

CULP INC  
Form 10-K  
July 12, 2012

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

FORM 10-K

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

For the fiscal year ended April 29, 2012

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  
(zip code)

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

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

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

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

YES  NO

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

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

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

Smaller Reporting Company

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

As of April 29, 2012, 12,702,806 shares of common stock were outstanding. As of October 30, 2011, the aggregate market value of the voting stock held by non-affiliates of the registrant on that date was \$87,350,477 based on the closing sales price of such stock as quoted on the New York Stock Exchange (NYSE), assuming, for purposes of this report, that all executive officers and directors of the registrant are affiliates.

#### DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement to be filed pursuant to Regulation 14A of the Securities and Exchange Commission in connection with its Annual Meeting of Shareholders to be held on September 18, 2012 are incorporated by reference into Part III of this Form 10-K.

---

CULP, INC.  
FORM 10-K REPORT  
TABLE OF CONTENTS

Item No.		Page
<u>PART I</u>		
1.	<u>Business</u>	
	<u>Overview</u>	2
	<u>General Information</u>	3
	<u>Segments</u>	3
	<u>Overview of Industry and Markets</u>	6
	<u>Overview of Bedding Industry</u>	6
	<u>Overview of Residential Furniture Industry</u>	7
	<u>Overview of Commercial Furniture Industry</u>	7
	<u>Products</u>	8
	<u>Manufacturing and Sourcing</u>	9
	<u>Product Design and Styling</u>	10
	<u>Distribution</u>	10
	<u>Sources and Availability of Raw Materials</u>	11
	<u>Seasonality</u>	11
	<u>Competition</u>	12
	<u>Environmental and Other Regulations</u>	12
	<u>Employees</u>	13
	<u>Customers and Sales</u>	14
	<u>Net Sales by Geographic Area</u>	15
	<u>Backlog</u>	15
1A.	<u>Risk Factors</u>	15
1B.	<u>Unresolved Staff Comments</u>	19
2.	<u>Properties</u>	19
3.	<u>Legal Proceedings</u>	20
4.	<u>Mine Safety Disclosure</u>	20
<u>PART II</u>		
5.	<u>Market for the Registrant’s Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities</u>	21
6.	<u>Selected Financial Data</u>	24
7.	<u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	25
7A.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	47
		3

8.	<u>Consolidated Financial Statements and Supplementary Data</u>	48
9.	<u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	84
9A(T).	<u>Controls and Procedures</u>	84
9B.	<u>Other Information</u>	86

---

Item No.		Page
<u>PART III</u>		
10.	<u>Directors, Executive Officers, and Corporate Governance</u>	86
11.	<u>Executive Compensation</u>	86
12.	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	86
13.	<u>Certain Relationships, Related Transactions, and Director Independence</u>	87
14.	<u>Principal Accountant Fees and Services</u>	87
<u>PART IV</u>		
15.	<u>Exhibits and Financial Statement Schedules</u>	88
	<u>Documents Filed as Part of this Report</u>	88
	<u>Exhibits</u>	88
	<u>Financial Statement Schedules</u>	88
	<u>Signatures</u>	92
	<u>Exhibit Index</u>	93

---

CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING INFORMATION

Parts I and II of this report contain “forward-looking statements” within the meaning of the federal securities laws, including the Private Securities Litigation Reform Act of 1995 (Section 27A of the Securities Act of 1933 and Section 27A of the Securities and Exchange Act of 1934). Such statements are inherently subject to risks and uncertainties. Further, forward-looking statements are intended to speak only as of the date on which they are made. 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, production levels, sales, gross profit margins, operating income, SG&A or other expenses, earnings, other performance measures, as well as any statements regarding future economic or industry trends or future developments. Factors that could influence the matters discussed in such statements include the level of housing starts and sales of existing homes, consumer confidence, trends in disposable income, and general economic conditions. Decreases in these economic indicators could have a negative effect on our business and prospects. Likewise, increases in interest rates, particularly home mortgage rates, and increases in consumer debt or the general rate of inflation, could affect the company adversely. Changes in consumer tastes or preferences toward products not produced by us could erode demand for our products. Changes in the value of the U.S. dollar versus other currencies could affect our financial results because a significant portion of our operations are located outside the United States. Strengthening of the U.S. dollar against other currencies could make our products less competitive on the basis of price in markets outside the United States, and strengthening of currencies in Canada and China can have a negative impact on our sales in the U.S. of products produced in those places. Also, economic and political instability in international areas could affect our operations or sources of goods in those areas, as well as demand for our products in international markets. Further information about these factors, as well as other factors that could affect our future operations or financial results and the matters discussed in forward-looking statements are included in the “Risk Factors” section of this report in Item 1A.

PART 1

ITEM 1. BUSINESS

Overview

Culp, Inc. manufactures, sources, and markets mattress fabrics used for covering mattresses and box springs, and upholstery fabrics primarily for use in production of upholstered furniture (residential and commercial).

We believe that Culp is the largest producer of mattress fabrics in North America, as measured by total sales, and one of the largest marketers of upholstery fabrics for furniture in North America, again measured by total sales. We have two operating segments — mattress fabrics and upholstery fabrics. The mattress fabric business markets fabrics that are used primarily in the production of bedding products, including mattresses, box springs, and mattress sets. The upholstery fabric business markets a variety of fabric products that are used in the production of residential and commercial upholstered furniture, sofas, recliners, chairs, loveseats, sectionals, sofa-beds, and office seating. Culp primarily markets fabrics that have broad appeal in the “good” and “better” priced categories of furniture and bedding.

Culp markets a variety of fabrics in different categories to its global customer base, including fabrics produced at our manufacturing facilities and fabrics produced by other suppliers. We had twelve active manufacturing plants and distribution facilities as of the end of fiscal 2012, which are located in North and South Carolina; Quebec, Canada; Shanghai, China; and Poznan, Poland. We also source fabrics from other manufacturers, located primarily in China and Turkey, with almost all of those fabrics being produced specifically for Culp and created by Culp designers. We operate distribution centers in North Carolina, and Shanghai, China, to facilitate distribution of our products, and early last year we opened a new distribution facility in Poznan, Poland. In recent years, the portion of total company sales represented by fabrics produced outside of the U.S. and Canada has increased, while sales of goods produced in the U.S. have decreased. This trend is due primarily to the upholstery fabrics segment, where more than 85% of our sales now consist of fabrics produced in China.

Total net sales in fiscal 2012 were \$254.4 million. The mattress fabrics segment had net sales of \$145.5 million (57.2% of total net sales), while the upholstery fabrics segment had net sales of \$108.9 million (42.8% of total net sales).

During fiscal 2011, our business was affected by continued weak business conditions, especially slow sales of home furnishings. In addition, both segments were significantly affected by higher raw material prices during the year, which led to an overall decline in profit margins. In spite of these conditions, the company had an overall increase in sales of five percent compared to the prior year, as well as higher pre-tax and net income.

Weak business conditions and slow sales of home furnishings, especially during the first half of the fiscal year, continued to affect our business during fiscal 2012. However, industry demand improved somewhat compared to the prior year, and we also had more positive responses from customers to innovative designs and new products introduced during the year. Sales increased in both our business segments, increasing 19% in mattress fabrics and 15% in upholstery fabrics. These sales levels represent our third consecutive year of increased revenues, and our fiscal 2012 net sales were the highest level in the past six years.

During fiscal 2012, both segments continued to build upon strategic initiatives and structural changes they made over the last several years. The platforms created through these changes allowed for a sharp focus on product innovation and introduction of new designs to drive sales growth and keep current with home furnishing trends.

The mattress fabrics segment has invested \$57 million over an eight year period in significant capital expenditures and acquisitions. These expenditures provided increased manufacturing capacity and more efficient equipment for this segment, as well as two successful acquisitions. Most recently, this segment announced a new joint marketing agreement to market sewn mattress covers, which will include establishment of a small production facility.

The upholstery fabrics segment underwent major changes over the past decade, transforming from a primarily U.S.-based manufacturing operation with large amounts of fixed assets to a more flexible variable cost model, with most fabrics sourced in China, while still maintaining control over the value-added components of fabric production such as design, finishing, quality control and distribution. These changes involved a multi-year restructuring process that ended in fiscal 2009, during which time our upholstery fabric sales declined considerably. The trend of declining upholstery sales has reversed, and sales in this segment have now increased for each of the past three fiscal years. Since the end of the multi-year restructuring, we have focused on product development and marketing, including the exploration of new markets. A part of this effort has been the establishment of a new marketing and distribution operation in Poland, known as Culp Europe, which accounted for about three percent of upholstery sales last year.

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

#### General Information

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

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

#### Segments

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



## Sales by Fiscal Year (\$ in Millions) and Percentage of Total Company Sales

Segment	Fiscal 2012	Fiscal 2011	Fiscal 2010
Mattress Fabrics	\$145.5 (57%)	\$122.4 (56%)	\$114.8 (56%)
Upholstery Fabrics			
Non-U.S.-Produced	\$95.5 (38%)	\$81.2 (37%)	\$77.3 (37%)
U.S.-Produced	\$13.4 (5%)	\$13.2 (6%)	\$14.3 (7%)
Total Upholstery	\$108.9 (43%)	\$94.4 (44%)	\$91.6 (44%)
Total company	\$254.4 (100%)	\$216.8 (100%)	\$206.4 (100%)

Additional financial information about our operating segments can be found in Note 18 to the Consolidated Financial Statements included in Item 8 of this report.

**Mattress Fabrics.** The mattress fabrics segment, known as Culp Home Fashions in the industry, manufactures and markets mattress fabric to bedding manufacturers. These fabrics encompass woven jacquard fabric, knitted fabric and some upholstery type fabrics. Culp Home Fashions has manufacturing facilities located in Stokesdale and High Point, North Carolina, and St. Jerome, Quebec, Canada. The Stokesdale and St. Jerome plants manufacture jacquard (damask) fabric. The Stokesdale plant also finishes jacquard and knit fabric, and houses the division offices and finished goods distribution capabilities. In fiscal 2009, a third manufacturing plant facility was added when we acquired the knitted mattress fabrics business of Bodet & Horst USA, including its manufacturing facilities in High Point. We have also maintained flexibility in our supply of the major categories of mattress fabrics. Almost all woven jacquard and knitted fabrics can be produced in multiple facilities, (internal or external to the company) providing us with mirrored, reactive capacity involving state-of-the-art capabilities across plant facilities.

Culp Home Fashions had capital expenditures during the period fiscal 2005 through 2012 totaling approximately \$38 million, which primarily provided for the purchase of faster and more efficient weaving machines as well as increased knit machine capacity. These capital expenditures also provided high technology finishing equipment for woven and knitted fabric. With most of these modernization and expansion projects completed, we expect lower capital expenditures in the near term for this segment.

The Bodet & Horst USA, LP acquisition in fiscal 2009 was another step to enhance and secure our competitive position, as we invested \$11.4 million to purchase the manufacturing operation that had been serving as our primary source of knitted mattress fabric. The completion of this acquisition not only secured our supply of knitted mattress fabrics, but allowed for improved supply logistics, greater control of product development, and accelerated responsiveness to our customers. Since the acquisition, we made further investments in knitting machines and finishing equipment, increasing our internal production capacity substantially.

Our recently announced joint marketing agreement for the production and marketing of sewn mattress covers represents a further step in our efforts to respond to industry demands. The CHF division has established a new venture to be known as Culp-Lava Applied Sewn Solutions, which is a joint marketing effort with A. Lava & Son Co. of Chicago, a leading provider of mattress covers. We are establishing a small manufacturing operation near our current plants in North Carolina, which will involve leased space and a limited capital investment in equipment, to produce and market sewn mattress covers, a growing product category in the bedding industry. Teaming with A. Lava & Son allows us to have two mirrored manufacturing facilities and great flexibility in meeting demand from bedding producers for mattress covers.

Upholstery Fabrics. The upholstery fabrics segment markets a wide variety of fabrics for residential and commercial furniture customers. The upholstery fabrics segment operates fabric manufacturing facilities in Anderson, South Carolina, and Shanghai, China. We market fabrics produced in these two locations, as well as a variety of upholstery fabrics sourced from third party producers, mostly in China. In each of the past two fiscal years, sales of non-U.S. produced upholstery accounted for more than 85% of our upholstery fabric sales.

Demand for U.S.-produced upholstery declined significantly over the past decade, and we took aggressive steps to reduce our U.S. manufacturing costs, capacity, and selling, general and administrative expenses. These restructuring actions reduced our U.S. upholstery operations to the one manufacturing plant in South Carolina and one upholstery distribution facility in Burlington, North Carolina.

During the time that U.S. upholstery operations were being reduced, we established operations in China and gradually expanded them over time to include a variety of activities. The facilities near Shanghai now include fabric sourcing, finishing, quality control and inspection operations, as well as a plant where sourced fabrics are cut and sewn into “kits” made to specifications of furniture manufacturing customers. More recent developments in our China operations include expansion of our product development and design capabilities in China and further strengthening of key strategic partnerships with mills. We also expanded our marketing efforts to sell our China products in countries other than the U.S., including the Chinese local market.

We established a new subsidiary during fiscal 2011 called Culp Europe, which is a marketing and distribution operation based in Poland, in an area with a high concentration of furniture suppliers. This operation targets furniture manufacturers in the European market. We view this market as a significant long-term opportunity for growth, with high living standards, fashion conscious consumers, and short replacement cycles for upholstered furniture. Culp Europe accounted for approximately 3% for our upholstery sales in fiscal 2012.

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

Even as economic conditions and furniture demand remained relatively weak during fiscal 2012, our upholstery fabrics sales increased for the third consecutive year. These gains reversed a ten year trend of declining upholstery sales that ended with fiscal 2009, as we substantially overhauled our operating model. We believe our increased sales in the upholstery fabrics segment were achieved primarily through implementation of a business strategy that included: 1) innovation in a low-cost environment, 2) speed to market execution, 3) consistent quality, 4) reliable service and lead times, and 5) increased recognition of and reliance on the Culp brand. A return to profitability in upholstery fabrics has been achieved through development of a unique business model that has enabled the upholstery segment to execute a strategy that we believe is clearly differentiated from competitors. In this way, we have maintained our ability to provide furniture manufacturers with products from every category of fabric used to cover upholstered furniture, and to meet continually changing demand levels and consumer preferences.

## Overview of Industry and Markets

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

## Overview of Bedding Industry

In calendar 2010 and 2011, the bedding industry experienced gains in both dollar and unit sales, reversing a recent trend of declining sales over several years prior to that. According to the International Sleep Products Association (ISPA), a trade association, the U.S. wholesale bedding industry increased dollar sales by 7.7% to 6.3 billion in 2011. Unit volume sales increased only slightly (0.2%) in 2011 compared to 2010, having experienced a 6.2% increase the previous year after four years of declines. Specialty bedding manufacturers, which produce mattresses that do not use inner spring construction, now account for about 30% of bedding dollar sales, but only 14% of the unit volume in the industry. This category of bedding, which has a higher average selling price, has continued to increase its share of total bedding sales, according to industry statistics. ISPA also reported that overall average unit prices in the bedding industry increased 7.5% in 2011, reversing a trend of declines in the prior two years.

The bedding industry is comprised of several hundred manufacturers, but the largest five manufacturers accounted for more than 70% of total wholesale shipments in 2011, while the top fifteen accounted for approximately 86%. Until recently, the industry has been mature and stable, generally experiencing slow and steady growth in sales. However, during the past few years sales have been more unpredictable, as the economic downturn caused two years of sales declines, followed by a return to growth in 2010. On a long-term basis, the stability of this market has been due in part to replacement purchases, which account for the majority of bedding industry sales.

Unlike the residential furniture industry, which has faced intense competition from imports, the U.S. bedding industry has largely remained a North American based business with limited competition from imports. Imports of bedding into the U.S. have increased in recent years, but imports still represent only a small fraction of total U.S. bedding sales. The primary reasons for this fact include: 1) the short lead times demanded by mattress manufacturers and retailers due to their quick service delivery model, 2) the limited inventories carried by manufacturers and retailers requires "just-in-time" delivery of product, 3) the customized nature of each manufacturer and retailer's product lines, 4) high shipping and import duty costs, 5) the relatively low direct labor content in mattresses, and 6) strong brand recognition and importance.

Other key trends in the bedding industry include:

Consumers have become increasingly aware of and are concerned with the health benefits of better sleep. This has caused an increased focus on the quality of bedding products and an apparent willingness on the part of consumers to upgrade their bedding.

While mattress fabrics serve the functional purpose of providing a soft and durable cover, there is a growing emphasis on the design knitted or woven into the fabrics to appeal to the customer's visual attraction and perceived value of the mattress on the retail floor. Mattress fabric design efforts are based on current trends in home decor and fashion.

Growth in non-traditional sources for retail mattress sales is now an important factor in home furnishings sales. These outlets, such as wholesale warehouse clubs and the internet, have the potential to increase overall consumption of goods due to convenience and high traffic volume which in turn result in higher turnover of product.