

WESTPEAK RESEARCH ASSOCIATION

Culp Inc. (CULP)

Manufacturing – Mattress and Furniture

“Soft Products in a Tough Industry”

May 22nd, 2018

Culp is a global manufacturer and seller of mattress fabrics, mattress covers and upholstery fabrics. Their products are either manufactured and designed themselves or are sourced through their contact of suppliers. Culp operates X operating facilities spanning globally from the U.S., Canada, China and Haiti. The company currently employs approximately 1325 people.

Thesis

Culp’s long-standing track record and first-rate product quality is why they have a leading market share among home-wear fabrics producers in North America. We believe their growth strategies, such as expanding sales into the Asia Pacific region and penetrating into hospitality market will help bolster and diversify their revenue stream, while also grabbing a larger market share in fast-growing markets. Their joint venture with A Lava and acquisition of Read Window Products are going to be catalysts’ that unfold in the long run, as the strong track record from these two companies in their respective industries will perfectly complement Culp’s penetration into these new markets. Led by a strong management team whose disciplined use of capital has allowed for a 10.6% ROA over the past 5 years, we believe that Culp will be able to accomplish their growth initiatives. While we foresee Culp’s revenue to grow, their margins are a serious concern.

While Culp’s operating margins are better than the industry average of 4.7%, Culp’s operation heavy reliance on raw materials, specifically petrochemicals, makes them very susceptible to changing prices. They also face tough competition, both, domestically and internationally, and with margins already quite slim, we fear that a price-war will be

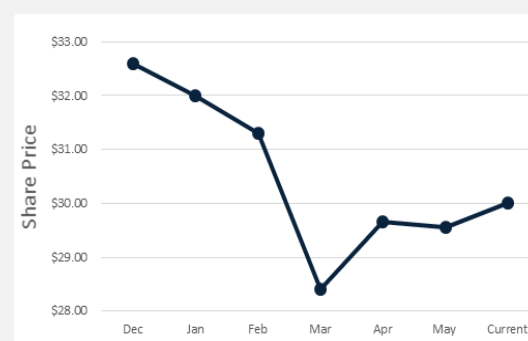
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Equity Research	Canada
Price Target	USD\$ 27.80
Rating	Hold
Share Price (May 22 nd Close)	CAD\$ 31.00
Total Return	-7.33%

Key Statistics	
52 Week H/L	\$34.05/\$24.95
Market Capitalization	\$389.69M
Average Daily Trading Volume	14,732
Net Debt	\$(22.34)M
Enterprise Value	\$322.67M
Net Debt/EBITDA	N/A
Diluted Shares Outstanding	\$12.45M
Free Float	88.34
Dividend Yield	1.06%

WestPeak’s Forecast			
	2017E	2018E	2019E
Revenue	\$310M	\$328M	\$345M
EBITDA	\$37M	\$36M	\$36M
Net Income	\$22M	\$13M	\$19M
EPS	\$1.78	\$1.05	\$1.52
P/E	18.1x	22.2x	15.0x
EV/EBITDA	10.2x	9.5x	10.1x

1-Year Price Performance



detrimental to Culp’s business in the long run. Due to concerns about the long-term sustainability of their business in this highly competitive industry, we would recommend a hold rating.

Valuation

Our target share price is \$27.80 based on the exit multiple method from our DCF method and the EV/EBITDA multiple from our comparable method, both weighted 50% equally. The discounted cash flow assumes both organic growth and inorganic growth through company strategic initiatives, upcoming catalysts and macroeconomic factors. The total expected return is -9.11% based on current share price.

Business Overview and Fundamentals

Business Summary

Culp Inc. is a producer of mattress fabrics and a marketer of upholstery fabrics in North America. The Company operates through two segments: the mattress fabrics segment and the upholstery fabrics segment. Its mattress fabrics segment manufactures and markets mattress fabrics and mattress covers to mattress manufacturers while its upholstery fabrics segment markets fabrics for residential and commercial furniture manufacturers. The fabrics sold by Culp are either produced at its manufacturing facilities or fabrics sourced from suppliers. Culp operates manufacturing facilities in the United States, Canada, China and Haiti.



Source: <http://www.culpinc.com/>

Products

Mattress Segment

Culp’s mattress fabrics segment, labeled as Culp Home Fashions, produces and sells mattress fabrics and covers to bedding manufacturers. Culp’s selection of mattress fabrics includes a variety of fabrics that come in a range of quality, materials, patterns and colors. The products are categorized by fabrics: woven jacquards, converted fabric and knitted fabric. Culp has made noteworthy investments in researching market fabrics that keep pace with current market trends and working with clients to come up with designs that meet their satisfaction. Culp’s

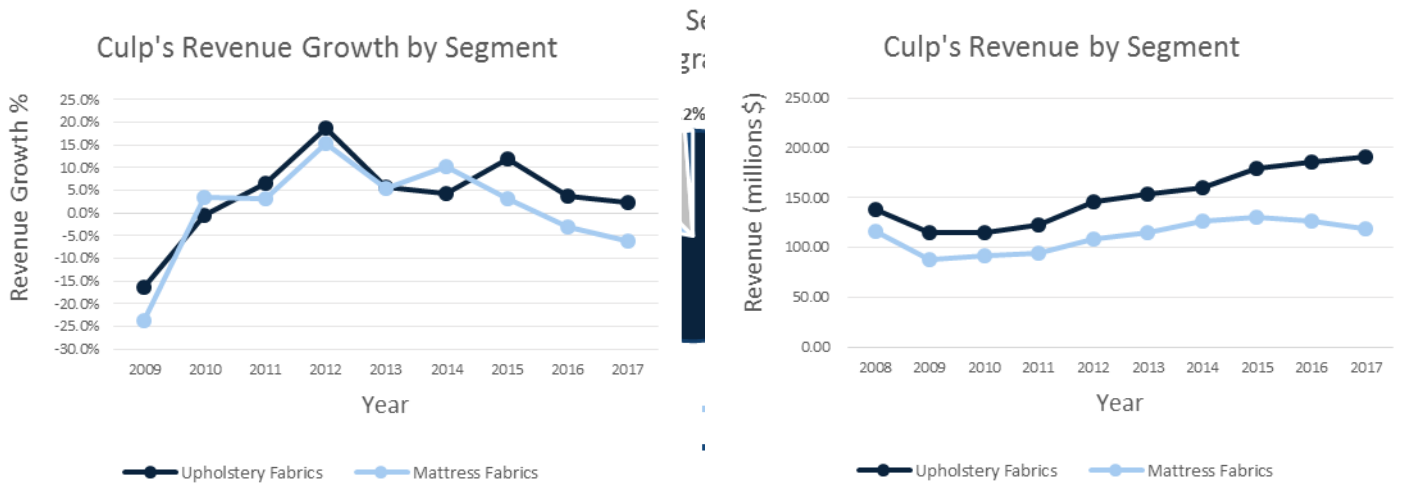
involvement in selling the mattress covers began in 2013 in partnership with A. Lava & Son Co. of Chicago, a leading provider of mattress covers, to create the Culp-Lava Applied Sewn Solutions (CLASS) venture.

Upholstery Segment

Culp’s upholstery fabrics segment manufactures and markets fabrics for residential and commercial furniture. Culp has created an upholstery fabrics development team, whose primary focus is designing cloths for furniture. The team searches continually for new ideas and for the best sources of raw materials, yarns, and fabrics, utilizing a global supply network, specifically in China.

Revenue Segmentation

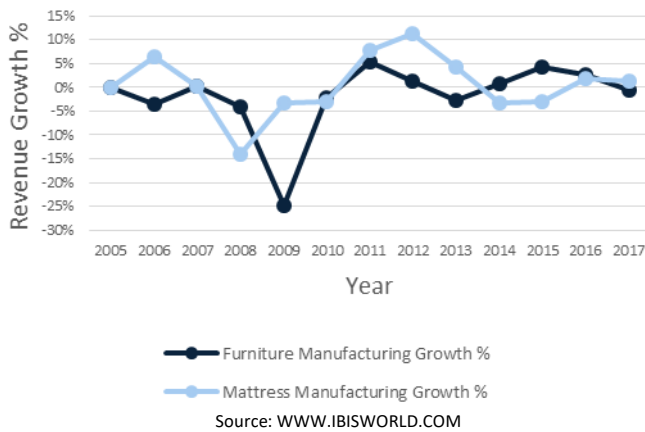
Mattress fabrics segment sales represented approximately 60% Culp’s net sales in each of the past three years with upholstery fabrics segment represented approximately 40% of net sales. In 2017 alone, Culp generated \$118.74 million from the upholstery fabric market and \$190.81 million from the mattress fabric market. Culp’s global presence allows them to have a diversified revenue stream. In 2017, 77.9% of their revenue was generated in the U.S., while 9.7% came from North America (excluding U.S.), and the remaining from the Far East and Asia. Between 2012 and 2017, Culp’s annual revenue grew from \$254.4 million to \$309.5 million, with a compounded annual growth rate (CAGR) of 3.6%.



Industry Analysis

Culp operates in the mattress and furniture manufacturing industry. While Culp’s mattress fabrics segment does not produce mattresses, they act as the primary inputs supplier for the mattress manufacturers, producing components of the mattress such as the fabric or the mattress cover. The change in supply and demand of mattresses and mattress fabric are intertwined and are both affected the same by changes in the macroeconomic environment. The upholstery fabrics segment similarly acts as the primary input supplier for furniture manufacturing industry, which can be separated by the residential and commercial. The residential furniture market is involved in the production residential furniture that is sold to customers for household usage, including products such as sofas, recliners, chairs and etc. The commercial industry is involved with the production furniture used for the hospitality industry and commercial offices, manufacturing products such as office furniture and wall covering.

Industry Revenue Growth % Comparison



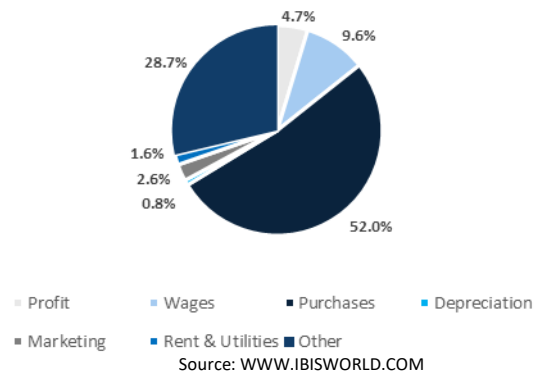
Industry Revenue Comparison



Mattress Manufacturing Industry

Over the past four years, the mattress manufacturing industry has recovered from recessionary lows, growing at an annualized rate of 0.2%. It is a cyclical industry, with some of its main macroeconomic driver’s disposable income levels, housing starts and furniture store revenue. The rapid growth in the economy over the past year sets up a profitable environment for the industry. Furthermore, the rising sentiment towards healthy living, coupled additional health benefits from advances made in mattresses by the industry, will contribute to continued growth in demand. However, the industry has continued to experience volatility due to factors such as imports and volatile commodity prices over the past five years, which has directly resulted in higher input prices. Purchases represent 52% of the industry costs, which are primarily oil and steel based materials. With oil prices forecasted to rise and potential tariffs on steel, volatility will rise making it very difficult for producers to plan their costs and pass on the added costs to consumers.

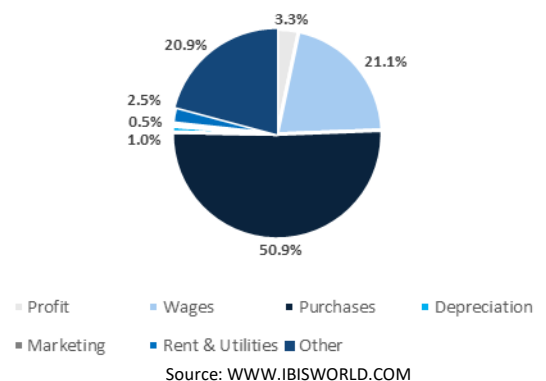
Mattress Manufacturing Industry Cost Structure



Furniture Manufacturing Industry

The furniture manufacturing industry, which is composed of both residential and commercial furniture manufacturing, has experienced varied growth over the past five years, with the industry growing by annualized rate of 1.8%. While the fluctuations in the furniture industry are generally positively correlated with economy, there are discrepancies which can be attributed to industry’s high wages cost due to the need for skilled design and craftsmanship. Purchases remain the largest portion of the industry costs however, due to not experience much volatility. Macroeconomic indicators such consumer sentiment, disposable income, unemployment rates and corporate profits, do still have significant control over the direction of the industry’s revenue. The furniture manufacturing industry have had revenue hindered by increased competition from international manufacturers, who are now also beginning to supply domestic wholesalers with their products to sell.

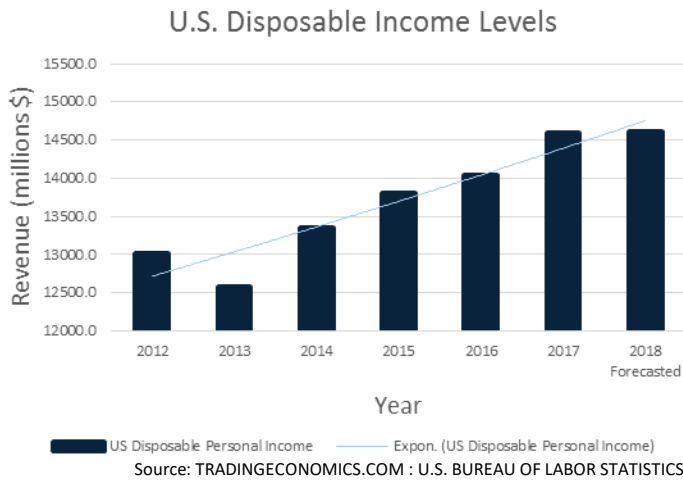
Furniture Manufacturing Industry Cost Structure



Economic Indicators

Disposable Income

Increases in household income can be a driver for higher mattress sales and higher average selling prices.



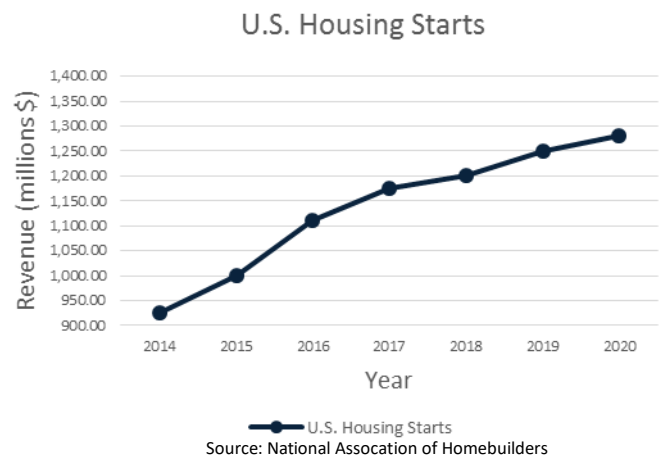
Mattresses and furniture’s, although are considered to be staple goods, can also be economically defined as a luxury goods, meaning demand increases proportionately as income rises. As consumers become wealthier, they tend to replace mattresses at a quicker rate and upgrade to more high-end mattresses during periods of income growth. Due to the economic growth over the past year, consumers’ disposable income is expected to rise in 2018, representing a potential opportunity for the industry.

Raw Material Prices

The fluctuation of raw material prices plays a major factor for the costs of the both mattress and furniture manufacturers. Raw materials are a large part of manufacturers’ operating expenses through input costs such as yarn, cotton, wool or petrochemicals, which is the underlying price of oil. The instabilities of these materials not only have a negative effect on profits, but also makes it difficult for manufacturers to forecast spending and costs, thus, hindering business efficiency.

Housing starts

Changes in property investment can have an effect on the demand for mattresses. With the number of housing units being constructed rising and forecasted to continue rising, this will drive the demand up for mattresses, as mattresses as they are a complementary good to housing, therefore increasing industry. The number of housing construction is expected to increase over 2017.



Furniture Store Demand

Furniture stores are the largest revenue stream for mattress and furniture manufacturers and any changes in demand from this steam has a major effect on the manufacturer’s revenues.

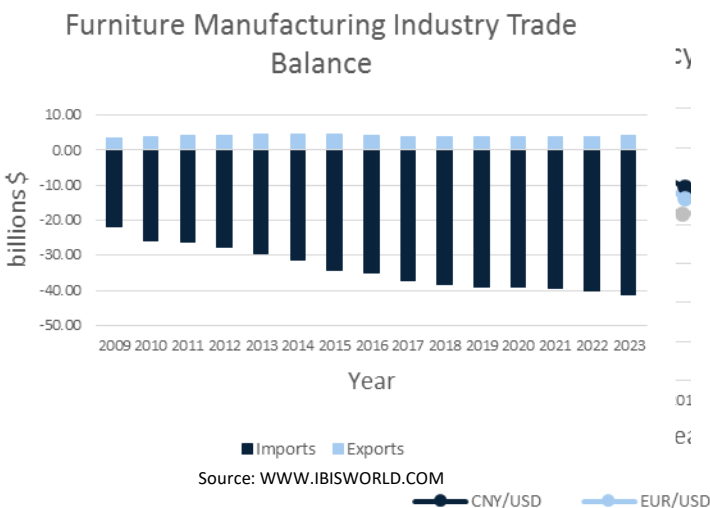
Demand in the furniture stores industry is a leading indicator for the mattress and furniture manufacturing industry, as growing demand for furniture or mattress means a growing need for supply. The drivers for furniture stores are somewhat similar to the mattress and furniture manufacturing industry, with disposable income levels and housing starts having the strongest influence.



Imports

Like most manufacturing industry, mattress and furniture manufacturers face competition from imports. Mattress imports historically have been a relatively small portion of the industry as the personalized nature of mattresses created barriers for international producers. However, over the past five years, import penetration has steadily increasing, due to factors such as the advancement of e-commerce, and is projected to continue growing.

Furniture imports have been consistently at high levels over the past five years, due to low-cost labor overseas, and is expected to continue growing. The value of the U.S. dollar however, is forecasted to depreciate in comparison with other major currencies such as the JPY and CNY, making export cheaper for domestic consumers and businesses. These forecasted increases in import penetration and USD value will have a negative effect on industry profit.

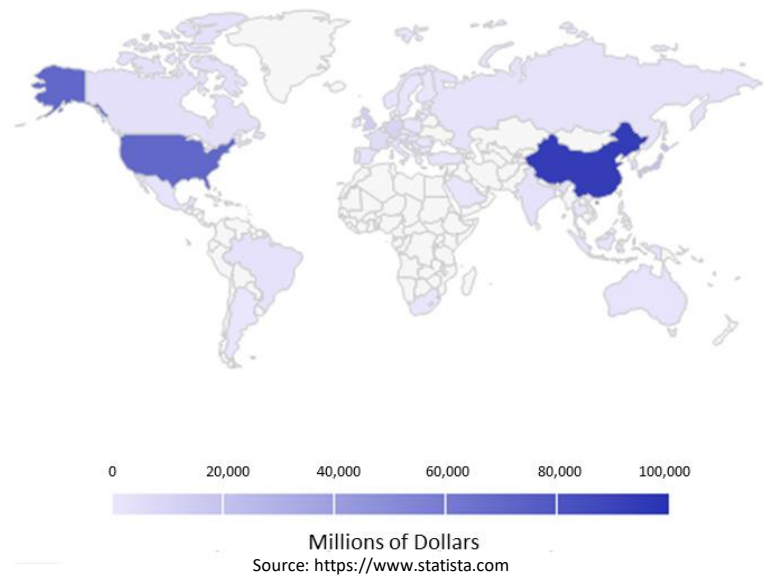


Growth Strategies

Further Expansion of Sales in Asia

Asia Pacific is presently the largest global contributor to the overall revenues of both the global mattress and furniture manufacturing industries. The region holds very enticing opportunities for growth for manufacturers as it is bolstered by two of the top three revenue contributing countries for the global mattress and furniture manufacturing industries, China and Japan. The APAC has experienced a massive rise in both residential and commercial property development, due to the rapid growth of emerging economies in the region over the past decade. Drivers such as the increased trend of urbanization, higher levels of income, and a prosperous hospitality industry due to increased tourism is not only causing a rise in demand for mattresses and furniture, but a rise in the average price of mattresses and furniture as demand for higher-end goods have also increased.

Global Furniture & Appliances Revenues



Culp upholstery segment already has multiple operating facilities in China, known as the Culp China Platform, which not only has reduced manufacturing costs, but has also connected them with new innovative fabrics from Chinese suppliers while also increasing their presence in the region. In the 2nd quarter of fiscal 2018, Culp put out a letter of intent to acquire a Chinese Mattress fabrics company, which they viewed this potential acquisition as a launch pad into Asia for their mattress fabrics business, however, the deal fell through. Despite this setback, Culp is still looking for opportunities for the mattress segment to enter into Asia and has continuously increased their marketing efforts in Asia for their upholstery.

In 2017, Asia only accounted for 11.2% of Culp’s total revenue, therefore, if the company can continue and follow through on this strategy, we can foresee major future growth in this region.

Penetration into the Hospitality Industry

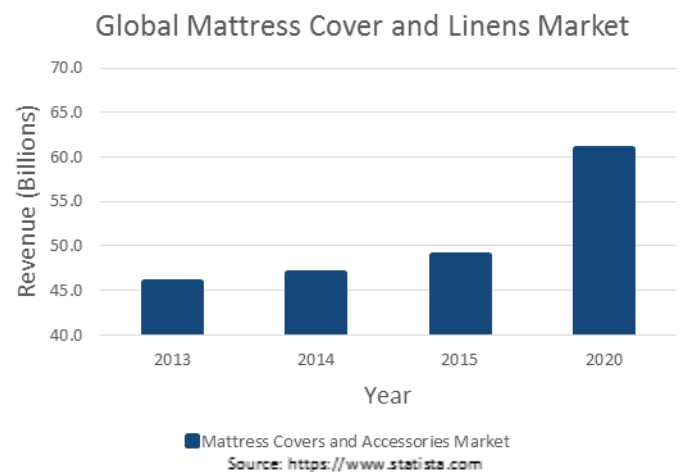
Culp is focused on increasing sales of their upholstery fabrics designed for the hospitality industry. The industry has outperformed the broader economy over the past five years, as growing demand for leisure and business travel has resulted in robust growth. To keep up with this demand, there has been a steady increase in the number

of hotels constructed, resulting a greater demand for products like Culp’s upholstery fabrics. Culp’s focus on the hospitality market isn’t just from a revenue standpoint, but also a profit standpoint. In an interview regarding the hospitality industry, Culp CEO Robert Saxon stated that what makes the industry so attractive is that the gross margins from this market is nearly double the margins of the residential markets, which has primarily been Culp’s focus.

Catalysts

Culp-Lava Applied Sewn Solutions (CLASS) Expansion

CLASS International Holdings, Ltd (CLIH) was a joint venture that began in fiscal 2013, and partnered Culp with A. Lava & Son Co. (A Lava), a leading provider of mattress covers, to produce high quality sewn mattress covers. A Lava vast experience and network in the sector, coupled with Culp’s manufacturing capabilities and product quality, meant an excellent opportunity for Culp to grab a larger market share in the fast-growing mattress cover sector. While the venture is still relatively new, the growing response to demand in the segment has already led to the construction of a manufacturing facility in Haiti, which only began production recently in Q2 2018. Culp’s focus on mattress covers will provide both a boost in the mattress segment’s revenue and a lesser reliance on the slower growing mattress fabrics business.



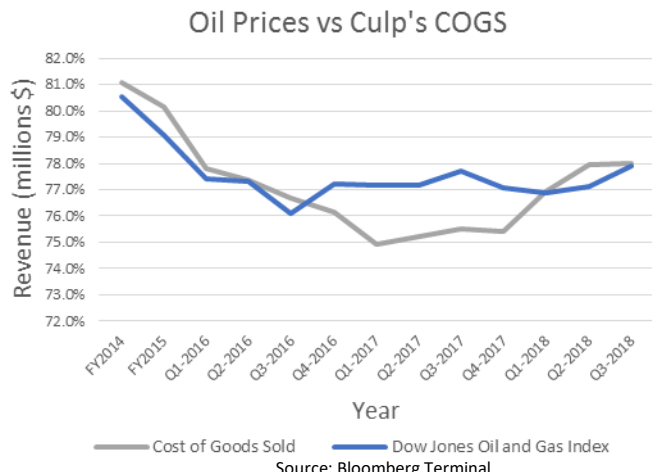
Acquisition of Read Window Products Inc.

Culp’s implemented their strategy of focusing on the hospitality industry by acquiring Read Window Products on March 8th, 2018. The acquisition was funded with cash and investments on hand and did not incur any additional debt. Read, a “turn-key provider” of bed and window fabrics for hospitality and commercial industries and had \$11 million worth of revenue in 2017. Read’s custom product line includes motorization, shades, drapery, upholstered headboards and shower curtains. What is especially enticing however, is Read’s long-term contracts as a fabrics provider for hotel chains such as Hilton, Marriott, Hyatt, Holiday Inn and etc. Hilton and Marriot are the two largest players in the hospitality market, accounting for 33% of the market share while Holiday Inn is a subsidiary of the InterContinental Hotels Group, who has the 3rd largest market share. Culp’s management and board members believe that this acquisition will perfectly complement Culp’s strategy of penetrating into the hospitality market as the combination of Culp’s products and Read’s expertise in the industry provides an excellent opportunity to take up market share in the sector.

Risks

Raw Material Costs

Both of Culp’s segments costs structures have raw materials purchases accounting for 60-70% of their production costs. Their raw material inventory follows their product inventory method, using a just-in-time



approach. Culp’s management have also adopted an approach of relying more on outsourcing for basic production needs such as fabrics, materials, and finishing services, from outside suppliers. This increase reliance on outside suppliers and raw materials for production not only places the company in a vulnerable position to changing material prices, also to delays in production from uncontrollable complications. Many of Culp’s raw materials are either produced by or are petrochemical products, which are heavily reliant on oil. Fluctuations in the prices for petrochemicals and

the underlying price of oil have a major impact in Culp’s material costs, as demonstrated in fiscal 2015 to fiscal 2017, where low oil prices worldwide boosted Culp’s profits through the fall in raw material prices. Culp’s sensitivity to material costs is a serious risk as it could potentially harm Culp’s production operations and their financial health.

Imports

Culp’s upholstery segment is part of an industry that is very vulnerable to imports. In 2017, imports took up 24.7% of U.S. demand for furniture, experiencing an annual growth of 4.7% in value in a span of five years. With many more digital channels for consumers to purchase imports, foreign manufacturers will continue to increase market share in the U.S. as their ability to lower production costs abroad will translate into lower prices for consumers. If this trend of increased imports continues long-term and Culp is unable to compete with the prices of imports, it will adversely affect their revenue.

Tough Domestic Competition

Culp also faces strong competition domestically, in particular the upholstery fabric industry. Culp competes with many other manufacturers of fabric, as well as converters who source fabrics from various producers and market them to manufacturers of furniture and mattresses. The highly competitive nature of the industries means they are constantly subject to the risk of losing market share. As a result of increased competition, there have been deflationary pressures on the prices for many of their products, which make it more difficult to pass

along increased operating costs such as raw materials, energy or labor in the form of price increases and puts downward pressure on their profit margins. In addition, the wide range of product offerings in the industries can make it more difficult to differentiate their products through design, styling, finish, and other techniques.

Management Team

Franklin N. Saxon – CEO

Mr. Franklin N. Saxon has been Culp’s CEO since May 1st, 2007. He has been employed by the Company since 1983, serving in various capacities, including chief financial officer from 1985 to 1998, president of Culp Velvets/Prints division from 1998-2001, CFO from 2001-2004, COO from 2004 to 2007. Since becoming Mr. Saxon became CEO, Culp’s stock has generated an annual return on equity of 10.22%, as Culp’s revenue CAGR during his tenure from fiscal 2008 to 2017 was 4.1%. Mr. Saxon also owns 92,811 shares of Culp, which is 0.75% ownership of the company and his total compensation for 2017 was \$2,032,480. We believe that Mr. Saxon has done a sufficient job as CEO as demonstrated by the company’s discipline use of capital and their return of equity during his tenure.

Kenneth R. Bowling – CFO & Corporate Secretary

Mr. Kenneth R. Bowling has been the CFO and the Corporate Secretary of Culp since May 1, 2007. Since joining Culp in 1997 as a controller for the Culp’s Velvets/Prints division, Mr. Bowling has gone on to be serve as the assistant treasurer of Culp from 2002 to 2004, and as Culp’s VP Finance from 2004 to 2007. Mr. Bowling’s total compensation for 2017 was \$614,954.

Boyd B. Chumbleu – President of Culp Home Fashion Division

Mr. Boyd B. Chumbley has been the President of Culp Upholstery Fabrics Division since 2016. Since joining Culp in 1984, Mr. Chumbley served as the VP of manufacturing for this segment from 1997-2004, President of Culp Inc.'s VelvetsPrints division from, 2004 to 2014 and as executive VP of Upholstery Fabrics Division from 2014 to 2016. Mr. Chumbley’s total compensation for 2017 was \$747,933.

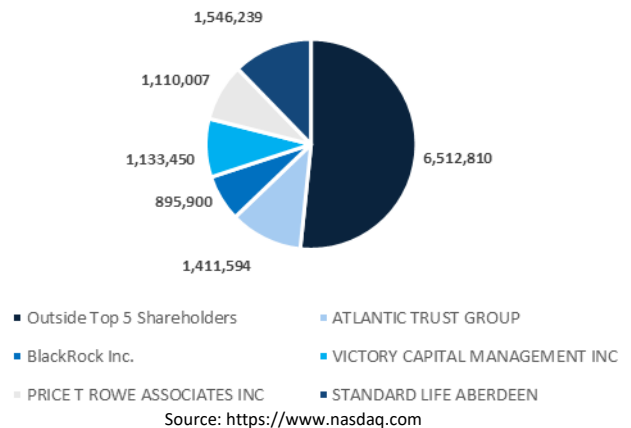
Robert G. Culp IV – President of Culp Home Fashion Division

Mr. Robert G. Culp, IV, has been the President of Home Fashions division at since June 2004. Mr. Culp has been with Culp since 1998 and served as the executive VP of the Culp Home Fashions division from 1998 to 2004. He is the son of Culp’s chairman and founder Mr. Robert Culp III. Mr. Culp’s total compensation for 2017 was \$1,025,346.

Shareholder Base, Liquidity, Market Depth

Culp was listed on the New York Stock Exchange in January, 1997 and issue 1.60 million shares for \$15.00 USD per share. Today, Culp has 12.61 million shares outstanding at a price of \$30.6 USD per share. 88.34% of the shares are owned by institutions, with Aberdeen Asset Management being the largest shareholder owning 12.19% of the total shares. Insiders in total own 11.66% of the company’s shares. Culp’s 6-month average trading volume was 21,833, which suggests relative illiquidity given the company’s \$334.6 million market capitalization. Culp has not repurchased any share in 2018 fiscal year but has \$5.0 million available in the company’s share repurchase program. Culp has will continue paying dividends to shareholders, having paid a \$0.36 dividend per share on an annualized basis, giving a dividend payout ratio of 18.09%. Culp’s management capital outlook may be to seek out potential acquisitions in Asia to help establish a market presence in the region for their mattress segment.

Culp's Majority Shareholders



Comparables Analysis

Majority of the comparable companies who produced similar products to Culp were usually private companies. The selected group of companies below are all public U.S. companies, produce similar products as Culp, and have similar equity values, with RH being the exception. The comparable companies, the average EV/EBITDA multiple was 10.9x and the average P/E multiple was 18.8x. Applying these multiples, we arrived at target share prices of \$29.14 and \$96.98 using the EV/EBITDA and P/E methods, respectively.

Unifi Inc.

Unifi Inc. manufactures and sells polyester and nylon yarns. The company operates through three segments: Polyester, Nylon, and International.

RH

RH operates as a retailer in the home furnishings market. The company offers products in various categories, including furniture, lighting, textiles, décor, outdoor and garden, tableware, and child and teen furnishings.

Knoll Inc.

Knoll, Inc. designs, manufactures, markets, and sells commercial and residential furniture, accessories, textiles, fine leathers, and felt for the workplace and home in the United States, Canada, and Europe. It operates in three segments: Office, Studio, and Coverings.

Haverty Furniture Cos Inc.

Haverty Furniture Companies, Inc. operates as a specialty retailer of residential furniture and accessories in the United States. The company offers furniture merchandise under the Haverty's brand. It also provides custom upholstery products, as well as mattress product lines under the Sealy, Tempur-Pedic, Serta, Stearns & Foster, and Beautyrest Black names.

Ethan Allen Interior Inc.

Ethan Allen Interiors Inc. operates as an interior design company, and manufacturer and retailer of home furnishings in North America, Europe, Asia, and the Middle East. The company operates through two segments, wholesale and Retail.

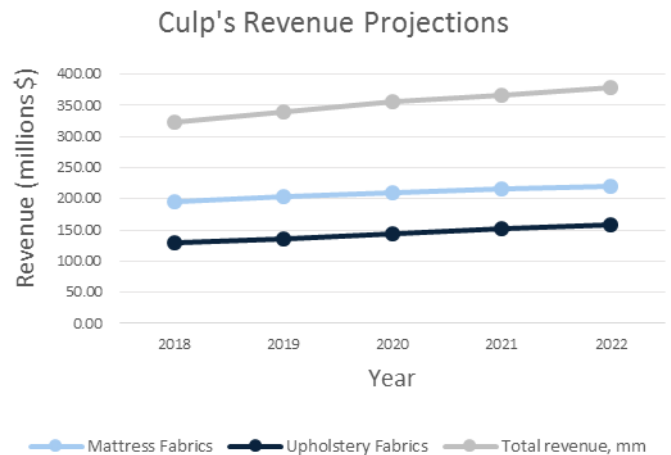
Discounted Cash Flow Analysis

Revenue Assumptions

Revenue has been forecasted to grow at an annualized rate of 4.7% over the next five years. Based on the combination of outlined catalysts, growth strategies and macroeconomic drivers, we expect the mattress and upholstery segment’s revenue to grow at 2.2% and 8.3% respectively in 2018, then at an annualized rate of 4% and 6% for 2019-2020, and then fall to an annualized rate of 2% and 5% for 2021-2022.

Read Windows Acquisition

The Read Windows acquisition will allow Culp to begin penetrating into the fast-growing hospitality market. The acquisition will increase Culp’s growth objectives through synergies, by pairing Culp’s high quality products and vast manufacturing capabilities with Read’s extensive network and contracts with industry leaders such as Hilton



and Marriot. This puts Culp in an excellent position to take up market share and be a long-term revenue driver for the upholstery segment.

CLASS International Holdings (CLIH) Joint Venture Haitian Operating Facility

The commencement of the CLASS’ low-cost facility in Haiti will bring what management describes as much needed production capacity. The facility only began production in quarter 2 of Fiscal 2018 and has only recently begun shipping out products from their facility in Haiti, with their strategy being to steadily increase capacity as demand continues to grow. The combination of Culp’s strong pre-existing mattress fabrics operations and A Lava’s expertise in the mattress cover business gives a strong indication of excellent revenue driver for the mattress segment.

Further Penetration into Foreign Markets

As Culp’s upholstery segment further penetrates into foreign markets such as China, we expect overseas revenue to gradually take up a larger share of Culp’s revenue stream. Culp’s mattress segment has yet to break into the Asian markets with management constantly looking for foreign acquisition opportunities to penetrate into the region. If successful, Culp’s mattress segments’ product innovation and diverse product mix will attract customers in the largest market for mattresses, increasing their overseas revenue stream. Culp’s special focus on hospitality will also play a factor as Southeast Asia has one of the largest hospitality and tourism industries in the world.

Economic Tailwinds

We believe that Culp market share and leading presence in the industry put them in a prime position to take advantage of the U.S. economic tailwinds. Factors such as growth in disposable income and the number of housing starts will drive demand for Culp’s products, boosting revenue. On the other hand however, the rising level of imports represents a growing threat from foreign manufacturers, potentially leading to a price-war which would negatively affect Culp’s revenue.

Cost Assumptions

Culp’s three major manufacturing costs were purchases, operations, and labor. We believe cost will grow at a slower rate compared to revenue growth, increasing margin expansion for the company.

Pricing for raw materials may see the largest increase due to growth in inflation and rise in oil prices. Majority of the raw materials purchased by Culp are petrochemical products, which acts as an underlying price of oil. US oil prices are forecasted to rise by 10% due to a combination of increased global demand and decrease in supply. Raw Materials account for 60-70% of production costs for both segment. Culp’s strategy of increased outsourcing for materials may also lead to a rise in manufacturing costs. We forecast the COGS % of revenue to rise to 78%

this year and rise to 80% over the next four years. This is extremely concerning as increases in production and input costs could adversely affect Culp’s operations.

Culp’s operational performance in their North American facilities has steadily improved in the past two following their investments in their capital projects and supply chain enhancements. Culp’s focus on improving operational efficiency in their North American facilities has been noticeable, with the mattress segment’s operating margins sequentially improved during fiscal 2018; 13.1%, 13.5%, and 13.9% for the first quarter, second quarter, and third quarter, respectively. We expect this trend of improved operating efficiency to continue with Culp’s North American Operations and will result in a decrease in operating expenses in the long run. Culp’s Chinese operation however, were negatively affected due increases in freight costs and disruptions in their supply chain by stoppages of multiple textile mills by the Chinese government. Unfavorable FX changes also negatively affected their Chinese operations. Nonetheless, we view this to be a short-term issue and do not foresee any major changes in cost for Culp’s operations in China.

We do expect labor costs to stay relatively flat over the next couple of years. Only in Culp’s Canadian operations, are their employee unionization, however, the collective bargaining agreement for the employees does not expire until February 1, 2020.

CAPEX Assumptions

The CAPEX average over the past three years has been approximately \$11 million annually, with the main focus being on plant consolidation and construction of new facilities. With these project finally completed, we believe that CAPEX will fall to approximately \$9 million in FY2018 and stay between \$7- 8 million over the next four years.

Weighted Average Cost of Capital (WACC)

We calculated a weighted average cost of capital (WACC) of 10.7%. We used a cost of equity at 10.7% and a cost of debt at 0%. The Beta value taken from Bloomberg was 1.84 and the pre-tax cost of debt was 0%. The risk-free rate used was 2.0% and a market risk premium of 4.8%. By using the DCF, we arrived at a share price for Culp at \$26.45.

Valuation

From the target share price of \$29.14 using the EV/EBITDA multiple from our comparable and the target share price of \$26.45 from the DCF formula, we arrived at a share price of \$27.80, using 50% weighting for both methods. The total expected return is -7.33% based on current share price.

Recommendation

Overall, Culp Inc. is a solid company with a strong industry reputation product quality, a strong balance sheet, and has steady growth in their operating cash flows. Culp has made strategic moves to expand their product range, by expanding their manufacturing capacity for their mattress cover venture and acquiring an industry leader in the hospitality furniture sector. The increased output for the fast-growing mattress cover industry along with the synergies from the Read Window acquisition will allow them to begin taking up market share in those sectors. While Culp’s revenue is mostly generated in North America, they’re growing focus on foreign markets such as China, who have the largest market for mattress and furniture, shows an enormous potential for growth in that region. There are various factors however, that could potentially stunt growth for the business. These factors include: raw material costs, imports and high domestic competition. Culp’s business is very reliant on raw materials, most notably petrochemical products, which makes them quite vulnerable to rise in material and oil prices. The potential of facing higher input prices along with increases in production could seriously affect Culp’s profit margins. Like any manufacturing company, Culp is susceptible to imports as the trend of domestic wholesalers relying more on foreign producers for their cheaper prices, means either Culp could lose sales or have to compete in a price war, both negatively affecting their business. Culp also faces strong competition domestically, as the growing number of firms who produce similar products could also mean a loss of market share and deflationary pressure on prices. Although there is more competition in their industry, if Culp can substantially increase their market share in foreign markets and lessen their reliance on revenue domestically, they could potentially have the opportunity for further future growth. However, in an industry where margins are already so slim, the potential risk of increased costs or lower prices are a risk too big to bear. Therefore, we currently recommend a hold rating for the company.

Pro Forma Income Statement

	Apr-14	Apr-15	Jul-15	Jul-16	Jul-17	Apr-19	Apr-20	Apr-21	Apr-22	Apr-23
	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021	FY2022
Income Statement										
Revenue	268.81	287.16	310.17	312.86	309.54	323.49	339.00	355.28	366.72	378.61
COGS	213.93	232.78	248.64	240.91	232.98	251.32	271.20	284.23	293.38	302.88
Gross profit	54.88	54.39	61.53	71.95	76.56	72.17	67.80	71.06	73.34	75.72
SG&A	28.45	28.66	32.78	36.77	39.16	37.68	38.65	39.79	40.34	41.65
R&D					0.00	0.00	0.00	0.00	0.00	0.00
OPEX					0.00	0.00	0.00	0.00	0.00	0.00
EBITDA	26.44	25.73	28.75	35.18	37.41	34.48	29.15	31.26	33.00	34.07
D&A	5.35	5.48	5.96	6.84	7.33	8.09	8.60	8.46	8.32	8.18
EBIT	21.09	20.25	22.79	28.34	30.08	26.40	20.55	22.80	24.69	25.89
Interest expense	0.63	0.43	0.06		0.00	0.07	0.00	0.00	0.00	0.00
Other expenses (income)	0.16	0.78	-0.23	0.44	0.38	0.51				
EBT	20.29	19.04	22.96	27.90	29.70	25.82	20.55	22.80	24.69	25.89
loss from investment in unconsolidated joint venture					0.02	0.13				
Income taxes	1.97	1.60	7.89	10.96	7.34	12.36	1.08	1.20	1.30	1.36
Net income	18.32	17.45	15.07	16.94	22.33	13.33	19.47	21.61	23.39	24.53
Shares outstanding, basic	12.2	12.2	12.2	12.3	12.3	12.42	12.42	12.42	12.42	12.42
Shares outstanding, diluted	12.5	12.4	12.4	12.5	12.5	12.52	12.52	12.52	12.52	12.52
Earnings per share, basic	\$ 1.50	\$ 1.43	\$ 1.23	\$ 1.38	\$ 1.81	\$ 1.07	\$ 1.57	\$ 1.74	\$ 1.88	\$ 1.97
Earnings per share, diluted	\$ 1.47	\$ 1.41	\$ 1.21	\$ 1.36	\$ 1.78	\$ 1.06	\$ 1.56	\$ 1.73	\$ 1.87	\$ 1.96

Pro Forma Cash Flow Statement

	Apr-14	Apr-15	Jul-15	Jul-16	Jul-17	Apr-19	Apr-20	Apr-21	Apr-22	Apr-23
	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021	FY2022
Cash Flow Statement										
Operating activities										
Net income	18.32	17.45	15.07	16.94	22.33	13.33	19.47	21.61	23.39	24.53
Depreciation	5.12	5.31	5.77	6.67	7.09	5.68	8.60	8.46	8.32	8.18
Amortization of other assets	0.24	0.17	0.19	0.17	0.24	0.25				
Depreciation and amortization	5.35	5.48	5.96	6.84	7.33	8.09	8.60	8.46	8.32	8.18
Stock-based compensation	0.56	0.71	0.79	2.74	3.36	2.42				
Excess tax benefit related to stock-based compens	-0.08	-0.14	-0.11	-0.84	-0.66	0.00				
Deferred income taxes	-0.34	-1.73	3.18	4.19	4.67	-3.02				
Realized loss on sale of short-term investments	0.00	0.00	0.00	0.13	0.01	0.00				
Loss (gain) on sale of equipment	0.00	-0.28	-0.08	-0.04	-0.13	0.00				
Foreign currency exchange gains	0.22	0.63	-0.08	-0.04	0.08	0.13				
Loss from investment in unconsolidated joint ventur	0.00	0.00	0.00	0.00	0.02	0.25				
Cash flow before working capital	24.03	22.11	24.73	29.92	37.01	21.20	28.07	30.07	31.71	32.72
Accounts receivable	1.67	-3.86	-1.64	4.48	-1.56	1.78	-2.39	-1.24	-0.87	-0.90
Inventories	-1.98	-2.20	-1.88	-4.41	-5.44	3.88	-0.66	-2.36	-1.66	-1.72
Other Current Assets	-0.05	-0.27	-0.15	-0.21	-0.50	-0.03				
Other Assets	-0.18	-0.07	-0.12	-0.05	0.03	-0.04				
Accounts payable - trade	-8.38	4.13	1.96	-3.79	5.83	1.72				
Accrued expenses and deferred compensation	2.53	0.03	3.37	0.75	0.56	-1.61				
Income taxes	-0.53	0.34	-0.16	0.09	-2.97	8.82	2.17	1.52	1.07	1.11
Accrued Restructuring	-0.04	0.00	0.00	0.00	0.00	2.07	1.11	0.58	0.41	0.42
Cash flow from operating activities	17.08	20.22	26.11	26.80	32.98	37.80	28.32	28.57	30.66	31.62
Investing activities										
Capital expenditures	-4.40	-5.26	-10.46	-11.48	-11.86	-8.60	-7.74	-7.61	-7.49	-7.36
Proceeds from the sale of equipment	0.00	0.41	0.73	0.23	0.14	0.01				
Proceeds from the sale of short-term investments	0.80	0.81	1.63	5.61	2.00	0.00				
Proceeds from the sale of long-term investments	0.00	0.00	0.00	0.00	0.00	0.06				
Purchase of short-term investments	-0.11	-1.95	-5.36	-0.10	-0.04	-0.04				
Purchase of long-term investments	0.00	-0.77	-1.65	-1.65	-32.37	-1.70				
Investment in unconsolidated joint venture	0.00	0.00	0.00	0.00	-1.13	-0.66				
Payment on life insurance policy	-0.02	-0.03	-0.02	-0.02	-0.02	-0.02				
proceeds from life insurance policies	0.72	0.00	0.32	0.00	0.00	0.00				
net cash paid for acquisition of assets (notes 2 and	0.00	-2.64	0.00	0.00	0.00	0.00				
Cash used in investing activities	-3.01	-9.42	-14.81	-7.40	-43.28	-10.95	-7.74	-7.61	-7.49	-7.36
Financing activities										
Dividends paid	-7.59	-2.20	-7.58	-8.14	-6.28	-6.72	-6.26	-6.26	-6.26	-6.26
Proceeds from line of credit	1.00	0.00	0.00	7.00	9.00	10.00				
excess tax benefit related to stock options exercis	0.08	0.14	0.11	0.84	0.66	0.00				
Proceeds from common stock issued	0.21	0.19	0.09	0.20	0.04	0.11				
Payments on line of credit	-1.33	0.00	-0.54	-7.00	-9.00	-10.00				
Payments on long-term debt	-2.52	-2.20	-2.20	-2.20	0.00	0.00				
Payments on debt issuance costs	0.00	0.00	0.00	0.00	0.00	0.00				
Payments on vendor-financed capital expenditures	0.00	0.00	0.00	0.00	-1.05	-3.75				
Repurchase of common stock	-5.02	0.00	-0.75	-2.40	0.00	0.00				
debt issuance costs	0.00	-0.08	0.00	-0.13	0.00	0.00				
Common stock surrendered for withholding taxes p	0.00	0.00	0.00	0.00	0.00	-1.53				
Cash from financing activities	-15.17	-4.15	-10.86	-11.83	-6.64	-11.89	-6.26	-6.26	-6.26	-6.26
FX effect	-0.38	-0.88	-0.02	0.50	-0.06	0.06				
Net change in cash	-1.49	5.77	0.42	8.06	-16.99	15.02	14.31	14.70	16.91	18.00
Beginning cash balance	25.02	23.53	29.30	29.73	37.79	20.80	35.82	50.13	64.83	81.74
Ending cash balance	23.53	29.30	29.73	37.79	20.80	35.82	50.13	64.83	81.74	99.74

Pro Forma Balance Sheet

	Apr-14	Apr-15	Jul-15	Jul-16	Jul-17	Apr-19	Apr-20	Apr-21	Apr-22	Apr-23
	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021	FY2022
Balance Sheet										
Current assets										
Cash and cash equivalents	23.53	29.30	29.73	37.79	20.80	35.82	50.13	64.83	81.74	99.74
Accounts receivable	23.39	27.41	28.75	23.48	24.58	23.39	25.78	27.02	27.89	28.79
Inventories	38.42	40.67	42.48	46.53	51.48	48.50	49.15	51.52	53.17	54.90
Income Tax Receivable	0.32	0.12	0.23	0.16	0.00	0.00	0.00	0.00	0.00	0.00
Short Term Investments	5.29	6.29	10.00	4.36	2.44	19.68	19.68	19.68	19.68	19.68
Other Current Assets	2.09	2.34	2.44	2.48	2.89	3.11	3.11	3.11	3.11	3.11
Deferred Income Taxes	7.71	6.23	4.79			0.00	0.00	0.00	0.00	0.00
Total current assets	100.75	112.38	118.42	114.79	102.19	130.50	147.86	166.15	185.59	206.22
Non-current assets										
Property and equipment	30.59	31.38	36.08	39.97	51.65	51.62	50.76	49.92	49.08	48.27
Goodwill	11.46	11.46	11.46	11.46	11.46	11.46	11.46	11.46	11.46	11.46
Deferred Income Taxes	0.75	2.04	0.45	2.32	0.42	1.94	1.94	1.94	1.94	1.94
Long-Term Investments		0.77	2.42	4.03	36.41	20.80	20.80	20.80	20.80	20.80
Investment in Unconsolidated joint venture				0.00	1.11	1.52	1.52	1.52	1.52	1.52
Other Assets	1.15	2.92	2.55	2.57	2.39	2.32	2.32	2.32	2.32	2.32
Total non-current assets	43.96	48.56	52.95	60.35	103.44	89.66	88.80	87.95	87.12	86.30
Total assets	144.71	160.94	171.37	175.14	205.63	220.16	236.66	254.11	272.71	292.52
	13%	0.00	0.00	0.00	0.00					
Current liabilities										
Current Maturities of long-term debt	2.20	2.20	2.20	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Accounts payable - Trade	22.36	26.69	28.41	23.99	29.10	29.56	31.73	33.25	34.33	35.44
Accrued Expenses	11.83	9.18	11.13	11.92	11.95	10.91	12.03	12.60	13.01	13.43
Accounts payable - Capital Expenditures	0.23	0.28	0.99	0.22	4.77	1.55	1.55	1.55	1.55	1.55
Income Tax Payable - Current	0.29	0.44	0.33	0.18	0.29	1.58	1.58	1.58	1.58	1.58
Lines of credit	0.56					0.00	0.00	0.00	0.00	0.00
Total current liabilities	37.46	38.79	43.06	36.32	46.10	43.60	46.89	48.99	50.47	52.00
Non-current liabilities										
Income Taxes Payable - Long Term	4.19	3.96	3.79	3.84	0.47	10.94	10.94	10.94	10.94	10.94
Deferred Income Taxes	3.08	1.01	1.05	1.48	3.59	2.10	2.10	2.10	2.10	2.10
Lines of credit		0.59		0.00	0.00	0.00	0.00	0.00	0.00	0.00
Deferred Compensation		2.64	4.04	4.69	5.52	7.22	7.22	7.22	7.22	7.22
Accounts payable - Capital Expenditures				0.00	1.32	0.00	0.00	0.00	0.00	0.00
long-term debt, less current maturities	4.40	2.20		0.00	0.00	0.00	0.00	0.00	0.00	0.00
Total non-current liabilities	11.67	10.41	8.88	10.01	10.90	20.25	20.25	20.25	20.25	20.25
Total liabilities	49.12	49.19	51.94	46.33	57.00	63.85	67.14	69.24	70.72	72.25
Shareholders' equity										
Preferred stock, \$0.05 par value, authorized 10,000,000						0.00	0.00	0.00	0.00	0.00
Common stock, \$0.05 par value, authorized 40,000,000	0.61	0.61	0.61	0.61	0.62	0.62	0.62	0.62	0.62	0.62
Capital contributed in excess of par value	41.90	42.93	43.16	43.80	47.42	48.41	48.41	48.41	48.41	48.41
Retained earnings (accumulated deficit)	53.02	68.26	75.75	84.55	100.60	107.21	120.42	135.77	152.90	171.18
Accumulated other comprehensive income (loss)	0.05	-0.06	-0.10	-0.14	0.00	0.06	0.06	0.06	0.06	0.06
Total shareholders' equity	95.58	111.74	119.43	128.81	148.63	156.30	169.52	184.86	201.99	220.27
Non-controlling interest						0.00	0.00	0.00	0.00	0.00
Total equity	95.58	111.74	119.43	128.81	148.63	156.30	169.52	184.86	201.99	220.27

Revenue Analysis

	Apr-13	Apr-14	Apr-15	Apr-16	Apr-17	Apr-18	Apr-19	Apr-20	Apr-21	Apr-22
	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021	FY2022
Growth Analysis										
Mattress Fabrics		4.3%	11.8%	3.7%	2.4%	2.2%	4.0%	4.0%	2.0%	2.0%
Upholstery Fabrics		10.2%	3.1%	-3.1%	-6.1%	8.3%	6.0%	6.0%	5.0%	5.0%
Total revenue growth, %		6.8%	8.0%	0.9%	-1.1%	4.5%	4.8%	4.8%	3.2%	3.2%
Segment Breakdown										
Mattress Fabrics	154.01	160.71	179.74	186.42	190.81	194.92	202.72	210.83	215.05	219.35
Upholstery Fabrics	114.80	126.46	130.43	126.44	118.74	128.56	136.28	144.45	151.67	159.26
Total revenue, mm	268.81	287.16	310.17	312.86	309.54	323.49	339.00	355.28	366.72	378.61

WACC Calculations

Cost of Equity			WACC					
Risk-free rate	2.0%	Perpetuity Growth Rate	11.00%	10.50%	10.00%	9.50%	9.00%	
Expected market return	6.8%		1.00%	\$ 16.97	\$ 17.78	\$ 18.67	\$ 19.67	\$ 20.80
Market risk premium	4.8%		1.50%	\$ 17.51	\$ 18.39	\$ 19.37	\$ 20.47	\$ 21.72
Beta	1.84		2.00%	\$ 18.11	\$ 19.07	\$ 20.15	\$ 21.38	\$ 22.78
Cost of equity	10.7%		2.50%	\$ 18.78	\$ 19.84	\$ 21.04	\$ 22.41	\$ 24.00
			3.00%	\$ 19.54	\$ 20.72	\$ 22.06	\$ 23.61	\$ 25.42
Cost of Debt			WACC					
Pre-tax cost of debt	0.0%	Terminal EV/EBITDA Multiple	11.00%	10.50%	10.00%	9.50%	9.00%	
Effective tax rate	21.0%		8.9 x	\$ 22.13	\$ 22.49	\$ 22.85	\$ 23.22	\$ 23.60
Cost of debt	0.0%		9.9 x	\$ 23.87	\$ 24.26	\$ 24.65	\$ 25.06	\$ 25.47
			10.9 x	\$ 25.60	\$ 26.02	\$ 26.45	\$ 26.90	\$ 27.35
			11.9 x	\$ 27.34	\$ 27.79	\$ 28.26	\$ 28.73	\$ 29.22
			12.9 x	\$ 29.07	\$ 29.56	\$ 30.06	\$ 30.57	\$ 31.09
WACC								
Total shareholders' equity	152,182.0							
Total outstanding debt	-							
Total capitalization	152,182.0							
Cost of equity	10.7%							
Cost of debt	0.0%							
WACC	10.7%							

Discounted Cash Flow Analysis

	Apr-14	Apr-15	Jul-15	Jul-16	Jul-17	Apr-19	Apr-20	Apr-21	Apr-22	Apr-23
	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021	FY2022
Free Cash Flow										
EBIT	21.09	20.25	22.79	28.34	30.08	26.40	20.55	22.80	24.69	25.89
Less: Tax expense	-4.43	-4.25	-4.79	-5.95	-6.32	-5.54	-4.32	-4.79	-5.18	-5.44
Add: Depreciation and amortization	5.35	5.48	5.96	6.84	7.33	8.09	8.60	8.46	8.32	8.18
Less: Capital expenditures	-4.40	-5.26	-10.46	-11.48	-11.86	-8.60	-7.74	-7.61	-7.49	-7.36
Less: Change in net working capital	-6.96	-1.89	1.39	-3.13	-4.03	16.60	0.24	-1.50	-1.05	-1.09
Unlevered free cash flow	10.65	14.33	14.89	14.63	15.20	36.94	17.34	17.36	19.28	20.18
Discount factor					0.00	0.25	1.25	2.25	3.25	4.25
Present value of unlevered free cash flow					0.00	13.19	15.26	13.81	13.85	13.09

Discounted Cash Flow Valuations

Perpetuity Growth Method	
Perpetuity growth rate	2.0%
PV sum of unlevered FCF	69,198.6
PV of terminal value	149,998.5
Enterprise value	219,197.1
Add: Cash	15,739.0
Less: Debt	-
Less: Other EV adjustments	-
Equity value	234,936.1
Shares outstanding	12,613.0
Implied share price	\$ 18.63

Current price	\$ 32.15
Implied price	\$ 18.63
Total return	-42.1%

Exit Multiple Method	
Terminal EV/EBITDA multiple	10.9 x
PV sum of unlevered FCF	69,198.6
PV of terminal value	240,879.3
Enterprise value	310,077.9
Add: Cash	15,739.0
Less: Debt	-
Less: Other EV adjustments	-
Equity value	325,816.9
Shares outstanding	12,613.0
Implied share price	\$ 25.83

Current price	\$ 30.00
Implied price	\$ 25.83
Total return	-13.9%

Comparables Analysis

Company	Ticker	Equity Value	Enterprise Value	EV/EBITDA Multiple			P/E Multiple		
				NTM EV/EBITDA	2017E EV/EBITDA	2018E EV/EBITDA	NTM P/E	2017E P/E	2018E P/E
Unifi Inc	UFI	564.01	649.06	58.3 x	10.1 x	11.4 x	18.9 x	20.1 x	18.8 x
RH	RH	2,169.94	3,273.04	10.6 x	15.0 x	13.9 x	19.3 x	715.2 x	66.9 x
Knoll Inc	KNL	973.08	1,479.61	9.2 x	11.1 x	9.2 x	14.3 x	13.6 x	13.4 x
Haverty Furniture Cos Inc	HVT	409.77	391.34	5.5 x	5.4 x	5.2 x	19.6 x	17.8 x	18.2 x
Ethan Allen Interior Inc	ETH	651.21	608.09	6.3 x	7.7 x	6.6 x	15.9 x	22.1 x	17.0 x
Culp Inc.	CULP	362.30	322.67	8.1 x	8.7 x	9.2 x	17.8 x	18.1 x	22.2 x
Median				9.2 x	10.1 x	9.2 x	18.9 x	20.1 x	18.2 x
Mean				18.0 x	9.9 x	9.2 x	17.6 x	157.8 x	26.9 x
High				58.3 x	15.0 x	13.9 x	19.6 x	715.2 x	66.9 x
Low				5.5 x	5.4 x	5.2 x	14.3 x	13.6 x	13.4 x
				EV/EBITDA Implied Price			P/E Implied Price		
Median				\$ 32.71	\$ 33.54	\$ 28.89	\$ 34.12	\$ 35.82	\$ 26.43
Mean				\$ 60.54	\$ 32.79	\$ 29.14	\$ 31.87	\$ 280.81	\$ 38.94
High				\$ 189.15	\$ 48.31	\$ 42.17	\$ 35.51	\$ 1,272.97	\$ 96.98
Low				\$ 20.63	\$ 19.27	\$ 17.79	\$ 25.93	\$ 24.16	\$ 19.45

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