II	2,500	2,500
Canadian government loan	778	788
	21,358	21,423
Current maturities of long-term debt	(7,378)	(7,375)
Long-term debt, current maturities of long-term debt	\$ 13,980	\$ 14,048
Lines of credit	\$ -	\$ -
Total borrowings	\$ 21,358	\$ 21,423

Unsecured Term Notes- Bodet & Horst Acquisition

In connection with the Bodet & Horst Asset Purchase Agreement, the company entered into the 2008 Note Agreement dated August 11, 2008. The 2008 Note Agreement provides for the issuance of \$11.0 million of unsecured term notes

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

with a fixed interest rate of 8.01% and a term of seven years. Principal payments of \$2.2 million per year are due on the notes beginning three years from the date of the 2008 Note Agreement. The 2008 Note Agreement contains customary financial and other covenants as defined in the 2008 Note Agreement.

Unsecured Term Notes- Existing

The company's existing unsecured term notes have a fixed interest rate of 8.80% (payable semi-annually in March and September and subject to prepayment provisions each fiscal quarter as defined in the agreement) and are payable over an average remaining term of 1.6 years through March 2010. The principal payments are required to be paid in annual installments over the next two years as follows: March 2009 - \$7.2 million; and March 2010 - \$7.1 million.

In connection with the 2008 Note Agreement, the company entered into a Consent and Amendment that amends the previously existing unsecured note purchase

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agreements. The purpose of the Consent and Amendment is for the existing note holders to consent to the 2008 Note Agreement and to provide that certain financial covenants in favor of the existing note holders will be on the same terms as those contained in the 2008 Note Agreement.

### Real Estate Loan - I

The company has a real estate loan that is secured by a lien on the company's corporate headquarters office located in High Point, NC. This term loan bears interest at the one-month LIBOR plus an adjustable margin (all in rate of 4.96% at August 3, 2008) based on the company's debt/EBITDA ratio, as defined in the agreement and is payable in monthly installments through September 2010, with a final payment of \$3.3 million in October 2010.

### Real Estate Loan - II

The company has a term loan in the amount of \$2.5 million in connection with the ITG asset purchase agreement. This term loan is secured by a lien on the company's corporate headquarters office located in High Point, NC and bears interest at the one-month LIBOR plus an adjustable margin (all in rate of 5.48% at August 3, 2008) based on the company's debt/EBITDA ratio, as defined in the agreement. This agreement requires the company to pay interest monthly with the entire principal due on June 30, 2010.

### Revolving Credit Agreement - United States

The company has an unsecured credit agreement that provides for a revolving loan commitment of \$6.5 million, including letters of credit up to \$5.5 million. This agreement expires on December 31, 2008, and bears interest at the one-month LIBOR plus an adjustable margin (all in rate of 4.96% at August 3, 2008) based on the company's debt/EBITDA ratio, as defined in the agreement. As of August 3, 2008, there were \$1.3 million in outstanding letters of credit (all of which related to workers compensation) and no borrowings outstanding under the agreement.

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Culp, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(unaudited)

### Revolving Credit Agreement - China

The company's China subsidiary has an unsecured revolving credit agreement with a bank in China to provide a line of credit available up to approximately \$5.0 million, of which approximately \$1.0 million includes letters of credit. This agreement bears interest at a rate determined by the Chinese government. There were no borrowings outstanding under the agreement as of August 3, 2008.

### Canadian Government Loan

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

### Overall

The company's loan agreements require that the company maintain compliance with

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certain financial ratios. At August 3, 2008, the company was in compliance with these financial covenants.

As of August 3, 2008, the principal payment requirements of long-term debt during the next five years are: Year 1 - \$7.4 million; Year 2 - \$10.0 million; Year 3 - \$3.5 million; Year 4 - \$195,000; Year 5 - \$195,000; and thereafter - \$65,000.

### 11. Capital Lease Obligation

In May 2008, the company entered into a capital lease to finance the construction of certain equipment related to its mattress fabrics segment. The lease agreement contains a bargain purchase option and bears interest at 8.5%. The lease agreement requires principal payments totaling \$1.4 million to commence on July 1, 2008, and to be paid in quarterly installments through April 2010. This agreement is secured by equipment with a carrying value of \$2.4 million. The principal payments required over the next two years are as follows: Year 1 - \$692,000; and Year 2 - \$458,000.

At August 3, 2008, the company has recorded \$1.4 million for equipment under capital leases. This balance is reflected in property, plant, and equipment in the accompanying consolidated balance sheet as of August 3, 2008. No depreciation expense was recorded on the equipment related to this lease for the three-month period ending August 3, 2008, as the equipment will be placed into service in the company's second quarter of fiscal 2009.

### 12. Interest Rate Hedging

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

The company accounts for the interest rate swap as a cash flow hedge whereby the fair value of this contract is reflected in other assets if the contract is in

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the company's favor or accrued expenses if the contract is in the bank's favor in the accompanying consolidated balance sheets with the offset recorded as accumulated other comprehensive loss. The fair value of the interest rate swap was approximately \$66,000 and \$75,000 in the bank's favor at August 3, 2008 and April 27, 2008, respectively.

### 13. Cash Flow Information

Payments for interest and income taxes follows:

	Three months ended	
(dollars in thousands)	August 3, 2008	July 29, 2007
-----		

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Interest	\$	159	\$	207
Net income tax (refund) payments		(53)		254

The company financed \$1.4 million of its capital expenditures through a capital lease for the three months ended August 3, 2008 (see note 11). The company did not finance any of its capital expenditures for the three months ended July 29, 2007. Interest costs of \$42,000 for the construction of qualifying fixed assets were capitalized and are being amortized over the related assets' estimated useful lives for the three months ended August 3, 2008. No interest costs were capitalized for the three months ended July 29, 2007.

### 14. Restructuring and Restructuring Related Charges

The following summarizes the fiscal 2009 activity in the restructuring accrual (dollars in thousands):

(dollars in thousands)	Balance, April 27, 2008	Employee Termination Benefit Adjustments	Employee Termination Benefit Payments Net of Cobra Premiums	Lease Termination and Other Exit Cost Adjustments
December 2006 Upholstery fabrics (1)	\$ 990	\$ 436	\$ (230)	\$ (12)
September 2005 Upholstery fabrics (2)	178	-	-	-
August 2005 Upholstery fabrics (3)	2	5	(7)	-
Fiscal 2005 Upholstery fabrics (4)	27	(27)	-	-
Fiscal 2003 Culp Decorative fabrics (5)	235	-	-	-
<b>Totals</b>	<b>\$ 1,432</b>	<b>\$ 414</b>	<b>\$ (237)</b>	<b>\$ (12)</b>

- (1) The restructuring accrual at August 3, 2008, represents employee termination benefits and lease termination and exit costs of \$885 and \$216, respectively. The restructuring accrual at April 27, 2008, represents employee termination benefits and lease termination and exit costs of \$679 and \$311, respectively.
- (2) The restructuring accrual at August 3, 2008, represents other exit costs of \$159. The restructuring accrual at April 27, 2008, represents other exit costs of \$178.
- (3) The restructuring accrual at April 27, 2008, represents employee termination benefits of \$2.
- (4) The restructuring accrual at April 27, 2008, represents employee termination benefits of \$27.
- (5) The restructuring accrual at August 3, 2008 and April 27, 2008 represents and lease termination and other exit costs of \$235.

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- (6) The company's existing restructuring plans as of August 3, 2008, have been



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substantially completed.

The following summarizes restructuring and related charges incurred for the three-month period ending August 3, 2008 (dollars in thousands):

(dollars in thousands)	Operating Costs on Closed Facilities	Lease Termination and Other Exit Costs	Write-Downs of Buildings and Equipment	Inventory Markdowns	Asset Movement Costs	Employee Termination Benefits
December 2006 Upholstery fabrics (7)	\$ 14	\$ (12)	\$ -	\$ -	\$ -	\$ 436
August 2005 Upholstery fabrics (8)	-	-	-	-	-	5
Fiscal 2005 Upholstery fabrics (9)	-	-	-	-	-	(27)
Totals	\$ 14	\$ (12)	\$ -	\$ -	\$ -	\$ 414

(7) Of this total charge, \$12 was recorded in cost of sales, \$2 was recorded in selling, general and administrative expense, and \$424 was recorded in restructuring expense in the 2009 Consolidated Statement of Net Income.

(8) This \$5 charge was recorded in restructuring expense in the 2009 Consolidated Statement of Net Income.

(9) This \$27 credit was recorded in restructuring expense in the 2009 Consolidated Statement of Net Income.

The following summarizes restructuring and related charges for the three-month period ending July 29, 2007. (dollars in thousands):

(dollars in thousands)	Operating Costs on Closed Facilities	Lease Termination and Other Exit Costs	Write-Downs of Buildings and Equipment	Inventory Markdowns	Accelerated Depreciation	Asset Movement Costs
December 2006 Upholstery fabrics (10)	\$ 481	\$ 333	\$ 362	\$ 57	\$ -	\$ 54
September 2005 Upholstery fabrics (11)	-	-	-	-	-	-
August 2005 Upholstery fabrics (12)	-	-	-	-	-	-
Fiscal 2005 Upholstery fabrics (13)	-	34	-	-	-	-
Fiscal 2003 Culp Decorative fabrics (14)	5	-	-	-	-	-
Totals	\$ 486	\$ 367	\$ 362	\$ 57	\$ -	\$ 54

(10) Of this total charge, \$512 was recorded in cost of sales, \$26 was recorded

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in selling, general, and, administrative expense, and \$460 was recorded in restructuring expense in the 2008 Consolidated Statement of Net Income.

- (11) This \$26 credit was recorded in restructuring expense in the 2008 Consolidated Statement of Net Income.
- (12) This \$10 credit was recorded in restructuring expense in the 2008 Consolidated Statement of Net Income.
- (13) This \$16 charge was recorded in restructuring expense in the 2008 Consolidated Statement of Net Income.

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- (14) The charge of \$5 for operating costs on closed plant facilities was recorded in cost of sales in the 2008 Consolidated Statement of Net Income. The \$8 credit for employee termination benefits was recorded in restructuring expense in the 2008 Consolidated Statement of Net Income.

### Consolidation of China Operations

On September 3, 2008, the board of directors approved changes to the upholstery fabric operations, including the consolidation of facilities in China and reduction of excess manufacturing capacity, which will involve exit and disposal charges to be incurred by the company. This action is in response to the extremely challenging industry conditions for upholstery fabrics and is expected to result in pre-tax charges of approximately \$3.9 million, of which \$3.5 million is expected to be non-cash items and \$400,000 is expected to result in cash expenditures. The company anticipates the charges to be made up of approximately \$2.1 million for accelerated depreciation related to leasehold improvements on facilities being exited, \$1.4 million for fixed asset write-downs, \$250,000 for lease termination costs, and \$100,000 for employee termination benefits and other costs related to dismantling, disposal, and moving of equipment and related assets. All these charges are expected to be incurred in the company's second and third quarters of fiscal 2009. The plant consolidations are expected to be completed by the end of the third quarter of fiscal 2009.

### 15. 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 options calculated using the treasury stock method. Weighted average shares used in the computation of basic and diluted net income per share follows:

(amounts in thousands)	Three months ended	
	August 3, 2008	July 29, 2007
Weighted average common shares outstanding, basic	12,648	12,583
Effect of dilutive stock options	88	145
Weighted average common shares outstanding, diluted	12,736	12,728

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Options to purchase 247,875 and 79,750 shares of common stock were not included in the computation of diluted net income per share for the three months ended August 3, 2008 and July 29, 2007, respectively, because the exercise price of the options was greater than the average market price of the common shares.

16. Comprehensive Income

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

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A summary of comprehensive income follows:

(dollars in thousands)	Three months ended	
	August 3, 2008	July 29, 2007
Net income	\$ 781	\$ 851
Gain on cash flow hedge, net of income taxes	6	4
Comprehensive income	\$ 787	\$ 855

17. Segment Information

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

The company evaluates the operating performance of its segments based upon income (loss) from operations before restructuring and related charges or credits and certain unallocated corporate expenses. Unallocated corporate expenses primarily represent compensation and benefits for certain executive officers and all costs related to being a public company. Segment assets include assets used in the operations of each segment and primarily consist of accounts receivable, inventories, and property, plant and equipment. The mattress fabrics segment also includes in segment assets, assets held for sale, goodwill and other non-current assets associated with the ITG acquisition. The upholstery fabrics segment also includes assets held for sale in segment assets.

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

(dollars in thousands)	Three months ended	
	August 3, 2008	July 29, 2007

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Net sales:			
Mattress Fabrics	\$	35,561	\$ 36,536
Upholstery Fabrics		23,760	28,694
		\$ 59,321	\$ 65,230
-----			
Gross profit:			
Mattress Fabrics	\$	6,344	\$ 5,805
Upholstery Fabrics		1,070	3,768
		7,414	9,573
Total segment gross profit			
Restructuring related charges		(12) (1)	(517)
		\$ 7,402	\$ 9,056
-----			
Selling, general, and administrative expenses:			
Mattress Fabrics	\$	2,128	\$ 2,042
Upholstery Fabrics		2,484	3,318

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Total segment selling, general, and administrative expenses		4,612	5,360
Unallocated corporate expenses		770	935
Restructuring related charges		2 (1)	26
		\$ 5,384	\$ 6,321
-----			
Income (loss) from operations:			
Mattress Fabrics	\$	4,216	\$ 3,763
Upholstery Fabrics		(1,414)	450
		2,802	4,213
Total segment income from operations			
Unallocated corporate expenses		(770)	(935)
Restructuring and related charges		(416) (2)	(975)
		1,616	2,303
Total income from operations			
Interest expense		(431)	(818)
Interest income		34	58
Other expense		(14)	(232)
		\$ 1,205	\$ 1,311
Income before income taxes			
-----			

(1) The \$12 represents other operating costs associated with a closed plant facility. The \$2 represents other operating costs associated with a closed plant facility. These charges relate to the Upholstery Fabrics segment.

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- (2) The \$416 represents \$414 for employee termination benefits, \$14 for other operating costs associated with a closed plant facility, and a credit of \$12 for lease termination and other exit costs. Of this total charge, \$12, \$2, and \$402 are included in cost of sales, selling, general, and administrative expense, and restructuring expense, respectively. These charges relate to the Upholstery Fabrics segment.
- (3) The \$517 represents restructuring related charges of \$460 for other operating costs associated with closed plant facilities and \$57 for inventory markdowns. The \$26 represents other operating costs associated with closed plant facilities. These charges relate to the Upholstery Fabrics segment.
- (4) The \$975 represents \$486 for other operating costs associated with closed plant facilities, \$367 for lease termination costs, \$362 for write-downs of a building and equipment, \$57 for inventory markdowns, \$54 for asset movement costs, a credit of \$149 for employee termination benefits, and a credit of \$202 for sales proceeds received on equipment with no carrying value. Of this total charge, \$517, \$26, and \$432 are included in cost of sales, selling, general, and administrative expense, and restructuring expense, respectively. These charges relate to the Upholstery Fabrics segment.

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

(dollars in thousands)	August 3, 2008	April 27, 2008
Segment assets:		
Mattress Fabrics		
Current assets (5)	\$ 26,355	\$ 27,572
Assets held for sale	35	35
Non-compete agreement, net	717	789
Goodwill	4,114	4,114
Property, plant and equipment (6)	22,893	21,687
Total mattress fabrics assets	54,114	54,197
Upholstery Fabrics		
Current assets (5)	28,671	34,895
Assets held for sale	792	792
Property, plant and equipment (7)	11,020	11,214
Total upholstery fabrics assets	40,483	46,901
Total segment assets	94,597	101,098
Non-segment assets:		
Cash and cash equivalents	6,352	4,914
Assets held for sale	4,783	4,783
Income taxes receivable	160	438
Deferred income taxes	33,616	33,810

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Other current assets	1,627	1,328
Property, plant and equipment	37	38
Other assets	1,618	1,620
<hr/>		
Total assets	\$ 142,790	\$ 148,029
<hr/>		

(dollars in thousands)	Three months ended	
	August 3, 2008	July 29, 2007
<hr/>		
Capital expenditures (8):		
Mattress Fabrics	\$ 1,967	\$ 339
Upholstery Fabrics	305	507
<hr/>		
Total capital expenditures	\$ 2,272	\$ 846
<hr/>		
Depreciation expense:		
Mattress Fabrics	\$ 758	\$ 897
Upholstery Fabrics	500	550
<hr/>		
Total segment depreciation expense	\$ 1,258	\$ 1,447
<hr/>		

- (5) Current assets represent accounts receivable and inventory for the respective segment.
- (6) The \$22.9 million at August 3, 2008, represents property, plant, and equipment located in the U.S. of \$14.7 million, located in Canada of \$8.1 million, and various corporate allocations of \$160,000. The \$21.7 million at April 27, 2008, represents property, plant, and equipment located in the U.S. of \$13.1 million, located in Canada of \$8.4 million, and various corporate allocations of \$168,000.
- (7) The \$11.0 million at August 3, 2008, represents property, plant, and equipment located in China of \$8.9 million, located in the U.S. of \$1.6 million, and various corporate allocations of \$480,000. The \$11.2 million at April 27, 2008, represents property, plant, and equipment located in China of \$9.0 million, located in the U.S. of \$1.7 million, and various corporate allocations \$501,000.

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

18. Income Taxes

Effective Income Tax Rate

The effective income tax rate (income taxes as a percentage of income before income taxes) for the three month periods ended August 3, 2008 and July 29, 2007 were 35.2% and 35.1%, respectively. The company's income tax expense and effective income tax rate for the three month periods ended August 3, 2008 and

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July 29, 2007, were based upon the estimated effective income tax rate applicable for the full year after giving effect to any significant items related specifically to interim periods. The effective income tax rate can be impacted over the fiscal year by the mix and timing of actual earnings from the company's U.S. operations and foreign sources versus annual projections and changes in foreign currencies in relation to the U.S. dollar.

### Deferred Income Taxes

In making the judgment about the realization of the U.S. net deferred tax assets, management has considered both negative and positive evidence, and concluded that sufficient positive evidence exists to overcome the cumulative losses experienced in recent years. Specifically, management considered the following, among other factors: nature of the company's products; history of positive earnings in the mattress fabrics segment; capital projects that have further enhanced the company's globally competitive cost structure in the mattress fabrics segment; the incremental sales volume from the purchase of certain assets from International Textile Group, Inc. (ITG) related to the mattress fabric product line of ITG's Burlington House Division, the purchase of certain assets from Bodet & Horst related to its knitted mattress fabric operation; recent restructuring actions in the U.S. upholstery fabrics business to adjust the U.S. cost structure and bring U.S. manufacturing capacity in line with demand; development of offshore manufacturing and sourcing programs to meet changing demands of upholstery fabric customers in the U.S.; and inter-company agreements with the company's China subsidiaries are expected to be in place in fiscal 2009 for various consulting services and intellectual property. Management's analysis of taxable income also included the following considerations: none of the company's net operating loss carryforwards have previously expired unused; the U.S. federal carryforward period is 20 years; and the company's current income tax loss carryforwards principally expire in 14-20 years; fiscal 2022 through 2028.

### Uncertainty In Income Taxes

At August 3, 2008, the company had \$5.1 million of total gross unrecognized tax benefits, of which \$4.7 million represents the amount of gross unrecognized tax benefits that, if recognized would favorably affect the income tax rate in future periods. The total gross unrecognized tax benefits of \$5.1 million as of August 3, 2008, are classified as income taxes payable -long-term in the accompanying consolidated balance sheets.

The company anticipates that the amount of unrecognized tax benefits will

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increase by approximately \$550,000 by the end of the fiscal year. This increase primarily relates to double taxation under applicable tax treaties with foreign tax jurisdictions.

### 19. 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.

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The transfer to this reserve must be made before distributions of any dividend to shareholders. As of August 3, 2008, the company's statutory surplus reserve was \$1.5 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.

### 20. Commitments and Contingencies

The company leased a manufacturing facility in Chattanooga, Tennessee from Joseph E. Proctor d/b/a Jepco Industrial Warehouses (the "Landlord") for a term of 10 years. This lease expired on April 30, 2008. The company closed this facility approximately five years ago and has not occupied the facility except to provide supervision and security. The company continued to make its lease payments to the landlord as required by the lease. A \$1.4 million lawsuit was filed by the Landlord on April 10, 2008, in the Circuit Court for Hamilton County Tennessee to collect the remainder of the rent due under the lease for the months of March and April of 2008, additional expenses to be paid by the company for March and April 2008, including utilities, insurance, property taxes, and other tenant-paid expenses that would result in the triple net rent due the Landlord, and for extensive repairs, refitting, renovation, and capital improvement items the Landlord alleges he is entitled to have the company pay for. The Landlord unilaterally took possession of the leased premises on or about March 10, 2008, even though the lease was in good standing and the company was entitled to complete possession. Consequently, the company has paid their lease payments through March 10, 2008 but the Landlord has not accepted the company's position. The company will assert the repossession action of the Landlord as a bar to his further action under the lease to collect any items from the company. A significant portion of the Landlord's claim relates to the company's alleged liability for physical damage to the premises, to refit the premises to its original condition, and to make physical improvements or alterations to the premises. The company disputes the matters described in this litigation and intends to defend itself vigorously.

A lawsuit was filed against the company and other defendants (Chromatex, Inc., Rossville Industries, Inc., Rossville Companies, Inc. and Rossville Investments, Inc.) on February 5, 2008 in United States District Court for the Middle District of Pennsylvania. The plaintiffs are Alan Shulman, Stanley Siegel, Ruth Cherenon as Personal Representative of Estate of Alan Cherenon, and Adrienne Rolla and M.F. Rolla as Executors of the Estate of Joseph Byrnes. The plaintiffs

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were partners in a general partnership that formerly owned a manufacturing plant in West Hazleton, Pennsylvania (the "Site"). Approximately two years after this general partnership sold the Site to defendants Chromatex, Inc. and Rossville Industries, Inc. the company leased and operated the Site as part of the company's Rossville/Chromatex division. The lawsuit involves court judgments that have been entered against the plaintiffs and against defendant Chromatex, Inc. requiring them to pay costs incurred by the United States Environmental Protection Agency ("USEPA") responding to environmental contamination at the



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Site, in amounts approximating \$8.6 million. Neither USEPA nor any other governmental authority has asserted any claim against the company on account of these matters. The plaintiffs seek contribution from the company and other defendants and a declaration that the company and the other defendants are responsible for environmental response costs under environmental laws and certain agreements. The company does not believe it has any liability for the matters described in this litigation and intends to defend itself vigorously. In addition, the company has an indemnification agreement with certain other defendants in the litigation pursuant to which the other defendants agreed to indemnify the company for any damages it incurs as a result of the environmental matters that are subject of this litigation and consequently no reserve has been recorded.

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

### 21. Recently Issued Accounting Pronouncements

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

In March 2008, the FASB issued Statement No. 161, "Disclosures about Derivative Instruments and Hedging Activities, An Amendment of FASB Statement No. 133." SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", does not provide adequate information about how derivative and hedging activities affect an entity's financial position, financial performance, and cash flows. Accordingly, SFAS No. 161 requires enhanced disclosures about an entity's derivative and hedging activities and thereby improves transparency of financial reporting. SFAS No. 161 is effective for fiscal and interim periods beginning after November 15, 2008 and is effective for the company in third quarter of fiscal 2009. The adoption of the provisions of SFAS No. 161 is not expected to have a material effect on the company's financial position.

In April 2008, the FASB issued FASB Staff Position (FSP) No. 142-3, "Determination of the Useful Life of Intangible Assets" (FSP 142-3). The guidance is intended to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142, "Goodwill and Other Intangible Assets", and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141(R), "Business Combinations", and other guidance

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under U.S. generally accepted accounting principles (GAAP). FSP 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008 and interim periods within those years. This statement is effective for the company in fiscal 2010 and is not expected to have a material effect on our consolidated financial statements to the extent we do not enter into a business acquisition subsequent to adoption.

In May 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles (SFAS 162)." SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity GAAP in the United States (the GAAP hierarchy). SFAS 162 is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU section 411, "The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles." The adoption of SFAS 162 is not expected to have a material impact on the company's results of operations, financial condition, and equity.

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### CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING INFORMATION

This report and the exhibits attached hereto contain statements that may be deemed "forward-looking statements" within the meaning of the federal securities laws, including the Private Securities Litigation Reform Act of 1995 (Section 27A of the Securities Act of 1933 and Section 27A of the Securities and Exchange Act of 1934). Such statements are inherently subject to risks and uncertainties. Further, forward looking statements are intended to speak only as of the date on which they are made. Forward-looking statements are statements that include projections, expectations or beliefs about future events or results or otherwise are not statements of historical fact. Such statements are often but not always characterized by qualifying words such as "expect," "believe," "estimate," "plan" and "project" and their derivatives, and include but are not limited to statements about expectations for the company's future operations or success, sales, gross profit margins, operating income, SG&A or other expenses, and earnings, as well as any statements regarding future economic or industry trends or future developments. Factors that could influence the matters discussed in such statements include the level of housing starts and sales of existing homes, consumer confidence, trends in disposable income, increases in utility and energy costs, and general economic conditions. Decreases in these economic indicators could have a negative effect on the company's business and prospects. Likewise, increases in interest rates, particularly home mortgage rates, and increases in consumer debt or the general rate of inflation, could affect the company adversely. In addition, changes in consumer preferences for various categories of furniture and bedding coverings, as well as changes in costs to produce such products (including import duties and quotas or other import costs) can have a significant effect on demand for the company's products. Changes in the value of the U.S. dollar versus other currencies can affect the company's financial results because a significant portion of the company's operations are located outside the United States. Strengthening of the U.S. dollar against other currencies could make the company's products less competitive on the basis of price in markets outside the United States, and strengthening of currencies in Canada and China can have a negative impact on the company's sales of

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products produced in those countries. Further, economic and political instability in international areas could affect the company's operations or sources of goods in those areas, as well as demand for the company's products in international markets. Also, the level of success in integrating the acquisition of assets from Bodet & Horst could affect the company's ability to meet its profitability goals. Finally, unanticipated delays or costs in executing restructuring actions could cause the cumulative effect of restructuring actions to fail to meet the objectives set forth by management. Further information about these factors, as well as other factors that could affect the company's future operations or financial results and the matters discussed in forward-looking statements are included in Item 1A "Risk Factors" section in the company's Form 10-K filed with the Securities and Exchange Commission on July 9, 2008 for the fiscal year ended April 27, 2008.

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

#### Results of Operations

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

#### Overview

The company's fiscal year is the 52 or 53 week period ending on the Sunday closest to April 30. The company's three months ended August 3, 2008, and July 29, 2007, represent 14 and 13 week periods, respectively. The company has operations classified into two business segments: mattress fabrics and upholstery fabrics. The mattress fabrics segment primarily manufacturers, sources and sells fabrics to bedding manufacturers. The upholstery fabrics segment sources, manufactures and sells fabrics primarily to residential and

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commercial (contract) furniture manufacturers. We believe that Culp is the largest marketer of mattress fabrics in North America, and one of the largest marketers of upholstery fabrics for furniture in North America, both measured by total sales.

The company evaluates the operating performance of its segments based upon income (loss) from operations before restructuring and related charges or credits and certain unallocated corporate expenses. Unallocated corporate expenses represent primarily compensation and benefits for certain executive officers and all costs related to being a public company. Segment assets include assets used in operations of each segment and primarily consist of accounts receivable, inventories, and property, plant, and equipment. The mattress fabrics segment also includes assets held for sale, goodwill and other non-current assets associated with the ITG acquisition in its segment assets. The upholstery fabrics segment also includes assets held for sale in its segment assets.

The following tables set forth the net sales, gross profit, selling, general and administrative expenses and operating income (loss) by segment for the three months ended August 3, 2008, and July 29, 2007.

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CULP, INC.  
 SALES, GROSS PROFIT AND OPERATING INCOME (LOSS) BY SEGMENT  
 FOR THE THREE MONTHS ENDED AUGUST 3, 2008 AND JULY 29, 2007

(Amounts in thousands)

	THREE MONTHS ENDED (UNAUDITED)			
	Amounts			Perce
	August 3, 2008	July 29, 2007	% Over (Under)	August 3, 2008
Net Sales by Segment				
Mattress Fabrics	\$ 35,561	36,536	(2.7)%	59.9
Upholstery Fabrics	23,760	28,694	(17.2)%	40.1
Net Sales	\$ 59,321	65,230	(9.1)%	100.0
Gross Profit by Segment				Gross
Mattress Fabrics	\$ 6,344	5,805	9.3%	17.8
Upholstery Fabrics	1,070	3,768	(71.6)%	4.5
Subtotal	7,414	9,573	(22.6)%	12.5
Restructuring related charges	(12) (1)	(517) (3)	(97.7)%	(0.0)
Gross Profit	\$ 7,402	9,056	(18.3)%	12.5
Sales, General and Administrative expenses by Segment				Perce
Mattress Fabrics	\$ 2,128	2,042	4.2%	6.0
Upholstery Fabrics	2,484	3,318	(25.1)%	10.5
Unallocated Corporate expenses	770	935	(17.6)%	1.3
Subtotal	5,382	6,295	(14.5)%	9.1
Restructuring related charges	2 (1)	26 (3)	(92.3)%	0.0

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Selling, General and Administrative expenses	5,384	6,321	(14.8)%	9.1
	=====	=====	=====	=====
Operating income (loss) by Segment				
-----				
Mattress Fabrics	\$ 4,216	3,763	12.0 %	11.9
Upholstery Fabrics	(1,414)	450	N.M.	(6.0)
Unallocated corporate expenses	(770)	(935)	17.6 %	(1.3)
	-----	-----	-----	-----
Subtotal	2,032	3,278	(38.0)%	3.4
Restructuring expense and restructuring related charges	(416) (2)	(975) (4)	(57.3)%	(0.7)
	-----	-----	-----	-----
Operating income	\$ 1,616	2,303	(29.8)%	2.7
	=====	=====	=====	=====
Depreciation by Segment				
-----				
Mattress Fabrics	\$ 758	897	(15.5)%	
Upholstery Fabrics	500	550	(9.1)%	
	-----	-----	-----	
Total Depreciation	1,258	1,447	(13.1)%	
	=====	=====	=====	

- (1) The \$12 represents other operating costs associated with a closed plant facility. The \$2 represents other operating costs associated with a closed plant facility.
- (2) The \$416 represents \$414 for employee termination benefits, \$14 for other operating costs associated with a closed plant facility, and a credit of \$12 for lease termination and other exit costs. Of this total charge, \$12, \$2, and \$402 are included in cost of sales, selling, general, and administrative expense, and restructuring expense, respectively.
- (3) The \$517 represents restructuring related charges of \$460 for other operating costs associated with closed plant facilities and \$57 for inventory markdowns. The \$26 represents other operating costs associated with a closed plant facility.
- (4) The \$975 represents \$486 for other operating costs associated with closed plant facilities, \$367 for lease termination costs, \$362 for write-downs of a building and equipment, \$57 for inventory markdowns, \$54 for asset movement costs, a credit of \$149 for employee termination benefits, and a credit of \$202 for sales proceeds received on equipment with no carrying value. Of this total charge, \$517, \$26 and \$432 are included in cost of sales, selling, general, and administrative expense, and restructuring expense, respectively.

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Three months ended August 3, 2008 compared with the Three Months ended July 29, 2007

Overview

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For the three months ended August 3, 2008, net sales decreased 9% to \$59.3 million compared with \$65.2 million for the first quarter of fiscal 2008. The company reported net income of \$781,000 or \$0.06 per diluted share, for the first quarter of fiscal 2009, which included restructuring and related pre-tax charges of \$416,000. The company reported net income of \$851,000, or \$0.07 per diluted share, for the first quarter of fiscal 2008, which included restructuring and related pre-tax charges of \$975,000.

### Restructuring and Related Charges

On September 3, 2008, the board of directors approved changes to the upholstery fabric operations, including the consolidation of facilities in China and reduction of excess manufacturing capacity, which will involve exit and disposal charges to be incurred by the company. This action is in response to the extremely challenging industry conditions for upholstery fabrics and is expected to result in pre-tax charges of approximately \$3.9 million, of which \$3.5 million is expected to be non-cash items and \$400,000 is expected to result in cash expenditures. The company anticipates the charges to be made up of approximately \$2.1 million for accelerated depreciation related to leasehold improvements on facilities being exited, \$1.4 million for fixed asset write-downs, \$250,000 for lease termination costs, and \$100,000 for employee termination benefits and other costs related to dismantling, disposal, and moving of equipment and related assets. All these charges are expected to be incurred in the company's second and third quarters of fiscal 2009. The plant consolidations are expected to be completed by the end of the third quarter of fiscal 2009.

During the first quarter of fiscal 2009, total restructuring and related charges were \$416,000, of which \$414,000 related to employee termination benefits, \$14,000 for other operating costs associated with a closed plant facility, and a credit of \$12,000 for lease termination and other exit costs. Of this total charge, \$12,000 was recorded in cost of sales, \$2,000 was recorded in selling, general, and administrative expense, and \$402,000 was recorded in restructuring expense in the 2009 Consolidated Statement of Net Income. These charges primarily relate to the December 2006 Upholstery Fabrics restructuring plan.

During the first quarter of fiscal 2008, total restructuring and related charges were \$975,000, of which \$486,000 related to other operating costs associated with closed plant facilities, \$367,000 for lease termination costs, \$362,000 for write-downs of a building and equipment, \$57,000 for inventory markdowns, \$54,000 for asset movement costs, a credit of \$149,000 for employee termination benefits, and a credit of \$202,000 for sales proceeds received on equipment with no carrying value. Of this total charge, \$517,000 was recorded in cost of sales, \$26,000 was recorded in selling, general, and administrative expense, and \$432,000 was recorded in restructuring expense in the 2008 Consolidated Statement of Net Income. These charges primarily relate to the December 2006 Upholstery Fabrics restructuring plan.

### Mattress Fabrics Segment

#### Asset Acquisition

Pursuant to an Asset Purchase Agreement among the company, Bodet & Horst USA, LP and Bodet & Horst GMBH & Co. KG (collectively "Bodet & Horst") dated August 11, 2008, the company purchased certain assets and assumed certain liabilities of the knitted mattress fabric operation of Bodet & Horst, including its manufacturing operation in High Point, North Carolina. The purchase involves the equipment, inventory, and intellectual property associated with the High Point manufacturing operation, which has served as the company's primary source of knitted mattress fabric for six years. Demand for this product line has grown significantly, as knits are increasingly being utilized on mattresses at volume

retail price points. The company is assuming the lease of the building where the operation is located and intends to continue operating the business in that location. The purchase price for the assets is cash in the amount of \$10.5 million, plus the assumption of certain liabilities, subject to adjustment after closing for changes in working capital through the date of closing. Also, in connection with the purchase, the company entered into a six-year consulting and non-compete agreement with the principal owner of Bodet & Horst, providing for payments to the owner in the amount of \$75,000 per year for the agreement's full six-year term.

The acquisition was financed by \$11.0 million of unsecured notes pursuant to a Note Purchase Agreement ("2008 Note Agreement") dated August 11, 2008. The 2008 Note Agreement has a fixed interest rate of 8.01% and a term of seven years. Principal payments of \$2.2 million per year are due on the notes beginning three years from the date of the 2008 Note Agreement. The 2008 Note Agreement contains customary financial and other covenants as defined in the 2008 Note Agreement.

In connection with the 2008 Note Agreement, the company entered into a Consent and Fifth Amendment (the "Consent and Amendment") that amends the previously existing unsecured note purchase agreements. The purpose of the Consent and Amendment is for the existing note holders to consent to the 2008 Note Agreement and to provide that certain financial covenants in favor of the existing note holders will be on the same terms as those contained in the 2008 Note Agreement.

Net Sales -- Mattress fabrics (known as mattress ticking) net sales for the first quarter of fiscal 2009 were \$35.6 million, a 3% decrease compared with \$36.5 million for the first quarter of fiscal 2008. On a unit volume basis, total yards sold for the first quarter of fiscal 2009 decreased by 4.7% compared with the first quarter of fiscal 2008. This trend reflects moderately softer consumer bedding demand in the first quarter of fiscal 2009 and the planned discontinuance of certain products from the ITG acquisition.

The average selling price of \$2.49 for the first quarter of fiscal 2009 increased 2.1% over the same period a year ago. This trend reflects a shift in product mix.

Operating Income -- For the first quarter of fiscal 2009, the mattress fabrics segment reported operating income of \$4.2 million, or 11.9% of net sales, compared to \$3.8 million, or 10.3% of net sales, for the first quarter of fiscal 2008. Selling, general, and administrative expenses as a percentage of net sales were 6.0% in the first quarter of fiscal 2009 compared with 5.6% in the first quarter of fiscal 2008.

Mattress fabrics continues to be a driving force in the company's business and accounted for 60% of the company's net sales for the first quarter of fiscal 2009 compared with 56% for the first quarter of fiscal 2008. During the first quarter of fiscal 2009, the company completed a \$5.0 million capital project to significantly strengthen its woven fabrics manufacturing operations and provide further reactive capacity to its customers. Additionally, the expanded capacity this capital project provides, should effectively position the company to pursue future growth opportunities. The recent acquisition of the knitted mattress fabrics operation of Bodet & Horst will further enhance the company's strong service platform with improved supply logistics from pattern inception to fabric delivery, allowing accelerated responsiveness and greater stability. With the weaving expansion and the completion of the Bodet & Horst acquisition, the company now has a large and modern, vertically integrated manufacturing platform in all major product categories of the mattress fabrics industry.

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Segment assets -- Segment assets consist of accounts receivable, inventory, assets held for sale, a non-compete agreement associated with the ITG acquisition, goodwill, and property, plant, and equipment. As of August 3, 2008, accounts receivable and inventory totaled \$26.4 million compared with \$27.6 million at April 27, 2008. As of August 3, 2008, and April 27, 2008, the carrying value of assets held for sale was \$35,000. The company expects that the final sale and disposal of these assets will be completed within a year from the date the plan of sale was adopted.

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As of August 3, 2008 and April 27, 2008, the carrying value of the non-compete agreement was \$717,000 and \$789,000, respectively. As of August 3, 2008 and April 27, 2008, the carrying value of the segment's goodwill was \$4.1 million.

Also as of August 3, 2008, property, plant and equipment totaled \$22.9 million compared with \$21.7 million at April 27, 2008. The \$22.9 million at August 3, 2008, represents property, plant, and equipment located in the U.S. of \$14.7 million, located in Canada of \$8.1 million, and various corporate allocations of \$160,000. The \$21.7 million at April 27, 2008, represents property, plant, and equipment located in the U.S. of \$13.1 million, located in Canada of \$8.4 million, and various corporate allocations of \$168,000.

### Upholstery Fabrics Segment

Net Sales -- Upholstery fabric net sales (which include both fabric and cut and sewn kits) for the first quarter of fiscal 2009 were \$23.8 million, a 17% decline compared with \$28.7 million in the first quarter of fiscal 2008. On a unit volume basis, total yards sold (which excludes fabric used in cut and sewn kits) for the first quarter of fiscal 2009 decreased by 17% compared with the first quarter of fiscal 2008. Average selling prices of \$4.36 increased 3.5% for the first quarter of fiscal 2009 compared with the first quarter of fiscal 2008. Upholstery fabrics sales reflect substantially lower demand industry wide, as well as continued very weak demand for U.S. produced upholstery fabrics, driven by consumer preference for leather and suede furniture and other imported furniture and fabrics. Net sales of upholstery fabrics produced outside the company's U.S. manufacturing operations were \$17.4 million in the first quarter of fiscal 2009, a decrease of 8% from \$18.9 million in the first quarter of fiscal 2008. Net sales of U.S. produced upholstery fabrics were \$6.3 million in the first quarter of fiscal 2009, a decrease of 35% from \$9.8 million in the first quarter of fiscal 2008.

Operating Income (Loss) - The upholstery fabrics segment had an operating loss for the first quarter of fiscal 2009 of \$1.4 million compared with operating income of \$450,000 for the first quarter of fiscal 2008. These results reflect the very difficult operating environment for the retail furniture industry. The uncertain economy, housing crisis, and high energy costs have continued to significantly influence consumer demand for furniture and have adversely affected the company's upholstery fabrics business for both U.S. produced and non U.S. produced goods. In response to this environment and our first quarter results, the company immediately put into operation a profit improvement plan in the upholstery fabrics business, including the following major actions in the second quarter of fiscal 2009:

- o Implemented a modest price increase on certain upholstery fabrics during the second fiscal quarter; and wherever possible, obtain price concessions from suppliers on certain high volume items where we could not increase our selling prices.



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- o Implemented a 20% reduction in selling, general and administrative expenses, totaling approximately \$2.0 million on an annual basis. This initiative was completed by the end of August 2008.
- o Consolidating our China operations into fewer facilities and reducing excess manufacturing capacity over the next five months, which will lower costs by approximately \$2.0 million on an annual basis. (See Restructuring and Related Charges section for further details).

Selling, general and administrative expenses for first quarter of fiscal 2009 were down 25% from the first quarter of fiscal 2008. This reduction is due to the company's restructuring activities, and this year over year improvement is expected to continue throughout fiscal 2009 based on the above actions described above.

Management remains cautiously optimistic about the company's long-term prospects in the upholstery fabrics business because of the following: a) we have been

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receiving significantly higher fabric placements, including cut and sewn kits with a broader base of customers; b) a declining base of competitors due to the challenging economic environment; c) the improving value we are providing to our customers from our China and U.S. operations; d) the benefits realized through operational improvements being made in our Anderson, South Carolina, velvet facility; and e) the expected results from our profit improvement plan. While these are all favorable indicators, management remains committed to taking additional steps if necessary to address the low profitability of the company's upholstery fabric operations, regardless of prevailing economic and business conditions. The company could experience additional inventory markdowns, write-downs of its property, plant, and equipment, and further restructuring charges in the upholstery fabric operations if sales and profitability continue to decline and further restructuring actions become necessary.

Segment Assets -- Segment assets consist of accounts receivable, inventory, property, plant, and equipment, and assets held for sale. As of August 3, 2008, accounts receivable and inventory totaled \$28.7 million compared to \$34.9 million at April 27, 2008. This decline reflects lower sales and improved working capital management. As of August 3, 2008, property, plant, and equipment totaled \$11.0 million compared to \$11.2 million at April 27, 2008. The \$11.0 million at August 3, 2008, represents property, plant, and equipment located in China of \$8.9 million, located in the U.S. of \$1.6 million, and various corporate allocations of \$480,000. The \$11.2 million at April 27, 2008, represents property, plant, and equipment located in China of \$9.0 million, located in the U.S. of \$1.7 million, and various corporate allocations of \$501,000.

At August 3, 2008 and April 27, 2008, this segment had assets held for sale with a carrying value of \$792,000 for certain equipment related to the company's U.S. upholstery fabric operations. The company expects that the final sale and disposal of these assets will be completed within a year from the date the plan of sale was adopted.

### Other Income Statement Categories

Selling, General and Administrative Expenses - Selling, general, and administrative expenses (SG&A) for the company as a whole were \$5.4 million for the first quarter of fiscal 2009 compared with \$6.3 million for the first quarter of fiscal 2008, a decrease of 15%. As a percent of net sales, SG&A expenses were 9.1% in the first quarter of fiscal 2009 compared with 9.7% in the

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first quarter of fiscal 2008. This trend primarily reflects the company's restructuring efforts associated with its U.S. upholstery fabric operations.

Interest Expense (Income) -- Interest expense for the first quarter of fiscal 2009 was \$431,000 compared to \$818,000 for the first quarter of fiscal 2008. This trend primarily reflects lower outstanding balances on the company's existing unsecured term notes and the decrease in the one-month LIBOR, which is the interest rate upon which the company's real estate loans are based. Interest expense is expected to increase for the remainder of fiscal 2009 due to the financing needed for the Bodet & Horst asset acquisition. Interest income was \$34,000 for the first quarter of fiscal 2009 compared to \$58,000 for the first quarter of fiscal 2008. This trend reflects lower cash and cash equivalent balances, which were invested in money market funds.

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Other Expense - Other expense for first quarter of fiscal 2009 was \$14,000 compared with \$232,000 for the first quarter of fiscal 2008. This change primarily reflects fluctuations in foreign currency exchange rates for subsidiaries domiciled in China and Canada.

### Income Taxes

#### Effective Income Tax Rate

The effective income tax rates (income taxes as a percentage of income before income taxes) for the three month periods ended August 3, 2008 and July 29, 2007 were 35.2% and 35.1%, respectively. The company's income tax expense and effective income tax rates for the three month periods ended August 3, 2008 and July 29, 2007, were based upon the estimated effective income tax rate applicable for the full year after giving effect to any significant items related specifically to interim periods. The effective income tax rate can be impacted over the fiscal year by the mix and timing of actual earnings from the company's U.S. operations and foreign sources versus annual projections and changes in foreign currencies in relation to the U.S. dollar.

#### Deferred Income Taxes

In making the judgment about the realization of the U.S. net deferred tax assets, management has considered both negative and positive evidence, and concluded that sufficient positive evidence exists to overcome the cumulative losses experienced in recent years. Specifically, management considered the following, among other factors: nature of the company's products; history of positive earnings in the mattress fabrics segment; capital projects that have further enhanced the company's globally competitive cost structure in the mattress fabrics segment; the incremental sales volume from the purchase of certain assets from International Textile Group, Inc. (ITG) related to the mattress fabric product line of ITG's Burlington House Division, the purchase of certain assets from Bodet & Horst related to its knitted mattress fabric operation; recent restructuring actions in the U.S. upholstery fabrics business to adjust the U.S. cost structure and bring U.S. manufacturing capacity in line with demand; development of offshore manufacturing and sourcing programs to meet changing demands of upholstery fabric customers in the U.S.; and inter-company agreements with the company's China subsidiaries are expected to be in place in fiscal 2009 for various consulting services and intellectual property. Management's analysis of taxable income also included the following considerations: none of the company's net operating loss carryforwards have previously expired unused; the U.S. federal carryforward period is 20 years; and the company's current income tax loss carryforwards principally expire in 14-20 years; fiscal 2022 through 2028.

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### Uncertainty In Income Taxes

At August 3, 2008, the company had \$5.1 million of total gross unrecognized tax benefits, of which \$4.7 million represents the amount of gross unrecognized tax benefits that, if recognized would favorably affect the income tax rate in future periods. The total gross unrecognized tax benefits of \$5.1 million as of August 3, 2008, are classified as income taxes payable -long-term in the accompanying consolidated balance sheets.

The company anticipates that the amount of unrecognized tax benefits will increase by approximately \$550,000 by the end of the fiscal year. This increase primarily relates to double taxation under applicable tax treaties with foreign tax jurisdictions.

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### Liquidity and Capital Resources

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

Cash and cash equivalents as of August 3, 2008, were \$6.4 million compared with \$4.9 million as of April 27, 2008. The company's cash position reflects improvement in cash flow from operations of \$3.3 million for the three months ended August 3, 2008 compared with \$1.1 million for the three months ended July 29, 2007. This increase in cash flow from operations reflects significant improvement in working capital management. The company's cash position also reflects cash outlays for capital expenditures of \$986,000, and payments on vendor-financed capital expenditures, a capital lease obligation, and long-term debt totaling \$899,000 for the three months ended August 3, 2008.

The company is taking further steps to support its liquidity, including ongoing efforts to improve working capital turnover, sell certain assets, and further reduce selling, general, and administrative expenses in its upholstery fabrics segment. Effective October 29, 2007, the company adopted a plan to sell its corporate headquarters, as the company is only utilizing one-half of the available space and with the sale can lower costs and reduce debt. The carrying value of the company's corporate headquarters is approximately \$4.8 million and is recorded in assets held for sale in the Consolidated Balance Sheets. The company will use the sales proceeds will be applied against the outstanding \$6.3 million mortgage balance.

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

Working Capital -- Accounts receivable as of August 3, 2008 decreased \$3.7 million or 16% in comparison to July 29, 2007. This decrease is primarily related to the decrease in sales volume in the first quarter of fiscal 2009 compared with the first quarter of fiscal 2008. Days sales outstanding totaled 31 days at August 3, 2008 and July 29, 2007, respectively. Inventories as of August 3, 2008, decreased \$7.3 million or 17% in comparison to July 29, 2007. This decrease in inventories primarily reflects lower sales volume and improved inventory management. Inventory turns for the first quarter of fiscal 2009 were 5.9 versus 5.4 for the first quarter of fiscal 2008. Operating working capital (comprised of accounts receivable and inventories, less accounts payable) was

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\$35.5 million at August 3, 2008, down from \$48.1 million at July 29, 2007. Working capital turnover was 6.0 and 5.2 at August 3, 2008 and July 29, 2007, respectively.

### Financing Arrangements

#### Unsecured Term Notes- Bodet & Horst Acquisition

In connection with the Bodet & Horst Asset Purchase Agreement, the company entered into the 2008 Note Agreement dated August 11, 2008. The 2008 Note Agreement provides for the issuance of \$11.0 million of unsecured term notes with a fixed interest rate of 8.01% and a term of seven years. Principal payments of \$2.2 million per year are due on the notes beginning three years from the date of the 2008 Note Agreement. The 2008 Note Agreement contains customary financial and other covenants as defined in the 2008 Note Agreement.

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#### Unsecured Term Notes- Existing

The company's existing unsecured term notes have a fixed interest rate of 8.80% (payable semi-annually in March and September and subject to prepayment provisions each fiscal quarter as defined in the agreement) and are payable over an average remaining term of 1.6 years through March 2010. The principal payments are required to be paid in annual installments over the next two years as follows: March 2009 - \$7.2 million; and March 2010 - \$7.1 million.

In connection with the 2008 Note Agreement, the company entered into a Consent and Amendment that amends the previously existing unsecured note purchase agreements. The purpose of the Consent and Amendment is for the existing note holders to consent to the 2008 Note Agreement and to provide that certain financial covenants in favor of the existing note holders will be on the same terms as those contained in the 2008 Note Agreement.

#### Real Estate Loan - I

The company has a real estate loan that is secured by a lien on the company's corporate headquarters office located in High Point, NC. This term loan bears interest at the one-month LIBOR plus an adjustable margin (all in rate of 4.96% at August 3, 2008) based on the company's debt/EBITDA ratio, as defined in the agreement and is payable in monthly installments through September 2010, with a final payment of \$3.3 million in October 2010.

#### Real Estate Loan - II

The company has a term loan in the amount of \$2.5 million in connection with the ITG asset purchase agreement. This term loan is secured by a lien on the company's corporate headquarters office located in High Point, NC and bears interest at the one-month LIBOR plus an adjustable margin (all in rate of 5.48% at August 3, 2008) based on the company's debt/EBITDA ratio, as defined in the agreement. This agreement requires the company to pay interest monthly with the entire principal due on June 30, 2010.

#### Revolving Credit Agreement - United States

The company has an unsecured credit agreement that provides for a revolving loan commitment of \$6.5 million, including letters of credit up to \$5.5 million. This agreement expires on December 31, 2008, and bears interest at the one-month LIBOR plus an adjustable margin (all in rate of 4.96% at August 3, 2008) based on the company's debt/EBITDA ratio, as defined in the agreement. As of August 3,

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2008, there were \$1.3 million in outstanding letters of credit (all of which related to workers compensation) and no borrowings outstanding under the agreement.

### Revolving Credit Agreement - China

The company's China subsidiary has an unsecured revolving credit agreement with a bank in China to provide a line of credit available up to approximately \$5.0 million, of which approximately \$1.0 million includes letters of credit. This agreement bears interest at a rate determined by the Chinese government. There were no borrowings outstanding under the agreement as of August 3, 2008.

### Canadian Government Loan

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

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### Overall

The company's loan agreements require that the company maintain compliance with certain financial ratios. At August 3, 2008, the company was in compliance with these financial covenants.

As of August 3, 2008, the principal payment requirements of long-term debt during the next five years are: Year 1 - \$7.4 million; Year 2 - \$10.0 million; Year 3 - \$3.5 million; Year 4 - \$195,000; Year 5 - \$195,000; and thereafter - \$65,000.

### Capital Expenditures

Capital expenditures for the three months ended August 3, 2008 were approximately \$2.3 million, of which \$986,000 was paid in cash and approximately \$1.4 million was financed through a capital lease. The capital spending of \$2.3 million consisted of \$2.0 million from the mattress fabrics segment and \$305,000 from the upholstery fabrics segment. Depreciation expense for the three months ended August 3, 2008 was approximately \$1.3 million, of which \$758,000 related to the mattress fabrics segment and \$500,000 related the upholstery fabrics segment.

The company currently expects total capital expenditures to be approximately \$4.0 million in fiscal 2009, of which \$2.6 million will be paid in cash and \$1.4 million was financed through a capital lease on a project initiated prior to the end of fiscal 2008. The capital spending of \$4.1 million primarily relates to the mattress fabrics segment. The company currently estimates depreciation expense to be \$8.1 million for fiscal 2009, of which \$4.0 million relates to the mattress fabrics segment and \$4.1 million relates to the upholstery fabrics segment (which includes \$2.1 million of accelerated depreciation related to leasehold improvements on facilities exited in China). The company expects the availability of funds from cash flow from operations and its revolving credit lines to fund its remaining capital needs.

The company has certain vendor financed arrangements regarding capital expenditures that bear interest with fixed interest rates ranging from 6% to 7.14%. The payment requirements for accounts payable-capital expenditures (both vendor-financed and non-vendor financed during the three years are: Year 1 - \$1.0 million; Year 2 - \$725,000; and Year 3 - \$550,000.

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In May 2008, the company entered into a capital lease to finance the construction of certain equipment related to its mattress fabrics segment. The lease agreement contains a bargain purchase option and bears interest at 8.5%. The lease agreement requires principal payments totaling \$1.4 million to commence on July 1, 2008, and to be paid in quarterly installments through April 2010. This agreement is secured by equipment with a carrying value of \$2.4 million. The principal payments required over the next two years are as follows: Year 1 - \$692,000; and Year 2 - \$458,000.

### Critical Accounting Policies and Recent Accounting Developments

Significant accounting policies adopted by the company in fiscal 2009 are as follows:

#### Fair Value Measurements:

The company adopted SFAS No. 157, Fair Value Measurements ("SFAS 157") and SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities ("SFAS 159"), on April 28, 2008. SFAS 157 (1) creates a single definition of fair value, (2) establishes a framework for measuring fair value, and (3) expands disclosure requirements about items measured at fair value. SFAS 157 applies to both items recognized and reported at fair value in the financial statements and items disclosed at fair value in the notes to the financial statements. SFAS 157 does not change existing accounting rules governing what can or what must be recognized and reported at fair value in the company's

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financial statements, or disclosed at fair value in the company's notes to the financial statements. Additionally, SFAS 157 does not eliminate practicability exceptions that exist in accounting pronouncements amended by SFAS 157 when measuring fair value. As a result, the company will not be required to recognize any new assets or liabilities at fair value.

Prior to SFAS 157, certain measurements of fair value were based on the price that would be paid to acquire an asset, or received to assume a liability (an entry price). SFAS 157 clarifies the definition of fair value as the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date (that is, an exit price). The exit price is based on the amount that the holder of the asset or liability would receive or need to pay in an actual transaction (or in a hypothetical transaction if an actual transaction does not exist) at the measurement date. In some circumstances, the entry and exit price may be the same; however, they are conceptually different.

Fair value is generally determined based on quoted market prices in active markets for identical assets or liabilities. If quoted market prices are not available, the company uses valuation techniques that place greater reliance on observable inputs and less reliance on unobservable inputs. In measuring fair value, the company may make adjustments for risks and uncertainties, if a market participant would include such an adjustment in its pricing.

SFAS 157 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 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

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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.

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

Fair value measurements at August 3, 2008 using:

	Quoted prices in active markets for identical assets	Significant other observable inputs	Significant unobservable inputs	
(amounts in thousands)	Level 1	Level 2	Level 3	
Assets:				
None	Not applicable	Not applicable	Not applicable	No
Liabilities:				
Interest Rate Swap Agreement	Not applicable	66	Not applicable	

As shown above, the interest rate swap derivative is valued based on fair value provided by the company's bank and is classified within level 2 of the fair value hierarchy. The determination of where an asset or liability falls in the hierarchy requires significant judgment. The company evaluates its hierarchy

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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, the company expects that changes in classifications between different levels will be rare.

Most derivative contracts are not listed on an exchange and require the use of valuation models. Consistent with SFAS 157, the company attempts to maximize the use of observable market inputs in its models. When observable inputs are not available, the company defaults to unobservable inputs. Derivatives valued based on models with significant unobservable inputs and that are not actively traded, or trade activity is one way, are classified within level 3 of the fair value hierarchy.

Some financial statement preparers have reported difficulties in applying SFAS 157 to certain nonfinancial assets and nonfinancial liabilities, particularly those acquired in business combinations and those requiring a determination of impairment. To allow the time to consider the effects of the implementation issues that have arisen, the FASB issued FSP FAS 157-2 ("FSP 157-2") on February 12, 2008 to provide a one-year deferral of the effective date of SFAS 157 for

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nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed in financial statements at fair value on a recurring basis (that is, at least annually). As a result of FSP 157-2, the company has not yet adopted SFAS 157 for nonfinancial assets and liabilities that are valued at fair value on a non-recurring basis. FSP 157-2 is effective for the company in fiscal 2010 and the company is evaluating the impact that the application of SFAS 157 to those nonfinancial assets and liabilities will have on its financial statements.

In February 2007, the FASB issued SFAS 159, The Fair Value Option for Financial Assets and Financial Liabilities. SFAS 159 provides the company with an option to elect fair value as the initial and subsequent measurement attribute for most financial assets and liabilities and certain other items. The fair value option election is applied on an instrument-by-instrument basis (with some exceptions), is irrevocable, and is applied to an entire instrument. The election may be made as of the date of initial adoption for existing eligible items. Subsequent to initial adoption, the company may elect the fair value option at initial recognition of eligible items, on entering into an eligible firm commitment, or when certain specified reconsideration events occur. Unrealized gains and losses on items for which the fair value option has been elected will be reported in earnings.

Upon adoption of SFAS 159 on April 28, 2008, the company did not elect to account for any assets and liabilities under the scope of SFAS 159 at fair value.

### Recently Issued Accounting Standards

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

In March 2008, the FASB issued Statement No. 161, "Disclosures about Derivative Instruments and Hedging Activities, An Amendment of FASB Statement No. 133." SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", does not provide adequate information about how derivative and hedging activities affect an entity's financial position, financial performance, and cash flows. Accordingly, SFAS No. 161 requires enhanced disclosures about an entity's derivative and hedging activities and thereby improves transparency of financial reporting. SFAS No. 161 is effective for fiscal and interim periods

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beginning after November 15, 2008 and is effective for the company in third quarter of fiscal 2009. The adoption of the provisions of SFAS No. 161 is not expected to have a material effect on the company's financial position.

In April 2008, the FASB issued FASB Staff Position (FSP) No. 142-3, "Determination of the Useful Life of Intangible Assets" (FSP 142-3). The guidance is intended to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142, "Goodwill and Other Intangible



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Assets", and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141(R), "Business Combinations", and other guidance under U.S. generally accepted accounting principles (GAAP). FSP 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008 and interim periods within those years. This statement is effective for the company in fiscal 2010 and is not expected to have a material effect on our consolidated financial statements to the extent we do not enter into a business acquisition subsequent to adoption.

In May 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles (SFAS 162)." SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity GAAP in the United States (the GAAP hierarchy). SFAS 162 is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU section 411, "The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles." The adoption of SFAS 162 is not expected to have a material impact on the company's results of operations, financial condition, and equity.

### Contractual Obligations

#### Unsecured Term Notes- Bodet & Horst Acquisition

In connection with the Bodet & Horst Asset Purchase Agreement, the company entered into the 2008 Note Agreement dated August 11, 2008. The 2008 Note Agreement provides for the issuance of \$11.0 million of unsecured term notes with a fixed interest rate of 8.01% and a term of seven years. Principal payments of \$2.2 million per year are due on the notes beginning three years from the date of the 2008 Note Agreement. The 2008 Note Agreement contains customary financial and other covenants as defined in the 2008 Note Agreement.

#### Capital Lease Obligation

In May 2008, the company entered into a capital lease to finance the construction of certain equipment related to its mattress fabrics segment. The lease agreement contains a bargain purchase option and bears interest at 8.5%. The lease agreement requires principal payments totaling \$1.4 million to commence on July 1, 2008, and to be paid in quarterly installments through April 2010. This agreement is secured by equipment with a carrying value of \$2.4 million. The principal payments required over the next two years are as follows: Year 1 - \$692,000; and Year 2 - \$458,000.

### Inflation

The cost of certain of the company's raw materials, principally yarn from petroleum derivatives, and utility/energy costs, have continued to impact on our financial results in fiscal 2009 as oil and energy prices increased and had an impact on the company's financial results. Any significant increase in the company's raw material costs, utility/energy costs and general economic inflation could have a material adverse impact on the company, because competitive conditions have limited the company's ability to pass significant operating cost increases on to its customers.

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

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The company is exposed to market risk from changes in interest rates on debt and foreign currency exchange rates. The company's market risk sensitive instruments

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are not entered into for trading purposes. The company's exposure to interest rate risk consists of floating rate debt based on the London Interbank Offered Rate (LIBOR) plus an adjustable margin under the company's revolving credit agreement in the United States and its real estate term loans. As of August 3, 2008, there were \$6.3 million in borrowings outstanding under the company's real estate term loans and no borrowings under the company's revolving credit agreement in the United States. In connection with the first real estate term loan, the company entered into a \$2,170,000 notional principal interest rate swap agreement, which represents 50% of the principal amount on the real estate term loan, and effectively converts the floating rate LIBOR based payments to fixed payments at 4.99% plus the spread calculated under the real estate term loan agreement. The company's unsecured term notes issued in connection with the Bodet & Horst acquisition have a fixed interest rate of 8.01%, the existing unsecured term notes have a fixed interest rate of 8.80%, and the Canadian government loan is non-interest bearing. The company's revolving credit agreement associated with its China subsidiary bears interest at a rate determined by the Chinese government. There were no borrowings outstanding under this agreement at August 3, 2008. At August 3, 2008, \$17.0 million of the company's total borrowings of \$21.4 million are at a fixed rate or non-interest bearing. Thus, the company would not expect any foreseeable change in the interest rates to have a material effect on the company's financial results.

The company is exposed to market risk from changes in the value of foreign currencies for their subsidiaries domiciled in China and Canada. The company generally does not use financial derivative instruments to hedge foreign currency exchange rate risks associated with its foreign subsidiaries. At August 3, 2008, the company did not have any foreign currency contracts outstanding. The company's foreign subsidiaries use the United States dollar as their functional currency. A substantial portion of the company's imports purchased outside the United States are denominated in U.S. dollars. A 10% change in either exchange rate at August 3, 2008, would not have a significant impact on the company's results of operations or financial position.

#### ITEM 4. CONTROLS AND PROCEDURES

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The company has conducted an evaluation of the effectiveness of its disclosure controls and procedures as of August 3, 2008, the end of the period covered by this report. This evaluation was conducted under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer. Based upon that evaluation, we have concluded that these disclosure controls and procedures were effective, to ensure that information required to be disclosed in the reports filed by us and submitted under the Securities Exchange Act of 1934, as amended (the "Exchange Act") is recorded, processed, summarized, and reported as and when required. Further, we concluded that our disclosure controls and procedures 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 disclosures.

There has been no change in our internal control over financial reporting that occurred during the quarter ended August 3, 2008 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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#### Part II - Other Information

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### Item 1. Legal Proceedings

There has not been any material changes with regards to our legal proceedings during the three months ended August 3, 2008. Our legal proceedings are disclosed in the company's annual report on Form 10-K filed with the Securities and Exchange Commission on July 9, 2008 for the fiscal year ended April 27, 2008.

### Item 1A. Risk Factors

In addition to the information set forth below in the quarterly report on Form 10-Q, you should carefully consider the factors discussed the factors discussed in Part 1, Item 1A "Risk Factors" in our annual report on Form 10-K filed with Securities and Exchange Commission on July 9, 2008 for the fiscal year ended April 27, 2008.

#### Difficulties In Integrating Our Recent Acquisition Could Negatively Affect The Profits of our Mattress Fabrics Segment

Pursuant to an asset purchase agreement among the company and Bodet & Horst dated August 11, 2008, the company purchased certain assets of their knitted mattress fabric operation (see additional disclosures on pages I-26 and I-27). We expect the asset acquisition to increase the profits of our mattress fabric segment, but our success will depend upon our ability to successfully integrate this product line into our business. These integration activities will place substantial demands on our management, operational resources, and service capabilities. If we experience customer dissatisfaction or operational problems as a result of integrating the additional business acquired, our mattress fabrics business could be negatively affected.

### Item 6. Exhibits

The following exhibits are filed as part of this report.

- 3(i) Articles of Incorporation of the company, as amended, were filed as Exhibit 3(i) to the company's Form 10-Q for the quarter ended July 28, 2002, filed September 11, 2002, and are incorporated herein by reference.
- 3(ii) Restated and Amended Bylaws of the company, as amended November 12, 2007, were filed as Exhibit 3.1 to the company's Form 8-K dated November 12, 2007, and incorporated herein by reference.
- 10.1 Form of stock option agreement for options granted to executive officers on June 17, 2008 pursuant to the 2007 Equity Incentive Plan.
- 10.2 Written summary of Culp Home Fashions Division Management Incentive Plan.
- 10.3 Written summary of Culp Inc. Corporate Management Incentive Plan.

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- 10.4 Asset Purchase Agreement among Culp Inc., Bodet & Horst USA, LP and Bodet & Horst GMBH & Co. KG, dated August 11, 2008, filed as Exhibit 10.1 to the company's Form 8-K dated August 11, 2008, and incorporated herein by reference.

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- 10.5 Note Purchase Agreement among Culp, Inc., Mutual of Omaha Insurance Company and United of Omaha Insurance Company dated August 11, 2008, filed as Exhibit 10.2 to the company's Form 8-K dated August 11, 2008, and incorporated herein by reference.
- 10.6 Consent and Fifth Amendment to Note Purchase Agreement dated August 11, 2008, by and among Culp, Inc., Life Insurance Company of North America, Connecticut General Life Insurance Company, Beachside & Co., MONY Life Insurance Company, United of Omaha Life Insurance Company, Mutual of Omaha Life Insurance Company, and Prudential Retirement Insurance and Annuity Company, filed as Exhibit 10.3 to the company's Form 8-K dated August 11, 2008, and incorporated herein by reference.
- 31.1 Certification of Chief Executive Officer Pursuant to Section 302 of Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer Pursuant to Section 302 of Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer Pursuant to Section 906 of Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer Pursuant to Section 906 of Sarbanes-Oxley Act of 2002.

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SIGNATURES

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

CULP, INC.  
(Registrant)

Date: September 10, 2008 By: /s/ Kenneth R. Bowling

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

By: /s/ Thomas B. Gallagher, Jr.

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

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EXHIBIT INDEX

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