CULP INC
Form 10-Q
March 08, 2019

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

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

For the quarterly period ended January 27, 2019
Commission File No. 1-12597

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

NORTH CAROLINA	56-1001967
(State or other jurisdiction of incorporation or other organization)	(I.R.S. Employer Identification No.)
1823 Eastchester Drive High Point, North Carolina	27265-1402
(Address of principal executive offices)	(zip code)

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

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

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

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

Large accelerated filer Accelerated filer Non-accelerated filer

Smaller Reporting Company Emerging Growth Company

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

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

Common shares outstanding at January 27, 2019: 12,368,413
Par Value: $0.05 per share

INDEX TO FORM 10-Q
For the period ended January 27, 2019

Item 1: Financial Statements

CULP, INC.
CONSOLIDATED STATEMENTS OF NET INCOME (LOSS)
FOR THE THREE AND NINE MONTHS ENDED JANUARY 27, 2019 AND JANUARY 28, 2018
UNAUDITED
(Amounts in Thousands, Except for Per Share Data)

	THREE MONTHS ENDED	
	January 27, 2019	January 28, 2018
Net sales	$77,226	85,310
Cost of sales	63,103	67,707
Gross profit	14,123	17,603
Selling, general and administrative expenses	10,038	9,959
Restructuring credit	(214)	-
Income from operations	4,299	7,644
Interest expense	-	31
Interest income	(251)	(132)
Other expense	288	229
Income before income taxes	4,262	7,516
Income taxes	1,225	8,208
(Income) loss from investment in unconsolidated joint venture	(23)	56
Net income (loss)	$3,060	(748)
Plus: Net loss attributable to non-controlling interest	94	-
Net income (loss) attributable to Culp, Inc. common shareholders	$3,154	(748)
Net income (loss) attributable to Culp Inc. common shareholders per share - basic	$0.25	(0.06)
Net income (loss) attributable to Culp Inc. common shareholders per share - diluted	$0.25	(0.06)
Average shares outstanding, basic	12,438	12,436
Average shares outstanding, diluted	12,465	12,436

	NINE MONTHS ENDED	
	January 27, 2019	January 28, 2018

Net sales	$225,705	245,541
Cost of sales	187,697	195,668
Gross profit	38,008	49,873
Selling, general and administrative expenses	28,174	28,876
Restructuring credit	(825)	-
Income from operations	10,659	20,997
Interest expense	38	69
Interest income	(552)	(391)
Other expense	688	903
Income before income taxes	10,485	20,416
Income taxes	3,407	11,956
Loss from investment in unconsolidated joint venture	109	249
Net income	$6,969	8,211
Plus: Net loss attributable to non-controlling interest	75	-
Net income attributable to Culp, Inc. common shareholders	$7,044	8,211
Net income attributable to Culp Inc. common shareholders per share - basic	$0.56	0.66
Net income attributable to Culp Inc. common shareholders per share - diluted	$0.56	0.65
Average shares outstanding, basic	12,488	12,425
Average shares outstanding, diluted	12,593	12,626

See accompanying notes to consolidated financial statements.

CULP, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
FOR THE THREE AND NINE MONTHS ENDED JANUARY 27, 2019 AND JANUARY 28, 2018
(UNAUDITED)
(AMOUNTS IN THOUSANDS)

	THREE MONTHS ENDED	
	January 27, 2019	January 28, 2018
Net income (loss)	$3,060	$(748)
Other comprehensive loss		
Unrealized holding losses on investments, net of tax	(75)	(4)
Reclassification adjustment for realized loss on investments	22	-
Total other comprehensive loss	(53)	(4)
Comprehensive income (loss)	$3,007	$(752)
Plus: Comprehensive loss attributable to non-controlling interest	94	-
Comprehensive income (loss) attributable to Culp, Inc. common shareholders	$3,101	$(752)

	NINE MONTHS ENDED	
	January 27, 2019	January 28, 2018
Net income	$6,969	$8,211
Other comprehensive income		
Unrealized gain on investments, net of tax		
Unrealized holding (losses) gains on investments	(78)	60
Reclassification adjustment for realized loss on investments	116	-
Total unrealized gain on investments	38	60
Unrealized gain on foreign currency cash flow hedge, net of tax		

Unrealized holding loss on foreign currency cash flow hedge	(8)	-
Reclassification adjustment for realized loss on foreign currency cash flow hedge	64	-
Total unrealized gain on foreign currency cash flow hedge	56	-
Total other comprehensive income	94	60
Comprehensive income	$7,063	$8,271
Plus: Comprehensive loss attributable to non-controlling interest	75	-
Comprehensive income attributable to Culp, Inc. common shareholders	$7,138	$8,271

See accompanying notes to consolidated financial statements.

I - 2

CULP, INC.
CONSOLIDATED BALANCE SHEETS
JANUARY 27, 2019, JANUARY 28, 2018 AND APRIL 29, 2018
UNAUDITED
(Amounts in Thousands)

	January 27, 2019	January 28, 2018	*April 29, 2018
Current assets:			
Cash and cash equivalents	$26,418	22,428	21,228
Short-term investments - Available for Sale	-	2,472	2,451
Short-term investments - Held-To-Maturity	13,544	17,206	25,759
Accounts receivable, net	26,142	26,097	26,307
Inventories	55,415	55,651	53,454
Other current assets	2,954	3,114	2,870
Total current assets	124,473	126,968	132,069
Property, plant and equipment, net	50,129	51,838	51,794
Goodwill	27,222	11,462	13,569
Intangible assets	10,542	1,397	4,275
Deferred income taxes	3,224	1,942	1,458
Long-term investments - Held-To-Maturity	-	13,625	5,035
Long-term investments - Rabbi Trust	6,834	7,176	7,326
Investment in unconsolidated joint venture	1,512	1,518	1,501
Other assets	972	918	957
Total assets	$224,908	216,844	217,984
Current liabilities:			
Accounts payable-trade	$28,401	32,434	27,237
Accounts payable - capital expenditures	91	1,554	1,776
Deferred revenue	492	-	809
Accrued expenses	9,740	8,842	9,325
Accrued restructuring costs	228	-	-
Income taxes payable - current	642	1,580	1,437
Total current liabilities	39,594	44,410	40,584
Accrued expenses - long-term	-	-	763
Contingent consideration - earn-out obligation	5,781	-	-
Income taxes payable - long-term	3,294	10,940	3,758
Deferred income taxes	2,225	2,096	2,150
Deferred compensation	6,782	7,216	7,353
Total liabilities	57,676	64,662	54,608
Commitments and Contingencies (Notes 13 and 22)			
Shareholders' equity			
Preferred stock, $0.05 par value, authorized 10,000,000	-	-	-
Common stock, $0.05 par value, authorized			

40,000,000 shares, issued and outstanding 12,368,413 at January 27, 2019; 12,450,276 at January 28, 2018; and 12,450,276 at April 29, 2018	619	623	623
Capital contributed in excess of par value	43,961	48,413	48,203
Accumulated earnings	118,186	103,090	114,635
Accumulated other comprehensive income (loss)	9	56	(85)
Total shareholders' equity attributable to Culp Inc.	162,775	152,182	163,376
Non-controlling interest	4,457	-	-
Total equity	167,232	152,182	163,376
Total liabilities and shareholders' equity	$224,908	216,844	217,984

* Derived from audited financial statements.

See accompanying notes to consolidated financial statements.

I - 3

CULP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED JANUARY 27, 2019 AND JANUARY 28, 2018
UNAUDITED
(Amounts in Thousands)

	NINE MONTHS ENDED	
	January 27, 2019	January 28, 2018
Cash flows from operating activities:		
Net income	$6,969	8,211
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	6,087	5,679
Amortization	592	248
Stock-based compensation	373	2,422
Deferred income taxes	(1,691)	(3,020)
Realized loss on sale of short-term investments (Available for Sale)	94	-
Gain on sale of property, plant, and equipment	(1,456)	-
Loss from investment in unconsolidated joint venture	109	249
Foreign currency exchange loss	12	133
Changes in assets and liabilities, net of effects of acquisition of businesses		
Accounts receivable	(38)	(923)
Inventories	(658)	(3,275)
Other current assets	(43)	(27)
Other assets	6	(37)
Accounts payable - trade	486	1,715
Deferred revenue	(317)	-
Accrued expenses and deferred compensation	(1,513)	(1,608)
Accrued restructuring costs	228	-
Income taxes	(1,155)	11,702
Net cash provided by operating activities	8,085	21,469
Cash flows from investing activities		
Net cash paid for acquisition of businesses	(12,096)	-
Capital expenditures	(2,954)	(6,657)
Proceeds from the sale of property, plant, and equipment	1,894	6
Investment in unconsolidated joint venture	(120)	(661)
Proceeds from the sale of short-term investments (Held to Maturity)	17,150	-
Proceeds from the sale of short-term investments (Available for Sale)	2,458	-
Purchase of short-term investments (Available for Sale)	(10)	(37)
Proceeds from the sale of long-term investments (Rabbi Trust)	1,233	57
Purchase of long-term investments (Rabbi Trust)	(795)	(1,699)
Premium payment on life insurance policy	-	(18)
Net cash provided by (used in) investing activities	6,760	(9,009)

Cash flows from financing activities:		
Proceeds from line of credit	12,000	10,000
Payments on line of credit	(12,000)	(10,000)
Payments on vendor-financed capital expenditures	(1,412)	(3,750)
Dividends paid	(3,493)	(5,722)
Common stock surrendered for withholding taxes payable	(1,303)	(1,530)
Common stock repurchased	(3,316)	-
Payments of debt issuance costs	(50)	-
Proceeds from common stock issued	-	111
Net cash used in financing activities	(9,574)	(10,891)
Effect of exchange rate changes on cash and cash equivalents	(81)	64
Increase in cash and cash equivalents	5,190	1,633
Cash and cash equivalents at beginning of period	21,228	20,795
Cash and cash equivalents at end of period	$26,418	22,428

See accompanying notes to consolidated financial statements.

CULP, INC.
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
NINE MONTHS ENDED JANUARY 27, 2019
UNAUDITED
(Dollars in thousands, except share data)

					Shareholders' equity attributable to Culp Inc.					
	Common Stock		Capital Contributed in Excess of Par		Accumulated	Accumulated Other Comprehensive (Loss)			Non-Controlling	Total
	Shares	Amount	Value		Earnings	Income		Total	Interest	Equity
Balance, April 29, 2018 *	12,450,276	$ 623	48,203		114,635	(85)		$ 163,376	$ -	$ 163,376
Net income	-	-	-		957	-		957	8	965
Acquisition of subsidiary with non-controlling interest	-	-	-		-	-		-	4,532	4,532
Stock-based compensation	-	-	(501	)	-	-		(501)	-	(501)
Unrealized gain on foreign currency cash flow hedge	-	-	-		-	15		15	-	15
Unrealized gain on investments	-	-	-		-	134		134	-	134
Common stock issued in connection with vesting of performance based restricted stock units	115,917	6	(6	)	-	-		-	-	-
Common stock issued in connection with vesting of time- based restricted stock units	1,200	-	-		-	-		-	-	-
Common stock surrendered for withholding taxes payable	(42,157)	(2)	(1,290	)	-	-		(1,292)	-	(1,292)
Common stock repurchased	(2,990)	-	(72	)	-	-		(72)	-	(72)
Dividends paid	-	-	-		(1,127)	-		(1,127)	-	(1,127)
Balance, July 29, 2018	12,522,246	627	46,334		114,465	64		161,490	4,540	166,030
Net income	-	-	-		2,933	-		2,933	11	2,944
Stock-based compensation	-	-	395		-	-		395	-	395
Unrealized gain on foreign currency cash flow hedge	-	-	-		-	41		41	-	41
Unrealized loss on investments	-	-	-		-	(43)		(43)	-	(43)
Fully vested common stock award	3,600	-	-		-	-		-	-	-
	(33,890)	(2)	(770	)	-	-		(772)	-	(772)

Common stock repurchased								
Dividends paid	-	-	-	(1,126)	-	(1,126)	-	(1,126)
Balance, October 28, 2018	12,491,956	$ 625	45,959	116,272	62	$ 162,918	$ 4,551	$ 167,469
Net income	-	-	-	3,154	-	3,154	(94)	3,060
Stock-based compensation	-	-	479	-	-	479	-	479
Unrealized loss on investments	-	-	-	-	(53)	(53)	-	(53)
Common stock surrendered for withholding taxes payable	-	-	(11)	-	-	(11)	-	(11)
Common stock repurchased	(123,543)	(6)	(2,466)	-	-	(2,472)	-	(2,472)
Dividends paid	-			(1,240)	-	(1,240)		(1,240)
Balance, January 27, 2019	12,368,413	$ 619	$ 43,961	$ 118,186	$ 9	$ 162,775	$ 4,457	$ 167,232

* Derived from audited financial statements.

See accompanying notes to consolidated financial statements.

CULP, INC.
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
NINE MONTHS ENDED JANUARY 28, 2018
UNAUDITED
(Dollars in thousands, except share data)

	Common Stock		Capital Contributed in Excess of Par	Accumulated	Accumulated Other Comprehensive (Loss)	Total Shareholders'
	Shares	Amount	Value	Earnings	Income	Equity
Balance, April 30, 2017 *	12,356,631	$ 618	47,415	100,601	(4)	$ 148,630
Net income	-	-	-	4,984	-	4,984
Stock-based compensation	-	-	757	-	-	757
Unrealized gain on investments	-	-	-	-	44	44
Common stock issued in connection with vesting of performance based restricted stock units	118,845	6	(6)	-	-	-
Common stock issued in connection with exercise of stock options	600	-	5	-	-	5
Common stock surrendered for withholding taxes payable	(34,915)	(2)	(1,133)	-	-	(1,135)
Dividends paid	-	-	-	(3,608)	-	(3,608)
Balance, July 30, 2017	12,441,161	622	47,038	101,977	40	149,677
Net income	-	-	-	3,976	-	3,976
Stock-based compensation	-	-	801	-	-	801
Unrealized gain on investments	-	-	-	-	20	20
Fully vested common stock award	4,800	-	-	-	-	-
Common stock issued in connection with vesting of time- based restricted stock units	1,200	-	-	-	-	-
Common stock surrendered for withholding taxes payable	(11,885)	-	(398)	-	-	(398)
Dividends paid	-	-	-	(996)	-	(996)
Balance, October 29, 2017	12,435,276	$ 622	47,441	104,957	60	$ 153,080
Net loss	-	-	-	(748)	-	(748)
Stock-based compensation	-	-	867	-	-	867
Unrealized loss on investments	-	-	-	-	(4)	(4)
Common stock issued in connection with exercise of stock options	15,000	1	105	-	-	106
Dividends paid	-			(1,119)	-	(1,119)
Balance, January 28, 2018	12,450,276	$ 623	$ 48,413	$ 103,090	$56	$ 152,182

* Derived from audited financial statements.

See accompanying notes to consolidated financial statements.

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

1. Basis of Presentation

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

The company's nine-months ended January 27, 2019, and January 28, 2018, represent 39-week periods, respectively.

2. Significant Accounting Policies

As of January 27, 2019, there were no changes in the nature of our significant accounting policies or the application of those policies from those reported in our annual report on Form 10-K for the year then ended April 29, 2018.

Recently Adopted Accounting Pronouncements

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

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

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

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

Recently Issued Accounting Pronouncements

Leases

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

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

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

3. Business Combinations

Read Window Products, LLC (Read)

Overview

Effective April 1, 2018, we entered into an Asset Purchase Agreement (Asset Agreement) to acquire certain assets and assume certain liabilities of Read, a source of custom window treatments for the hospitality and commercial industries. Based in Knoxville, Tennessee, Read is a turn-key provider of window treatments that offers sourcing of upholstery fabrics and other products, measuring, and installation services of their own products. Read's custom product line includes motorization, shades, upholstered drapery, upholstered headboards and shower curtains. In addition, Read supplies soft goods such as decorative top sheets, coverlets, duvet covers, bed skirts, bolsters and pillows, for leading hospitality brands worldwide. The addition of window treatments and other soft goods to our product line allows us to be a more complete source of fabrics for the hospitality market, in which we believe there are significant growth opportunities.

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

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

Assets Acquired and Liabilities Assumed

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

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

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

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

The Asset Agreement contains a contingent consideration arrangement that requires us to pay a former shareholder of Read an earn-out payment based on adjusted EBITDA, as defined in the Asset Agreement, for calendar year 2018 in excess of fifty percent of a pre-established adjusted EBITDA target. As of January 27, 2019, based on actual financial results in relation to the pre-established adjusted EBITDA target, a contingent payment will not be made, and therefore, no contingent liability has been recorded.

Other

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

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

eLuxury, LLC (eLuxury)

Overview

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

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

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

Assets Acquired and Liabilities Assumed

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

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

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

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

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

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

Consolidation and Non-Controlling Interest

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

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

Based on the terms of the Equity Agreement, we believe the related risks associated with the ownership interests are aligned and therefore, the total consideration of $18.1 million for the 80% controlling interest provides information for the equity value of eLuxury as a whole, and therefore, is useful in estimating fair value of the 20% noncontrolling interest. In order to determine the carrying value of our noncontrolling interest in eLuxury, we applied the Hypothetical-Liquidation-At-Book-Value method (HLBV). HLBV is an approach that is used in practice to determine the carrying value of a noncontrolling interest if it is consistent with an existing profit-sharing arrangement such as the Equity Agreement. Therefore, the carrying amount of the noncontrolling interest of $4.5 million represents the $4.5 million fair value determined at the acquisition date plus its allocation of net loss totaling $75,000 subsequent to the acquisition date and through the end of our third quarter of fiscal 2019.

Other

Acquisitions costs totaling $270,000 were included in selling, general, and administrative expenses in our Consolidated Statement of Net Income for the nine-month period ending January 27, 2019.

Actual revenue and net loss for the period June 22, 2018 through January 27, 2019 were included in our Consolidated Statement of Net Income for the nine-months ended January 27, 2019, and totaled $11.8 million and $248,000, respectively.

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

Pro Forma Financial Information

The following unaudited pro forma consolidated results of operations for the three-month and nine-month periods ending January 27, 2019, and January 28, 2018, have been prepared as if the acquisitions of Read had occurred on May 2, 2016 and eLuxury had occurred on May 1, 2017.

	Three Months Ended	
(dollars in thousands, except per share data)	January 27, 2019	January 28, 2018
Net Sales	$77,226	$93,451
Income from operations	4,299	7,257
Net income (loss)	3,060	(1,073)
Net loss (income) - noncontrolling interest	94	(36)
Net income (loss) – Culp Inc. common shareholders	3,154	(1,109)
Net income (loss) per share (basic) – Culp Inc. common shareholders	0.25	(0.09)
Net income (loss) per share (diluted) –Culp Inc. common shareholders	0.25	(0.09)

	Nine Months Ended	
(dollars in thousands, except per share data)	January 27, 2019	January 28, 2018
Net Sales	$228,830	$270,950
Income from operations	10,657	20,799
Net income	6,943	7,901
Net loss (income) - noncontrolling interest	83	(27)
Net income – Culp Inc. common shareholders	7,026	7,874
Net income per share (basic) –Culp Inc. common shareholders	0.56	0.63
Net income per share (diluted) –Culp Inc. common shareholders	0.56	0.62

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

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

4. Accounts Receivable

A summary of accounts receivable follows:

(dollars in thousands)	January 27, 2019	January 28, 2018	April 29, 2018
Customers	$26,748	$27,666	$28,097
Allowance - doubtful accounts	(388)	(357)	(357)
Allowance - cash discounts	(197)	(222)	(245)
Allowance - sales returns & allowances (1)	(21)	(990)	(1,188)
	$26,142	$26,097	$26,307

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

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

	Nine months ended	
(dollars in thousands)	January 27, 2019	January 28, 2018
Beginning balance	$(357)	$ (414)
Provision for bad debts	(78)	57
Net write-offs, net of recoveries	47	-
Ending balance	$(388)	$ (357)

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

	Nine months ended	
(dollars in thousands)	January 27, 2019	January 28, 2018
Beginning balance	$(1,433)	$(1,220)
Adoption of ASC Topic 606 (1)	1,145	-
Provision for returns, allowances and discounts	(1,612)	(2,332)
Credits issued	1,682	2,340
Ending balance	$(218)	$(1,212)

5. Revenue

Revenue from Contracts with Customers

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

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

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

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

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

Currently, we expect the adoption of this new standard to be immaterial to our net income on an ongoing basis. The effect of adopting ASC 606 on our Consolidated Statements of Net Income for the three-month and nine-month periods ended January 27, 2019, are as follows:

(dollars in thousands)	Three Months Ended January 27, 2019	Adjustments Due to ASC 606 Adoption (1)	Balances Without ASC 606 Adoption
Statements of Net Income			
Net Sales	$77,226	$ 13	$77,239
Cost of Sales	63,103	13	63,116

(dollars in thousands)	Nine Months Ended January 27, 2019	Adjustments Due to ASC 606 Adoption	Balances Without ASC 606 Adoption

		(1)	
Statements of Net Income			
Net Sales	$225,705	$ (17)	$225,688
Cost of Sales	187,697	(17)	187,680

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

The effect of adopting ASC 606 on our Consolidated Balance Sheets for the period ended January 27, 2019, is as follows:

(dollars in thousands)	January 27, 2019	Adjustments Due to ASC 606 Adoption (1)	Balances Without ASC 606 Adoption
Balance Sheet			
Assets:			
Accounts Receivable	$26,142	$ (1,092)	$ 25,050
Other Current Assets	2,954	(17)	2,937
Liabilities:			
Accrued Expenses	$9,740	(1,109)	$ 8,631

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

Nature of Performance Obligations

Our operations are classified into three business segments: mattress fabrics, upholstery fabrics, and home accessories. The mattress fabrics segment manufactures, sources, and sells fabrics and mattress covers primarily to bedding manufacturers. The upholstery fabrics segment manufactures, sources, develops, and sells fabrics primarily to residential and commercial furniture manufacturers. Effective April 1, 2018, we acquired Read (see Note 3 for further details), a turn key provider of window treatments that offer sourcing of upholstery fabrics and other products, measurement, and installation services of their own products for the hospitality and commercial industries. In addition, Read supplies soft goods such as decorative top sheets, coverlets, duvet covers, bed skirts, bolsters and pillows. The home accessories segment is our new finished products business that manufactures, sources, and sells bedding accessories and home goods directly to consumers and businesses through global e-commerce and business-to-business sales channels.

Our primary performance obligations include the sale of mattress fabrics, upholstery fabrics, bedding and home accessories products, as well as the performance of customized fabrication and installation services associated with window treatments.

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

Significant Judgments

Revenue is recognized upon the transfer of control of promised products or services to customers in an amount that reflects the consideration we expect to receive in exchange for those products or services. We determined that our customer purchase orders represent contracts as defined in the new standard. In addition to purchase orders, we also have supply contracts with certain customers that define standard terms and conditions. Our contracts generally include promises to sell either upholstery fabric, mattress fabric, or bedding accessories and home goods products or promises to provide fabrication and installation services associated with customized window treatments. The transaction price is typically allocated to performance obligations based upon stand-alone selling prices. We did not disclose the value of unsatisfied performance obligations as substantially all of any unsatisfied performance obligations as of January 27, 2019, will be satisfied within one year or less. Revenue associated with sales of our products are recognized at the point-in-time when control of the promised goods has been transferred to the customer. The point-in-time when control transfers to the customer depends on the contractually agreed upon shipping terms, but typically occurs once the product has been shipped or once it has been delivered to a location specified by the customer. For certain warehousing arrangements, transfer of control to the customer is deemed to have occurred when the customer pulls the inventory for use in their production. Revenue associated with our customized fabrication services, which are performed on various types of window treatments, is recognized over time once the customized products are deemed to have no alternative use but for which we have an enforceable right to payment for the services performed. Revenue for our customized fabrication services is recognized over time using the output method based on units produced. Revenue associated with our installation services is also recognized over time as the customer receives and consumes the benefits of the promised installation services. Revenue associated with our installation services is recognized over time using the output method based on units installed.

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

Revenue is measured as the amount of consideration we expect to receive in exchange for the transfer of the promised products and services. The amount of consideration we expect to receive changes due to variable consideration associated with allowances for sales returns, early payment discounts, and volume rebates that we offer to customers. The amount of variable consideration which is included in the transaction price is only included in net sales to the extent that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur in a future period. Our mattress fabrics and upholstery fabrics business segments only allow product returns to the extent that the products or services did not meet the contractually agreed upon specifications at the time of the sale. Customers must receive authorization prior to returning those products. Our home accessories business segment allow returns for any reason provided the product is returned within the stated time frame, generally 30 days, unless the product was customized in which case a defect must be present in order to return the product. Estimates of allowances for sales returns are based on historical data, current potential product return issues, and known sales returns for which customers have been granted return authorization. Known sales returns for which customers have been granted permission to return products for a refund or credit, continue to be recorded as a contra account receivable. Estimates for potential future sales returns and related customer accommodations are now recorded within accrued expenses as required by the new standard. Under the new standard we record estimates for sales returns on a gross basis rather than a net basis and an estimate for a right of return asset is recorded in other current assets and cost of goods sold. Variable consideration associated with early payment cash discounts are estimated using current payment trends and historical data on a customer-by-customer basis. The variable consideration associated with volume rebates are based on the portion of the rebate earned relative to the total amount of rebates the customer is expected to earn over the rebate period as determined using historical data and projections.

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

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

Contract Assets & Liabilities

Certain contracts, primarily those for customized fabrication and installation services, require upfront customer deposits that result in a contract liability which is recorded on the Consolidated Balance Sheet as deferred revenue. If upfront deposits or prepayment are not required, customers may be granted credit terms which generally range from 15 – 45 days. Such terms are common within the industries in which we are associated and are not considered financing arrangements. There were no contract assets recognized as of January 27, 2019.

A summary of the activity of deferred revenue for the three-month and nine-month periods ended January 27, 2019 follows:

(dollars in thousands)	Three Months Ended January 27, 2019
Balance as of October 28, 2018	$ 649
Revenue recognized on contract liabilities during the period	(637)
Payments received for services not yet rendered during the period	480
Balance as of January 27, 2019	$ 492

(dollars in thousands)	Nine Months Ended January 27, 2019
Balance as of April 29, 2018	$809
Revenue recognized on contract liabilities during the period	(2,171)
Payments received for services not yet rendered during the period	1,854
Balance as of January 27, 2019	$492

Disaggregation of Revenue

The following table presents our disaggregated revenue by segment, timing of revenue recognition, and product sales versus services rendered for the three-month period ending January 27, 2019:

Net Sales

(dollars in thousands)	Mattress Fabrics	Upholstery Fabrics	Home Accessories	Total
Products transferred at a point in time	$35,732	$ 34,730	$ 4,390	$74,852

Services transferred over time	-	2,374	-	2,374
Total Net Sales	$35,732	$ 37,104	$ 4,390	$77,226