

CULP INC
Form 10-Q
September 12, 2014

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, 2014
Commission File No. 1-12597

CULP, INC.

(Exact name of registrant as specified in its charter)

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

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

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

27265-1402
(zip code)

(336) 889-5161

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer o

Accelerated filer x

Non-accelerated filer o

Smaller Reporting Company o

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

Edgar Filing: CULP INC - Form 10-Q

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, 2014: 12,216,766
Par Value: \$0.05 per share

INDEX TO FORM 10-Q
For the period ended August 3, 2014

	Page
Part I - Financial Statements	
<u>Item 1. Financial Statements: (Unaudited)</u>	
<u>Consolidated Statements of Net Income -- Three Months Ended August 3, 2014 and July 28, 2013</u>	I-1
<u>Consolidated Statements of Comprehensive Income - Three Months Ended August 3, 2014 and July 28, 2013</u>	I-2
<u>Consolidated Balance Sheets -- August 3, 2014, July 28, 2013, and April 27, 2014</u>	I-3
<u>Consolidated Statements of Cash Flows -- Three Months Ended August 3, 2014 and July 28, 2013</u>	I-4
<u>Consolidated Statements of Shareholders' Equity</u>	I-5
<u>Notes to Consolidated Financial Statements</u>	I-6
<u>Cautionary Statement Concerning Forward-Looking Information</u>	I-25
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	I-26
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	I-41
<u>Item 4. Controls and Procedures</u>	I-41
<u>Part II - Other Information</u>	
<u>Item 1. Legal Proceedings</u>	II-1
<u>Item 1A. Risk Factors</u>	II-1
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	II-1
<u>Item 6. Exhibits</u>	II-2
<u>Signatures</u>	II-3

Item 1: Financial Statements

CULP, INC.
CONSOLIDATED STATEMENTS OF NET INCOME
FOR THE THREE MONTHS ENDED AUGUST 3, 2014 AND JULY 28, 2013
UNAUDITED
(Amounts in Thousands, Except for Per Share Data)

		THREE MONTHS ENDED	
		August 3, 2014	July 28, 2013
Net sales	\$	76,060	70,141
Cost of sales		63,345	57,067
Gross profit		12,715	13,074
Selling, general and administrative expenses		7,419	7,100
Income from operations		5,296	5,974
Interest expense		68	140
Interest income		(142)	(92)
Other (income) expense		(89)	391
Income before income taxes		5,459	5,535
Income taxes		2,115	2,305
Net income	\$	3,344	3,230
Net income per share, basic	\$	0.27	0.27
Net income per share, diluted		0.27	0.26
Average shares outstanding, basic		12,212	12,148
Average shares outstanding, diluted		12,404	12,366

See accompanying notes to the consolidated financial statements.

CULP, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
FOR THE THREE MONTHS ENDED AUGUST 3, 2014 AND JULY 28, 2013
UNAUDITED

	THREE MONTHS ENDED	
	August 3, 2014	July 28, 2013
Net income	\$3,344	3,230
Other comprehensive loss		
Unrealized loss on investments	(10)	(135)
Total other comprehensive loss	(10)	(135)
Comprehensive income	3,334	3,095

See accompanying notes to consolidated financial statements.

CULP, INC.
CONSOLIDATED BALANCE SHEETS
AUGUST 3, 2014, JULY 28, 2013 AND APRIL 27, 2014
UNAUDITED
(Amounts in Thousands)

	August 3, 2014	July 28, 2013	* April 27, 2014
Current assets:			
Cash and cash equivalents	\$ 24,665	21,423	29,303
Short-term investments	6,311	6,174	6,294
Accounts receivable, net	24,239	24,493	27,409
Inventories	41,688	41,770	40,674
Deferred income taxes	6,203	7,747	6,230
Income taxes receivable	136	292	121
Other current assets	2,308	3,408	2,344
Total current assets	105,550	105,307	112,375
Property, plant and equipment, net	31,891	30,808	31,376
Goodwill	11,462	11,462	11,462
Deferred income taxes	973	651	2,040
Long-term investments	1,749	-	765
Other assets	2,587	2,873	2,917
Total assets	\$ 154,212	151,101	160,935
Current liabilities:			
Current maturities of long-term debt	\$ 2,200	2,200	2,200
Accounts payable-trade	24,458	27,821	26,686
Accounts payable - capital expenditures	204	-	277
Accrued expenses	6,365	8,704	9,181
Income taxes payable - current	387	320	442
Total current liabilities	33,614	39,045	38,786
Income taxes payable - long-term	4,037	4,176	3,962
Deferred income taxes	1,013	4,335	1,013
Line of credit	569	560	586
Deferred compensation	3,632	-	2,644
Long-term debt, less current maturities	2,200	4,400	2,200
Total liabilities	45,065	52,516	49,191

Commitments and Contingencies (Note 16)

Shareholders' equity

Edgar Filing: CULP INC - Form 10-Q

Preferred stock, \$0.05 par value, authorized 10,000,000	-	-	-
Common stock, \$0.05 par value, authorized 40,000,000 shares, issued and outstanding 12,216,766 at August 3, 2014; 12,241,405 at July 28, 2013; and 12,250,030 at April 27, 2014	610	612	612
Capital contributed in excess of par value	42,505	42,296	42,932
Accumulated earnings	66,102	55,758	68,260
Accumulated other comprehensive loss	(70)	(81)	(60)
Total shareholders' equity	109,147	98,585	111,744
 Total liabilities and shareholders' equity	 \$ 154,212	 151,101	 160,935

* Derived from audited financial statements.

See accompanying notes to consolidated financial statements.

I-3

CULP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED AUGUST 3, 2014 AND JULY 28, 2013
UNAUDITED
(Amounts in Thousands)

	THREE MONTHS ENDED	
	August 3, 2014	July 28, 2013
Cash flows from operating activities:		
Net income	\$3,344	3,230
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	1,399	1,305
Amortization of other assets	47	39
Stock-based compensation	46	152
Excess tax benefit related to stock-based compensation	(99)	(114)
Deferred income taxes	1,193	1,438
Gain on sale of equipment	(45)	(74)
Foreign currency exchange (gains) losses	(201)	96
Changes in assets and liabilities, net of effects of acquisition of assets:		
Accounts receivable	3,168	(1,049)
Inventories	(1,021)	(3,271)
Other current assets	40	(1,300)
Other assets	283	(11)
Accounts payable - trade	(2,224)	5,284
Accrued expenses and deferred compensation	(1,855)	(3,131)
Income taxes	(24)	81
Net cash provided by operating activities	4,051	2,675
Cash flows from investing activities:		
Capital expenditures	(2,333)	(884)
Proceeds from the sale of equipment	391	104
Cash paid for business acquisition	-	(2,640)
Purchase of short-term investments	(27)	(1,023)
Purchase of long-term investments	(984)	-
Net cash used in investing activities	(2,953)	(4,443)
Cash flows from financing activities:		
Excess tax benefit related to stock-based compensation	99	114
Common stock repurchased	(556)	-
Dividends paid	(5,502)	(489)
Proceeds from common stock issued	-	145
Net cash used in financing activities	(5,959)	(230)

Effect of exchange rate changes on cash and cash equivalents	223	(109)
Decrease in cash and cash equivalents	(4,638)	(2,107)
Cash and cash equivalents at beginning of period	29,303	23,530
Cash and cash equivalents at end of period	\$24,665	21,423

See accompanying notes to consolidated financial statements.

I-4

CULP, INC.
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
UNAUDITED

(Dollars in thousands, except share data)

	Common Stock		Capital Contributed	Accumulated	Accumulated	Total
	Shares	Amount	in Excess of Par Value	Earnings	Other Comprehensive Income (Loss)	Shareholders' Equity
Balance, April 28, 2013	12,224,894	\$ 611	41,901	53,017	54	\$ 95,583
Net income	-	-	-	17,447	-	17,447
Stock-based compensation	-	-	710	-	-	710
Unrealized loss on investments	-	-	-	-	(114)	(114)
Excess tax benefit related to stock based compensation	-	-	143	-	-	143
Fully vested common stock award	3,000	-	-	-	-	-
Common stock issued in connection with exercise of stock options	23,125	1	193	-	-	194
Common stock surrendered for withholding taxes payable	(989)	-	(15)	-	-	(15)
Dividends paid	-	-	-	(2,204)	-	(2,204)
Balance, April 27, 2014 *	12,250,030	612	42,932	68,260	(60)	111,744
Net income	-	-	-	3,344	-	3,344
Stock-based compensation	-	-	46	-	-	46
Unrealized loss on investments	-	-	-	-	(10)	(10)
Excess tax benefit related to stock based compensation	-	-	99	-	-	99
Common stock repurchased	(32,269)	(2)	(554)	-	-	(556)
Common stock surrendered for withholding taxes payable	(995)	-	(18)	-	-	(18)
Dividends paid	-	-	-	(5,502)	-	(5,502)
Balance, August 3, 2014	12,216,766	\$ 610	42,505	66,102	(70)	\$ 109,147

* 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 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 11, 2014 for the fiscal year ended April 27, 2014.

The company’s three months ended August 3, 2014 and July 28, 2013, represent 14 and 13 week periods, respectively.

2. Significant Accounting Policies

As of August 3, 2014, 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 27, 2014.

Recently Adopted Accounting Pronouncements

None

Recently Issued Accounting Pronouncements

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

In May 2014, the FASB issued accounting guidance on revenue recognition. The amended guidance will 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. This guidance will be effective in our fiscal 2018 first quarter and will be required to be applied retrospectively. We are currently assessing the impact that this guidance will have on our consolidated financial statements at this time.

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

3. Business Combinations – Mattress Fabric Segment

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

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

Direct acquisition costs related to this business combination totaled \$83,000.

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

(dollars in thousands)	Fair Value
Equipment (Note 10)	\$ 890
Non-compete agreement (Notes 7 and 10)	882
Customer relationships (Notes 7 and 10)	868
	\$ 2,640

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

4. Stock-Based Compensation

Incentive Stock Option Awards

We did not grant any incentive stock option awards during the first quarter of fiscal 2015.

At August 3, 2014, options to purchase 153,950 shares of common stock were outstanding and exercisable, had a weighted average exercise price of \$6.70 per share, and a weighted average contractual term of 3.4 years. At August 3, 2014, the aggregate intrinsic value for options outstanding and exercisable was \$1.7 million.

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

No options were exercised during the three months ending August 3, 2014. The aggregate intrinsic value for options exercised for the three months ending July 28, 2013 was \$171,000.

At August 3, 2014, there were no unvested incentive stock option awards. Therefore, there was no unrecognized compensation cost related to incentive stock option awards at August 3, 2014.

No compensation expense was recorded on incentive stock options for the three months ended August 3, 2014. We recorded \$6,000 of compensation expense on incentive stock option grants within selling, general, and administrative expense for the three months ended July 28, 2013.

Common Stock Awards

We did not grant any common stock awards during the first quarter of fiscal 2015.

Time Vested Restricted Stock Awards

We did not grant any time vested restricted stock awards during the first quarter of fiscal 2015.

We recorded \$4,000 and \$27,000 of compensation expense within selling, general, and administrative expense for time vested restricted stock awards for the three month periods ending August 3, 2014, and July 28, 2013, respectively.

At August 3, 2014, there were no outstanding and unvested shares of time vested restricted stock. Therefore, there was no unrecognized compensation cost related to time vested restricted stock awards at August 3, 2014.

During the three month period ended August 3, 2014, 61,667 shares of time vested restricted stock vested and had a weighted average fair value of \$257,000 or \$4.17 per share. During the three month period ended July 28, 2013, 61,667 shares of time vested restricted stock vested and had a weighted average fair value of \$249,000 or \$4.04 per share.

Performance Based Restricted Stock Units

Fiscal 2015 Grant

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

Fiscal 2014 Grant

On June 25, 2013, certain key members of management were granted performance based restricted common stock units which could earn up to 72,380 shares of common stock if certain performance targets are met as defined in the related restricted stock unit agreements. These awards were valued based on the fair market value on the date of grant.

The fair value of these awards was \$17.12 per share, which represents the closing price of our common stock on the date of grant. The vesting of these awards is over the requisite service period of three years.

I-8

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

Fiscal 2013 Grant

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

Overall

The company recorded compensation expense of \$42,000 and \$119,000 within selling, general, and administrative expense for performance based restricted stock units for the three month periods ending August 3, 2014 and July 28, 2013, respectively. Compensation cost is recorded based on an assessment each reporting period of the probability if certain performance goals will be met during the vesting period. If performance goals are not probable of occurrence, no compensation cost will be recognized and any recognized compensation cost would be reversed.

As of August 3, 2014, the remaining unrecognized compensation cost related to the performance based restricted stock units was \$1.3 million, which is expected to be recognized over a weighted average vesting period of 2.2 years.

5. Accounts Receivable

A summary of accounts receivable follows:

(dollars in thousands)	August 3, 2014		July 28, 2013		April 27, 2014
Customers	\$ 25,212		\$ 25,829		\$ 28,461
Allowance for doubtful accounts	(438))	(743))	(573)
Reserve for returns and allowances and discounts	(535))	(593))	(479)
	\$ 24,239		\$ 24,493		\$ 27,409

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

(dollars in thousands)	Three months ended	
	August 3, 2014	July 28, 2013
Beginning balance	\$(573)	\$ (780)
Provision for bad debts	69	7
Net write-offs, net of recoveries	66	