CULP INC
Form 10-Q
March 09, 2012

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 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)	27265-1402 (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 filero	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

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 29, 2012: 12,692,574
Par Value: $0.05 per share

INDEX TO FORM 10-Q
For the period ended January 29, 2012

Item 1: Financial Statements

CULP, INC.
CONSOLIDATED STATEMENTS OF NET INCOME
FOR THE THREE AND NINE MONTHS ENDED JANUARY 29, 2012 AND JANUARY 30, 2011
UNAUDITED
(Amounts in Thousands, Except for Per Share Data)

		THREE MONTHS ENDED	
		January 29, 2012	January 30, 2011
Net sales	$	60,450	51,652
Cost of sales		51,939	43,413
Gross profit		8,511	8,239
Selling, general and administrative expenses		5,518	5,129
Restructuring expense		-	7
Income from operations		2,993	3,103
Interest expense		181	224
Interest income		(148)	(57)
Other expense		83	28
Income before income taxes		2,877	2,908
Income taxes		1,075	483
Net income	$	1,802	2,425
Net income per share, basic	$	0.14	0.19
Net income per share, diluted		0.14	0.18
Average shares outstanding, basic		12,536	13,005
Average shares outstanding, diluted		12,677	13,228

		NINE MONTHS ENDED	
		January 29, 2012	January 30, 2011
Net sales	$	178,733	156,443
Cost of sales		152,698	130,886
Gross profit		26,035	25,557
Selling, general and			

administrative expenses		16,995		14,544	
Income from operations		9,040		11,013	
Interest expense		590		659	
Interest income		(387	)	(144	)
Other expense		132		111	
Income before income taxes		8,705		10,387	
Income taxes		(1,168	)	213	
Net income	$	9,873		10,174	
Net income per share, basic	$	0.77		0.79	
Net income per share, diluted		0.76		0.77	
Average shares outstanding, basic		12,777		12,936	
Average shares outstanding, diluted		12,918		13,218	

See accompanying notes to consolidated financial statements.

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CULP, INC.
CONSOLIDATED BALANCE SHEETS
JANUARY 29, 2012, JANUARY 30, 2011 AND MAY 1, 2011
UNAUDITED
(Amounts in Thousands)

	January 29, 2012	January 30, 2011	* May 1, 2011
Current assets:			
Cash and cash equivalents	$15,096	17,259	23,181
Short-term investments	8,511	5,518	7,699
Accounts receivable, net	22,012	16,909	20,209
Inventories	32,910	26,407	28,723
Deferred income taxes	2,767	296	293
Assets held for sale	45	112	75
Income taxes receivable	-	407	79
Other current assets	2,522	1,521	2,376
Total current assets	83,863	68,429	82,635
Property, plant and equipment, net	30,285	30,571	30,296
Goodwill	11,462	11,462	11,462
Deferred income taxes	3,903	1,322	3,606
Other assets	1,944	2,093	2,052
Total assets	$131,457	113,877	130,051
Current liabilities:			
Current maturities of long-term debt	$2,400	2,400	2,412
Line of credit	875	-	-
Accounts payable-trade	23,489	17,121	24,871
Accounts payable - capital expenditures	15	203	140
Accrued expenses	7,594	5,971	7,617
Accrued restructuring costs	40	71	44
Deferred income taxes	-	-	82
Income taxes payable - current	208	289	646
Total current liabilities	34,621	26,055	35,812
Income taxes payable - long-term	4,040	3,934	4,167
Deferred income taxes	659	622	596
Long-term debt, less current maturities	6,766	9,166	9,135
Total liabilities	46,086	39,777	49,710
Commitments and Contingencies (Note 17)			

Shareholders' equity	85,371	74,100	80,341
Total liabilities and shareholders' equity	$131,457	113,877	130,051
Shares outstanding	12,693	13,214	13,264

* Derived from audited financial statements.

See accompanying notes to consolidated financial statements.

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CULP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED JANUARY 29, 2012 AND JANUARY 30, 2011
UNAUDITED
(Amounts in Thousands)

	NINE MONTHS ENDED	
	January 29, 2012	January 30, 2011
Cash flows from operating activities:		
Net income	$ 9,873	10,174
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	3,600	3,205
Amortization of other assets	183	385
Stock-based compensation	258	280
Excess tax benefit related to stock-based compensation	(39)	(285)
Deferred income taxes	(2,751)	(1,219)
(Gain) loss on sale of equipment	(157)	15
Foreign currency exchange (gains) losses	(196)	33
Changes in assets and liabilities:		
Accounts receivable	(1,769)	3,053
Inventories	(4,045)	(291)
Other current assets	(159)	204
Other assets	(49)	13
Accounts payable - trade	(1,709)	(5,459)
Accrued expenses	(1)	(3,822)
Accrued restructuring	(4)	(253)
Income taxes	(305)	379
Net cash provided by operating activities	2,730	6,412
Cash flows from investing activities:		
Capital expenditures	(3,715)	(5,580)
Proceeds from the sale of equipment	188	27
Purchase of short-term investments	(4,821)	(4,532)
Proceeds from the sale of short-term investments	4,096	2,037
Net cash used in investing activities	(4,252)	(8,048)
Cash flows from financing activities:		
Proceeds from lines of credit	6,323	-
Payments on lines of credit	(5,500)	-
Payments on long-term debt	(2,354)	(129)
Payments on vendor-financed capital expenditures	-	(188)
Proceeds from common stock issued	237	591

Common stock repurchased		(5,384	)	-	
Debt issuance costs		(26	)	(27	)
Excess tax benefit related to stock-based compensation		39		285	
Net cash (used in) provided by financing activities		(6,665	)	532	
Effect of exchange rate changes on cash and cash equivalents		102		68	
Decrease in cash and cash equivalents		(8,085	)	(1,036	)
Cash and cash equivalents at beginning of period		23,181		18,295	
Cash and cash equivalents at end of period	$	15,096		17,259	

See accompanying notes to consolidated financial statements.

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

	Common Stock Shares	Amount	Capital Contributed in Excess of Par Value	Accumulated Earnings	Accumulated Other Comprehensive Income	Total Shareholders' Equity
Balance, May 2, 2010	13,051,785	$652	49,459	12,833	103	$63,047
Net income	-	-	-	16,164	-	16,164
Stock-based compensation	-	-	360	-	-	360
Loss on cash flow hedge, net of taxes	-	-	-	-	(103)	(103)
Common stock issuable in connection with performance based units	40,000	2	(2)	-	-	-
Common stock withheld for withholding taxes payable and cost of option exercises	(60,415)	(3)	(560)	-	-	(563)
Excess tax benefit related to stock based compensation	-	-	339	-	-	339
Fully vested common stock award	3,114	-	-	-	-	-
Common stock issuable in connection with stock option plans	229,974	12	1,085	-	-	1,097
Balance, May 1, 2011	13,264,458	663	50,681	28,997	-	80,341
Net income	-	-	-	9,873	-	9,873
Stock-based compensation	-	-	258	-	-	258
Unrealized gain on short-term investments	-	-	-	-	7	7
Excess tax benefit related to stock based compensation	-	-	39	-	-	39
Common stock repurchased	(624,459)	(31)	(5,353)	-	-	(5,384)
Fully vested common stock award	3,075	-	-			-
Common stock issued in connection with stock option plans	49,500	2	235	-	-	237
Balance, January 29, 2012	12,692,574	$634	45,860	38,870	7	$85,371

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 in accordance with accounting principles generally accepted in the U.S. 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 15, 2011 for the fiscal year ended May 1, 2011.

The company's nine-months ended January 29, 2012 and January 30, 2011, represent 39 week periods, respectively.

2. Significant Accounting Policies

As of January 29, 2012, 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 May 1, 2011.

Recently Adopted Accounting Pronouncements

ASC Topic 605

In October 2009, the FASB issued ASU 2009-13, which amends ASC Topic 605, "Revenue Recognition", to revise accounting guidance related to revenue arrangements with multiple deliverables. The guidance relates to the determination of when the individual deliverables included in a multiple-element arrangement may be treated as separate units of accounting and modifies the manner in which the transaction consideration is allocated across the individual deliverables. Also, this guidance expands the disclosure requirements for revenue arrangements with multiple deliverables. This guidance was effective as of May 2, 2011 (the beginning of our fiscal 2012) and did not have an impact on our consolidated results of operations and financial condition.

Recently Issued Accounting Pronouncements

ASC Topic 220

In June of 2011, the FASB issued ASU No. 2011-05, which amends ASC Topic 220, "Comprehensive Income", to revise accounting guidance related to the presentation of comprehensive income in an entity's financial statements. The guidance allows an entity the option to present the total comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with a total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount of comprehensive income. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity or notes to the financial statements. This revised guidance does not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. As a result, this guidance is effective for our first quarter of fiscal 2013. The FASB amended this guidance in December

2011 to postpone a requirement to present items that are reclassified from other comprehensive income to net income on the face of the financial statement where the components of net income and other comprehensive income are presented and reinstate previous guidance related to such reclassifications. This guidance will change how we present comprehensive income in our consolidated financial statements as we currently present the components of other comprehensive income and total comprehensive income as part of our notes to the consolidated financial statements (see Note 13).

Culp, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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In September 2011, the FASB issued amended guidance that permits an entity to make a qualitative assessment of whether it is more likely than not that a reporting unit's fair value is less than its carrying amount before applying the current two-step goodwill impairment test. If an entity concludes that it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, it would not be required to perform the two-step impairment test for that reporting unit. This guidance is effective for interim and annual reporting periods beginning April 30, 2012, with early adoption permitted, and will not have a material impact on our results of operations, cash flows or financial position.

3. Stock-Based Compensation

Common Stock Award

On October 1, 2011, we granted a total of 3,075 shares of common stock to our board of directors. These shares of common stock vested immediately and were measured at $8.45 per share, which represents the closing price of the company's common stock at the date of grant.

On October 1, 2010, we granted a total of 3,114 shares of common stock to our board of directors. These shares of common stock vested immediately and were measured at $10.02 per share, which represents the closing price of the company's common stock at the date of grant.

We recorded $26,000 and $31,000 of compensation expense within selling, general, and administrative expense for these common stock awards for the nine-month period ending January 29, 2012 and January 30, 2011, respectively.

Incentive Stock Option Awards

We did not grant any incentive stock option awards during the first nine months of fiscal 2012.

At January 29, 2012, options to purchase 219,375 shares of common stock were outstanding, had a weighted average exercise price of $7.26 per share, and a weighted average contractual term of 5.3 years. At January 29, 2012, the aggregate intrinsic value for options outstanding was $403,000.

At January 29, 2012, outstanding options to purchase 168,175 shares of common stock were exercisable, had a weighted average exercise price of $7.56 per share, and a weighted average contractual term of 5.1 years. At January 29, 2012, the aggregate intrinsic value for options exercisable was $259,000.

The aggregate intrinsic value for options exercised during nine-month periods ended January 29, 2012 and January 30, 2011, were $196,000 and $820,000, respectively.

The remaining unrecognized compensation cost related to incentive stock option awards at January 29, 2012, was $96,000 which is expected to be recognized over a weighted average period of 1.1 years.

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

We recorded $101,000 and $111,000 of compensation expense on incentive stock option grants within selling, general, and administrative expense for the nine-month periods ended January 29, 2012, and January 30, 2011, respectively.

Time Vested Restricted Stock Awards

We did not grant any time vested restricted stock awards during the first nine months of fiscal 2012.

We recorded $131,000 and $126,000 of compensation expense within selling, general, and administrative expense for time vested restricted stock awards for the nine-month periods ending January 29, 2012 and January 30, 2011, respectively.

At January 29, 2012, there were 185,000 shares of time vested restricted stock outstanding and unvested. Of the 185,000 shares outstanding and unvested, 105,000 shares (granted on January 7, 2009) vest in equal one-third installments on May 1, 2012, 2013, and 2014, respectively. The remaining 80,000 shares (granted on July 1, 2009) vest in equal one-third installments on July 1, 2012, 2013, and 2014, respectively. At January 29, 2012, the weighted average fair value of these outstanding and unvested shares was $3.65 per share.

During the nine-month period ending January 29, 2012, 10,000 shares of time vested restricted stock vested and had a weighted average fair value of $18,800 or $1.88 per share.

At January 29, 2012, the remaining unrecognized compensation cost related to the unvested restricted stock awards was $203,000, which is expected to be recognized over a weighted average vesting period of 1.7 years.

Performance Based Restricted Stock Units

We did not grant any performance based restricted stock units during the first nine months of fiscal 2012.

On January 7, 2009 (fiscal 2009), certain key management employees and a non-employee were granted 120,000 shares of performance based restricted stock units. This award contingently vested in one-third increments, if in any discrete period of two consecutive quarters from February 2, 2009 through April 30, 2012, certain performance goals are met. As of August 1, 2010 (fiscal 2011), the performance goals as defined in the agreement were met and as a result, all of the performance based restricted stock units have vested.

No compensation cost was recorded for performance based restricted stock units for the nine-month period ended January 29, 2012, as all performance based restricted stock units that have been granted by the company were fully vested at the end of fiscal 2011. We recorded $12,000 within selling, general, and administrative expense for performance based restricted stock units for the nine-month period ended January 30, 2011.

Other Share-Based Arrangements

Effective May 2, 2011, we entered into an agreement in which we granted a non-employee a stock appreciation right that is indexed on 70,000 shares of our common stock. This agreement requires us to settle in cash an amount equal to $35,000, plus the excess, if any, over a stock appreciation right value of $700,000 at May 2, 2011. This stock appreciation right value of $700,000 represents the 70,000 indexed shares of common stock noted above measured at the closing price per share of $10 at May 2, 2011. The cash settlement in connection with the stock appreciation right value would represent the difference between a stock appreciation right value that is indexed on the 70,000 shares of common stock noted above and based on the highest closing price per share of our common stock for the period May 2, 2011 through June 30, 2012 (limited to $12 per share) and the $700,000 stock appreciation right value at May 2, 2011. This award will vest over the period May 2, 2011 through June 30, 2012 as this represents the non-employee’s required service period.

Culp, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Compensation expense associated with this agreement was $44,000 for the nine-months ended January 29, 2012.

4. Accounts Receivable

A summary of accounts receivable follows:

(dollars in thousands)	January 29, 2012	May 1, 2011
Customers	$23,113	$21,562
Allowance for doubtful accounts	(561)	(776)
Reserve for returns and allowances and discounts	(540)	(577)
	$22,012	$20,209

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

	Nine months ended	
(dollars in thousands)	January 29, 2012	January 30, 2011
Beginning balance	$(776)	$(1,322)
Provision for bad debts	18	295
Net write-offs, net of recoveries	197	(19)
Ending balance	$(561)	$(1,046)

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

	Nine months ended	
(dollars in thousands)	January 29, 2012	January 30, 2011
Beginning balance	$(577)	$(534)
Provision for returns, allowances and discounts	(1,929)	(1,606)
Credits issued	1,966	1,550
Ending balance	$(540)	$(590)

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

5. Inventories

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

A summary of inventories follows:

(dollars in thousands)	January 29, 2012	May 1, 2011
Raw materials	$5,032	$6,130
Work-in-process	2,475	2,421
Finished goods	25,403	20,172
	$32,910	$28,723

6. Other Assets

A summary of other assets follows:

(dollars in thousands)	January 29, 2012	May 1, 2011
Cash surrender value – life insurance	$1,327	$1,323
Non-compete agreements, net	369	480
Other	248	249
	$1,944	$2,052

We recorded non-compete agreements in connection with our asset purchase agreements with International Textile Group, Inc. (ITG) and Bodet & Horst at their fair values based on valuation techniques. The non-compete agreement associated with ITG was amortized on a straight line basis over the four year life of the agreement and expired at the end of the third quarter of fiscal 2011. The non-compete agreement associated with Bodet & Horst is amortized on a straight line basis over the six year life of the agreement and requires quarterly payments of $12,500 over the life of the agreement. As of January 29, 2012, the total remaining non-compete payments were $125,000.

The gross carrying amount of these non-compete agreements was $1.0 million at January 29, 2012 and May 1, 2011, respectively. At January 29, 2012 and May 1, 2011, accumulated amortization for these non-compete agreements was $692,000 and $544,000, respectively. Amortization expense for these non-compete agreements was $148,000 and $363,000 for the nine month periods ended January 29, 2012 and January 30, 2011, respectively. The remaining amortization expense (which includes the total remaining Bodet & Horst non-compete payments of $125,000) for the next four fiscal years follows: FY 2012 - $49,000; FY 2013 - $198,000; FY 2014 - $198,000; and FY 2015 - $49,000. The weighted average amortization period for these non-compete agreements is 2.5 years as of January 29, 2012.

At January 29, 2012 and May 1, 2011, we had four life insurance contracts with death benefits to the respective insured totaling $12.9 million. Our cash surrender value – life insurance balances of $1.3 million at January 29, 2012 and May 1, 2011, respectively, are collectible upon death of the respective insured.

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

7. Accrued Expenses

A summary of accrued expenses follows:

(dollars in thousands)	January 29, 2012	May 1, 2011
Compensation, commissions and related benefits	$4,480	$6,032
Interest	324	184
Other accrued expenses	2,790	1,401
	$7,594	$7,617

8. Long-Term Debt and Lines of Credit

A summary of long-term debt follows:

(dollars in thousands)	January 29, 2012	May 1, 2011
Unsecured senior term notes	$8,800	$11,000
Canadian government loan	366	547
	9,166	11,547
Current maturities of long-term debt	(2,400)	(2,412)
Long-term debt, less current maturities of long-term debt	$6,766	$9,135

Unsecured Term Notes

In connection with the Bodet & Horst acquisition in 2008, we entered into a note agreement dated August 11, 2008. This agreement provided for the issuance of $11.0 million of unsecured term notes with a fixed interest rate of 8.01% and a term of seven years. Principal payments of $2.2 million per year are due on the notes beginning August 11, 2011. The principal payments are payable over an average term of 3.5 years through August 11, 2015. Any principal prepayments will be assessed a penalty as defined in the agreement. This agreement contains customary financial and other covenants as defined in the agreement.

We made our first principal payment of $2.2 million associated with this note agreement on August 11, 2011.

Government of Quebec Loan

We have an agreement with the Government of Quebec for a term loan that is non-interest bearing and is payable in 48 equal monthly installments (denominated in Canadian dollars) commencing December 1, 2009. The proceeds were used to partially finance capital expenditures at our Rayonese facility located in Quebec, Canada.

Revolving Credit Agreement – United States

At May 1, 2011, we had an unsecured Amended and Restated Credit Agreement that provided for a revolving loan commitment of $6.5 million, including letters of credit up to $3.0 million. This agreement was set to expire August 15, 2012. On August 25, 2011, we entered into a seventeenth amendment to the Amended and Restated Credit Agreement, amending the agreement effective May 1, 2011 (the end of our fiscal 2011). This amendment extends the expiration date of the line of credit through August 25, 2013, increases the revolving loan commitment from $6.5

million to $10.0 million, and decreases the capital expenditure limit for fiscal years 2012 and 2013 from $10.0 million to $6.0 million. On January 17, 2012, and in connection with the Culp Europe Credit Agreement discussed below, we entered into an eighteenth amendment to decrease our revolving loan commitment from $10.0 million to $7.6 million.

Culp, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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The amended agreement provides for a pricing matrix to determine the interest rate payable on loans made under the agreement (applicable interest rate of 1.88% at January 29, 2012). As of January 29, 2012, there were $50,000 in outstanding letters of credit (all of which related to workers compensation). At January 29, 2012 and May 1, 2011, there were no borrowings outstanding under the agreement.

Revolving Credit Agreement – China

At January 29, 2012, we had an unsecured credit agreement associated with our operations in China that provides for a line of credit of up to 40 million RMB (approximately $6.3 million USD at January 29, 2012). This agreement expires on September 2, 2012 and has an interest rate determined by the Chinese government. There were no borrowings outstanding under the agreement as of January 29, 2012 and May 1, 2011.

Revolving Credit Agreement - Europe

On January 17, 2012, we entered into an unsecured credit agreement associated with our operations in Poland that provides for a line of credit up to 6.8 million Polish Zloty (approximately $2.1 million USD at January 29, 2012). This agreement expires on January 15, 2013 and bears interest at WIBOR (Warsaw Interbank Offered Rate) plus 2% (applicable interest rate of 6.89% at January 29, 2012). At January 29, 2012, $875,000 (2.8 million Polish Zloty) was outstanding under this agreement.

Overall

Our loan agreements require, among other things, that we maintain compliance with certain financial covenants. At January 29, 2012, the company was in compliance with these financial covenants.

At January 29, 2012, the principal payment requirements of long-term debt during the next four years are: Year 1 – $2.4 million; Year 2 - $2.4 million; Year 3 - $2.2 million; and Year 4 - $2.2 million.

The fair value of the company's long-term debt is estimated by discounting the future cash flows at rates currently offered to the company for similar debt instruments of comparable maturities. At January 29, 2012, the carrying value of the company's long-term debt was $9.2 million and the fair value was $8.2 million. At May 1, 2011, the carrying value of the company's long-term debt was $11.5 million and the fair value was $10.2 million.

9. Fair Value of Financial Instruments

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

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

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

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

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

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

	Fair value measurements at January 29, 2012 using:			
	Quoted prices in active markets for identical assets	Significant other observable inputs	Significant unobservable inputs	
(amounts in thousands)	Level 1	Level 2	Level 3	Total
Assets:				
Low Duration Bond Fund	$ 2,021	N/A	N/A	$ 2,021
Limited Term Bond Fund	2,042	N/A	N/A	2,042
Intermediate Term Bond Fund	1,045	N/A	N/A	1,045

	Fair value measurements at May 1, 2011 using:			
	Quoted prices in active markets for identical assets	Significant other observable inputs	Significant unobservable inputs	
(amounts in thousands)	Level 1	Level 2	Level 3	Total
Assets:				
Low Duration Bond Fund	$ 1,003	N/A	N/A	$ 1,003

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

Short-term investments include short-term bond funds and deposit accounts that have maturities of less than one year. Our short-term bond funds are classified as available-for-sale and their unrealized gains or losses are included in other comprehensive income. Our short-term bond funds were recorded at their fair value of $5.1 million and $1.0 million at January 29, 2012 and May 1, 2011, respectively. At January 29, 2012 and May 1, 2011, the fair value of our short-term bond funds approximates its cost basis.

The carrying amount of cash and cash equivalents, short-term investments that pertain to interest bearing deposit accounts, accounts receivable, other current assets, accounts payable and accrued expenses approximates fair value because of the short maturity of these financial instruments.

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10. Derivatives

In accordance with the provisions ASC Topic 815, Derivatives and Hedging, our Canadian dollar foreign exchange contract was designated as a cash flow hedge, with the fair value of this financial instrument recorded in other assets and changes in fair value recorded in accumulated other comprehensive income. ASC Topic 815 requires disclosure of gains and losses on derivative instruments in the following tabular format.

(Amounts in Thousands)
Fair Values of Derivative Instruments As of,

	January 29,2012		May 1, 2011	
Derivatives designated as hedging instruments under ASC Topic 815	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Canadian dollar foreign exchange contract	Other assets	$ -	Other assets	$ -

Derivatives in ASC Topic 815 Net Investment Hedging Relationships	Amt of Gain (Loss) (net of tax) Recognized in OCI on Derivative (Effective Portion) and recorded in Other assets and Accrued Expenses at Fair Value 2012	2011	Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) 2012	2011	Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)	Amount of Gain (net of tax) or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing) 2012	2011
Canadian Dollar Foreign Exchange Contract	$ -	$ (103)	Other Expense	$ -	$ 5	Other Expense	$ -	$ 79

On January 21, 2009, we entered into a Canadian dollar foreign exchange rate contract to mitigate the risk of foreign exchange rate fluctuations associated with our loan from the Government of Quebec. This agreement effectively converted the Canadian dollar principal payments at a fixed Canadian dollar foreign exchange rate compared with the United States dollar of 1.218 and was due to expire on November 1, 2013. During the first quarter of fiscal 2011, we elected to terminate this contract due to the favorable Canadian dollar foreign changes rates in comparison to the fixed contractual rate noted above.

During the fourth quarter of fiscal 2012, we entered into an agreement to enter foreign exchange contracts that mitigate the risk of foreign exchange rate fluctuations for inventory purchases associated with our operations located in Poland. These contracts effectively convert USD inventory payments at a fixed USD foreign exchange rate compared with the Polish Zloty.

11. Cash Flow Information

Payments for interest and income taxes follows:

	Nine months ended	
(dollars in thousands)	January 29, 2012	January 30, 2011
Interest	$449	$454
Net income tax payments	1,886	1,054

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No interest costs were capitalized for the nine months ending January 29, 2012. Interest costs of $17,000 for the construction of qualifying property, plant, and equipment were capitalized for the nine months ending January 30, 2011.

During the nine-month period ending January 29, 2012, no shares of common stock were withheld to satisfy withholding tax liabilities and other costs incurred in connection with vesting of performance based restricted stock units or the exercise of options to purchase common stock. During the nine-month period ending January 30, 2011, 33,835 shares of common stock were withheld to satisfy withholding tax liabilities and other costs incurred in connection with 40,000 shares of common stock issued and related to the vesting of performance based restricted stock units and the exercise of 72,000 options to purchase of common stock. The total withholding tax liabilities and other costs incurred totaled $329,000.

12. Net Income Per Share

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

	Three months ended	
(amounts in thousands)	January 29, 2012	January 30, 2011
Weighted average common shares outstanding, basic	12,536	13,005
Dilutive effect of stock-based compensation	141	223
Weighted average common shares outstanding, diluted	12,677	13,228

Options to purchase 142,750 shares of common stock were not included in the computation of diluted net income per share for the three months ended January 29, 2012, as the exercise price of the options was greater than the average market price of the common shares. All options of common stock were included in the computation of diluted net income per share as the exercise price of the options was less than average market price of the common shares for the three months ended January 30, 2011.

The computations of basic net income per share did not include 185,000 and 195,000 shares of time vested restricted common stock as these shares were unvested for the three months ending January 29, 2012 and January 30, 2011, respectively.

	Nine months ended	
(amounts in thousands)	January 29, 2012	January 30, 2011
Weighted average common shares outstanding, basic	12,777	12,936
Dilutive effect of stock-based compensation	141	282
Weighted average common shares outstanding, diluted	12,918	13,218

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Options to purchase 142,750 shares of common stock were not included in the computation of diluted net income per share for the nine months ended January 29, 2012, as the exercise price of the options was greater than the average market price of the common shares. All options of common stock were included in the computation of diluted net income for the nine months ended January 30, 2011, as the exercise price of the options was less than the average market price of the common shares.

The computations of basic net income per share did not include 185,000 and 195,000 shares of time vested restricted common stock as these shares were unvested for the nine months ending January 29, 2012 and January 30, 2011, respectively.

13. Comprehensive Income

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

A summary of comprehensive income follows:

	Nine months ended	
(dollars in thousands)	January 29, 2012	January 30, 2011
Net income	$9,873	$10,174
Unrealized gains on short-term investments	7	-
Loss on cash flow hedge, net of income taxes	-	(103)
Comprehensive income	9,880	$10,071

14. Segment Information

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

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

Financial information for the company's operating segments follows:

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	Three months ended		
(dollars in thousands)	January 29, 2012	January 30, 2011	
Net sales:			
Mattress Fabrics	$ 34,719	$ 27,991	
Upholstery Fabrics	25,731	23,661	
	$ 60,450	$ 51,652	
Gross profit:			
Mattress Fabrics	$ 5,104	$ 4,596	
Upholstery Fabrics	3,407	3,643	
	$ 8,511	$ 8,239	
Selling, general, and administrative expenses:			
Mattress Fabrics	$ 1,970	$ 1,780	
Upholstery Fabrics	2,653	2,517	
Total segment selling, general, and administrative expenses	4,623	4,297	
Unallocated corporate expenses	895	832	
	$ 5,518	$ 5,129	
Income from operations:			
Mattress Fabrics	$ 3,134	$ 2,816	
Upholstery Fabrics	754	1,126	
Total segment income from operations	3,888	3,942	
Unallocated corporate expenses	(895)	(832)	
Restructuring expense	-	(7)	(1)
Total income from operations	2,993	3,103	
Interest expense	(181)	(224)	
Interest income	148	57	
Other expense	(83)	(28)	
Income before income taxes	$ 2,877	$ 2,908	

(1) The $7 restructuring charge represents $17 for lease termination and other exit costs offset by a credit of $10 for sales proceeds received on equipment with no carrying value. This restructuring charge relates to the Upholstery Fabrics segment.

	Nine months ended		
(dollars in thousands)	January 29, 2012		January 30, 2011
Net sales:			
Mattress Fabrics	$ 102,130		$ 87,244
Upholstery Fabrics	76,603		69,199
	$ 178,733		$ 156,443
Gross profit:			
Mattress Fabrics	$ 16,180		$ 15,616
Upholstery Fabrics	9,932		9,941
Total segment gross profit	$ 26,112		$ 25,557
Other non-recurring charges	(77)	(2)	-
	$ 26,035		$ 25,557
Selling, general, and administrative expenses:			

Mattress Fabrics	$	6,094			$	5,480	
Upholstery Fabrics		8,186				6,394	
Total segment selling, general, and administrative expenses		14,280				11,874	
Unallocated corporate expenses		2,715				2,670	
	$	16,995			$	14,544	
Income from operations:							
Mattress Fabrics	$	10,087			$	10,136	
Upholstery Fabrics		1,745				3,547	
Total segment income from operations		11,832				13,683	
Unallocated corporate expenses		(2,715	)			(2,670	)
Other non-recurring charges		(77	)	(2)		-	
Total income from operations		9,040				11,013	
Interest expense		(590	)			(659	)
Interest income		387				144	
Other expense		(132	)			(111	)
Income before income taxes	$	8,705			$	10,387	

(2) The $77 other non-recurring charge represents employee termination benefits associated with our Anderson, SC plant facility. This non-recurring charge relates to the Upholstery Fabrics segment.

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

(dollars in thousands)	January 29, 2012	May 1, 2011
Segment assets:		
Mattress Fabrics		
Current assets (3)	$28,638	$25,456
Assets held for sale	14	14
Non-compete agreements, net	369	480
Goodwill	11,462	11,462
Property, plant and equipment (4)	28,210	28,581
Total mattress fabrics assets	68,693	65,993
Upholstery Fabrics		
Current assets (3)	26,284	23,476
Assets held for sale	31	61
Property, plant and equipment (5)	1,246	967
Total upholstery fabrics assets	27,561	24,504
Total segment assets	96,254	90,497
Non-segment assets:		
Cash and cash equivalents	15,096	23,181
Short-term investments	8,511	7,699
Income taxes receivable	-	79
Deferred income taxes	6,670	3,899
Other current assets	2,522	2,376
Property, plant and equipment (6)	829	748
Other assets	1,575	1,572
Total assets	$131,457	$130,051

	Nine months ended	
(dollars in thousands)	January 29, 2012	January 30, 2011
Capital expenditures (7):		
Mattress Fabrics	$2,761	$5,040
Upholstery Fabrics	481	170
Unallocated Corporate	351	193
Total capital expenditures	$3,593	$5,403
Depreciation expense:		
Mattress Fabrics	$3,163	$2,795
Upholstery Fabrics	437	410
Total depreciation expense	$3,600	$3,205

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(3) Current assets represent accounts receivable and inventory for the respective segment.

(4) The $28.2 million at January 29, 2012, represents property, plant, and equipment of $19.8 million and $8.4 million located in the U.S. and Canada, respectively. The $28.6 million at May 1, 2011, represents property, plant, and equipment of $20.0 million and $8.6 million located in the U.S. and Canada, respectively.

(5) The $1.2 million at January 29, 2012, represents property, plant, and equipment located in the U.S. of $957, located in China of $179, and located in Poland of $110. The $967 at May 1, 2011, represents property, plant, and equipment located in the U.S. of $727, located in China of $184, and located in Poland of $56.

(6) The $829 and $748 at January 29, 2012 and May 1, 2011, respectively, represent property, plant, and equipment associated with unallocated corporate departments and corporate departments shared by both the mattress and upholstery fabric segments. Property, plant, and equipment associated with corporate are located in the U.S.

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

15. Income Taxes

Effective Income Tax Rate

We recorded an income tax benefit of $1.2 million, or (13.4)% of income before income tax expense, for the nine month period ended January 29, 2012, compared to income tax expense of $213,000, or 2.1% of income before income tax expense, for the nine month period ended January 30, 2011. Our effective income tax rates for the nine month periods ended January 29, 2012, and January 30, 2011, were based upon the estimated effective income tax rate applicable for the full year after giving effect to any significant items related specifically to interim periods. The effective income tax rate can be affected over the fiscal year by the mix and timing of actual earnings from our U.S. operations and foreign sources versus annual projections and changes in foreign currencies in relation to the U.S. dollar.

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The effective income tax rate of (13.4)% for the nine month period ended January 29, 2012 is different from the amount obtained by applying our statutory rate of 34% to income before income taxes for the following reasons:

The effective income tax rate was reduced by 50% for a reduction in our valuation allowance associated with our U.S. net deferred income tax assets. This 50% reduction in our effective income tax rate is due to a change in judgment about the realization of our U.S. net deferred income tax assets in future years. Since the realization of our U.S. net deferred income tax assets is a result of a change in judgment about future years, we recorded an income tax benefit of $4.4 million that represents a discrete event in which the full tax effects were recorded for the nine month period ending January 29, 2012.

The effective income tax rate was reduced by 7% for taxable income subject to lower statutory income tax rates in foreign jurisdictions (Canada and China) compared with the statutory income tax rate of 34% for the United States.

The effective income tax rate was increased 7% for an increase in unrecognized tax benefits.

The effective income tax rate was increased by 2.6% for stock-based compensation and other miscellaneous items.

The effective income tax rate of 2.1% for the nine month period ended January 30, 2011 is different from the amount obtained by applying our statutory rate of 34% to income before income taxes for the following reasons:

The effective income tax rate was reduced by 31% for a reduction in our valuation allowance recorded against our net deferred income tax assets. Of this 31% reduction in our effective income tax rate, 19% and 12% pertain to our operations located in the U.S. and China, respectively. The 19% reduction in our effective income tax rate from our U.S. operations is due to the realization of our U.S. net deferred income tax assets from ordinary taxable income projected for fiscal 2011. Since the realization of our U.S. net deferred income tax assets were from ordinary taxable income in the current fiscal year, its tax effects are included in the computation of the annual effective tax rate for fiscal 2011. The 12% reduction in our effective income tax rate from our China operations is due to a change in judgment about the realization of our China net deferred income tax assets in future years. Since the realization of our China net deferred income tax assets is a result of a change in judgment about future years, we recorded an income tax benefit of $1.3 million that represents a discrete event in which the full tax effects were recorded for the nine month period ended January 30, 2011.

The income tax rate was reduced by 7% for taxable income subject to lower statutory income tax rates in foreign jurisdictions (Canada and China) compared with the statutory income tax rate of 34% for the United States.

The income tax rate was reduced by 3% for adjustments made to our Canadian deferred income tax liabilities and associated with our election to file our Canadian income tax returns in U.S. dollars commencing with our fiscal 2011 tax year. Our Canadian income tax returns were filed in Canadian dollars for fiscal years prior to fiscal 2011. This adjustment totaled $315,000 and represented a discrete event in which the full tax effects were recorded during the nine-month period ended January 30, 2011.

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The income tax rate increased 9% for an increase in unrecognized tax benefits. This 9% increase in the income tax rate also includes an income tax benefit of $107,000 or a reduction in the income tax rate of 1% for the subsequent recognition of unrecognized tax benefits. This adjustment of $107,000 represents a discrete event in which the full tax effects were recorded during the nine month period ended January 30, 2011.

The income tax rate was increased by 0.1% for stock-based compensation and other miscellaneous items.

Deferred Income Taxes

Summary

In accordance with ASC Topic 740, we evaluate our deferred income taxes to determine if a valuation allowance is required. ASC Topic 740 requires that companies assess whether a valuation allowance should be established based on the consideration of all available evidence using a “more likely than not” standard, with significant weight being given to evidence that can be objectively verified. Since the company operates in multiple jurisdictions, we assess the need for a valuation allowance on a jurisdiction-by-jurisdiction basis, taking into account the effects of local tax law. Based on our assessments, we recorded a partial valuation allowance of $12.1 million and $16.4 million against our net deferred income tax assets associated with our U.S. operations at January 29, 2012, and May 1, 2011, respectively. No valuation allowance has been recorded against our net deferred income tax assets associated with our operations located in China, Canada, and Europe.

United States

Our net deferred income tax asset regarding our U.S. operations primarily pertains to incurring significant U.S. pre-tax losses over prior fiscal years, with U.S. loss carryforwards totaling $60.0 million at May 1, 2011. Due to the favorable results of our multi-year restructuring process in our upholstery fabric operations and key acquisitions and capital investments made for our mattress fabric segment, on a cumulative three-year basis ending May 1, 2011 (the end of our fiscal 2011), our U.S. operations earned a pre-tax income of $4.2 million. In addition, our U.S. operations reported a pre-tax income over fiscal years 2011 and 2010 totaling $8.2 million. We believe that fiscal years 2011 and 2010 are a more indicative measure of future pre-tax income as these fiscal years reflect operating performance after the cost savings of recent profit-improvement and restructuring plans were realized, as well as the full operational effects of the acquisitions associated with the company’s mattress fabric operations located in the U.S.

This improvement continued through the second quarter of fiscal 2012, as our U.S. operations earned a cumulative pretax income through the second quarter of fiscal 2012 and fiscal years 2011 and 2010 totaling $10.0 million. This continued earnings improvement from our U.S. operations was driven by our mattress fabric operations (which primarily resides in the U.S.). During the second quarter of fiscal 2012, our mattress fabric operations had net sales totaling $35.2 million compared with $28.3 million in the second quarter of fiscal 2011. In addition, our mattress fabric operations had operating income totaling $3.8 million in the second quarter of fiscal 2012 compared with $3.3 million in the second quarter of fiscal 2011. These improved results in the second quarter of fiscal 2012, which were better than expected, can be attributed to increased sales from our sales and marketing initiatives and new programs with customers who are leading suppliers in the bedding industry. Collectively, these developments increased our confidence in forecasting U.S. taxable income through fiscal 2014 in the second quarter of fiscal 2012. Based on the continuation of these trends in the third quarter of fiscal 2012, we maintain our position that we can forecast U.S. taxable income through 2014. During the third quarter of fiscal 2012, our mattress fabric operations had net sales totaling $34.7 million compared with $28.0 million in the third quarter of fiscal 2011. In addition, our mattress fabric operations had operating income totaling $3.1 million in the third quarter of fiscal 2012 compared with $2.8 million in the third quarter of fiscal 2011.

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Although our U.S. operations have reported pre-tax income on a cumulative three-year basis, the significant uncertainty in the overall economic climate, has made it very difficult to forecast medium and long-term financial results associated with our U.S. operations. Since it will take a significant period of time for our U.S. operations to realize its U.S. net deferred income tax assets based on earned and forecasted U.S. pre-tax income levels, we believe it is too uncertain to project U.S. pre-tax income levels associated with our U.S. operations after fiscal 2014 that support a “more likely than not” assertion at the end of our third quarter of fiscal 2012.

Based on the positive and negative evidence noted above, we recorded a partial valuation allowance of $12.1 million at January 29, 2012, against the net deferred income tax assets associated with our U.S. operations that are expected to reverse beyond fiscal 2014 and we recognized an income tax benefit of $4.4 million in the second quarter of fiscal 2012 for the reduction in this valuation allowance for projected U.S. taxable income in fiscal years 2013 and 2014 to reduce our U.S. loss carryforwards.

Overall

The recorded valuation allowance of $12.1 million has no effect on our operations, loan covenant compliance, or the possible realization of the U.S. income tax loss carryforwards in the future. If it is determined that it is “more likely than not” that we will realize any of these U.S. income tax loss carryforwards, an income tax benefit would be recognized at that time.

At January 29, 2012, the current deferred income tax asset of $2.8 million represents $2.5 million and $256,000 from our operations located in the U.S. and China, respectively. At May 1, 2011, the current deferred income tax asset of $293,000 pertains to our operations located in China. At May 1, 2011, the current deferred income tax liability of $82,000 pertains to our operations located in Canada. At January 29, 2012, the non-current deferred income tax asset of $3.9 million represents $2.8 million and $1.1 million from our operations located in the U.S. and China, respectively. At May 1, 2011, the non-current deferred income tax asset of $3.6 million represents $2.3 million and $1.3 million from our operations located in the U.S. and China, respectively. At January 29, 2012 and May 1, 2011, the non-current deferred income tax liability of $659,000 and $596,000 pertains to our operations located in Canada.

Uncertainty In Income Taxes

At January 29, 2012, we had $12.3 million of total gross unrecognized tax benefits, of which $4.0 million represents the amount of gross unrecognized tax benefits that, if recognized would favorably affect the income tax rate in future periods. Of the $12.3 million in gross unrecognized tax benefits as of January 29, 2012, $8.3 million were classified as net non-current deferred income taxes and $4.0 million were classified as income taxes payable –long-term in the accompanying consolidated balance sheets.

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At May 1, 2011, we had $11.7 million of total gross unrecognized tax benefits, of which $4.2 million would favorably affect the income tax rate in future periods. Of the $11.7 million in total gross unrecognized tax benefits as of May 1, 2011, $7.5 million were classified as net non-current deferred income taxes and $4.2 million were classified as income taxes payable – long-term in the accompanying consolidated balance sheets.

We estimate that the amount of gross unrecognized tax benefits will increase by approximately $1.0 million for fiscal 2012. This increase primarily relates to double taxation under applicable tax treaties with foreign tax jurisdictions.

16. Statutory Reserves

Our subsidiaries located in China are required to transfer 10% of their net income, as determined in accordance with the People's Republic of China (PRC) accounting rules and regulations, to a statutory surplus reserve fund until such reserve balance reaches 50% of the company's registered capital.

The transfer to this reserve must be made before distributions of any dividend to shareholders. As of January 29, 2012, the company's statutory surplus reserve was $2.9 million, representing 10% of accumulated earnings and profits determined in accordance with PRC accounting rules and regulations. The surplus reserve fund is non-distributable other than during liquidation and can be used to fund previous years' losses, if any, and may be utilized for business expansion or converted into share capital by issuing new shares to existing shareholders in proportion to their shareholding or by increasing the par value of the shares currently held by them provided that the remaining reserve balance after such issue is not less than 25% of the registered capital.

Our subsidiaries located in China can transfer funds to the parent company with the exception of the statutory surplus reserve of $2.9 million to assist with debt repayment, capital expenditures, and other expenses of the company's business.

17. Commitments and Contingencies

Chromatex Environmental Claim

A lawsuit was filed against us and other defendants (Chromatex, Inc., Rossville Industries, Inc., Rossville Companies, Inc. and Rossville Investments, Inc.) on February 5, 2008 in United States District Court for the Middle District of Pennsylvania. The plaintiffs are Alan Shulman, Stanley Siegel, Ruth Cherenson as Personal Representative of Estate of Alan Cherenson, and Adrienne Rolla and M.F. Rolla as Executors of the Estate of Joseph Byrnes. The plaintiffs were partners in a general partnership that formerly owned a manufacturing plant in West Hazleton, Pennsylvania (the "Site"). Approximately two years after this general partnership sold the Site to defendants Chromatex, Inc. and Rossville Industries, Inc., we leased and operated the Site as part of our Rossville/Chromatex division. The lawsuit involves court judgments that have been entered against the plaintiffs and against defendant Chromatex, Inc. requiring them to pay costs incurred by the United States Environmental Protection Agency ("USEPA") responding to environmental contamination at the Site, in amounts approximating $8.6 million, plus unspecified future environmental costs. Neither USEPA nor any other governmental authority has asserted any claim against us on account of these matters. The plaintiffs seek contribution from us and other defendants and a declaration that the company and the other defendants are responsible for environmental response costs under environmental laws and certain agreements. The plaintiffs also assert that we tortiously interfered with contracts between them and other defendants in the case and diverted assets to prevent the plaintiffs from being paid monies owed to them. We do not believe we have any liability for the matters described in this litigation and intend to defend ourselves vigorously. In addition, we have an indemnification agreement with certain other defendants in the litigation pursuant to which the other defendants agreed to indemnify us for any damages we incur as a result of the environmental matters that are the subject of this litigation, although it is unclear whether the indemnitors have significant assets at this time. Since the loss is not probable and cannot be estimated, no reserve has been recorded.

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Other Litigation

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

Purchase Commitments

At January 29, 2012, and May 1, 2011, we had open purchase commitments to acquire equipment for our mattress fabrics segment totaling $1.4 million and $980,000, respectively.