# 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 October 30, 2022**
**Commission File No. 1-12597**

## CULP, INC.

(Exact name of registrant as specified in its charter)

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

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

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

| Title of Each Class | Trading Symbol(s) | Name of Each Exchange On Which Registered |
|---|---|---|
| Common Stock, par value $.05/ Share | CULP | New York Stock Exchange |

**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 such filing requirements for the past 90 days.** ☒ YES NO ☐

**Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period after the registrant was required to submit such files).** ☒ YES NO ☐

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

| | | | |
|---|---|---|---|
| Large accelerated filer | ☐ | Accelerated filer | ☒ |
| Non-accelerated filer | ☐ | Smaller Reporting Company | ☒ |
| | | Emerging Growth Company | ☐ |

**If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.** ☐

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

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

**Common shares outstanding as of December 7, 2022: 12,293,762**
**Par Value: $0.05 per share**

**INDEX TO FORM 10-Q**

**For the period ended October 30, 2022**

## Item 1: Financial Statements

# CULP, INC.
## CONSOLIDATED STATEMENTS OF NET (LOSS) INCOME
## FOR THE THREE MONTHS ENDED OCTOBER 30, 2022, AND OCTOBER 31, 2021
## UNAUDITED
## (Amounts in Thousands, Except for Per Share Data)

| | THREE MONTHS ENDED | |
|---|---|---|
| | **October 30, 2022** | October 31, 2021 |
| Net sales | **$ 58,381** | $ 74,561 |
| Cost of sales | **(60,594)** | (63,834) |
| Gross (loss) profit | **(2,213)** | 10,727 |
| Selling, general and administrative expenses | **(9,103)** | (9,087) |
| Restructuring expense | **(615)** | — |
| (Loss) income from operations | **(11,931)** | 1,640 |
| Interest income | **79** | 59 |
| Other income (expense) | **829** | (404) |
| (Loss) income before income taxes | **(11,023)** | 1,295 |
| Income tax expense | **(1,150)** | (444) |
| Net (loss) income | **(12,173)** | 851 |
| | | |
| Net (loss) income per share - basic | **$ (0.99)** | $ 0.07 |
| Net (loss) income per share - diluted | **$ (0.99)** | $ 0.07 |
| Average shares outstanding, basic | **12,280** | 12,223 |
| Average shares outstanding, diluted | **12,280** | 12,316 |

See accompanying notes to consolidated financial statements.

# CULP, INC.
# CONSOLIDATED STATEMENTS OF NET (LOSS) INCOME
# FOR THE SIX MONTHS ENDED OCTOBER 30, 2022, AND OCTOBER 31, 2021
# UNAUDITED
# (Amounts in Thousands, Except for Per Share Data)

| | SIX MONTHS ENDED | |
|---|---|---|
| | **October 30, 2022** | October 31, 2021 |
| Net sales | **$ 120,985** | $ 157,608 |
| Cost of sales | **(119,071)** | (134,382) |
| Gross profit | **1,914** | 23,226 |
| Selling, general and administrative expenses | **(17,968)** | (18,268) |
| Restructuring expense | **(615)** | — |
| (Loss) income from operations | **(16,669)** | 4,958 |
| Interest income | **96** | 132 |
| Other income (expense) | **747** | (640) |
| (Loss) income before income taxes | **(15,826)** | 4,450 |
| Income tax expense | **(2,046)** | (1,349) |
| Net (loss) income | **$ (17,872)** | $ 3,101 |
| | | |
| Net (loss) income per share - basic | **$ (1.46)** | $ 0.25 |
| Net (loss) income per share - diluted | **$ (1.46)** | $ 0.25 |
| Average shares outstanding, basic | **12,259** | 12,268 |
| Average shares outstanding, diluted | **12,259** | 12,369 |

See accompanying notes to consolidated financial statements.

# CULP, INC.
# CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME
# FOR THE THREE AND SIX MONTHS ENDED OCTOBER 30 , 2022, AND OCTOBER 31, 2021
# UNAUDITED
# (Amounts in Thousands)

| | THREE MONTHS ENDED | |
|---|---|---|
| | **October 30, 2022** | October 31, 2021 |
| Net (loss) income | **$ (12,173 )** | $ 851 |
| Unrealized holding loss on investments, net of tax | **(46 )** | (5 ) |
| Reclassification adjustment for realized gain on sale of investments | **—** | (4 ) |
| Comprehensive (loss) income | **$ (12,219 )** | $ 842 |

| | SIX MONTHS ENDED | |
|---|---|---|
| | **October 30, 2022** | October 31, 2021 |
| Net (loss) income | **$ (17,872 )** | $ 3,101 |
| Unrealized holding (loss) gain on investments, net of tax | **(53 )** | 143 |
| Reclassification adjustment for realized gain on investments | **—** | (4 ) |
| Comprehensive (loss) income | **$ (17,925 )** | $ 3,240 |

See accompanying notes to consolidated financial statements.

## CULP, INC.
## CONSOLIDATED BALANCE SHEETS
## OCTOBER 30, 2022, OCTOBER 31, 2021, AND MAY 1, 2022
## UNAUDITED
## (Amounts in Thousands)

| | **October 30, 2022** | October 31, 2021 | * May 1, 2022 |
|---|---|---|---|
| Current assets: | | | |
| Cash and cash equivalents | $ **19,137** | 16,956 | 14,550 |
| Short-term investments - held-to-maturity | **—** | 1,564 | — |
| Short-term investments - available for sale | **—** | 9,709 | — |
| Short-term investments - rabbi trust | **2,237** | — | — |
| Accounts receivable, net | **22,443** | 32,316 | 22,226 |
| Inventories | **52,224** | 63,781 | 66,557 |
| Current income taxes receivable | **510** | 613 | 857 |
| Other current assets | **3,462** | 3,811 | 2,986 |
| Total current assets | **100,013** | 128,750 | 107,176 |
| Property, plant and equipment, net | **38,832** | 43,265 | 41,702 |
| Right of use assets | **11,609** | 13,649 | 15,577 |
| Intangible assets | **2,440** | 2,816 | 2,628 |
| Long-term investments - rabbi trust | **7,526** | 9,036 | 9,357 |
| Long-term investments - held-to-maturity | **—** | 8,353 | — |
| Deferred income taxes | **493** | 452 | 528 |
| Other assets | **717** | 3,004 | 595 |
| Total assets | $ **161,630** | 209,325 | 177,563 |
| Current liabilities: | | | |
| Accounts payable - trade | $ **24,298** | 40,525 | 20,099 |
| Accounts payable - capital expenditures | **200** | 176 | 473 |
| Operating lease liability - current | **2,655** | 2,878 | 3,219 |
| Deferred compensation | **2,237** | — | — |
| Deferred revenue | **1,527** | 679 | 520 |
| Accrued expenses | **7,594** | 11,019 | 7,832 |
| Accrued restructuring | **33** | — | — |
| Income taxes payable - current | **969** | 646 | 413 |
| Total current liabilities | **39,513** | 55,923 | 32,556 |
| Operating lease liability - long-term | **4,194** | 7,914 | 7,062 |
| Income taxes payable - long-term | **2,629** | 3,099 | 3,097 |
| Deferred income taxes | **5,700** | 4,918 | 6,004 |
| Deferred compensation | **7,486** | 9,017 | 9,343 |
| Total liabilities | **59,522** | 80,871 | 58,062 |
| Commitments and Contingencies (Notes 9, 15, and 16) | | | |
| Shareholders' equity | | | |
| Preferred stock, $0.05 par value, authorized 10,000,000 | **—** | — | — |
| Common stock, $0.05 par value, authorized 40,000,000 shares, issued and outstanding 12,293,762 at October 30, 2022; 12,209,710 at October 31, 2021, and 12,228,629 at May 1, 2022 | **615** | 611 | 611 |
| Capital contributed in excess of par value | **43,671** | 42,719 | 43,143 |
| Accumulated earnings | **57,843** | 84,839 | 75,715 |
| Accumulated other comprehensive (loss) income | **(21 )** | 285 | 32 |
| Total shareholders' equity | **102,108** | 128,454 | 119,501 |
| Total liabilities and shareholders' equity | $ **161,630** | 209,325 | 177,563 |

* Derived from audited financial statements.

See accompanying notes to consolidated financial statements.

# CULP, INC.
# CONSOLIDATED STATEMENTS OF CASH FLOWS
# FOR THE SIX MONTHS ENDED OCTOBER 30, 2022, AND OCTOBER 31, 2021
# UNAUDITED
# (Amounts in Thousands)

| | SIX MONTHS ENDED | |
|---|---|---|
| | **October 30, 2022** | October 31, 2021 |
| Cash flows from operating activities: | | |
| Net (loss) income | $ **(17,872)** | 3,101 |
| Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities: | | |
| Depreciation | **3,489** | 3,471 |
| Non-cash inventory charges | **6,439** | 579 |
| Amortization | **214** | 267 |
| Stock-based compensation | **565** | 709 |
| Deferred income taxes | **(269)** | (319) |
| Realized gain from the sale of short-term investments available for sale | — | (4) |
| Gain sale of equipment | **(232)** | — |
| Foreign currency exchange (gain) loss | **(1,168)** | 170 |
| Changes in assets and liabilities: | | |
| Accounts receivable | **(443)** | 5,441 |
| Inventories | **7,192** | (8,329) |
| Other current assets | **(728)** | 39 |
| Other assets | **58** | (987) |
| Accounts payable – trade | **6,027** | (2,269) |
| Deferred revenue | **1,007** | 139 |
| Accrued expenses and deferred compensation | **1,254** | (2,908) |
| Accrued restructuring | **33** | — |
| Income taxes | **601** | (428) |
| Net cash provided by (used in) operating activities | **6,167** | (1,328) |
| Cash flows from investing activities: | | |
| Capital expenditures | **(1,051)** | (3,901) |
| Proceeds from the sale of equipment | **465** | — |
| Proceeds from the maturity of short-term investments (Held to Maturity) | — | 3,200 |
| Purchase of short-term and long-term investments (Held to Maturity) | — | (8,876) |
| Purchase of short-term investments (Available for Sale) | — | (4,371) |
| Proceeds from the sale of short-term investments (Available for Sale) | — | 306 |
| Proceeds from the sale of long-term investments (rabbi trust) | **46** | — |
| Purchase of long-term investments (rabbi trust) | **(505)** | (580) |
| Net cash used in investing activities | **(1,045)** | (14,222) |
| Cash flows from financing activities: | | |
| Dividends paid | — | (2,699) |
| Common stock repurchased | — | (1,752) |
| Common stock surrendered for withholding taxes payable | **(33)** | (50) |
| Payments of debt issuance costs | **(206)** | — |
| Net cash used in financing activities | **(239)** | (4,501) |
| Effect of exchange rate changes on cash and cash equivalents | **(296)** | (2) |
| Increase (decrease) in cash and cash equivalents | **4,587** | (20,053) |
| Cash and cash equivalents at beginning of period | **14,550** | 37,009 |
| Cash and cash equivalents at end of period | $ **19,137** | 16,956 |

See accompanying notes to consolidated financial statements.

# CULP, INC.
# CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
# SIX-MONTHS ENDED OCTOBER 30, 2022
# UNAUDITED
# (Dollars in thousands, except share data)

| | Common Stock | | Capital Contributed in Excess | Accumulated | Accumulated Other Comprehensive | Total Shareholders' |
|---|---|---|---|---|---|---|
| | Shares | Amount | of Par Value | Earnings | Income | Equity |
| Balance, May 1, 2022 * | 12,228,629 | $ 611 | $ 43,143 | $ 75,715 | $ 32 | $ 119,501 |
| Net loss | — | — | — | (5,699 ) | — | (5,699 ) |
| Stock-based compensation | — | — | 252 | — | — | 252 |
| Unrealized loss on investments | — | — | — | — | (7 ) | (7 ) |
| Common stock issued in connection with the vesting of performance-based restricted stock units | 913 | — | — | — | — | — |
| Common stock issued in connection with the vesting of time-based restricted stock units | 32,199 | 2 | (2 ) | — | — | — |
| Common stock surrendered in connection with payroll withholding taxes | (6,708 ) | — | (52 ) | — | — | (52 ) |
| Fully vested common stock award | 19,753 | 1 | (1 ) | — | — | — |
| Balance, July 31, 2022 | 12,274,786 | $ 614 | $ 43,340 | $ 70,016 | $ 25 | $ 113,995 |
| Net loss | — | — | — | (12,173 ) | — | (12,173 ) |
| Stock-based compensation | — | — | 313 | — | — | 313 |
| Unrealized loss on investments | — | — | — | — | (46 ) | (46 ) |
| Common stock issued in connection with the vesting of performance-based restricted stock units | 669 | — | — | — | — | — |
| Common stock surrendered in connection with payroll withholding taxes | (20 ) | — | 19 | — | — | 19 |
| Fully vested common stock award | 18,327 | 1 | (1 ) | — | — | — |
| Balance, October 30, 2022 | 12,293,762 | $ 615 | $ 43,671 | $ 57,843 | $ (21 ) | $ 102,108 |

* Derived from audited financial statements.

See accompanying notes to consolidated financial statements

# CULP, INC.
# CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
# SIX-MONTHS ENDED OCTOBER 31, 2021
# UNAUDITED
# (Dollars in thousands, except share data)

| | Common Stock | | Capital Contributed in Excess | Accumulated | Accumulated Other Comprehensive | Total Shareholders' |
|---|---|---|---|---|---|---|
| | Shares | Amount | of Par Value | Earnings | Income | Equity |
| Balance, May 2, 2021 * | 12,312,822 | $ 616 | $ 43,807 | $ 84,437 | $ 146 | $ 129,006 |
| Net income | — | — | — | 2,250 | — | 2,250 |
| Stock-based compensation | — | — | 274 | — | — | 274 |
| Unrealized gain on investments | — | — | — | — | 148 | 148 |
| Common stock issued in connection with the vesting of performance-based restricted stock units | 10,863 | — | — | — | — | — |
| Common stock surrendered in connection with payroll withholding taxes | (3,025 ) | — | (50 ) | — | — | (50 ) |
| Fully vested common stock award | 4,312 | — | — | — | — | — |
| Common stock repurchased | (48,686 ) | (2 ) | (721 ) | — | — | (723 ) |
| Dividends paid | — | — | — | (1,356 ) | — | (1,356 ) |
| Balance, August 1, 2021 | 12,276,286 | $ 614 | $ 43,310 | $ 85,331 | $ 294 | $ 129,549 |
| Net income | — | — | — | 851 | — | 851 |
| Stock-based compensation | — | — | 435 | — | — | 435 |
| Unrealized loss on investments | — | — | — | — | (9 ) | (9 ) |
| Fully vested common stock award | 6,426 | — | — | — | — | — |
| Common stock repurchased | (73,002 ) | (3 ) | (1,026 ) | — | — | (1,029 ) |
| Dividends paid | — | — | — | (1,343 ) | — | (1,343 ) |
| Balance, October 31, 2021 | 12,209,710 | $ 611 | $ 42,719 | $ 84,839 | $ 285 | $ 128,454 |

* Derived from audited financial statements.

See accompanying notes to consolidated financial statements.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
## (Unaudited)

### 1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Culp, Inc. and its majority-owned subsidiaries (the "company") include all adjustments that are, in the opinion of management, necessary for fair presentation of the results of operations and financial position. All these adjustments are of a normal recurring nature. Results of operations for interim periods may not be indicative of future results. The unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements that are included in the company's annual report on Form 10-K filed with the Securities and Exchange Commission on July 15, 2022, for the fiscal year ended May 1, 2022.

Certain amounts presented in the prior period have been reclassified to conform to the current period financial statement presentation. A non-cash charge totaling $579,000 for markdowns of inventory estimated based on our policy for aged inventory was reclassified from the line item "Inventories" to the line item "Non-cash inventory charges" in the Consolidated Statement of Cash Flows for the six-months ended October 31, 2021. This reclassification did not have an effect on previously reported net cash used in operating activities and decrease in cash and cash equivalents.

The company's six-months ended October 30, 2022, and October 31, 2021, each represent 26-week periods.

### 2. Significant Accounting Policies

As of October 30, 2022, 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, 2022.

*Recently Adopted Accounting Pronouncements*

There were not any recently adopted accounting pronouncements during the first half of fiscal 2023.

*Recently Issued Accounting Pronouncements*

Currently, there are no new recent accounting pronouncements that are expected to have a material effect on our consolidated financial statements.

### 3. Allowance for Doubtful Accounts

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

| | Six Months Ended | |
|---|---|---|
| (dollars in thousands) | October 30, 2022 | October 31, 2021 |
| Beginning balance | $ 292 | $ 591 |
| Provision for bad debts | 49 | (23) |
| Write-offs, net of recoveries | (53) | (34) |
| Ending balance | $ 288 | $ 534 |

During the six-month periods ended October 30, 2022, and October 31, 2021, we assessed the credit risk of our customers within our accounts receivable portfolio. Our risk assessment includes the respective customer's (i) financial position; (ii) past payment history; (iii) management's general ability; and (iv) historical loss experience; as well as (v) any other ongoing economic conditions. After our risk assessment was completed, we assigned credit grades to our customers, which in turn, were used to determine our allowance for doubtful accounts totaling $288,000 and $534,000 as of October 30, 2022, and October 31, 2021, respectively.

On June 25, 2022, a customer and its affiliates associated with our mattress fabrics segment announced that they filed voluntary petitions for reorganization under Chapter 11 of the U.S. Bankruptcy Code. Subject to court approval, our customer and its affiliates entered into an asset purchase agreement for the sale of substantially all of their assets. The proposed buyer under the asset purchase agreement has also provided a commitment for debtor-in-possession financing to allow our customer and its affiliates to conduct normal business operations pending the anticipated closing of the sale. A credit loss associated with accounts receivable outstanding as of May 1, 2022, for this customer and its affiliates was not recorded as we received payment in full regarding these invoices, and based on information available to us at this time, we do not believe there is a risk of material loss on these accounts. In addition, based on the information available to us at this time, we currently do not expect to record a material credit loss associated with accounts receivable for this customer and its affiliates for outstanding invoices after May 1, 2022 relating to products sold prior to the bankruptcy filing. During the second quarter of fiscal 2023, we received payments on a portion of the outstanding invoices after May 1, 2022, and we currently expect to receive payments on the remaining outstanding invoices after May 1, 2022, during the third quarter of fiscal 2023.

**4. Revenue from Contracts with Customers**

*Nature of Performance Obligations*

Our operations are classified into two business segments: mattress fabrics and upholstery fabrics. The mattress fabrics segment manufactures, sources, and sells fabrics and mattress covers primarily to bedding manufacturers. The upholstery fabrics segment develops, manufactures, sources, and sells fabrics primarily to residential and commercial furniture manufacturers. In addition, the upholstery fabrics segment includes Read Window Products LLC ("Read"), which provides window treatments and sourcing of upholstery fabrics and other products, as well as measuring and installation services for Read's products, to customers in the hospitality and commercial industries. Read also supplies soft goods such as decorative top sheets, coverlets, duvet covers, bed skirts, bolsters, and pillows.

Our primary performance obligations include the sale of mattress fabrics and upholstery fabrics, as well as the performance of customized fabrication and installation services for Read's products associated with window treatments.

*Contract Assets & Liabilities*

Certain contracts, primarily those for customized fabrication and installation services associated with Read, require upfront customer deposits that result in a contract liability which is recorded in the Consolidated Balance Sheets as deferred revenue. Our terms are customary within the industries in which we operate and are not considered financing arrangements. There were no contract assets recognized as of October 30, 2022, October 31, 2021, and May 1, 2022.

A summary of the activity associated with deferred revenue follows:

| | Six months ended | |
|---|---|---|
| (dollars in thousands) | October 30, 2022 | October 31, 2021 |
| Beginning balance | $ 520 | $ 540 |
| Revenue recognized on contract liabilities | (1,747) | (1,445) |
| Payments received for services not yet rendered | 2,754 | 1,584 |
| Ending balance | $ 1,527 | $ 679 |

*Disaggregation of Revenue*

The following table presents our disaggregated revenue by segment, timing of revenue recognition, and product sales versus services rendered for the three-month period ending October 30, 2022:

| *(dollars in thousands)* | Mattress Fabrics | Upholstery Fabrics | Total |
|---|---|---|---|
| Products transferred at a point in time | $ 26,230 | $ 29,883 | $ 56,113 |
| Services transferred over time | — | 2,268 | 2,268 |
| Total Net Sales | $ 26,230 | $ 32,151 | $ 58,381 |

The following table presents our disaggregated revenue by segment, timing of revenue recognition, and product sales versus services rendered for the six-month period ending October 30, 2022:

| *(dollars in thousands)* | Mattress Fabrics | Upholstery Fabrics | Total |
|---|---|---|---|
| Products transferred at a point in time | $ 55,602 | $ 61,406 | $ 117,008 |
| Services transferred over time | — | 3,977 | 3,977 |
| Total Net Sales | $ 55,602 | $ 65,383 | $ 120,985 |

The following table presents our disaggregated revenue by segment, timing of revenue recognition, and product sales versus services rendered for the three-month period ending October 31, 2021:

| *(dollars in thousands)* | Mattress Fabrics | Upholstery Fabrics | Total |
|---|---|---|---|
| Products transferred at a point in time | $ 40,883 | $ 31,415 | $ 72,298 |
| Services transferred over time | — | 2,263 | 2,263 |
| Total Net Sales | $ 40,883 | $ 33,678 | $ 74,561 |

The following table presents our disaggregated revenue by segment, timing of revenue recognition, and product sales versus services rendered for the six-month period ending October 31, 2021:

| (dollars in thousands) | Mattress Fabrics | Upholstery Fabrics | Total |
|---|---|---|---|
| Products transferred at a point in time | $ 83,941 | $ 69,705 | $ 153,646 |
| Services transferred over time | — | 3,962 | 3,962 |
| Total Net Sales | $ 83,941 | $ 73,667 | $ 157,608 |

**5. Inventories**

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

A summary of inventories follows:

| (dollars in thousands) | October 30, 2022 | October 31, 2021 | May 1, 2022 |
|---|---|---|---|
| Raw materials | $ 9,859 | $ 10,626 | $ 13,477 |
| Work-in-process | 3,724 | 4,480 | 4,237 |
| Finished goods | 38,641 | 48,675 | 48,843 |
| | $ 52,224 | $ 63,781 | $ 66,557 |

*Substantial and Unusual Losses Resulting from Subsequent Measurement of Inventory*

Overall

**Second Quarter of Fiscal 2023 and 2022**

For the second quarter of fiscal 2023, we incurred a non-cash inventory charge totaling $5.3 million. This charge represents a $2.9 million write down of inventory to its net realizable value associated with our mattress fabrics segment, $2.3 million related to markdowns of inventory estimated based on our policy for aged inventory in both our mattress and upholstery fabrics segments, and $98,000 for the loss on disposal and markdowns of inventory related to the exit of our cut and sew upholstery fabrics operation located in Shanghai, China (see Note 8 to the consolidated financial statements). Of the $5.3 million non-cash inventory charge for the second quarter of fiscal 2023, $3.8 million and $1.5 million pertained to our mattress fabrics and upholstery fabrics segments, respectively.

For the second quarter of fiscal 2022, we incurred a non-cash inventory charge totaling $226,000 that related to markdowns of inventory estimated based on our policy for aged inventory for both mattress and upholstery fabrics segments.

**Year to Date Through Second Quarter of Fiscal 2023 and 2022**

For the six-month period of fiscal 2023, we incurred a non-cash inventory charge totaling $6.4 million. This charge represents a $2.9 million write down of inventory to its net realizable value associated with our mattress fabrics segment, $3.4 million related to markdowns of inventory estimated based on our policy for aged inventory in both our mattress and upholstery fabrics segments, and $98,000 for the loss on disposal and markdowns of inventory related to the exit of our cut and sew upholstery fabrics operation located in Shanghai, China (see Note 8 to the consolidated financial statements). Of the $6.4 million non-cash inventory charge for the six-month period of fiscal 2023, $4.2 million and $2.2 million pertained to our mattress fabrics and upholstery fabrics segments, respectively.

The non-cash inventory charge of $579,000 for the six-month period of fiscal 2022 represents markdowns of inventory estimated based on our policy for aged inventory in both mattress and upholstery fabrics segments.

Mattress Fabrics Segment - Net Realizable Value

During the second quarter of fiscal 2023, our mattress fabrics segment experienced a 35.8% decline in net sales compared with the second quarter of fiscal 2022. This decline in net sales led to a significant decrease in gross margin to (8.7%), excluding the non-cash charge of $3.8 million disclosed above, during the second quarter of fiscal 2023, as compared with gross margin of 15.0% during the second quarter of fiscal 2022. The significant decline in net sales and profitability during the second quarter of fiscal 2023 stemmed from a greater than anticipated decline in consumer discretionary spending, which we believe was due to the following factors: (i) inflationary effects of commodities such as gas, food, and other necessities; (ii) a significant increase in interest rates; (iii) the pulling forward of demand for home goods products during the early years of the COVID-19 pandemic, which demand has now shifted to travel, leisure, and other services; and (iv) excess inventory held by customers due to the decline in consumer demand. Based on this evidence, management conducted a thorough review of its mattress fabrics inventory, and as result, recorded a charge of $2.9 million within cost of sales to write down inventory to its net realizable value. This $2.9 million charge was based on management's best estimates of product sales prices, customer demand trends, and its plans to transition to new products. Based on the current unfavorable macroeconomic conditions, it is possible that the estimates used by management to determine the write down of inventory to its net realizable value could be materially different from the actual amounts or its results. These differences could result in higher than expected inventory provisions, which could adversely affect the company's results of operations and financial condition in the near term.

**6. Intangible Assets**

A summary of intangible assets follows:

| *(dollars in thousands)* | October 30, 2022 | October 31, 2021 | May 1, 2022 |
|---|---|---|---|
| Tradename | $ 540 | $ 540 | $ 540 |
| Customer relationships, net | 1,486 | 1,787 | 1,636 |
| Non-compete agreement, net | 414 | 489 | 452 |
| | $ 2,440 | $ 2,816 | $ 2,628 |

*Tradename*

Our tradename as of October 30, 2022, October 31, 2021, and May 1, 2022, pertained to Read, a separate reporting unit within the upholstery fabrics segment. This tradename was determined to have an indefinite useful life at the time of its acquisition, and therefore is not being amortized. However, we are required to assess this tradename annually or between annual tests if we believe indicators of impairment exist. Based on our assessment as of October 30, 2022, no indicators of impairment existed, and therefore we did not record any asset impairment charges associated with our tradename through the second quarter of fiscal 2023.

*Customer Relationships*

A summary of the change in the carrying amount of our customer relationships follows:

| | Six months ended | |
|---|---|---|
| *(dollars in thousands)* | October 30, 2022 | October 31, 2021 |
| Beginning balance | $ 1,636 | $ 1,937 |
| Amortization expense | (150) | (150) |
| Ending balance | $ 1,486 | $ 1,787 |

Our customer relationships are amortized on a straight-line basis over useful lives ranging from nine to seventeen years.

The gross carrying amount of our customer relationships was $3.1 million as of October 30, 2022, October 31, 2021, and May 1, 2022, respectively. Accumulated amortization for these customer relationships was $1.6 million, $1.3 million, and $1.5 million as of October 30, 2022, October 31, 2021, and May 1, 2022, respectively.

The remaining amortization expense for the next five fiscal years and thereafter follows: FY 2023 - $151,000; FY 2024 - $301,000; FY 2025 - $301,000; FY 2026 - $301,000; FY 2027 - $279,000; and thereafter - $153,000.

The weighted average amortization period for our customer relationships was 5.2 years as of October 30, 2022.

*Non-Compete Agreement*

A summary of the change in the carrying amount of our non-compete agreement follows:

| | Six months ended | |
|---|---|---|
| *(dollars in thousands)* | October 30, 2022 | October 31, 2021 |
| Beginning balance | $ 452 | $ 527 |
| Amortization expense | (38) | (38) |
| Ending balance | $ 414 | $ 489 |

Our non-compete agreement is associated with a prior acquisition by our mattress fabrics segment and is amortized on a straight-line basis over the fifteen-year life of the agreement.

The gross carrying amount of our non-compete agreement was $2.0 million as of October 30, 2022, October 31, 2021, and May 1, 2022, respectively. Accumulated amortization for our non-compete agreement was $1.6 million, $1.5 million, and $1.6 million as of October 30, 2022, October 31, 2022, and May 1, 2022, respectively.

The remaining amortization expense for the next five years and thereafter follows: FY 2023 - $37,000; FY 2024 - $76,000; FY 2025 - $76,000; FY 2026 - $76,000; FY 2027 - $76,000, and thereafter - $73,000.

The weighted average amortization period for the non-compete agreement was 5.5 years as of October 30, 2022.

*Impairment*

As of October 30, 2022, management reviewed the long-lived assets associated with our mattress fabrics segment, which consisted of property, plant, and equipment, right of use assets, and finite-lived intangible assets (collectively known as the "Asset Group"), for impairment, as events and changes in circumstances occurred that indicated the carrying amount of the Asset Group may not be recoverable. During the second quarter of fiscal 2023, our mattress fabrics segment experienced a 35.8% decline in net sales compared with the second quarter of fiscal 2022. This decline in net sales led to a significant decrease in gross margin to (23.1%) during the second quarter of fiscal 2023, as compared with gross margin of 15.0% during the second quarter of fiscal 2022. The significant decline in net sales and profitability during the second quarter of fiscal 2023 stemmed from a greater than anticipated decline in consumer discretionary spending, which we believe was due to the following factors: (i) inflationary effects of commodities such as gas, food, and other necessities; (ii) a significant increase in interest rates; (iii) the pulling forward of demand for home goods products during the early years of the COVID-19 pandemic, which demand has now shifted to travel, leisure, and other services; and (iv) excess inventory held by customers due to the decline in consumer demand.

Based on the above evidence, we were required to determine the recoverability of the Asset Group, which is classified as held and used, by comparing the carrying amount of the Asset Group to the sum of the future undiscounted cash flows expected to result from its use and eventual disposition. If the carrying amount of an asset group exceeds its estimated future cash flows, an impairment charge is recognized for the excess of the carrying amount over the fair value (i.e., the sum of undiscounted future cash flows) of the asset. The carrying amount of the Asset Group totaled $38.8 million, which relates to property, plant, and equipment of $35.9 million, right of use assets of $2.1 million, a non-compete agreement of $414,000, and customer relationships of $383,000. Based on the comparison of the carrying amount of the Asset Group to the sum of its future undiscounted cash flows from its use and eventual disposition, we determined no impairment existed as of October 30, 2022, as the carrying amount of the Asset Group totaling $38.8 million did not exceed the sum of its future undiscounted cash flows.

## 7. Accrued Expenses

A summary of accrued expenses follows:

| *(dollars in thousands)* | | October 30, 2022 | | October 31, 2021 | | May 1, 2022 |
|---|---|---|---|---|---|---|
| Compensation, commissions and related benefits | $ | 4,489 | $ | 5,986 | $ | 4,248 |
| Other accrued expenses | | 3,105 | | 5,033 | | 3,584 |
| | $ | 7,594 | $ | 11,019 | $ | 7,832 |

## 8. Exit and Disposal Activity

During the second quarter of fiscal 2023, we closed our cut and sew upholstery fabrics operation located in Shanghai, China, which included the termination of an agreement to lease a building. This strategic action, along with the further use of our Asian supply chain, was our response to adjust our operating costs to better align with the declining consumer demand for cut and sewn products.

The following summarizes our restructuring expense and restructuring related charges that were associated with the above exit and disposal activity:

| *(dollars in thousands)* | | Six Months Ended October 30, 2022 |
|---|---|---|
| Employee termination benefits | $ | 468 |
| Loss on disposal and markdowns of inventory | | 98 |
| Loss on disposal of equipment | | 80 |
| Lease termination costs | | 47 |
| Other associated costs | | 20 |
| Restructuring expense and restructuring related charges (1) | $ | 713 |

(1) Of the total $713,000, $615,000 and $98,000 were recorded to restructuring expense and cost of sales, respectively, in the Consolidated Statement of Net Loss for the six-month period ending October 30, 2022.

The following summarizes the activity in accrued restructuring for the six-month period ending October 30, 2022:

| *(dollars in thousands)* | Employee Termination Benefits | Lease Termination Costs | Other Associated Costs | Total |
|---|---|---|---|---|
| Beginning balance | $ — | $ — | $ — | $ — |
| Accrual established in fiscal 2023 | 468 | 47 | — | 515 |
| Expenses incurred | — | — | 20 | 20 |
| Payments | (468) | (16) | (18) | (502) |
| Ending balance | $ — | $ 31 | $ 2 | $ 33 |

## 9. Lines of Credit

*Revolving Credit Agreement – United States*

Existing Credit Agreement

As of May 1, 2022, we had a Credit Agreement (the “Existing Credit Agreement”) with Wells Fargo Bank, N.A. (“Wells Fargo”) that provided a revolving loan commitment of $30 million, was set to expire on August 15, 2022, and allowed us to issue letters of credit not to exceed $1 million.

Amended Agreement

Effective June 24, 2022, we entered into an Amended and Restated Credit Agreement (“the Amended Agreement”) with Wells Fargo. The Amended Agreement amends, restates, supersedes, and serves as a replacement for the Existing Credit Agreement. The Amended Agreement provides a revolving credit facility of up to $40 million, is secured by a lien on the company’s assets, and expires in June 2025. The proceeds of borrowings under the Amended Agreement are to be used for working capital and other general corporate purposes.

The company’s available borrowings under the Amended Agreement are based on a borrowing base calculation using certain accounts receivable and inventory of the company, subject to certain sub-limits as defined in the Amended Agreement, to be calculated on a monthly basis. As of October 30, 2022, our available borrowings based on the borrowing base calculation under the Amended Agreement was $26.8 million.

Similar to the Existing Credit Agreement, the Amended Agreement contains a sub-facility that allows the company to issue letters of credit in an aggregate amount not to exceed $1 million.

Borrowings under the Amended Agreement bear interest at a rate calculated using a margin (the “Applicable Margin”) over the Federal Reserve Bank of New York’s secured overnight funding rate (SOFR). The Applicable Margin is set initially at 1.35% and may vary under the terms of the Amended Agreement from 1.35% to 2.50%, depending on the ratio of the company’s consolidated debt to consolidated EBITDA, as defined in the Amended Agreement, determined on a quarterly basis. The Amended Agreement contains customary affirmative and negative covenants and requires compliance by the company with certain financial covenants, including minimum tangible net worth of $100 million plus 50% of annual net income, and a minimum ratio of consolidated EBITDA to consolidated net interest expense of 3.0 to 1.0 as defined in the Amended Agreement. The EBITDA to interest expense covenant does not apply under the Amended Agreement during the first three quarters of the company’s fiscal 2023, but during that period, the company must maintain “access to liquidity” of $15 million, which is defined as unencumbered liquid assets plus available and unused credit under the revolving credit facility as calculated using the borrowing base, as defined in the Amended Agreement.

First Amendment

On August 19, 2022, we entered into a First Amendment to the Amended Agreement (“the First Amendment”) with Wells Fargo. The terms of the First Amendment amend the time period in which the financial covenant for the minimum ratio of consolidated EBITDA to consolidated net interest expense applies, such that this EBITDA to interest expense covenant does not apply during any of the four quarters of the Company’s fiscal 2023. During that time period, we are still required to maintain minimum “access to liquidity” of $15 million as mentioned in the above Amended Agreement section.

Subsequent Event

We executed a non-binding term sheet during the second quarter of fiscal 2023 with Wells Fargo for a new revolving credit facility (the "Credit Facility") of up to $40 million, secured by the company's assets. This proposed Credit Facility will replace our Amended Agreement and, based on information available at this time, is expected to provide greater borrowing availability and better flexibility with minimal financial covenants. The company's borrowing availability under the Credit Facility will be based on a calculation using certain of the company's accounts receivable and inventory, determined on a monthly basis. The completion of the Credit Facility is subject to the parties entering into applicable definitive agreements, which may contain additional or different terms from those described herein.

Overall

Effective June 24, 2022, interest was charged under the Amended Agreement at a rate (applicable interest rate of 4.38% as of October 30, 2022) calculated using the Applicable Margin over SOFR based on the ratio of the company’s consolidated debt to consolidated EBITDA, as defined in the Amended Agreement. Under the Existing Credit Agreement interest was charged at a rate (applicable interest rate of 1.74% and 2.40% as of October 31, 2021, and May 1, 2022, respectively) as a variable spread over LIBOR based on a ratio of debt to EBITDA, as defined in the Existing Credit Agreement.

There were $275,000 of outstanding letters of credit provided by the Amended Agreement and Existing Credit Agreement as of October 30 2022, October 31, 2021, and May 1, 2022. As of October 30, 2022, we had $725,000 remaining for the issuance of additional letters of credit.

There were no borrowings outstanding under either the Amended Agreement or e Existing Credit Agreement, as applicable, as of October 30, 2022, October 31, 2021, and May 1, 2022, respectively.

*Revolving Credit Agreements – China Operations*

Denominated in Chinese Yuan Renminbi (“RMB”)

We have an unsecured credit agreement denominated in RMB with a bank located in China that provides for a line of credit of up to 40 million RMB ($5.5 million USD as of October 30, 2022). Interest charged under this agreement is based on an interest rate determined by the Chinese government at the time of borrowing and was set to expire on November 15, 2022.

On November 24, 2022, we renewed this agreement, which renewal maintains our borrowing capacity of 40 million RMB and extends the expiration date to November 24, 2023.

There were no borrowings outstanding under this agreement as of October 30, 2022, October 31, 2021, and May 1, 2022, respectively.

Denominated in United States Dollar (“USD”)

We had an unsecured credit agreement denominated in USD with another bank located in China that provided for a line of credit of up to $2 million USD, which expired on August 30, 2022. Currently, the company does not plan to renew or replace this agreement.

*Overall*

Our loan agreements require, among other things, that we maintain compliance with certain financial covenants. As of October 30, 2022, we complied with our financial covenants.

Interest paid during the first half of fiscal 2023 totaled $8,000. No interest payments were made during the first half of fiscal 2022.

**10. Fair Value**

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:

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 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.

*Recurring Basis*

The following tables present information about assets measured at fair value on a recurring basis:

| | Fair value measurements as of October 30, 2022, 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: | | | | |
| U.S. Government Money Market Fund | $ 9,089 | N/A | N/A | $ 9,089 |
| Growth Allocation Mutual Funds | 438 | N/A | N/A | 438 |
| Moderate Allocation Mutual Fund | 77 | N/A | N/A | 77 |
| Other | 159 | N/A | N/A | 159 |

| | Fair value measurements as of October 31, 2021, 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: | | | | |
| U.S. Government Money Market Fund | $ 8,351 | N/A | N/A | $ 8,351 |
| Bond Mutual Funds | 4,384 | N/A | N/A | 4,384 |
| Inflation Protected Bond Mutual Funds | 2,975 | N/A | N/A | 2,975 |
| Mortgage Securities Mutual Funds | 1,118 | N/A | N/A | 1,118 |
| Large Cap Equity Mutual Funds | 694 | N/A | N/A | 694 |
| Growth Allocation Mutual Funds | 449 | N/A | N/A | 449 |
| Preferred Securities Mutual Fund | 282 | N/A | N/A | 282 |
| U.S. Event Driven Equity Mutual Fund | 203 | N/A | N/A | 203 |
| Moderate Allocation Mutual Fund | 88 | N/A | N/A | 88 |
| Other | 201 | N/A | N/A | 201 |

| | Fair value measurements as of May 1, 2022, 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: | | | | |
| U.S. Government Money Market Fund | $ 8,683 | N/A | N/A | $ 8,683 |
| Growth Allocation Mutual Funds | 435 | N/A | N/A | 435 |
| Moderate Allocation Mutual Fund | 81 | N/A | N/A | 81 |
| Other | 158 | N/A | N/A | 158 |

*Short-Term Investments – Available for Sale*

During the fourth quarter of fiscal 2022, we sold all of our remaining short-term investments classified as available-for-sale, and therefore we did not report short-term investments classified as available-for-sale in the accompanying Consolidated Balance Sheets as of October 30, 2022, and May 1, 2022. As of October 31, 2021, our short-term investments classified as available-for-sale (i) consisted of various types of bond and equity mutual funds, (ii) were recorded at their fair value totaling $9.7 million, (iii) had an unrealized gain of $116,000, (iv) approximated their cost basis, and (v) resided with our U.S. operations.

*Short-Term and Long-Term Investments - Held-To-Maturity*

During the fourth quarter of fiscal 2022, we sold all of our remaining investments classified as held-to-maturity, and therefore we did not report short-term or long-term investments classified as held-to-maturity in the accompanying Consolidated Balance Sheets as of October 30, 2022, and May 1, 2022. As of October 31, 2021, our investments classified as held-to-maturity consisted of investment grade U.S. corporate bonds, foreign bonds, and government bonds. These investments were classified as held-to-maturity as we had the positive intent and ability to hold these investments until maturity. Our held-to-maturity investments were recorded as either current or noncurrent in our Consolidated Balance Sheets, based on the maturity date in relation to the respective reporting period and were recorded at amortized cost.

As of October 31, 2021, our held-to-maturity investments had an amortized cost and fair value totaling $9.9 million and resided with our U.S. operations.

Our held-to-maturity investments were classified as level 2 within the fair value hierarchy as they were traded over the counter within a broker network and not on an active market. The fair values of our held-to-maturity investments were determined based on a published source that provided an average bid price. The average bid price was based on various broker prices that were determined based on market conditions, interest rates, and the rating of the respective bond investment.

*Investments - Rabbi Trust*

We have a rabbi trust for the participants of our deferred compensation plan (the “Plan”), that enables participants to credit their contributions to various investment options under the Plan. The investments associated with the rabbi trust consist of a U.S. Government money market fund and various equity related mutual funds that are classified as available-for-sale.

As of October 30, 2022, our investments associated with our rabbi trust totaled $9.8 million, of which $2.2 million and $7.6 million were classified as short-term and long-term, respectively. As of October 31, 2021, our investments associated with our rabbi trust totaled $9.0 million, all of which were classified as long-term. As of May 1, 2022, our investments associated with our rabbi trust totaled $9.4 million, all of which were classified as long-term. The investments associated with our rabbi trust had an accumulated unrealized loss of $21,000 as of October 30, 2022, an accumulated unrealized gain of $169,000, and $32,000, as of October 31, 2021, and May 1, 2022, respectively.

The fair value of our long-term investments associated with our rabbi trust approximates their cost basis.

*Other*

The carrying amount of our cash and cash equivalents, accounts receivable, other current assets, accounts payable, and accrued expenses approximated their fair value because of the short maturity of these financial instruments.

**11. Net (Loss) Income Per Share**

Basic net (loss) income per share is computed using the weighted-average number of shares outstanding during the period. Diluted net (loss) 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 (loss) income per share are as follows:

| | Three months ended | |
|---|---|---|
| *(amounts in thousands)* | October 30, 2022 | October 31, 2021 |
| Weighted average common shares outstanding, basic | 12,280 | 12,223 |
| Dilutive effect of stock-based compensation | — | 93 |
| Weighted average common shares outstanding, diluted | 12,280 | 12,316 |

During the second quarter of fiscal 2023, 42,127 shares of unvested common stock were not included in the computation of diluted net loss per share as their effect would be antidilutive due to the decrease in the price per share of our common stock during the reporting period compared with the price per share of our common stock as of the respective grant dates of the related stock-based compensation awards. In addition, during the second quarter of fiscal 2023, 35,077 shares of unvested common stock were not included in the computation of diluted net loss per share as we incurred a net loss during the reporting period.

During the second quarter of fiscal 2022, 13,484 shares of unvested common stock were not included in the computation of diluted net income per share as their effect would be antidilutive due to the decrease in the price per share of our common stock during the reporting period compared with the price per share of our common stock as of the respective grant dates of the related stock-based compensation awards.

| | Six months ended | |
|---|---|---|
| *(amounts in thousands)* | October 30, 2022 | October 31, 2021 |
| Weighted average common shares outstanding, basic | 12,259 | 12,268 |
| Dilutive effect of stock-based compensation | — | 101 |
| Weighted average common shares outstanding, diluted | 12,259 | 12,369 |

During the first half of fiscal 2023, 37,852 shares of unvested common stock were not included in the computation of diluted net loss per share as their effect would be antidilutive due to the decrease in the price per share of our common stock during the reporting period compared with the price per share of our common stock as of the respective grant dates of the related stock-based compensation awards. In addition, during the first half of fiscal 2023, 47,249 shares of unvested common stock were not included in the computation of diluted net loss per share as we incurred a net loss during the reporting period.

During the first half of fiscal 2022, 1,561 shares of unvested common stock were not included in the computation of diluted net income per share as their effect would be antidilutive due to the decrease in the price per share of our common stock during the reporting period compared with the price per share of our common stock as of the respective grant dates of the related stock-based compensation awards.

## 12. Segment Information

*Overall*

Our operations are classified into two business segments: mattress fabrics and upholstery fabrics. The mattress fabrics segment manufactures, sources, and sells fabrics and mattress covers primarily to bedding manufacturers. The upholstery fabrics segment develops, manufactures, sources, and sells fabrics primarily to residential and commercial furniture manufacturers. In addition, this segment includes Read, which provides window treatments and sourcing of upholstery fabrics and other products, as well as measuring and installation services for Read's products, to customers in the hospitality and commercial industries. Read also supplies soft goods such as decorative top sheets, coverlets, duvet covers, bed skirts, bolsters, and pillows.

*Financial Information*

We evaluate the operating performance of our business segments based upon (loss) income from operations before certain unallocated corporate expenses and other items that are not expected to occur on a regular basis. Cost of sales for each segment includes costs to develop, 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 executives and their support staff, all costs associated with being a public company, amortization of intangible assets, and other miscellaneous expenses. Segment assets include assets used in the operations of each segment and consist of accounts receivable, inventories, property, plant, and equipment, and right of use assets. Intangible assets are not included in segment assets as these assets are not used by the Chief Operating Decision Maker to evaluate the respective segment's operating performance, allocate resources to individual segments, or determine executive compensation.

Statements of operations for our operating segments are as follows:

| | Three months ended | |
|---|---|---|
| | October 30, 2022 | October 31, 2021 |
| net sales by segment: | | |
| mattress fabrics | $ 26,230 | $ 40,883 |
| upholstery fabrics | 32,151 | 33,678 |
| net sales | $ 58,381 | $ 74,561 |
| gross (loss) profit: | | |
| mattress fabrics | $ (6,057) | $ 6,146 |
| upholstery fabrics | 3,942 | 4,581 |
| total segment gross (loss) profit | $ (2,115) | $ 10,727 |
| restructuring related charge (1) | (98) | — |
| gross (loss) profit | $ (2,213) | $ 10,727 |
| selling, general, and administrative expenses by segment: | | |
| mattress fabrics | $ 2,945 | $ 3,007 |
| upholstery fabrics | 3,680 | 3,553 |
| unallocated corporate expenses | 2,478 | 2,527 |
| selling, general, and administrative expenses | $ 9,103 | $ 9,087 |
| (loss) income from operations by segment: | | |
| mattress fabrics | $ (9,002) | $ 3,139 |
| upholstery fabrics | 262 | 1,028 |
| unallocated corporate expenses | (2,478) | (2,527) |
| total segment (loss) income from operations | $ (11,218) | $ 1,640 |
| restructuring expense (2) | (615) | — |
| restructuring related charge (1) | (98) | — |
| (loss) income from operations | $ (11,931) | $ 1,640 |
| interest income | 79 | 59 |
| other income (expense) | 829 | (404) |
| (loss) income before income taxes | $ (11,023) | $ 1,295 |

(1) Restructuring related charge for the three-months ended October 30, 2022, represents $98,000 of losses on disposal and markdowns of inventory associated with the exit of our cut and sew upholstery fabrics operation located in Shanghai, China. This $98,000 restructuring related charge was recorded to cost of sales in the Consolidated Statements of Net Loss for the three-months ending October 30, 2022.

(2) Restructuring expense for the three-months ended October 30, 2022, represents $468,000 for employee termination benefits, $80,000 that relates to a loss on disposal of equipment, $47,000 for lease termination costs, and $20,000 of other associated costs related to the exit of our cut and sew upholstery fabrics operation located in Shanghai, China.

| | Six months ended | |
|---|---|---|
| | October 30, 2022 | October 31, 2021 |
| net sales by segment: | | |
| mattress fabrics | $ 55,602 | $ 83,941 |
| upholstery fabrics | 65,383 | 73,667 |
| net sales | $ 120,985 | $ 157,608 |
| gross (loss) profit: | | |
| mattress fabrics | $ (6,093) | $ 12,941 |
| upholstery fabrics | 8,105 | 10,285 |
| total segment gross profit | $ 2,012 | $ 23,226 |
| restructuring related charge (1) | (98) | — |
| gross profit | $ 1,914 | $ 23,226 |
| selling, general, and administrative expenses by segment: | | |
| mattress fabrics | $ 5,829 | $ 6,191 |
| upholstery fabrics | 7,302 | 6,990 |
| unallocated corporate expenses | 4,837 | 5,087 |
| selling, general, and administrative expenses | $ 17,968 | $ 18,268 |
| (loss) income from operations by segment: | | |
| mattress fabrics | $ (11,922) | $ 6,750 |
| upholstery fabrics | 803 | 3,295 |
| unallocated corporate expenses | (4,837) | (5,087) |
| total segment (loss) income from operations | $ (15,956) | $ 4,958 |
| restructuring expense (2) | (615) | — |
| restructuring related charge (1) | (98) | — |
| (loss) income from operations | $ (16,669) | $ 4,958 |
| interest income | 96 | 132 |
| other income (expense) | 747 | (640) |
| (loss) income before income taxes | $ (15,826) | $ 4,450 |

(1) Restructuring related charge for the six-months ended October 30, 2022, represents $98,000 of losses on disposal and markdowns of inventory associated with the exit of our cut and sew upholstery fabrics operation located in Shanghai, China. This $98,000 restructuring related charge was recorded to cost of sales in the Consolidated Statements of Net Loss for the six-months ending October 30, 2022.

(2) Restructuring expense for the six-months ended October 30, 2022, represents $468,000 for employee termination benefits, $80,000 that relates to a loss on disposal of equipment, $47,000 for lease termination costs, and $20,000 of other associated costs related to the exit of our cut and sew upholstery fabrics operation located in Shanghai, China.

Balance sheet information for our operating segments follows:

| *(dollars in thousands)* | October 30, 2022 | October 31, 2021 | May 1, 2022 |
|---|---|---|---|
| Segment assets: | | | |
| Mattress Fabrics: | | | |
| Accounts receivable | $ 8,700 | $ 16,639 | $ 9,865 |
| Inventory | 30,300 | 34,498 | 39,028 |
| Property, plant and equipment (1) | 35,853 | 40,673 | 38,731 |
| Right of use assets (2) | 2,087 | 3,838 | 3,469 |
| Total mattress fabrics assets | 76,940 | 95,648 | 91,093 |
| Upholstery Fabrics: | | | |
| Accounts receivable | 13,743 | 15,677 | 12,361 |
| Inventory | 21,924 | 29,283 | 27,529 |
| Property, plant and equipment (3) | 2,150 | 1,680 | 2,030 |
| Right of use assets (4) | 5,898 | 5,472 | 8,124 |
| Total upholstery fabrics assets | 43,715 | 52,112 | 50,044 |
| Total segment assets | 120,655 | 147,760 | 141,137 |
| Non-segment assets: | | | |
| Cash and cash equivalents | 19,137 | 16,956 | 14,550 |
| Short-term investments - available for sale | — | 9,709 | — |
| Short-term investments - held-to-maturity | — | 1,564 | — |
| Short-term investments - rabbi trust | 2,237 | — | — |
| Current income taxes receivable | 510 | 613 | 857 |
| Other current assets | 3,462 | 3,811 | 2,986 |
| Deferred income taxes | 493 | 452 | 528 |
| Property, plant and equipment (5) | 829 | 912 | 941 |
| Right of use assets (6) | 3,624 | 4,339 | 3,984 |
| Intangible assets | 2,440 | 2,816 | 2,628 |
| Long-term investments - rabbi trust | 7,526 | 9,036 | 9,357 |
| Long-term investments - held-to-maturity | — | 8,353 | — |
| Other assets | 717 | 3,004 | 595 |
| Total assets | $ 161,630 | $ 209,325 | $ 177,563 |

| | Six months ended | |
|---|---|---|
| *(dollars in thousands)* | October 30, 2022 | October 31, 2021 |
| Capital expenditures (7): | | |
| Mattress Fabrics | $ 267 | $ 2,030 |
| Upholstery Fabrics | 447 | 397 |
| Unallocated Corporate | 60 | 1,302 |
| Total capital expenditures | $ 774 | $ 3,729 |
| Depreciation expense: | | |
| Mattress Fabrics | $ 3,088 | $ 3,071 |
| Upholstery Fabrics | 401 | 400 |
| Total depreciation expense | $ 3,489 | $ 3,471 |

(1) The $35.9 million as of October 30, 2022, represents property, plant, and equipment of $23.8 million, $11.4 million, and $679,000 located in the U.S., Canada, and Haiti, respectively. The $40.7 million as of October 31, 2021, represents property, plant, and equipment of $27.3 million, $12.6 million, and $836,000 located in the U.S., Canada, and Haiti, respectively. The $38.7 million as of May 1, 2022, represents property, plant, and equipment of $25.6 million, $12.4 million, and $757,000 located in the U.S., Canada, and Haiti, respectively.

(2) The $2.1 million as of October 30, 2022, represents right of use assets of $1.8 million, $167,000, and $164,000 located in Haiti, Canada, and the U.S., respectively. The $3.8 million as of October 31, 2021, represents right of use assets of $2.2 million, $1.3 million, and $309,000 located in Haiti, the U.S., and Canada, respectively. The $3.5 million as of May 1, 2022, represents right of use assets of $2.0 million, $1.2 million, and $291,000 located in Haiti, the U.S., and Canada, respectively.

(3) The $2.2 million as of October 30, 2022, represents property, plant, and equipment of $1.0 million, $1.0 million, and $137,000 located in the U.S., Haiti, and China, respectively. The $1.7 million as of October 31, 2021, represents property, plant, and equipment of $1.1 million, $368,000, and $242,000 located in the U.S., China, and Haiti, respectively. The $2.0 million as of May 1, 2022, represents property, plant, and equipment of $1.0 million, $756,000, and $255,000 located in the U.S., Haiti, and China, respectively.

(4) The $5.9 million as of October 30, 2022, represents right of use assets of $2.5 million, $2.0 million and $1.4 million located in Haiti, China, and the U.S., respectively. The $5.5 million as of October 31, 2021, represents right of use assets of $4.3 million and $1.2 million located in China and the U.S., respectively. The $8.1 million as of May 1, 2022, represents right of use assets of $3.7 million, $2.6 million, and $1.8 million located in China, Haiti, and the U.S., respectively.

(5) The $829,000, $912,000, and $941,000 as of October 30, 2022, October 31, 2021, and May 1, 2022, respectively, represent property, plant, and equipment associated with unallocated corporate departments and corporate departments shared by our mattress fabrics and upholstery fabrics segments. Property, plant, and equipment associated with our corporate departments reside in the U.S.

(6) The $3.6 million, $4.3 million, and $4.0 million as of October 30, 2022, October 31, 2021, and May 1, 2022, respectively, represent right of use assets located in the U.S.

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

## 13. Income Taxes

*Effective Income Tax Rate*

We recorded income tax expense of $2.0 million, or (12.9%) of loss before income taxes, for the six-month period ending October 30, 2022, compared with income tax expense of $1.3 million, or 30.3% of income before income taxes, for the six-month period ending October 31, 2021.

Our effective income tax rates for the six-month periods ended October 30, 2022, and October 31, 2021, 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. When calculating the annual estimated effective income tax rates for the six-month periods ended October 30, 2022, and October 31, 2021, we were subject to loss limitation rules. These loss limitation rules require any taxable loss associated with our U.S. or foreign operations to be excluded from the annual estimated effective income tax rate calculation if it was determined that no income tax benefit could be recognized during the current fiscal year. 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 subsidiaries located in China, Canada, and Haiti versus annual projections, as well as changes in foreign currency exchange rates in relation to the U.S. dollar.

The following schedule summarizes the principal differences between income tax expense at the U.S. federal income tax rate and the effective income tax rate reflected in the consolidated financial statements for the six-month periods ending October 30, 2022, and October 30, 2021:

| | October 30, 2022 | October 31, 2021 |
|---|---|---|
| U.S. federal income tax rate | 21.0 % | 21.0 % |
| U.S. valuation allowance | (36.7 ) | (4.5 ) |
| Withholding taxes associated with foreign jurisdictions | (3.3 ) | 6.1 |
| Foreign income tax rate differential | 3.2 | 3.9 |
| Tax effects of local currency foreign exchange gains (losses) | 4.7 | (0.4 ) |
| Stock-based compensation | (0.6 ) | 0.2 |
| Global Intangible Low Taxed Income Tax ("GILTI") | — | 3.3 |
| Other | (1.2 ) | 0.7 |
| | (12.9 ) | 30.3 % |

Our consolidated effective income tax rate during the first half of fiscal 2023 was much more negatively affected by the mix of earnings between our U.S. operations and our foreign subsidiaries, as compared to the first half of fiscal 2022. During the first half of 2023, we incurred a significant pre-tax loss from our U.S. operations, and therefore, a significant income tax benefit was not recognized due to a full valuation allowance being applied against our U.S. net deferred income tax assets. In addition, all of our taxable income in the first half of fiscal 2023 was earned by our foreign operations located in China and Canada, which have higher income tax rates than the U.S. In comparison, as of the end of the second quarter of fiscal 2022, our U.S. operations were projected to earn a level of pre-tax income that did not have a significant effect on our full valuation allowance or our consolidated effective income tax rate.

*U.S. Valuation Allowance*

We evaluate the realizability of our U.S. net deferred income tax assets to determine if a valuation allowance is required. We 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, considering the effects of local tax law.

As of October 30, 2022, we evaluated the realizability of our U.S. net deferred income tax assets to determine if a full valuation allowance was required. Based on our assessment, we determined we still have a recent history of significant cumulative U.S. taxable losses, in that we experienced U.S. taxable losses during each of the last three fiscal years from 2020 through 2022, and we are currently expecting significant U.S. pre-tax losses to continue during fiscal 2023. As a result of the significant weight of this negative evidence, we believe it is more likely than not that our U.S. deferred income tax assets will not be fully realizable, and therefore we provided for a full valuation allowance against our U.S. net deferred income tax assets.

Based on our assessments as of October 30, 2022, October 31, 2021, and May 1, 2022, valuation allowances against our net deferred income tax assets pertain to the following:

| *(dollars in thousands)* | October 30, 2022 | October 31, 2021 | May 1, 2022 |
|---|---|---|---|
| U.S. federal and state net deferred income tax assets | $ 13,958 | 9,155 | 9,527 |
| U.S. capital loss carryforward | 2,330 | 2,330 | 2,330 |
| | $ 16,288 | 11,485 | 11,857 |

*Undistributed Earnings*

We assess whether the undistributed earnings from our foreign subsidiaries will be reinvested indefinitely or eventually distributed to our U.S. parent company and whether we are required to record a deferred income tax liability for those undistributed earnings from foreign subsidiaries that will not be reinvested indefinitely. As of October 30, 2022, we assessed the liquidity requirements of our U.S. parent company and determined that our undistributed earnings and profits from our foreign subsidiaries would not be reinvested indefinitely and would eventually be distributed to our U.S. parent company. The conclusion reached from this assessment was consistent with prior reporting periods.

As a result of the 2017 Tax Cuts and Jobs Act, a U.S. corporation is allowed a 100% dividend received deduction for earnings and profits received from a 10% owned foreign corporation. Therefore, a deferred income tax liability will be required only for unremitted withholding taxes associated with earnings and profits generated by our foreign subsidiaries that will ultimately be repatriated to the U.S. parent company. As a result, as of October 30, 2022, October 31, 2021, and May 1, 2022, we recorded a deferred income tax liability of $4.0 million, $3.4 million, and $3.5 million, respectively.

*Uncertain Income Tax Positions*

An unrecognized income tax benefit for an uncertain income tax position can be recognized in the first interim period if the more-likely-than-not recognition threshold is met by the end of the reporting period, or is effectively settled through examination, or negotiation, or litigation, or the statute of limitations for the relevant taxing authority to examine and challenge the tax position has expired. If it is determined that any of the above conditions occur regarding our uncertain income tax positions, an adjustment to our unrecognized income tax benefit will be recorded at that time.

As of October 30, 2022, and May 1, 2022, we had a $1.1 million total gross unrecognized income tax benefit, of which the entire amount was classified as income taxes payable – long-term in the accompanying Consolidated Balance Sheets. As of October 31, 2021, we had a $1.4 million total gross unrecognized income tax benefit, of which $1.1 million and $380,000 were recorded to income taxes payable – long-term and noncurrent deferred income taxes, respectively, in the accompanying Consolidated Balance Sheets.

As of October 30, 2022, and May 1, 2022, we had a $1.1 million total gross unrecognized income tax benefit, of which the entire $1.1 million would favorably affect the income tax rate in future periods. As of October 31, 2021, we had a $1.4 million total gross unrecognized income tax benefit, of which $1.1 million would favorably affect the income tax rate in future periods.

Our gross unrecognized income tax benefit of $1.1 million as of October 30, 2022, relates to income tax positions for which significant change is currently not expected within the next year. This amount primarily relates to double taxation under applicable income tax treaties with foreign tax jurisdictions.

*Income Taxes Paid*

The following table sets forth taxes paid by jurisdiction:

| *(dollars in thousands)* | Six Months Ended October 30, 2022 | Six Months Ended October 31, 2021 |
|---|---|---|
| United States Transition Tax Payment | $ 265 | $ 266 |
| China Income Taxes | 1,286 | 921 |
| China - Withholding Taxes Associated With Earnings and Profits Distributed to the U.S. | — | 487 |
| Canada - Income Taxes | 161 | 427 |
| | $ 1,712 | $ 2,101 |

## 14. Stock-Based Compensation

*Equity Incentive Plan Description*

On September 16, 2015, our shareholders approved an equity incentive plan titled the Culp, Inc. 2015 Equity Incentive Plan (the "2015 Plan"). The 2015 Plan authorizes the grant of stock options intended to qualify as incentive stock options, nonqualified stock options, stock appreciation rights, restricted stock, restricted stock units, performance-based units, and other equity and cash related awards as determined by the Compensation Committee of our board of directors. An aggregate of 1,200,000 shares of common stock were authorized for issuance under the 2015 Plan, with certain sub-limits that would apply with respect to specific types of awards that may be issued as defined in the 2015 Plan.

As of October 30, 2022, there were 242,188 shares available for future equity-based grants under the 2015 Plan.

*Performance-Based Restricted Stock Units*

**Senior Executives**

We grant performance-based restricted stock units to senior executives which could earn up to a certain number of shares of common stock if certain performance targets are met over a three-fiscal year performance period as defined in the related restricted stock unit award agreements. The number of shares of common stock that are earned based on performance targets that have been achieved may be adjusted based on a market-based total shareholder return component as defined in the related restricted stock unit award agreements.

Our performance-based restricted stock units granted to senior executives were measured based on their fair market value on the date of grant. The fair market value per share was determined using the Monte Carlo simulation model for the market-based total shareholder return component and the closing price of our common stock for the performance-based component.

The following table provides assumptions used to determine the fair market value of the market-based total shareholder return component using the Monte Carlo simulation model on our outstanding performance-based restricted stock units granted to senior executives on August 10, 2022 and July 22, 2021:

| | *August 10, 2022* | *July 22, 2021* |
|---|---|---|
| Closing price of our common stock | $ 5.06 | $14.75 |
| Expected volatility of our common stock | 48.2% | 54.2% |
| Expected volatility of peer companies (1) | 41.6% - 105.1% | 45.7% - 101.5% |
| Risk-free interest rate | 3.13% | 0.33% |
| Dividend yield | 0.00% | 3.00% |
| Correlation coefficient of peer companies (1) | 0.05 - 0.23 | 0.03 - 0.35 |

(1) The expected volatility and correlation coefficient of our peer companies for the August 10, 2022 and July 22, 2021, grant dates were based on peer companies that were approved by the Compensation Committee of our board of directors as an aggregate benchmark for determining the market-based total shareholder return component. Therefore, we disclosed ranges of the expected volatility and correlation coefficient for the companies that represented this peer group.

**Key Employees**

We grant performance-based restricted stock units to key employees which could earn up to a certain number of shares of common stock if certain performance targets are met over a three-fiscal year performance period as defined in the related restricted stock unit award agreements. Our performance-based restricted stock units granted to key employees were measured based on the fair market value (the closing price of our common stock) on the date of grant. No market-based total shareholder return component was included in these awards.

**Overall**

The following table summarizes information related to our grants of performance-based restricted stock units associated with senior executives and key employees that were unvested as of October 30, 2022:

| Date of Grant | (3) Performance-Based Restricted Stock Units Awarded | (4) Restricted Stock Units Expected to Vest | Price Per Share | Vesting Period |
|---|---|---|---|---|
| August 10, 2022 (1) | 178,714 | — | $ 5.77 (5) | 3 years |
| July 22, 2021 (1) | 122,476 | — | $ 15.93 (6) | 3 years |
| July 22, 2021 (2) | 20,500 | — | $ 14.75 (7) | 3 years |

(1) Performance-based restricted stock units awarded to senior executives.

(2) Performance-based restricted stock units awarded to key employees.

(3) Amounts represent the maximum number of common stock shares that could be earned if certain performance targets are met as defined in the related restricted stock unit agreements.

(4) Compensation cost is based on an assessment each reporting period to determine the probability of whether or not certain performance goals will be met and how many shares are expected to be earned as of the end of the vesting period. These amounts represent the number of shares that were expected to vest as of October 30, 2022.

(5) Price per share represents the fair market value per share ($1.14 per $1, or an increase of $0.71 to the closing price of our common stock on the date of grant) determined using the Monte Carlo simulation model for the market-based total shareholder return component and the closing price of our common stock ($5.06) for the performance-based component of the performance-based restricted stock units granted to senior executives on August 10, 2022.

(6) Price per share represents the fair market value per share ($1.08 per $1, or an increase of $1.18 to the closing price of our common stock on the date of grant) determined using the Monte Carlo simulation model for the market-based total shareholder return component and the closing price of our common stock ($14.75) for the performance-based component of the performance-based restricted stock units granted to senior executives on July 22, 2021.

(7) Price per share represents the closing price of our common stock on the date of grant.

The following table summarizes information related to our performance-based restricted stock units that vested during the six-month periods ending October 30, 2022, and October 31, 2021:

| Fiscal Year | Performance-Based Restricted Stock Units Vested | | (3) Fair Value | | (4) Price Per Share |
|---|---|---|---|---|---|
| Fiscal 2023 (1) | 545 | $ | 3 | $ | 5.10 |
| Fiscal 2023 (2) | 437 | $ | 2 | $ | 5.10 |
| Fiscal 2022 (1) | 5,051 | $ | 87 | $ | 17.14 |
| Fiscal 2022 (2) | 5,812 | $ | 100 | $ | 17.14 |

(1) Performance-based restricted stock units vested by senior executives.

(2) Performance-based restricted stock units vested by key employees.

(3) Dollar amounts are in thousands.

(4) Price per share is derived from the closing price of our common stock on the date the respective performance-based restricted stock units vested.

We recorded compensation expense of $2,000 and $109,000 within selling, general, and administrative expenses for the six-month periods ending October 30, 2022, and October 31, 2021, respectively. Compensation expense is recorded based on an assessment each reporting period to determine the probability of whether or not certain performance targets will be met and how many shares are expected to be earned as of the end of the vesting period. If certain performance goals are not expected to be achieved, compensation expense would not be recorded, and any previously recognized compensation expense would be reversed.

*Time-Based Restricted Stock Units*

The following table summarizes information related to our grants of time-based restricted stock unit awards associated with senior executives and key members of management that were unvested as of October 30, 2022:

| Date of Grant | Time-Based Restricted Stock Units Awarded | | (1) Price Per Share | Vesting Period |
|---|---|---|---|---|
| September 6, 2022 | 37,671 | $ | 4.58 | 1 to 3 years |
| August 10, 2022 | 82,016 | $ | 5.06 | 3 years |
| July 22, 2021 | 37,591 | $ | 14.75 | 3 years |
| August 6, 2020 | 129,095 | $ | 11.01 | 3 years |
| August 2, 2018 | 10,000 | $ | 24.35 | 5 years |

(1) Price per share represents closing price of common stock on the date the respective award was granted.

The following table summarizes information related to our time-based restricted stock units that vested during the six-month periods ending October 30, 2022:

| Fiscal Year | Time-Based Restricted Stock Units Vested | | (3) Fair Value | | (4) Price Per Share |
|---|---|---|---|---|---|
| Fiscal 2023 (1) | 19,786 | $ | 101 | $ | 5.10 |
| Fiscal 2023 (2) | 13,013 | $ | 66 | $ | 5.10 |

(1) Time-based restricted stock units vested by senior executives.

(2) Time-based restricted stock units vested by key employees.

(3) Dollar amounts are in thousands.

(4) Price per share is derived from the closing price of our common stock on the date the respective time-based restricted stock units vested.

Overall

We recorded compensation expense of $396,000 and $446,000 within selling, general, and administrative expenses associated with our time-based restricted stock unit awards for the six-month periods ending October 30, 2022, and October 31, 2021, respectively.

As of October 30, 2022, the remaining unrecognized compensation expense related to our time-based restricted stock units was $1.3 million, which is expected to be recognized over a weighted average vesting period of 1.9 years. As of October 30, 2022, the time-based restricted stock units that are expected to vest had a fair value totaling $1.5 million.

*Common Stock Awards*

We granted a total of 18,326 and 19,753 shares of common stock to our outside directors on October 3, 2022 and July 1, 2022, respectively. These shares of common stock vested immediately and were measured at their fair value on the date of grant. The fair value of these awards was $4.57 and $4.24 per share on October 3, 2022 and July 1, 2022, respectively, which represents the closing price of our common stock on the date of grant.

We granted a total of 6,426 and 4,312 shares of common stock to our outside directors on October 1, 2021 and July 1, 2021, respectively. These shares of common stock vested immediately and were measured at their fair value on the date of grant. The fair value of these awards was $13.03 and $16.24 per share on October 1, 2021 and July 1, 2021, respectively, which represents the closing price of our common stock on the date of grant.

We recorded $167,000 and $154,000 of compensation expense within selling, general, and administrative expenses for common stock awards to our outside directors for the six-month periods ending October 30, 2022, and October 31, 2021, respectively.

## 15. Leases

*Overview*

We lease manufacturing facilities, showroom and office space, distribution centers, and equipment under operating lease arrangements. Our operating leases have remaining lease terms of one to nine years, with renewal options for additional periods ranging up to twelve years.

*Balance Sheet*

The right of use assets and lease liabilities associated with our operating leases as of October 30, 2022, October 31, 2021, and May 1, 2022, are as follows:

| *(dollars in thousands)* | October 30, 2022 | October 31, 2021 | May 1, 2022 |
|---|---|---|---|
| Right of use assets | $ 11,609 | $ 13,649 | $ 15,577 |
| Operating lease liability - current | 2,655 | 2,878 | 3,219 |
| Operating lease liability – noncurrent | 4,194 | 7,914 | 7,062 |

*Supplemental Cash Flow Information*

| *(dollars in thousands)* | Six Months Ended October 30, 2022 | Six Months Ended October 31, 2021 |
|---|---|---|
| Operating lease liability payments | $ 1,068 | $ 1,436 |
| Right of use assets exchanged for lease liabilities | — | 2,614 |

Operating lease expense for the three-month periods ended October 30, 2022, and October 31, 2021, was $959,000 and $905,000, respectively. Operating lease expense for the six-month periods ended October 30, 2022, and October 31, 2021, was $2.0 million and $1.8 million, respectively. Short-term lease and variable lease expenses were immaterial for the three-month and six-month periods ended October 30, 2022, and October 31, 2021.

*Other Information*

Maturity of our operating lease liabilities for the remainder of fiscal 2023, the subsequent next four fiscal years, and thereafter follows:

| *(dollars in thousands)* | | |
|---|---|---|
| 2023 | $ | 1,377 |
| 2024 | | 2,575 |
| 2025 | | 1,578 |
| 2026 | | 334 |
| 2027 | | 298 |
| Thereafter | | 1,028 |
| | $ | 7,190 |
| Less: interest | | (341 ) |
| Present value of lease liabilities | $ | 6,849 |

As of October 30, 2022, the weighted average remaining lease term and discount rate for our operating leases follows:

| | October 30, 2022 |
|---|---|
| Weighted average lease term | 4.0 years |
| Weighted average discount rate | 3.39 % |

*Impairment*

See section titled "Impairment" located at Note 6 to the notes to the consolidated financial statements for further details of our assessment and conclusions reached regarding impairment of long-lived assets associated with our mattress fabrics segment that included property, plant, and equipment, right of use assets, and finite-lived intangible assets (i.e., customer relationships and non-compete agreement) that are classified as held and used.

**16. Commitments and Contingencies**

*Litigation*

The company is involved in legal proceedings and claims which have arisen in the ordinary course of business. Management has determined that it is not reasonably possible that these actions, when ultimately concluded and settled, will have a material adverse effect upon the financial position, results of operations, or cash flows of the company.

*Accounts Payable – Capital Expenditures*

As of October 30, 2022, October 31, 2021, and May 1, 2022, we had total amounts due regarding capital expenditures totaling $200,000, $176,000, and $473,000, respectively, which pertained to outstanding vendor invoices, none of which were financed.

*Purchase Commitments – Capital Expenditures*

As of October 30, 2022, we had open purchase commitments to acquire equipment for our mattress fabrics segment totaling $444,000.

**17. Statutory Reserves**

Our subsidiary located in China was required to transfer 10% of its 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 reached 50% of the company's registered capital. As of October 30, 2022, the statutory surplus reserve fund represents the 50% registered capital requirement, and therefore, our subsidiary located in China is no longer required to transfer 10% of its net income in accordance with PRC accounting rules and regulations.

The transfer to this reserve must be made before distributions of any dividend to shareholders. As of October 30, 2022, the company's statutory surplus reserve was $4.0 million. The statutory surplus reserve fund is non-distributable other than during liquidation and can be used to fund previous years' losses, if any. The statutory surplus reserve fund 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.

The company's subsidiary located in China can transfer funds to the parent company, except for the statutory surplus reserve of $4.0 million, to assist with debt repayment, capital expenditures, and other expenses of the company's business.

## 18. Common Stock Repurchase Program

In March 2020, our board of directors approved an authorization for us to acquire up to $5.0 million of our common stock. Under the common stock repurchase program, shares may be purchased from time to time in open market transactions, block trades, through plans established under the Securities Exchange Act Rule 10b5-1, or otherwise. The number of shares purchased and the timing of such purchases will be based on working capital requirements, market and general business conditions, and other factors, including alternative investment opportunities.

During the first half of fiscal 2023, we did not repurchase any shares of our common stock. During the first half of fiscal 2022, we repurchased 121,688 shares of our common stock at a cost of $1.8 million.

As of October 30, 2022, we had $3.2 million available for additional repurchases of our common stock.

## 19. Dividend Program

On June 29, 2022, our board of directors announced the decision to suspend the company's quarterly cash dividend. Considering the current and expected macroeconomic conditions, we believe that preserving capital and managing our liquidity is in the company's best interest to support future growth and the long-term interests of our shareholders. Accordingly, we did not make any dividend payments during first half of fiscal 2023.

During the first half of fiscal 2022, dividend payments totaled $2.7 million, which represented a quarterly dividend payment of $0.11 per share.

**CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING INFORMATION**

This report and the exhibits attached hereto 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 21E of the Securities and Exchange Act of 1934). Such statements are inherently subject to risks and uncertainties that may cause actual events and results to differ materially from such statements. Further, forward looking statements are intended to speak only as of the date on which they are made, and we disclaim any duty to update or alter such statements to reflect any changes in management's expectations or any change in the assumptions or circumstances on which such statements are based, whether due to new information, future events, or otherwise. 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," "anticipate," "estimate," "intend," "plan," "project," and their derivatives, and include but are not limited to statements about expectations for our future operations, production levels, new product launches, sales, profit margins, profitability, operating income, capital expenditures, working capital levels, income taxes, SG&A or other expenses, pre-tax income, earnings, cash flow, and other performance or liquidity measures, as well as any statements regarding potential acquisitions, future economic or industry trends, public health epidemics, or future developments. There can be no assurance that we will realize these expectations or meet our guidance, or that these beliefs will prove correct.

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 us adversely. The future performance of our business depends in part on our success in conducting and finalizing acquisition negotiations and integrating acquired businesses into our existing operations. Changes in consumer tastes or preferences toward products not produced by us could erode demand for our products. Changes in tariffs or trade policy, or 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 of products produced in those places. Also, economic or 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. The impact of public health epidemics on employees, customers, suppliers, and the global economy, such as the global coronavirus pandemic currently affecting countries around the world, could also adversely affect our operations and financial performance. In addition, the impact of potential goodwill or intangible asset impairments could affect our financial results. Increases in freight costs, labor costs, and raw material prices, including increases in market prices for petrochemical products, can also significantly affect the prices we pay for shipping, labor, and raw materials, respectively, and in turn, increase our operating costs and decrease our profitability. Finally, disruption in our customers' supply chains for non-fabric components may cause declines in new orders and/or delayed shipping of existing orders while our customers wait for other components, which could adversely affect our financial results. 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 Item 1A "Risk Factors" section in our most recent Form 10-K and Form 10-Q reports filed with the Securities and Exchange Commission. A forward-looking statement is neither a prediction nor a guarantee of future events or circumstances, and those future events or circumstances may not occur.

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

The following analysis of financial condition and results of operations should be read in conjunction with the consolidated financial statements and notes and other exhibits included elsewhere in this report.

**General**

Our fiscal year is the 52 or 53-week period ending on the Sunday closest to April 30. The six months ended October 30, 2022, and October 31, 2021, both represent 26-week periods.

Our operations are classified into two business segments: mattress fabrics and upholstery fabrics.

The mattress fabrics segment manufactures, sources, and sells fabrics and mattress covers primarily to bedding manufacturers. We currently have mattress fabric operations located in Stokesdale, NC, High Point, NC, Quebec, Canada, and Ouanaminthe, Haiti. During the second quarter of fiscal 2023, we took action to begin implementing a rationalization of our U.S.-based mattress fabrics cut and sew platform, which will include a closure of our two High Point, NC, facilities associated with this business during the third quarter of fiscal 2023.

The upholstery fabrics segment develops, sources, manufactures, and sells fabrics primarily to residential and commercial furniture manufacturers. We have upholstery fabric operations located in Shanghai, China, and Burlington, NC. During the third quarter of fiscal 2022, we also commenced operation of a new leased facility in Ouanaminthe, Haiti, dedicated to the production of cut and sewn upholstery kits. Additionally, Read Window Products, LLC ("Read"), a wholly-owned subsidiary with operations located in Knoxville, TN, provides window treatments and sourcing of upholstery fabrics and other products, as well as measuring and installation services for Read's products, to customers in the hospitality and commercial industries. Read also supplies soft goods such as decorative top sheets, coverlets, duvet covers, bed skirts, bolsters, and pillows.

**Executive Summary**

We evaluate the operating performance of our business segments based upon (loss) income from operations before certain unallocated corporate expenses and other items that are not expected to occur on a regular basis. Cost of sales for each business segment includes costs to develop, manufacture, or source our products, including costs such as raw material and finished good purchases, direct and indirect labor, overhead, and incoming freight charges. Unallocated corporate expenses primarily represent compensation and benefits for certain executive officers and their support staff, all costs associated with being a public company, amortization of intangible assets, and other miscellaneous expenses.

Results of Operations

| | Three Months Ended | | |
|---|---|---|---|
| *(dollars in thousands)* | October 30, 2022 | October 31, 2021 | Change |
| Net sales | $ 58,381 | $ 74,561 | (21.7)% |
| Gross (loss) profit | (2,213) | 10,727 | (120.6)% |
| Gross margin | (3.8)% | 14.4% | (1820)bp |
| Selling, general, and administrative expenses | 9,103 | 9,087 | 0.2% |
| Restructuring expense | 615 | — | 100.0% |
| (Loss) income from operations | (11,931) | 1,640 | N.M. |
| Operating margin | (20.4)% | 2.2% | (2260)bp |
| (Loss) income before income taxes | (11,023) | 1,295 | N.M. |
| Income tax expense | 1,150 | 444 | 159.0% |
| Net (loss) income | (12,173) | 851 | N.M. |

| | Six Months Ended | | |
|---|---|---|---|
| *(dollars in thousands)* | October 30, 2022 | October 31, 2021 | Change |
| Net sales | $ 120,985 | $ 157,608 | (23.2)% |
| Gross profit | 1,914 | 23,226 | (91.8)% |
| Gross margin | 1.6% | 14.7% | (1310)bp |
| Selling, general, and administrative expenses | 17,968 | 18,268 | (1.6)% |
| Restructuring expense | 615 | — | 100.0% |
| (Loss) income from operations | (16,669) | 4,958 | N.M. |
| Operating margin | (13.8)% | 3.1% | (1690)bp |
| (Loss) income before income taxes | (15,826) | 4,450 | N.M. |
| Income tax expense | 2,046 | 1,349 | 51.7% |
| Net (loss) income | (17,872) | 3,101 | N.M. |

Net Sales

Overall, our net sales for the second quarter of fiscal 2023 decreased by 21.7% compared with the same period a year ago, with mattress fabrics sales decreasing 35.8% and upholstery fabrics sales decreasing 4.5%. Our net sales for the first half of fiscal 2023 decreased by 23.2% compared with the same period a year ago, with mattress fabrics sales decreasing 33.8% and upholstery fabrics sales decreasing 11.2%.

The decrease in net sales in our mattress fabrics segment for both the second quarter and the first half of fiscal 2023 reflects an ongoing slowdown in consumer demand in the domestic mattress industry. The impact of this industry softness has been exacerbated by mattress manufacturers and retailers continuing to work through an excess of inventory, delaying the timing of shipments and new product rollouts. The decrease in net sales during both periods was partially offset by certain pricing and surcharge actions in effect that were not in effect during the same periods a year ago. These pricing actions increased net sales for the division by approximately 0.7% during the second quarter and by approximately 1.4% during the first half of fiscal 2023.

The decrease in net sales for our upholstery fabrics segment for both the second quarter and the first half of fiscal 2023 reflects reduced demand for our residential upholstery fabrics products, driven by a slowdown in new retail business in the residential home furnishings industry. The decrease in net sales during both periods was partially offset by higher sales in our hospitality/contract fabric business, as compared to the prior-year periods, as well as certain pricing and surcharge actions in effect that were not in effect during the same periods a year ago. These pricing actions increased net sales for the division by approximately 3.0% during the second quarter and by approximately 3.6% during the first half of fiscal 2023.

See the Segment Analysis section below for further details.

Income Before Income Taxes

Overall, our loss before income taxes for the second quarter of fiscal 2023 was $(11.0) million, compared with income before income taxes of $1.3 million for the prior-year period, while our loss before income taxes for the first six months of fiscal 2023 was $(15.8) million, compared with income before income taxes of $4.5 million for the prior-year period.

Operating performance for the second quarter of fiscal 2023, as compared to the prior-year period, was primarily affected by lower sales; impairment charges due to the write down of inventory to its net realizable value and inventory closeout sales for our mattress fabrics segment; markdowns of inventory due to our aged inventory policy for both our mattress fabrics and upholstery fabrics segment; and restructuring and related charges associated with our upholstery fabrics segment. Operating performance for the first half of fiscal 2023 was also materially pressured by the same factors, as well as continued inflationary pressures; labor challenges within both our mattress fabrics business and our Read business that resulted in increased employee training costs and operating inefficiencies, including quality issues within our mattress fabrics segment; and additional costs and operating inefficiencies associated with our new upholstery fabrics cut and sew facility in Haiti. These pressures were partially offset by slightly lower total SG&A expense for the six-month period, due primarily to lower incentive compensation expense during the first quarter of fiscal 2023, as well as a more favorable foreign exchange rate associated with our upholstery fabric operations in China.

See the Segment Analysis section below for further details.

Income Taxes

We recorded income tax expense of $2.0 million, or (12.9%) of loss before income taxes, for the six-month period ended October 30, 2022, compared with income tax expense of $1.3 million, or 30.3% of income before income taxes, for the six-month period ended October 31, 2021.

Our consolidated effective income tax rate during the first half of fiscal 2023 was much more negatively affected by the mix of earnings between our U.S. operations and foreign subsidiaries, as compared to the first half of fiscal 2022. During the first half of fiscal 2023, we incurred a significant pre-tax loss from our U.S. operations, and therefore, a significant income tax benefit was not recognized due to a full valuation allowance being applied against our U.S. net deferred income tax assets. In addition, all of our taxable income in the first half of fiscal 2023 was earned by our foreign operations located in China and Canada, which have higher income tax rates than the U.S. In comparison, as of the end of the second quarter of fiscal 2022, our U.S. operations were projected to earn a level of pre-tax income that did not have a significant effect on our full valuation allowance or our consolidated effective income tax rate.

Refer to Note 13 of the consolidated financial statements for further details regarding our provision for income taxes.

Liquidity

As of October 30, 2022, our cash and cash equivalents (collectively, "cash") totaled $19.1 million, an increase of $4.5 million, compared with $14.6 million as of May 1, 2022. This increase was primarily due to (i) $6.2 million in net cash provided by operating activities, partially offset by (ii) capital expenditures totaling $1.1 million

Our net cash provided by operating activities was $6.2 million during the first half of fiscal 2023, an increase of $7.5 million compared with net cash used in operating activities of $(1.3) million during the first half of fiscal 2022. This trend primarily reflects (i) a reduction of inventory related to the significant decline in net sales, improved alignment of inventory purchases with current customer demand trends, and promotional programs to reduce aged raw materials and finished goods inventory; (ii) an increase in accounts payable that primarily related to our upholstery fabrics operations located in China, as the mandated COVID-19 related shutdowns were lifted during the first quarter of fiscal 2023; and (iii) annual incentive payments made during the first quarter of fiscal 2022 that did not recur during the first quarter of fiscal 2023, partially offset by (iv) a decrease in net cash earnings during the first half of fiscal 2023 as compared with the first half of fiscal 2022.

As of October 30, 2022, there were no outstanding borrowings under our lines of credit.

Dividend Program

On June 29, 2022, our board of directors announced the decision to suspend the company's quarterly cash dividend. Considering the current and expected macroeconomic conditions, we believe that preserving capital and managing our liquidity is in the company's best interest to support future growth and the long-term interests of our shareholders. Accordingly, we did not make any dividend payments during the first half of fiscal 2023.

During the first half of fiscal 2022, dividend payments totaled $2.7 million, which represented a quarterly cash dividend payment of $0.11 per share.

Our board of directors has sole authority to determine if and when we will declare future dividends, and on what terms. We will continue to reassess our dividend policy each quarter. Future dividend payments will depend on our earnings, capital requirements, financial condition, excess availability under our lines of credit, market and economic conditions, and other factors we consider relevant.

Common Stock Repurchases

In March 2020, our board of directors approved an authorization for us to acquire up to $5.0 million of our common stock. Under the common stock repurchase program, shares may be purchased from time to time in open market transactions, block trades, through plans established under the Securities Exchange Act Rule 10b5-1, or otherwise. The number of shares purchased and the timing of such purchases are based on working capital requirements, market and general business conditions, and other factors, including alternative investment opportunities.

During the first half of fiscal 2023, we did not purchase any shares of our common stock. As a result, as of October 30, 2022, $3.2 million is available for additional repurchases of our common stock. Despite the current share repurchase authorization, the company does not expect to repurchase any shares through at least the third quarter of fiscal 2023.

During the first half of fiscal 2022, we repurchased 121,688 shares of common stock at a cost of $1.8 million.

**Segment Analysis**

Mattress Fabrics Segment

| | Three Months Ended | | |
|---|---|---|---|
| *(dollars in thousands)* | October 30, 2022 | October 31, 2021 | Change |
| Net sales | $ 26,230 | $ 40,883 | (35.8)% |
| Gross (loss) profit | (6,057) | 6,146 | (198.6)% |
| Gross profit margin | (23.1)% | 15.0% | (3810)bp |
| Selling, general, and administrative expenses | 2,945 | 3,007 | (2.1)% |
| (Loss) income from operations | (9,002) | 3,139 | (386.8)% |
| Operating margin | (34.3)% | 7.7% | (4200)bp |

| (dollars in thousands) | Six Months Ended October 30, 2022 | October 31, 2021 | Change |
|---|---|---|---|
| Net sales | $ 55,602 | $ 83,941 | (33.8)% |
| Gross (loss) profit | (6,093 ) | 12,941 | (147.1)% |
| Gross margin | (11.0 )% | 15.4 % | (2640)bp |
| Selling, general, and administrative expenses | 5,829 | 6,191 | (5.8)% |
| (Loss) income from operations | (11,922 ) | 6,750 | (276.6)% |
| Operating margin | (21.4 )% | 8.0 % | (2940)bp |

*Net Sales*

Mattress fabrics sales decreased 35.8% in the second quarter of fiscal 2023 compared to the prior-year period. Mattress fabrics sales decreased 33.8% in the first half of fiscal 2023 compared to the first half of fiscal 2022.

The decrease in mattress fabrics net sales for the second quarter and for the first six months of fiscal 2023 reflects an ongoing slowdown in consumer demand in the domestic mattress industry. We believe this slowdown is primarily due to inflationary pressures affecting consumer spending, as well as a shift in demand from home goods to travel, leisure, and entertainment following a pulling forward of demand for home goods during the early years of the COVID-19 pandemic. The impact of this industry softness has been exacerbated by mattress manufacturers and retailers continuing to work through an excess of inventory, delaying the timing of shipments and new product rollouts. The decrease in net sales during both periods was partially offset by certain pricing and surcharge actions in effect that were not in effect during the same periods a year ago. These pricing actions increased net sales for the division by approximately 0.7% during the second quarter and by approximately 1.4% during the first half of fiscal 2023.

Despite the headwinds, we remained focused on inventory reductions and cash generation during the quarter. We continued to execute our product-driven strategy, with an emphasis on innovation, design creativity, and personalized customer service. Additionally, the strength and flexibility of our global manufacturing and sourcing operations in the U.S., Canada, Haiti, Asia, and Turkey continued to enable us to support the evolving needs of our mattress fabrics and cover customers during the period. We believe our market position remains solid, with strong new placements, although the timing for new product rollouts continues to be affected by customers working through their existing excess inventory.

Looking ahead, we expect the current macroeconomic environment will continue to affect consumer spending trends for some time, resulting in ongoing industry softness that may reduce demand for our mattress fabrics and cover products and continue to delay the timing of new product rollouts.  We expect these conditions are likely to pressure results through at least the fourth quarter of fiscal 2023. Additionally, the ongoing impacts of the COVID-19 pandemic, as well as Russia's invasion of Ukraine, including its effect on petrochemical pricing and consumer spending, remain unknown and depend on factors beyond our knowledge or control. At this time, we cannot reasonably estimate the ongoing impact of the COVID-19 pandemic or the evolving impact of the Russia-Ukraine war on our mattress fabrics segment; however, either of these situations could cause disruption that could adversely affect our operations and financial performance.

*Gross Profit, Selling, General & Administrative Expenses, and Operating Income*

The decrease in mattress fabrics profitability during the second quarter of fiscal 2023, as compared to the prior-year period, was primarily due to operating inefficiencies from lower sales volume; $2.9 million in impairment charges due to the write down of inventory to its net realizable value, $2.1 million in  losses on the closeout sale of raw material and finished goods inventory, and $869,000 in markdowns of inventory due to our policy for aged inventory; and inefficiencies due to quality issues. The timing of the inventory impacts was mostly driven by our customers' focus on new product offerings to introduce at the retail level, as well as inflationary pressures, changes in consumer spending, and ongoing macro conditions.

Mattress fabrics profitability for the first half of fiscal 2023 was pressured by the same factors that affected the second quarter, as well as labor challenges, including inefficiencies due to hiring and training new employees; higher raw material costs; and an additional $499,000 in markdowns of inventory due to our policy for aged inventory during the first quarter, offset slightly by lower SG&A due primarily to lower incentive compensation expense during the first quarter.

We implemented two targeted price increases on select product lines during the second quarter to help offset the continued rise in raw material costs. Based on demand trends for sewn mattress covers, we also began to implement a restructuring and rationalization of our U.S.-based cut and sewn cover platform during the quarter, initiating a move of our R&D and prototyping capabilities from our High Point, North Carolina, location to our facility in Stokesdale, North Carolina. The result of this move  is the discontinuation of our higher-cost on-shore production capabilities, with planned closures of our two leased facilities in High Point, North Carolina, during the third quarter of fiscal 2023. We believe this move will allow us to generate cost savings by utilizing our lower-cost mattress cover production and sourcing capabilities in Haiti and Asia, where we can scale operations to align with demand and continue to support the needs of our customers.

We expect the ongoing industry softness affecting sales volumes, as well as continued inflationary pressures, will affect profitability through at least the fourth quarter of fiscal 2023, although we believe these headwinds will be mitigated to some extent by our ongoing efforts to control internal costs and improve efficiencies. We will consider further adjustments to right-size and restructure our operations as necessary to align with current demand levels, as well as additional reasonable pricing actions as necessary to further mitigate and manage inflation.

*Segment assets*

Segment assets consist of accounts receivable, inventory, property, plant, and equipment, and right of use assets.

| *(dollars in thousands)* | October 30, 2022 | October 31, 2021 | May 1, 2022 |
|---|---|---|---|
| Accounts receivable | $ 8,700 | $ 16,639 | $ 9,865 |
| Inventory | 30,300 | 34,498 | 39,028 |
| Property, plant & equipment | 35,853 | 40,673 | 38,731 |
| Right of use assets | 2,087 | 3,838 | 3,469 |
| | $ 76,940 | $ 95,648 | $ 91,093 |

Refer to Note 12 of the consolidated financial statements for disclosures regarding determination of our segment assets.

*Accounts Receivable*

As of October 30, 2022, accounts receivable decreased by $7.9 million, or 47.7%, compared with October 31, 2021. This trend reflects the significant decrease in net sales during second quarter of fiscal 2023 compared with the second quarter of fiscal 2022, as described in the *Net Sales* section above.  In addition, we experienced faster cash collections with a significant customer during the second quarter of fiscal 2023 compared with the second quarter of fiscal 2022, which led to a decline in days' sales outstanding to 30 days for the second quarter of fiscal 2023, as compared with 37 days for the second quarter of fiscal 2022.

As of October 30, 2022, accounts receivable decreased by $1.2 million, or 11.8%, compared with May 1, 2022. This trend reflects a decrease in net sales during the second quarter of fiscal 2023 compared with the fourth quarter of fiscal 2022. Net sales during the second quarter of fiscal 2023 was $26.2 million, a decrease of $3.6 million, or 11.9%, compared with net sales of $29.8 million during the fourth quarter of fiscal 2022. Days' sales outstanding was 30 days for both the second quarter of fiscal 2023 and the fourth quarter of fiscal 2022.

*Inventory*

As of October 30, 2022, inventory decreased by $4.2 million, or 12.2%, compared with October 31, 2021. This trend reflects (i) the significant decrease in net sales during the second quarter of fiscal 2023 compared with the second quarter of fiscal 2022, as described in the *Net Sales* section above; (ii) a $3.8 million non-cash charge recorded during the second quarter of fiscal 2023, which includes $2.9 million related to a write down of inventory to its net realizable value and $869,000 related to markdowns of inventory estimated based on our policy for aged inventory; and (iii) promotional programs to reduce aged raw materials and finished goods inventory; partially offset by (iv) higher raw material, labor, and overhead costs stemming from inflationary pressures.

As of October 30, 2022, inventory decreased by $8.7 million, or 22.4%, compared with May 1, 2022.  This trend reflects a (i) the decrease in net sales during the second quarter of fiscal 2023 compared with the fourth quarter of fiscal 2022, as described above; (ii) a $4.2 million non-cash charge recorded in the first half of fiscal 2023, which includes $2.9 million related to a write down of inventory to its net realizable value and $1.3 million related to markdowns of inventory estimated based on our policy for aged inventory; and (iii) promotional programs to reduce aged raw materials and finished goods inventory; partially offset by (iv) higher raw material, labor, and overhead costs stemming from inflationary pressures.

Inventory turns were 3.9 for the second quarter of fiscal 2023, compared with 4.2 for the second quarter of fiscal 2022 and 2.9 for the fourth quarter of fiscal 2022.

*Property, Plant, & Equipment*

The $35.9 million as of October 30, 2022, represents property, plant, and equipment of $23.8 million, $11.4 million, and $679,000 located in the U.S., Canada, and Haiti, respectively. The $40.7 million as of October 31, 2021, represents property, plant, and equipment of $27.3 million, $12.6 million, and $836,000 located in the U.S., Canada, and Haiti, respectively. The $38.7 million as of May 1, 2022, represents property, plant, and equipment of $25.6 million, $12.4 million, and $757,000 located in the U.S., Canada, and Haiti, respectively.

As of October 30, 2022, property, plant, and equipment has steadily decreased compared with October 31, 2021, as we have reduced our capital spending as a result of current and expected macroeconomic conditions.

*Right of Use Assets*

The $2.1 million as of October 30, 2022, represents right of use assets of $1.8 million, $167,000, and $164,000 located in Haiti, Canada, and the U.S., respectively. The $3.8 million as of October 31, 2021, represents right of use assets of $2.2 million, $1.3 million, and $309,000 located in Haiti, the U.S., and Canada, respectively. The $3.5 million as of May 1, 2022, represents right of use assets of $2.0 million, $1.2 million, and $291,000 located in Haiti, the U.S., and Canada, respectively.

As of October 31, 2022, right of use assets have steadily decreased compared with October 31, 2021, due to rent expense recognized over the terms of the respective lease agreements, as well as the reduction in the terms for two lease agreements associated with the closure of our mattress cover operation located in High Point, NC, which are now set to expire during the third quarter of fiscal 2023. The reduction in the right of use assets associated with the expiration of these two leases agreements associated with our mattress cover operation was offset by a corresponding decrease to the related lease liabilities.

Upholstery Fabrics Segment

*Net Sales*

| | Three Months Ended | | | | |
|---|---|---|---|---|---|
| *(dollars in thousands)* | October 30, 2022 | | October 31, 2021 | | % Change |
| Non-U.S. Produced | $ 29,679 | 92% | $ 31,306 | 93% | (5.2 )% |
| U.S. Produced | 2,472 | 8% | 2,372 | 7% | 4.2 % |
| Total | $ 32,151 | 100% | $ 33,678 | 100% | (4.5 )% |

| | Six Months Ended | | | | |
|---|---|---|---|---|---|
| *(dollars in thousands)* | October 30, 2022 | | October 31, 2021 | | % Change |
| Non-U.S. Produced | $ 61,119 | 93% | $ 69,528 | 94% | (12.1 )% |
| U.S. Produced | 4,264 | 7% | 4,139 | 6% | 3.0 % |
| Total | $ 65,383 | 100% | $ 73,667 | 100% | (11.2 )% |

Upholstery fabrics sales decreased 4.5% in the second quarter of fiscal 2023 compared to the prior-year period, which was adversely affected by COVID-related shutdowns in Vietnam during the quarter. Upholstery fabrics sales decreased by 11.2% for the first half of fiscal 2023, as compared to the first half of fiscal 2022.

The decrease in upholstery fabrics net sales for the second quarter and for the first half of fiscal 2023 reflects reduced demand for our residential upholstery fabrics products compared to the prior-year periods, driven by a slowdown in new retail business in the residential home furnishings industry. The decrease in net sales was partially offset by higher sales in both our hospitality/contract fabric business and our Read business, as compared to the prior-year periods, as well as pricing and surcharge actions in effect that were not in effect during the same periods a year ago. These actions increased net sales for the division by approximately 3.0% during the quarter and by approximately 3.6% during the first half of fiscal 2023.

Looking ahead, we expect the slowdown in new retail business for the residential home furnishings industry may affect demand for our residential business for some period of time. Despite this challenge, we believe our business is well positioned for the long-term with our product-driven strategy and innovative product offerings, as well as our flexible Asian platform and our long-term supplier relationships.

Notably, the ongoing economic and health effects of the COVID-19 pandemic, as well as the impact of Russia's invasion of Ukraine, including its effect on petrochemical pricing and consumer spending, remain unknown and depend on factors beyond our control. At this time, we cannot reasonably estimate the impact on our upholstery fabrics segment, but we note that if conditions worsen in either of these situations, including additional COVID-19-related shutdowns of our China operations, the impact on our operations, and/or on our suppliers, customers, consumers, and the global economy, could adversely affect our financial performance.

*Gross Profit, Selling, General & Administrative Expenses, and Operating Income*

| *(dollars in thousands)* | Three Months Ended October 30, 2022 | Three Months Ended October 31, 2021 | Change |
|---|---|---|---|
| Gross profit | 3,942 | 4,581 | (13.9)% |
| Gross margin | 12.3 % | 13.6 % | (130)bp |
| Selling, general, and administrative expenses | 3,680 | 3,553 | 3.6% |
| Restructuring expense | 615 | — | 100.0% |
| Income from operations | 262 | 1,028 | (74.5)% |
| Operating margin | 0.8 % | 3.1 % | (230)bp |

| *(dollars in thousands)* | Six Months Ended October 30, 2022 | Six Months Ended October 31, 2021 | Change |
|---|---|---|---|
| Gross profit | 8,105 | 10,285 | (21.2)% |
| Gross margin | 12.4 % | 14.0 % | (160)bp |
| Selling, general, and administrative expenses | 7,302 | 6,990 | 4.5% |
| Restructuring expense | 615 | — | 100.0% |
| Income from operations | 803 | 3,295 | (75.6)% |
| Operating margin | 1.2 % | 4.5 % | (330)bp |

The decrease in upholstery fabrics profitability for the second quarter of fiscal 2023, as compared to the prior-year period, primarily reflects lower residential sales and $1.4 million in inventory markdowns due to our policy for aged inventory, as well as operating inefficiencies in our cut and sew operation in Haiti due primarily to reduced customer demand during the latter part of the quarter. These pressures were partially offset by a significantly more favorable foreign exchange rate associated with our operations in China, as well as an improved contribution from our Read business.

Upholstery fabrics profitability for the first half of fiscal 2023 was affected by the same factors that affected the second quarter, as well as labor challenges and inflationary pressures affecting the Read business during the first quarter and an additional $689,000 in markdowns of inventory due to our policy for aged inventory during the first quarter.

Based on market dynamics for cut and sewn products and the strength of our Asian supply chain, we took action during the second quarter to restructure and adjust our model for this platform with the closure of our cut and sew facility located in Shanghai, China. We believe this move will allow us to reduce our operating costs while maintaining our ability to support our customers, grow our cut and sew business, and maintain our competitive advantages through our lower-cost manufacturing and sourcing operations in Asia and Haiti.

Looking ahead, we expect ongoing industry softness affecting sales volumes in our residential business, as well as continued operating inefficiencies at our Haiti cut and sew facility due to reduced demand driven by macro-economic conditions, will continue to pressure our profitability. We will continue our ongoing cost reduction efforts and will consider further adjustments to right-size and restructure our operations as necessary to align with current demand levels.

*Exit and Disposal Activity*

During the second quarter of fiscal 2023, we closed our cut and sew upholstery fabrics operation located in Shanghai, China, which included the termination of an agreement to lease a building. This strategic action, along with the further use of our Asian supply chain, was our response to adjust our operating costs to align with declining consumer demand for cut and sewn products.

The following summarizes our restructuring expense and restructuring related charges that were associated with the above exit and disposal activity:

| *(dollars in thousands)* | Six Months Ended October 30, 2022 |
|---|---|
| Employee termination benefits | $ 468 |
| Loss on disposal and markdowns of inventory | 98 |
| Loss on disposal of equipment | 80 |
| Lease termination costs | 47 |
| Other associated costs | 20 |
| Restructuring expense and restructuring related charges (1) | $ 713 |

(1) Of the total $713,000, $615,000 and $98,000 were recorded to restructuring expense and cost of sales, respectively, in the Consolidated Statement of Net Loss for the six-month period ending October 30, 2022.

*Segment Assets*

Segment assets consist of accounts receivable, inventory, property, plant, and equipment, and right of use assets.

| *(dollars in thousands)* | October 30, 2022 | October 31, 2021 | May 1, 2022 |
|---|---|---|---|
| Accounts receivable | $ 13,743 | $ 15,677 | $ 12,361 |
| Inventory | 21,924 | 29,283 | 27,529 |
| Property, plant & equipment | 2,150 | 1,680 | 2,030 |
| Right of use assets | 5,898 | 5,472 | 8,124 |
| | $ 43,715 | $ 52,112 | $ 50,044 |

Refer to Note 12 of the consolidated financial statements for disclosures regarding determination of our segment assets.

*Accounts Receivable*

As of October 30, 2022, accounts receivable decreased by $1.9 million, or 12.3%, compared with October 31, 2021. This trend reflects the decrease in net sales during the second quarter of fiscal 2023 compared with the second quarter of fiscal 2022, as described in the *Net Sales* section above. In addition, we experienced faster cash collections with a significant customer during the second quarter of fiscal 2023 compared with the second quarter of fiscal 2022, which led to a decline in days' sales outstanding to 35 days for the second quarter of fiscal 2023, as compared with 41 days for the second quarter of fiscal 2022.

As of October 30, 2022, accounts receivable increased by $1.4 million, or 11.2%, compared with May 1, 2022. This trend reflects the increase in net sales related to our upholstery fabrics operations located in China, as the mandated COVID-19 related shutdowns during the fourth quarter of fiscal 2022 were lifted during the first quarter of fiscal 2023. Net sales for the upholstery fabrics segment were $32.2 million during the second quarter of fiscal 2023, an increase of $5.0 million, or 18.4%, compared with net sales of $27.2 million during the fourth quarter of fiscal 2022. The increase in accounts receivable attributable to this increase in net sales was offset by faster cash collections with a significant customer during the second quarter of fiscal 2023, as compared with the fourth quarter of fiscal 2022. This led to a decline in days' sales outstanding to 35 days for the second quarter of fiscal 2023, as compared with 40 days for the fourth quarter of fiscal 2022.

*Inventory*

As of October 30, 2022, inventory decreased by $7.4 million, or 25.1%, compared with October 31, 2021. This trend reflects (i) the decrease in net sales during the second quarter of fiscal 2023 compared with the second quarter of fiscal 2022, as described in the *Net Sales* section above; (ii) a $1.5 million non-cash charge recorded during the second quarter of fiscal 2023, which includes $1.4 million of markdowns of inventory estimated based on our policy for aged inventory and $98,000 that was associated with the loss on disposal and markdowns of inventory related to the exit from our cut and sew upholstery fabrics operation located in Shanghai, China; and (iii) promotional programs to reduce aged raw materials and finished goods inventory; partially offset by (iv) higher raw material, labor, and overhead costs stemming from inflationary pressures.

As of October 30, 2022, inventory decreased by $5.6 million, or 20.4%, compared with May 1, 2022. This trend reflects (i) the reduction in inventory, despite the increase in net sales, during the second quarter of fiscal 2023 compared with the fourth quarter of fiscal 2022, due to improved alignment of inventory purchases with current customer demand trends; (ii) a $2.2 million non-cash charge recorded during the first half of fiscal 2023, which includes $2.1 million of markdowns of inventory estimated based on our policy for aged inventory and $98,000 that was associated with the loss on disposal and markdowns of inventory related to the exit from our cut and sew upholstery fabrics operation located in Shanghai, China, and (iii) promotional programs to reduce aged raw materials and finished goods inventory; partially offset by (iv) higher raw material, labor, and overhead costs stemming from inflationary pressures.

Inventory turns were 3.8 for the second quarter of fiscal 2023, compared with 4.3 for the second quarter of fiscal 2022 and 3.0 for the fourth quarter of fiscal 2022.

*Property, Plant, & Equipment*

The $2.2 million as of October 30, 2022, represents property, plant, and equipment of $1.0 million, $1.0 million, and $137,000 located in the U.S., Haiti, and China, respectively. The $1.7 million as of October 31, 2021, represents property, plant, and equipment of $1.1 million, $368,000, and $242,000 located in the U.S., China, and Haiti, respectively. The $2.0 million as of May 1, 2022, represents property, plant, and equipment of $1.0 million, $756,000, and $255,000 located in the U.S., Haiti, and China, respectively.

As of October 30, 2022, property, plant, and equipment increased compared with October 31, 2021, due to the start-up and subsequent increase in production at our new upholstery cut and sew operation located in Haiti that commenced during the third quarter of fiscal 2022.

*Right of Use Assets*

The $5.9 million as of October 30, 2022, represents right of use assets of $2.5 million, $2.0 million, and $1.4 million located in Haiti, China, and the U.S., respectively. The $5.5 million as of October 31, 2021, represents right of use assets of $4.3 million and $1.2 million located in China and the U.S., respectively. The $8.1 million as of May 1, 2022, represents right of use assets of $3.7 million, $2.6 million, and $1.8 million located in China, Haiti, and the U.S., respectively.

As of October 30, 2022, our right of use assets increased by $426,000, or 7.8%, compared with October 31, 2021. This increase represents our agreement to lease a 90,000 square foot facility located in Haiti that commenced during the third quarter of fiscal 2022, partially offset by (i) a decrease related to a six-month forgiveness of rent payments associated with COVID relief permitted by the Chinese government for all building lease agreements located in Shanghai, China, and (ii) the termination of a building lease agreement in connection with the exit from our cut and sew upholstery fabrics operation located in Shanghai, China.

As of October 30, 2022, our right of use assets decreased by $2.2 million, or 27.4%, compared with May 1, 2022. This decrease mostly represents (i) a six-month forgiveness of rent payments associated with COVID relief permitted by the Chinese government for all building lease agreements located in Shanghai, China, and (ii) the termination of a building lease agreement in connection with the exit from our cut and sew upholstery fabrics operation located in Shanghai, China.

<u>Other Income Statement Categories</u>

| | Three Months Ended | | |
|---|---|---|---|
| *(dollars in thousands)* | October 30, 2022 | October 31, 2021 | % Change |
| SG&A expenses | $ 9,103 | $ 9,087 | 0.2 % |
| Interest income | 79 | 59 | 33.9 % |
| Other income (expense) | 829 | (404 ) | (305.2 )% |

| | Six Months Ended | | |
|---|---|---|---|
| *(dollars in thousands)* | October 30, 2022 | October 31, 2021 | % Change |
| SG&A expenses | $ 17,968 | $ 18,268 | (1.6 )% |
| Interest income | 96 | 132 | (27.3 )% |
| Other income (expense) | 747 | (640 ) | (216.7 )% |

*Selling, General, and Administrative Expenses*

Selling, general, and administrative expenses during the second quarter and the first half of fiscal 2023 are comparable with the prior-year periods.

*Interest Income*

The increase in interest income during the second quarter of fiscal 2023, as compared with the second quarter of fiscal 2022, is mostly due to the significant increase in market interest rates during fiscal 2023.

The decrease in interest income for the first half of fiscal 2023, as compared with the first half of fiscal 2022, is mostly due to the liquidation of all of our remaining short-term investments classified as available-for-sale and corporate bond investments classified as held-to-maturity during the fourth quarter of fiscal 2022, partially offset by the significant increase in market interest rates during fiscal 2023.

*Other Income (Expense)*

Management is required to assess certain economic factors to determine the currency of the primary economic environment in which our foreign subsidiaries operate. Based on our assessments, the U.S. dollar was determined to be the functional currency of our operations located in China and Canada.

The change from other income during the second quarter and the first half of fiscal 2023, as compared to other expense during the second quarter and first half of fiscal 2022, is due mostly to more favorable foreign exchange rates applied against our balance sheet accounts denominated in Chinese Renminbi to determine the corresponding U.S. dollar financial reporting amounts. During the second quarter of fiscal 2023, we reported a foreign exchange gain associated with our China operations of $1.0 million, compared with a foreign exchange loss of $(151,000) during the second quarter of fiscal 2022. During the first half of fiscal 2023, we reported a foreign exchange gain of $1.2 million, compared with a foreign exchange loss of $(160,000) during the first half of fiscal 2022.

The significant $1.2 million foreign exchange rate gain reported during the first half of fiscal 2023, which is mostly non-cash, was mostly offset by $1.1 million of income tax expense that increased our income tax payments. This $1.1 million of income tax expense was associated with taxable foreign exchange rate gains on more favorable foreign exchange rates applied against balance sheet accounts denominated in U.S. dollars to determine the Chinese Renminbi local currency amounts. The foreign exchange rate gains associated with our U.S. dollar denominated balance sheet accounts related to our operations located in China is taxable income, as we incur income tax expense and pay income taxes in China's local currency.

Income Taxes

*Effective Income Tax Rate & Income Tax Expense*

We recorded income tax expense of $2.0 million, or (12.9%) of loss before income taxes, for the six-month period ending October 30, 2022, compared with income tax expense of $1.3 million, or 30.3% of income before income taxes, for the six-month period ending October 31, 2021.

Our effective income tax rates for the six-month periods ended October 30, 2022, and October 31, 2021, 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. When calculating the annual estimated effective income tax rate for the six-month periods ended October 30, 2022, and October 31, 2021, we were subject to loss limitation rules. These loss limitation rules require any taxable loss associated with our U.S. or foreign operations to be excluded from the annual estimated effective income tax rate calculation if it was determined that no tax benefit could be recognized during the current fiscal year. 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 subsidiaries located in China, Canada, and Haiti versus annual projections, as well as changes in foreign currency exchange rates in relation to the U.S. dollar.

The following schedule summarizes the principal differences between income tax expense at the U.S. federal income tax rate and the effective income tax rate reflected in the consolidated financial statements for the six-month periods ending October 30, 2022, and October 31, 2021:

| | October 30, 2022 | October 31, 2021 |
|---|---|---|
| U.S. federal income tax rate | 21.0 % | 21.0 % |
| U.S. valuation allowance | (36.7 ) | (4.5 ) |
| Withholding taxes associated with foreign jurisdictions | (3.3 ) | 6.1 |
| Foreign income tax rate differential | 3.2 | 3.9 |
| Tax effects of local currency foreign exchange gains (losses) | 4.7 | (0.4 ) |
| Stock-based compensation | (0.6 ) | 0.2 |
| Global Intangible Low Taxed Income Tax ("GILTI") | — | 3.3 |
| Other | (1.2 ) | 0.7 |
| | (12.9 ) | 30.3 % |

Our consolidated effective income tax rate during the first half of fiscal 2023 was much more negatively affected by the mix of earnings between our U.S. operations and foreign subsidiaries, as compared to the first half of fiscal 2022. During the first half of fiscal 2023, we incurred a significant pre-tax loss from our U.S. operations, and therefore, a significant income tax benefit was not recognized due to a full valuation allowance being applied against our U.S. net deferred income tax assets. In addition, all of our taxable income in the first half of fiscal 2023 was earned by our foreign operations located in China and Canada, which have higher income tax rates than the U.S. In comparison, as of the end of the second quarter of fiscal 2022, our U.S. operations were projected to earn a level of pre-tax income that did not have a significant effect on our full valuation allowance or our consolidated effective income tax rate.

*U.S. Valuation Allowance*

We evaluate the realizability of our U.S. net deferred income tax assets to determine if a valuation allowance is required. We 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, considering the effects of local tax law.

As of October 30, 2022, we evaluated the realizability of our U.S. net deferred income tax assets to determine if a full valuation allowance was required. Based on our assessment, we determined that we still have a recent history of significant cumulative U.S. taxable losses, in that we experienced U.S. taxable losses during each of the last three fiscal years from 2020 through 2022, and we are currently expecting significant U.S. pre-tax losses to continue during fiscal 2023. As a result of the significant weight of this negative evidence, we believe it is more likely than not that our U.S. deferred income tax assets will not be fully realizable, and therefore we provided for a full valuation allowance against our U.S. net deferred income tax assets.

Based on our assessments as of October 30, 2022, October 31, 2021, and May 1, 2022, valuation allowances against our net deferred income tax assets pertain to the following:

| *(dollars in thousands)* | October 30, 2022 | October 31, 2021 | May 1, 2022 |
|---|---|---|---|
| U.S. federal and state net deferred income tax assets | $ 13,958 | 9,155 | 9,527 |
| U.S. capital loss carryforward | 2,330 | 2,330 | 2,330 |
| | $ 16,288 | 11,485 | 11,857 |

*Undistributed Earnings*

Refer to Note 13 of the consolidated financial statements for disclosures regarding our assessments of our recorded deferred income tax liability balances associated with undistributed earnings from our foreign subsidiaries as of October 30, 2022, October 31, 2021, and May 1, 2022, respectively.

*Uncertain Income Tax Positions*

Refer to Note 13 of the consolidated financial statements for disclosures regarding our assessments of our uncertain income tax positions as of October 30, 2022, October 31, 2021, and May 1, 2022, respectively.

*Income Taxes Paid*

The following table sets forth taxes paid by jurisdiction:

| *(dollars in thousands)* | Six Months Ended October 30, 2022 | Six Months Ended October 31, 2021 |
|---|---|---|
| United States Transition Tax Payment | $ 265 | $ 266 |
| China Income Taxes | 1,286 | 921 |
| China - Withholding Taxes Associated With Earnings and Profits Distributed to the U.S. | — | 487 |
| Canada - Income Taxes | 161 | 427 |
| | $ 1,712 | $ 2,101 |

*Future Liquidity*

We are currently projecting annual cash income tax payments of approximately $3.2 million for fiscal 2023, compared with $3.1 million for fiscal 2022. These estimated payments are management's current projections only and can be affected over the year by actual earnings from our foreign subsidiaries located in China and Canada versus annual projections, changes in the foreign exchange rates associated with our China operations in relation to the U.S. dollar, and the timing of when significant capital projects will be placed into service, which determines the deductibility of accelerated depreciation.

Additionally, we currently expect to pay minimal income taxes in the U.S. on a cash basis during fiscal 2023 due to the immediate expensing of U.S. capital expenditures and our existing U.S. federal net operating loss carryforwards that totaled $23.7 million as of May 1, 2022, which are projected to increase as a result of the significant U.S. loss carryforward we expect to generate during fiscal 2023.

As of October 30, 2022, we will be required to pay annual U.S. federal transition tax payments, in accordance with the 2017 Tax Cuts and Jobs Act ("TCJA"), as follows: FY 2024 - $499,000; FY 2025 - $665,000; and FY 2026 - $831,000.

**Liquidity and Capital Resources**

Liquidity

*Overall*

Currently, our sources of liquidity include cash, cash flow from operations, and amounts available under our revolving credit lines. As of October 30, 2022, we believe our cash of $19.1 million, cash flow from operations, and the current availability under our revolving credit lines totaling $32.3 million (Refer to Note 9 of the consolidated financial statements for further details) will be sufficient to fund our foreseeable business needs, commitments, and contractual obligations.

As of October 30, 2022, our cash and cash equivalents (collectively, "cash") totaled $19.1 million, an increase of $4.5 million compared with $14.6 million as of May 1, 2022. This increase was primarily due to $6.2 million in net cash provided by operating activities, partially offset by capital expenditures totaling $1.1 million.

Our net cash provided by operating activities was $6.2 million during the first half of fiscal 2023, an increase of $7.5 million compared with net cash used in operating activities of $(1.3) million during the first half of fiscal 2023. This change primarily reflects (i) a reduction of inventory related to the significant decline in net sales, improved alignment of inventory purchases with current customer demand trends, and promotional programs to reduce aged raw materials and finished goods inventory; (ii) an increase in accounts payable that primarily related to our upholstery fabrics operations located in China, as the mandated COVID-19 related shutdowns were lifted during the first quarter of fiscal 2023; and (iii) annual incentive payments made during the first quarter of fiscal 2022 that did not recur during the first quarter of fiscal 2023, partially offset by (iv) a decrease in net cash earnings during the first half of fiscal 2023 compared with the first half of fiscal 2022.

As of October 30, 2022, there were no outstanding borrowings under our lines of credit.

The income taxes we pay also affect our liquidity. See the above section titled *"Income Taxes Paid"* of this Item 2 – MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION for further detail.

Our cash balance may be adversely affected by factors beyond our control, such as (i) customer demand trends, (ii) supply chain disruptions, (iii) rising interest rates and inflation, (iv) world events (including the Russia-Ukraine war), and (v) the continuing uncertainty associated with COVID-19. These factors could cause delays in receipt of payment on accounts receivable and could increase cash disbursements due to rising prices.

*By Geographic Area*

A summary of our cash and investments by geographic area follows:

| *(dollars in thousands)* | October 30, 2022 | October 31, 2021 | May 1, 2022 |
|---|---|---|---|
| United States | $ 11,255 | $ 25,906 | $ 4,430 |
| China | 5,734 | 9,101 | 9,502 |
| Canada | 1,194 | 967 | 267 |
| Haiti | 945 | 598 | 341 |
| Cayman Islands | 9 | 10 | 10 |
| | $ 19,137 | $ 36,582 | $ 14,550 |

The total balance as of October 31, 2021, includes short-term investments classified as available-for-sale and short-term and long-term investments classified as held-to-maturity that were liquidated in their entirety during the fourth quarter of fiscal 2022, and therefore, the total balances as of October 30, 2022, and May 1, 2022, solely represent cash.

*Common Stock Repurchase Program*

In March 2020, our board of directors approved an authorization for us to acquire up to $5.0 million of our common stock. Under the common stock repurchase program, shares may be purchased from time to time in open market transactions, block trades, through plans established under the Securities Exchange Act Rule 10b5-1, or otherwise. The number of shares purchased and the timing of such purchases are based on working capital requirements, market and general business conditions, and other factors, including alternative investment opportunities.

During the first half of fiscal 2023, we did not purchase any shares of our common stock. As a result, as of October 30, 2022, $3.2 million is available for additional repurchases of our common stock. Despite the current share repurchase authorization, the company does not expect to repurchase any shares through at least the third quarter of fiscal 2023.

During the first half of fiscal 2022, we repurchased 121,688 shares of common stock at a cost of $1.8 million.

*Dividend Program*

On June 29, 2022, our board of directors announced the decision to suspend the company's quarterly cash dividend. Considering the current and expected macroeconomic conditions, we believe that preserving capital and managing our liquidity is in the company's best interest to support future growth and the long-term interests of our shareholders. Accordingly, we did not make any dividend payments during the first half of fiscal 2023.

During the first half of fiscal 2022, dividend payments totaled $2.7 million, which represented a quarterly cash dividend payment of $0.11 per share.

Our board of directors has sole authority to determine if and when we will declare future dividends, and on what terms. We will continue to reassess our dividend policy each quarter. Future dividend payments will depend on our earnings, capital requirements, financial condition, excess availability under our lines of credit, market and economic conditions, and other factors we consider relevant.

Working Capital

*Operating Working Capital*

Operating working capital (accounts receivable and inventories, less accounts payable-trade, accounts payable-capital expenditures, and deferred revenue) was $48.6 million as of October 30, 2022, compared with $54.7 million as of October 31, 2021, and $67.7 million as of May 1, 2022. Operating working capital turnover was 4.4 during the second quarter of fiscal 2023, compared with 6.5 during the second quarter of fiscal 2022 and 5.2 during the fourth quarter of fiscal 2022.

*Accounts Receivable*

Accounts receivable was $22.4 million as of October 30, 2022, a decrease of $9.9 million, or 30.6%, compared with $32.3 million as of October 31, 2021. This change reflects the significant decrease in net sales during the second quarter of fiscal 2023 as compared with the second quarter of fiscal 2022. Net sales were $58.4 million during the second quarter of fiscal 2023, a decrease of $16.2 million, or 21.7%, compared with net sales of $74.6 million during the second quarter of fiscal 2022. In addition, we experienced faster cash collections with significant customers associated with our mattress and upholstery fabrics segments during the second quarter of fiscal 2023, as compared with the second quarter of fiscal 2022, which led to a decline in days' sales outstanding to 33 days for the second quarter of fiscal 2023, compared with 39 days during the second quarter of fiscal 2022.

Accounts receivable was $22.4 million as of October 30, 2022, which is comparable with the $22.2 million in accounts receivable as of May 1, 2022. This reflects an increase in net sales during the second quarter of fiscal 2023 as compared with the fourth quarter of fiscal 2022. Net sales were $58.4 million during the second quarter of fiscal 2023, an increase of $1.5 million, or 2.5%, compared with net sales of $56.9 million during the fourth quarter of fiscal 2022. The increase in accounts receivable due to this increase in net sales was offset by a decrease in days' sales outstanding, which was 33 days for the second quarter of fiscal 2023 compared with 35 days for the fourth quarter of fiscal 2022.

*Inventory*

Inventory was $52.2 million as of October 30, 2022, a decrease of $11.6 million, or 18.1%, compared with $63.8 million as of October 31, 2021. This decrease reflects (i) the 21.7% decrease in net sales during the second quarter of fiscal 2023, as compared with the second quarter of fiscal 2022; (ii) a $5.2 million non-cash charge recorded during the second quarter of fiscal 2023, which includes $2.9 million related to a write down of inventory to its net realizable value and $2.3 million related to the markdowns of inventory estimated based on our policy for aged inventory; (iii) $98,000 for the loss on disposal and markdowns of inventory related to the exit from our cut and sew upholstery fabrics operation located in Shanghai, China; and (iv) promotional programs to reduce aged raw materials and finished goods inventory, partially offset by (v) higher raw material, labor, and overhead costs stemming from inflationary pressures.

Inventory was $52.2 million as of October 30, 2022, decreased by $14.3 million, or 21.5%, compared with $66.6 million as of May 1, 2022. This decrease reflects (i) improved alignment of inventory purchases with current customer demand trends in our upholstery fabrics segment; (ii) a $6.3 million non-cash charge recorded during the first half of fiscal 2023, which includes $2.9 million related to a write down of inventory to its net realizable value and $3.4 million related to the markdowns of inventory estimated based on our policy for aged inventory; (iii) $98,000 for the loss on disposal and markdowns of inventory related to the exit from our cut and sew upholstery fabrics operation located in Shanghai, China; and (iv) promotional programs to reduce aged raw materials and finished goods inventory, partially offset by (v) higher raw material, labor, and overhead costs stemming from inflationary pressures.

Inventory turns were 4.3 for the second quarter of fiscal 2023, as compared with 4.2 for the second quarter of fiscal 2022 and 3.1 for the fourth quarter of fiscal 2022.

*Accounts Payable - Trade*

Accounts payable - trade was $24.3 million as of October 30, 2022, a decrease of $16.2 million, or 40.0%, compared with $40.5 million as of October 31, 2021. This decrease primarily reflects the significant decrease in net sales during the second quarter of fiscal 2023, as compared with the second quarter of fiscal 2022. Net sales were $58.4 million during the second quarter of fiscal 2023, a decrease of $16.2 million, or 21.7%, compared with net sales of $74.6 million during the second quarter of fiscal 2022. In addition, the decrease in accounts payable is also due to the improved alignment of inventory purchases with current customer demand trends.

Accounts payable - trade was $24.3 million as of October 30, 2022, an increase of $4.2 million, or 20.9%, compared with $20.1 million as of May 1, 2022. This trend reflects the significant increase in net sales related to our upholstery fabrics operations located in China during the second quarter of fiscal 2023, as compared to the fourth quarter of fiscal 2022, as the mandated COVID-19 related shutdowns that were in place during the fourth quarter of fiscal 2022 were lifted during the first quarter of fiscal 2023. Net sales for the upholstery fabrics segment were $32.2 million during the second quarter of fiscal 2023, an increase of $5.0 million, or 18.4%, compared with net sales of $27.2 million during the fourth quarter of fiscal 2022. The increase in accounts payable associated with our upholstery fabrics segment was partially offset by the significant decline in net sales associated with our mattress fabrics segment during the second quarter of fiscal 2023, as compared with the fourth quarter of fiscal 2022. Net sales for the mattress fabrics segment during the second quarter of fiscal 2023 were $26.2 million, a decrease of $3.6 million, or 11.9%, compared with net sales of $29.8 million during the fourth quarter of fiscal 2022.

Financing Arrangements

Currently, we have revolving credit agreements with banks for our U.S parent company and our operations located in China. The purposes of our revolving lines of credit are to support potential short-term cash needs in different jurisdictions, mitigate our risk associated with foreign currency exchange rate fluctuations, and ultimately repatriate earnings and profits from our foreign subsidiaries to our U.S. parent company to take advantage of the TCJA, which allows a U.S. corporation a 100% dividend received income tax deduction on earnings and profits repatriated to the U.S. from 10% owned foreign corporations.

As of October 30, 2022, we did not have any outstanding borrowings associated with our revolving credit agreements.

Our loan agreements require, among other things, that we maintain compliance with certain financial covenants. As of October 30, 2022, we were in compliance with these financial covenants.

Refer to Note 9 of the consolidated financial statements for further disclosure regarding our revolving credit agreements.

Capital Expenditures and Depreciation

*Overall*

Capital expenditures on a cash basis were $1.1 million during the first half of fiscal 2023, compared with $3.9 million for the same period a year ago. Capital expenditures on a cash basis during the first half of fiscal 2023 pertained to capital expenditures associated with our new upholstery fabrics cut and sew operation located in Haiti and manufacturing equipment associated with our mattress fabrics segment, as well as IT equipment associated with both of our business segments. Capital expenditures on a cash basis during the first half of fiscal 2022 mostly related to our mattress fabrics segment.

Depreciation expense was $3.5 million during the first half of fisca1 2023 and fiscal 2022. Depreciation expense mostly related to our mattress fabrics segment for both periods.

*Accounts Payable – Capital Expenditures*

As of October 30, 2022, we had total amounts due regarding capital expenditures totaling $200,000 that pertained to outstanding vendor invoices, none of which were financed. The total amount outstanding of $200,000 is required to be paid based on normal credit terms.

*Purchase Commitments – Capital Expenditures*

As of October 30, 2022, we had open purchase commitments to acquire equipment for our mattress fabrics segment totaling $444,000.

**Critical Accounting Policies and Recent Accounting Developments**

As of October 30, 2022, there were no changes in our significant accounting policies or the application of those policies from those reported in our annual report on Form 10-K for the year ended May 1, 2022.

Refer to Note 2 of the consolidated financial statements for recently adopted and issued accounting pronouncements, if any, since the filing of our Form 10-K for the year ended May 1, 2022.

**Contractual Obligations**

There were no significant or new contractual obligations since those reported in our annual report on Form 10-K for the year ended May 1, 2022.

**Inflation**

Any significant increase in our raw material costs, utility/energy costs, and general economic inflation could have a material adverse impact on the company, because competitive conditions have limited our ability to pass significant operating cost increases on to customers. During fiscal 2022 and continuing through the first half of fiscal 2023, higher freight costs, labor costs, and raw material prices have increased the prices we pay for shipping, labor, and raw materials. Inflationary pressures also began to affect consumer spending during the second half of fiscal 2022, and these pressures have continued through the first half of fiscal 2023. We are unable to predict how long these trends will last, or to what extent inflationary pressures may affect the economic and purchasing cycle for home furnishing products (and therefore affect demand for our products) over the short and long term.

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

*Interest Rates*

We are exposed to market risk from changes in interest rates with regards to our revolving credit agreements.

Effective June 24, 2022, we entered into an amended and restated U.S. revolving credit agreement ("Amended Agreement") that required interest to be charged at a rate (applicable interest rate of 4.38% as of October 30, 2022) calculated using an applicable margin over the Federal Reserve Bank of New York's secured overnight fund rate (SOFR), as defined in the Amended Agreement. As of October 30, 2022, there were no outstanding borrowings under the Amended Agreement.

Our revolving credit line associated with our operations located in China bears interest at a rate determined by the Chinese government at the time of borrowing. As of October 30, 2022, there were no borrowings outstanding under our revolving credit agreement associated with our operations located in China.

*Foreign Currency*

We are exposed to market risk from changes in the value of foreign currencies for our subsidiaries domiciled in Canada and China. We try to maintain a natural hedge by keeping a balance of our assets and liabilities denominated in the local currency of our subsidiaries domiciled in Canada and China. However, there is no assurance that we will be able to continually maintain this natural hedge. Our foreign subsidiaries use the United States dollar as their functional currency. A substantial portion of the company's imports purchased outside the United States are denominated in U.S. dollars. A 10% change in the above exchange rates as of October 30, 2022, would not have materially affected our results of operations or financial position.

## ITEM 4. CONTROLS AND PROCEDURES

As of October 30, 2022, we conducted an evaluation of the effectiveness of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). This evaluation was conducted under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that these disclosure controls and procedures were effective as of such date, in all material respects, to ensure that information required to be disclosed in the reports filed by us and submitted under the Exchange Act, is recorded, processed, summarized, and reported as and when required, and that these disclosure controls and procedures were effective as of such date to ensure that information required to be disclosed in reports filed by us under the Exchange Act is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, in a manner to allow timely decisions regarding the required disclosure.

During the quarter ended October 30, 2022, there were no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Part II – Other Information**

Item 1. Legal Proceedings

There have not been any material changes to our legal proceedings during the three months ended October 30, 2022. Our legal proceedings are disclosed in the company's annual report on Form 10-K filed with the Securities and Exchange Commission on July 15, 2022, for the fiscal year ended May 1, 2022.

Item 1A. Risk Factors

There have not been any material changes to our risk factors during the three months ended October 30, 2022. Our risk factors are disclosed in Item 1A "Risk Factors" of the company's annual report on Form 10-K filed with the Securities and Exchange Commission on July 15, 2022, for the fiscal year ended May 1, 2022.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

**ISSUER PURCHASES OF EQUITY SECURITIES**

| Period | (a) Total Number of Shares Purchased | (b) Average Price Paid per Share | (c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | (d) Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (1) |
|---|---|---|---|---|
| August 1, 2022 to September 4, 2022 | — | — | — | $ 3,248,094 |
| September 5, 2022 to October 2, 2022 | — | — | — | $ 3,248,094 |
| October 3, 2022 to October 30, 2022 | — | — | — | $ 3,248,094 |
| Total | — | — | — | $ 3,248,094 |

(1) In March 2020, our board of directors approved an authorization for us to acquire up to $5.0 million of our common stock.

Item 6. Exhibits

**The following exhibits are submitted as part of this report.**

| | |
|---|---|
| 10.1 | Form of Annual Incentive Award Agreement. |
| 31.1 | Certification of Chief Executive Officer Pursuant to Rule 13a-14(a)/15d-14(a). |
| 31.2 | Certification of Chief Financial Officer Pursuant to Rule 13a-14(a)/15d-14(a). |
| 32.1 | Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350. |
| 32.2 | Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350. |
| 101.INS | Inline XBRL Instance Document |
| 101.SCH | Inline XBRL Taxonomy Extension Schema Document |
| 101.CAL | Inline XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.LAB | Inline XBRL Taxonomy Extension Label Linkbase Document |
| 101.PRE | Inline XBRL Taxonomy Extension Presentation Linkbase Document |
| 101.DEF | Inline XBRL Taxonomy Extension Definition Linkbase Document |

104 Cover Page Interactive Data File (formatted as Inline XBRL with applicable taxonomy extension information contained in Exhibits 101).

## SIGNATURES

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

**CULP, INC.**
**(Registrant)**

Date: December 9, 2022

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

By: /s/ Thomas B. Gallagher, Jr.
Thomas B. Gallagher, Jr.
Vice President of Finance
(Authorized to sign on behalf of the registrant and also signing as principal accounting officer)

# ANNUAL INCENTIVE AWARD AGREEMENT

**THIS ANNUAL INCENTIVE AWARD AGREEMENT** (the "**Agreement**"), dated as of ______________, is between **CULP, INC.**, a North Carolina corporation (the "**Corporation**"), and ____________________ ("**Recipient**").

## Background Statement

The Corporation desires to grant to Recipient an Annual Incentive Award (the "**Award**") pursuant to the Culp, Inc. 2015 Equity Incentive Plan (the "**Plan**"). Capitalized terms used but not defined in this Agreement shall have the meanings given to them in the Plan.

## STATEMENT OF AGREEMENT

**NOW**, **THEREFORE**, the parties hereby agree as follows:

**Section 1.Grant of Award**. The Corporation hereby grants to Recipient the Award described below.

The Award will pay an incentive bonus for the Performance Period stated below to Recipient upon final determination by the Compensation Committee (the "**Committee**") of the Corporation's board of directors that a bonus payment is due pursuant to the terms of this Agreement and the Plan.

The bonus payment due hereunder is calculated with reference to the Total Bonus Percentage for the Reporting Unit in which Recipient participates. The bonus due to Recipient is the Total Bonus Percentage for Recipient's Reporting Unit multiplied by Recipient's Bonus Opportunity.

**Performance Period**: The Corporation's fiscal year ending ___________.

**Reporting Unit**: _________

**Bonus Opportunity**: Recipient's Bonus Opportunity is _____% of Recipient's base salary during the Performance Period.

**Total Bonus Percentage** (i) for each of the Culp Home Fashions and Culp Upholstery Fabrics Reporting Unit is calculated using the percentage amounts derived from Schedule A attached hereto, 20% of which is based upon the total Adjusted Operating Income results for Recipient's Reporting Unit during the Performance Period (the "**Division OI Bonus Percentage**"), and 80% of which is based upon the total Adjusted Free Cash Flow results for Recipient's Reporting Unit during the Performance Period (the "**Division FCF Bonus Percentage**"), in each case with straight line interpolation being used to determine Division OI Bonus Percentage and Division FCF Bonus Percentage amounts between the amounts shown on Schedule A; upon determination of the Division OI Bonus Percentage and the Division FCF Bonus Percentage for each such Reporting Unit, the Total Bonus Percentage is calculated as follows: (20% multiplied by the Division OI Bonus Percentage) plus (80% multiplied by the Division FCF Bonus Percentage) = Total Bonus Percentage for such Reporting Unit; and (ii) for the Corporate Shared Services Reporting Unit is calculated using the percentage amounts derived from Schedule A attached hereto, 100% of which is based upon the total Adjusted Free Cash Flow results for the Corporate Shared Services Reporting Unit during the Performance Period (the "**Shared Services FCF Bonus Percentage**); provided, however, that in the event the Adjusted Operating Income for the Corporate Shared Services Reporting Unit reflects a loss (i.e., an Adjusted Operating Loss), then a negative moderator will be applied as a downward adjustment against any bonus earned by the Recipient as a result of the Shared Services FCF Bonus Percentage, with such moderator applied to reduce the earned bonus as follows:

| | |
|---|---|
| For an Adjusted Operating Loss up to $500,000 | 5% reduction |
| For an Adjusted Operating Loss from $500,001 to $1 million | 10% reduction |
| For an Adjusted Operating Loss from $1,000,001 to $1.5 million | 15% reduction |
| For an Adjusted Operating Loss that is greater than $1.5 million | 20% reduction |

The maximum Total Bonus Percentage for this award for each Reporting Unit is 200%.

"**Adjusted Operating Income**" shall mean operating income or loss for a Reporting Unit as calculated and recorded on the Reporting Unit's financial statements, but excluding (prior to) the payment of bonus payments related to bonuses awarded under this form of Agreement under the annual incentive plan, and also excluding extraordinary and non-recurring items including restructuring and related charges, goodwill or fixed asset impairment charges, prepayment fees on debt, other extraordinary charges or credits, and the effects of acquisitions, and also excluding any other items that the Committee deems appropriate for exclusion.

"**Adjusted Free Cash Flow**" (i) for the Corporate Shared Services Reporting Unit shall mean such Reporting Unit's net cash provided by (used in) operating activities (which shall include and be calculated using the Adjusted Operating Income, as defined above, for the Reporting Unit), less cash capital expenditures and payments on vendor-financed capital expenditures, plus any proceeds from sale of property, plant, and equipment, plus proceeds from the sale of long-term investments associated with the Corporation's rabbi trust, less the purchase of long-term investments associated with the Corporation's rabbi trust, and plus or minus the effects of exchange rate changes on cash and cash equivalents, in each case as calculated and reported on the Reporting Unit's financial statements, and also excluding any other items that the Committee deems appropriate for exclusion; and (ii) for each Division Reporting Unit shall mean such Division's cash from earnings (which shall include and be calculated using Adjusted Operating Income, as defined above, for the Division), plus or minus cash from working capital, less cash capital expenditures, and plus proceeds from sale of property, plant, and equipment, in each case as calculated and reported by the Division, and also excluding any other items the Committee deems appropriate for exclusion.

**Section 2.Vesting**. The bonus amount to be paid hereunder will vest and become payable upon final determination of the amount to be paid by the Corporation and the Committee, provided, however, that if such determination is made by the Committee prior to the Corporation's filing with the Securities and Exchange Commission ("**SEC**") of its annual report on Form 10-K that relates to the financial results for the applicable Performance Period, then the bonus amount to be paid here under will not vest and become payable until after such filing is complete.

Notwithstanding the foregoing, all unvested Awards (and a bonus payment at Recipient's Bonus Opportunity) shall immediately vest and become payable upon the occurrence of the following:

(a) termination of Recipient's employment by reason of the death or Disability of Recipient; or

(b) Recipient's employment is terminated by the Corporation in anticipation of a Change of Control, or

(c) Recipient is employed by the Corporation or an affiliate thereof at the time a Change of Control occurs, and at any time during the 18-month period following such Change of Control (provided that the bonus payment provided for hereunder shall have not already become due and been paid),

(i) Recipient's employment is terminated by the Corporation or an affiliate thereof for any reason other than for death, Disability or Cause, or

(ii) Recipient terminates his/her employment for Good Reason within one year following the initial existence of the conditions giving rise to such Good Reason.

**Section 3.Additional Definitions**. For purposes of this Agreement, the following terms shall have the meanings indicated below:

"**Cause**" shall mean (i) the commission by Recipient of a felony (or crime involving moral turpitude); (ii) theft, conversion, embezzlement or misappropriation by Recipient of funds or other assets of the Corporation or its Subsidiaries or any other act of fraud with respect to the Corporation or its Subsidiaries (including without limitation the acceptance of bribes or kickbacks or other acts of self-dealing); (iii) intentional, grossly negligent or unlawful misconduct by Recipient that causes significant harm to the Corporation or its Subsidiaries; or (iv) repeated instances of intoxication with alcohol or drugs while conducting business during regular business hours.

"**Change of Control**" shall have the meaning given to such term in the Plan. In addition, for an award that vests according to Adjusted Operating Income or Adjusted Free Cash Flow of a Division, "**Change of Control**" shall be deemed to have occurred upon consummation of a sale of all or substantially all of the assets of such Division by the Corporation to an unaffiliated third party.

"**Disability**" shall have the meaning given to such term in the primary disability benefit plan of the Corporation in which Recipient participates. In the absence of any such plan, "**Disability**" shall mean any physical or mental impairment that renders Recipient unable to perform the essential functions of Recipient's job with the Corporation and its Subsidiaries for a period of at least 120 days, either with or without reasonable accommodation. At the Corporation's request, Recipient shall submit to an examination by a duly licensed physician who is mutually acceptable to the Corporation and Recipient for the purpose of ascertaining the existence of a Disability, and shall authorize the physician to release the results of Recipient's examination to the Corporation.

"**Good Reason**" shall mean, without Recipient's express written consent, the existence of any of the following conditions unless such conditions are fully corrected within thirty days after Recipient notifies the Corporation of the existence of such conditions as hereinafter provided:

(a) a material diminution in Recipient's authority, duties or responsibilities;

(b) a material diminution in the authority, duties or responsibilities of the supervisor to whom Recipient is required to report;

(c) a material diminution in Recipient's base salary, other than as a result of across-the-board salary reductions similarly affecting all management personnel of the Corporation; or

(d) a material change in the geographic location at which Recipient must regularly perform services for the Corporation.

Recipient shall notify the Corporation that he/she believes that one or more of the conditions described above exists, and of his/her intention to terminate employment for Good Reason as a result thereof, within sixty days after the time that he/she gains knowledge of such conditions. Recipient shall not deliver a notice of termination of employment for Good Reason until thirty days after he/she delivers the notice described in the preceding sentence, and Recipient may do so only if the conditions described in such notice have not been fully corrected by the Corporation.

**Section 4.Settlement**.

As soon as reasonably practicable following (i) a determination by the Corporation that a bonus payment is due hereunder and (ii) the Corporation's filing with the SEC of its annual report on Form 10-K that relates to the financial results for the applicable Performance Period of the Award, the bonus will be paid in cash, or will be paid in accordance with any proper and valid election under the Culp, Inc. Deferred Compensation Plan for Key Employees, but only if such election has been made in accordance with the policies and procedures of the Corporation pursuant to such plan.

**Section 5.Forfeiture**. All bonus amounts that do not vest pursuant to **Section 2** shall automatically be cancelled and forfeited by Recipient effective as of the earlier to occur of (a) the first day after the end of the Performance Period (to the extent that neither Adjusted Operating Income nor Adjusted Free Cash Flow for the relevant Reporting Unit is sufficient to cause any bonus payment to vest pursuant to the terms of this Agreement), (b) the termination by Recipient of his/her employment with the Corporation or its Subsidiaries for any reason, except as otherwise determined by the Committee, in its sole discretion (for example, under circumstances in which Recipient will continue providing Services to the Corporation as a director, consultant, or independent contractor following any such termination by Recipient, or such other circumstances as determined by the Committee), or (c) the termination by the Corporation of

Recipient's employment with the Corporation or its Subsidiaries for any reason (including with or without Cause) (each such event being referred to herein as a "**Forfeiture Event**"). Upon the occurrence of a Forfeiture Event, all unvested bonus amounts shall automatically, without further action by the Corporation or Recipient, be cancelled and forfeited.

**Section 6.Tax Matters**.

(a) Recipient shall promptly pay to the Corporation all federal, state and local income, social security and payroll taxes of any kind required by law to be withheld with respect to the vesting or payment of a bonus hereunder, and the Corporation, to the extent permitted by law, have the right to deduct from any payment of any kind otherwise due to Recipient all federal, state and local income, social security and payroll taxes of any kind required by law to be withheld with respect to the vesting or payment of a bonus earned hereunder.

(b) Notwithstanding anything in this Agreement to the contrary, if a Change of Control occurs and if Recipient is entitled under any agreement or arrangement (including, without limitation, this Agreement) to receive compensation that would constitute a parachute payment (including, without limitation, the vesting of any rights) within the meaning of Section 280G of the Internal Revenue Code of 1986, as amended (the "**Code**") but for the operation of this sentence, then the amount of all such payments shall be reduced, as determined by the Corporation, to the extent necessary to cause the aggregate present value of all payments in the nature of compensation to Recipient that are contingent on a change in the ownership or effective control of the Corporation, or in the ownership of a substantial portion of the assets of the Corporation, not to exceed 2.99 times Recipient's "base amount," all within the meaning of Section 280G of the Code and the regulations promulgated thereunder. The parties intend for the immediately preceding sentence to be interpreted and applied so as to prevent Recipient from receiving, with respect to a Change of Control, an excess parachute payment within the meaning of Section 280G of the Code.

**Section 7.Clawback**.

(a) If the Corporation's reported financial or operating results become subject to a material negative restatement, the Committee may require Recipient to pay to the Corporation an amount corresponding to the amount that the Committee determines would not have been vested or paid if the Corporation's results as originally published had been equal to the Corporation's results as subsequently restated; provided that any requirement or claim under this Section 7(a) must be made, if at all, within five years after the date the amount claimed was originally vested or paid, whichever is later.

In the alternative, the Committee may require Recipient to repay or return compensation awarded hereunder pursuant to such rules as may be adopted from time to time pursuant to Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, to the extent applicable. By acceptance of any Award or bonus payment hereunder, Recipient expressly acknowledges and agrees that any and all amounts paid to Recipient hereunder are and will be fully subject to the terms of any policy regarding repayment, recoupment or clawback of compensation now or hereafter adopted by the

Corporation in response to the requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act, rulemaking of the Securities and Exchange Commission or otherwise. Recipient acknowledges and agrees that any such policy will apply to any and all bonus amounts paid hereunder in accordance with its terms, whether retroactively or prospectively, and agrees to cooperate fully with the Corporation to facilitate the recovery of any that the Committee determines in its sole discretion is required to be recovered pursuant to the terms of such policy.

The obligations of Recipient to make payments or return bonus amounts paid hereunder under this Section 7(a) are independent of any involvement by such Recipient in events that led to the restatement. The provisions of this Section 7(a) are in addition to, not in lieu of, any remedies that the Corporation may have against any persons whose misconduct caused or contributed to a need to restate the Corporation's reported results.

(b) If at any time within three years of the vesting or payment of any award to Recipient under this Agreement, whichever is later, Recipient's employment is terminated for Cause (or, if such termination is deemed not to be for Cause, but the Corporation determines at any time during such three-year period that the Corporation could have terminated Recipient's employment for Cause based on Recipient's conduct during his or her time of employment with the Corporation), then if any part of the underlying conduct or circumstances giving rise to such determination of Cause by the Corporation took place at any time during the applicable vesting period for each such award, as specified in this Agreement, then the Committee may require Recipient to pay to the Corporation an amount corresponding to each award that vested or was paid to Recipient pursuant to this Agreement.

By acceptance of any Award or bonus payment hereunder, Recipient expressly acknowledges and agrees that any and all amounts paid to Recipient hereunder are and will be fully subject to the terms of the foregoing clawback provision, and agrees to cooperate fully with the Corporation to facilitate the recovery of any such amounts that the Committee requires to be recovered pursuant to the foregoing.

**Section 8.Miscellaneous**.

(a) **Governing Law**. This Agreement shall be construed, administered and governed in all respects under and by the applicable internal laws of the State of North Carolina, without giving effect to the principles of conflicts of laws thereof.

(b) **Entire Agreement; Amendment and Waiver**. This Agreement and the Award granted hereunder shall be subject to the terms of the Plan, which hereby is incorporated into this Agreement as though set forth in full herein. Recipient hereby acknowledges receipt of a copy of the Plan. This Agreement and the Plan reflect the entire agreement between the parties hereto and supersede any prior or contemporaneous written or oral understanding or agreement regarding the subject matter hereof. This Agreement may not be modified, amended, supplemented or waived except by a writing signed by the parties hereto, and such writing must refer specifically to this Agreement.

(c) **Assignment; Binding Effect**. Except as permitted by the Plan, this Agreement and the Award granted hereunder may not be assigned, pledged, hypothecated or transferred by Recipient in any manner. This Agreement, as amended from time to time, shall be binding upon, inure to the benefit of and be enforceable by the heirs, successors and assigns of the parties hereto; provided, however, that this provision shall not permit any assignment in contravention of the terms contained elsewhere herein.

(d) **No Right to Employment**. Nothing in this Agreement shall confer on Recipient any right to continue in the employ of the Corporation or any of its Subsidiaries.

(e) **Counterparts**. This Agreement may be executed in one or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument. Delivery of an executed counterpart of this Agreement by facsimile or other electronic device shall be equally as effective as delivery of an original executed counterpart of this Agreement. Any party delivering an executed counterpart of this Agreement by facsimile or other electronic device shall also deliver an original executed counterpart of this Agreement, but the failure to deliver an original executed counterpart of this Agreement shall not affect the validity, enforceability and binding effect of this Agreement.

(f) **Notices**. Any notice hereunder to the Corporation shall be addressed to the Corporation's principal executive office, Attention: Compensation Committee, and any notice hereunder to Recipient shall be addressed to Recipient at his last address in the records of the Corporation, subject to the right of either party to designate at any time hereafter in writing a different address. Any notice shall be deemed to have been given when delivered personally, one (1) day after dispatch if sent by reputable overnight courier, fees prepaid, or three (3) days following mailing if sent by registered mail, return receipt requested, postage prepaid and addressed as set forth above.

[Signature page is the next page.]

**IN WITNESS WHEREOF**, this Agreement has been duly executed as of the date first written above.

**CULP, INC.**,
a North Carolina corporation

By: ____
Name: ____
Title: ____

**RECIPIENT**

____
______________________________

# SCHEDULE A

| OI Bonus Percentage | Adjusted Operating Income Results |
|---|---|
| 0% | Below $X |
| 20% | X |
| 25% | X |
| 50% | X |
| 75% | X |
| 100% | Target Level |
| 125% | X |
| 150% | X |
| 175% | X |
| 200% | Maximum |

| FCF Bonus Percentage | Adjusted Free Cash Flow Results |
|---|---|
| 0% | Less than $X |
| X% | X |
| X% | X |
| X% | X |
| X% | X |
| 100% | Target Level |
| X% | X |
| X% | X |
| X% | X |
| 200% | Maximum |

**Exhibit 31.1**

# CERTIFICATIONS

I, Robert G. Culp, IV, certify that:

1. I have reviewed this Form 10-Q of Culp, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Robert G. Culp, IV

Robert G. Culp, IV
President and Chief Executive Officer
(Principal Executive Officer)

Date: December 9, 2022

**Exhibit 31.2**

**CERTIFICATIONS**

I, Kenneth R. Bowling, certify that:

1. I have reviewed this Form 10-Q of Culp, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Kenneth R. Bowling

Kenneth R. Bowling
Executive Vice President and
Chief Financial Officer
(Principal Financial Officer)

Date: December 9, 2022

**Exhibit 32.1**

Certification Pursuant to
18 U.S.C. Section 1350,
as Adopted Pursuant to
Section 906 of the Sarbanes-Oxley Act of 2002

In connection with the Quarterly Report of Culp, Inc. (the "Company") on Form 10-Q for the period ended October 30, 2022, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Robert G. Culp, IV, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Robert G. Culp, IV
Robert G. Culp, IV
President and Chief Executive Officer

December 9, 2022

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906 has been provided to Culp, Inc. and will be retained by Culp, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

**Exhibit 32.2**

Certification Pursuant to
18 U.S.C. Section 1350,
as Adopted Pursuant to
Section 906 of the Sarbanes-Oxley Act of 2002

In connection with the Quarterly Report of Culp, Inc. (the "Company") on Form 10-Q for the period ended October 30, 2022, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Kenneth R. Bowling, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Kenneth R. Bowling

Kenneth R. Bowling
Executive Vice President and Chief Financial Officer

December 9, 2022

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906 has been provided to Culp, Inc. and will be retained by Culp, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.