

FLEXSTEEL INDUSTRIES INC  
Form 10-Q  
October 24, 2011

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

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FORM 10-Q

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**Quarterly Report Pursuant to Section 13 or 15(d) of the  
Securities Exchange Act of 1934**

For the quarterly period ended September 30, 2011

or

**Transition Report Pursuant to Section 13 or 15(d) of the  
Securities Exchange Act of 1934**

For the transition period from            to

Commission file number **0-5151**

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**FLEXSTEEL INDUSTRIES, INC.**

(Exact Name of Registrant as Specified in Its Charter)

Incorporated in State of Minnesota  
(State or other Jurisdiction of  
Incorporation or Organization)

42-0442319  
(I.R.S. Identification No.)

3400 JACKSON STREET  
DUBUQUE, IOWA 52004-0877  
(Address of Principal Executive Offices) (Zip Code)

(563) 556-7730  
(Registrant's Telephone Number, Including Area Code)

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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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).  
Yes . No .

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

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one).

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

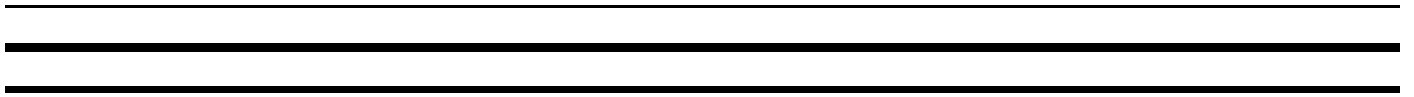
Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No .

Common Stock - \$1.00 Par Value

Shares Outstanding as of September 30, 2011

6,762,236



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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

FLEXSTEEL INDUSTRIES, INC. AND SUBSIDIARIES  
 CONSOLIDATED BALANCE SHEETS  
 (Amounts in thousands, except per share data)

|   | September 30,<br>2011<br>(UNAUDITED) | June 30,<br>2011  |
|---|--------------------------------------|-------------------|
| <b>ASSETS</b>   |                                      |                   |
| <b>CURRENT ASSETS:</b>  |                                      |                   |
| Cash  | \$ 14,086                            | \$ 17,889         |
| Trade receivables less allowance for doubtful accounts:<br>September 30, 2011, \$2,013; June 30, 2011, \$2,000  | 32,137                               | 31,451            |
| Inventories   | 78,377                               | 73,680            |
| Deferred income taxes   | 3,980                                | 3,700             |
| Other   | 1,425                                | 1,633             |
| Total current assets  | 130,005                              | 128,353           |
| <b>NON-CURRENT ASSETS:</b>  |                                      |                   |
| Property, plant and equipment, net  | 21,274                               | 21,387            |
| Deferred income taxes   | 2,490                                | 2,560             |
| Other assets  | 11,750                               | 12,377            |
| <b>TOTAL</b>  | <b>\$ 165,519</b>                    | <b>\$ 164,677</b> |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>  |                                      |                   |
| <b>CURRENT LIABILITIES:</b>   |                                      |                   |
| Accounts payable trade  | \$ 9,841                             | \$ 9,899          |
| <b>Accrued liabilities:</b>   |                                      |                   |
| Payroll and related items   | 5,464                                | 6,922             |
| Insurance   | 5,599                                | 5,645             |
| Other   | 6,437                                | 5,204             |
| Total current liabilities   | 27,341                               | 27,670            |
| <b>LONG-TERM LIABILITIES:</b>   |                                      |                   |
| Deferred compensation   | 5,390                                | 5,270             |
| Other liabilities   | 2,598                                | 3,164             |
| Total liabilities   | 35,329                               | 36,104            |
| <b>SHAREHOLDERS EQUITY:</b>   |                                      |                   |
| Cumulative preferred stock \$50 par value;<br>authorized 60,000 shares; outstanding none  |                                      |                   |
| Undesignated (subordinated) stock \$1 par value;<br>authorized 700,000 shares; outstanding none   |                                      |                   |
| Common stock \$1 par value; authorized 15,000,000 shares;<br>outstanding September 30, 2011, 6,762,236 shares;<br>outstanding June 30, 2011, 6,710,612 shares | 6,762                                | 6,711             |
| Additional paid-in capital  | 6,851                                | 6,698             |
| Retained earnings   | 117,401                              | 115,699           |
| Accumulated other comprehensive loss  | (824)                                | (535)             |
| Total shareholders equity   | 130,190                              | 128,573           |
| <b>TOTAL</b>  | <b>\$ 165,519</b>                    | <b>\$ 164,677</b> |

See accompanying Notes to Consolidated Financial Statements (Unaudited).

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FLEXSTEEL INDUSTRIES, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)  
(Amounts in thousands, except per share data)

|   | Three Months Ended<br>September 30, |           |
|---|-------------------------------------|-----------|
|   | 2011                                | 2010      |
| NET SALES   | \$ 81,520                           | \$ 87,230 |
| COST OF GOODS SOLD                                    | (62,556)                            | (67,624)  |
| GROSS MARGIN  | 18,964                              | 19,606    |
| SELLING, GENERAL AND ADMINISTRATIVE                   | (15,331)                            | (14,898)  |
| FACILITY CLOSING COSTS                                |                                     | (1,016)   |
| OPERATING INCOME                                      | 3,633                               | 3,692     |
| OTHER INCOME  | 125                                 | 101       |
| INCOME BEFORE INCOME TAXES                            | 3,758                               | 3,793     |
| PROVISION FOR INCOME TAXES                            | (1,380)                             | (1,450)   |
| NET INCOME  | \$ 2,378                            | \$ 2,343  |
| WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING: |                                     |           |
| Basic   | 6,727                               | 6,660     |
| Diluted   | 6,969                               | 6,839     |
| EARNINGS PER SHARE OF COMMON STOCK:                   |                                     |           |
| Basic   | \$ 0.35                             | \$ 0.35   |
| Diluted   | \$ 0.34                             | \$ 0.34   |
| DIVIDENDS DECLARED PER COMMON SHARE                   | \$ 0.10                             | \$ 0.075  |

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
(Amounts in thousands)

|   | Three Months Ended<br>September 30, |          |
|---|-------------------------------------|----------|
|   | 2011                                | 2010     |
| NET INCOME  | \$ 2,378                            | \$ 2,343 |
| UNREALIZED (LOSSES) GAINS ON SECURITIES                           | (466)                               | 200      |
| INCOME TAX BENEFIT (EXPENSE) RELATED TO SECURITIES (LOSSES) GAINS | 177                                 | (76)     |
| OTHER COMPREHENSIVE (LOSS) INCOME, NET OF TAX                     | (289)                               | 124      |
| COMPREHENSIVE INCOME  | \$ 2,089                            | \$ 2,467 |

See accompanying Notes to Consolidated Financial Statements (Unaudited).

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FLEXSTEEL INDUSTRIES, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)  
(Amounts in thousands)

|   | Three Months Ended<br>September 30, |          |
|---|-------------------------------------|----------|
|   | 2011                                | 2010     |
| <b>OPERATING ACTIVITIES:</b>  |                                     |          |
| Net income  | \$ 2,378                            | \$ 2,343 |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                     |          |
| Depreciation  | 690                                 | 722      |
| Changes in provision for losses on accounts receivable                            | (70)                                | 240      |
| Deferred income taxes   | (33)                                | (86)     |
| Stock-based compensation expense  | 118                                 | 135      |
| (Gain) loss on disposition of capital assets                                      | (3)                                 | 15       |
| Changes in operating assets and liabilities:                                      |                                     |          |
| Trade receivables   | (617)                               | (2,285)  |
| Inventories   | (4,698)                             | (5,754)  |
| Other current assets  | 209                                 | (373)    |
| Other assets  | 17                                  | (8)      |
| Accounts payable trade  | (54)                                | 1,107    |
| Accrued liabilities   | (445)                               | 228      |
| Other long-term liabilities   | (565)                               | 95       |
| Deferred compensation   | 119                                 | 16       |
| Net cash used in operating activities   | (2,954)                             | (3,605)  |
| <b>INVESTING ACTIVITIES:</b>  |                                     |          |
| Proceeds from sales of investments  | 227                                 | 201      |
| Purchases of investments  | (82)                                | (74)     |
| Proceeds from sale of capital assets  | 3                                   | 18       |
| Capital expenditures  | (580)                               | (384)    |
| Net cash used in investing activities   | (432)                               | (239)    |
| <b>FINANCING ACTIVITIES:</b>  |                                     |          |
| Dividends paid  | (503)                               | (332)    |
| Proceeds from issuance of common stock  | 86                                  | 155      |
| Net cash used in financing activities   | (417)                               | (177)    |
| Decrease in cash  | (3,803)                             | (4,021)  |
| Cash at beginning of period   | 17,889                              | 8,278    |
| Cash at end of period   | \$ 14,086                           | \$ 4,257 |

SUPPLEMENTAL CASH FLOW INFORMATION Cash paid during the period for:  
(Amounts in thousands)

|                        | Three Months Ended<br>September 30, |          |
|------------------------|-------------------------------------|----------|
|                        | 2011                                | 2010     |
| Income taxes paid, net | \$ 95                               | \$ 1,260 |

See accompanying Notes to Consolidated Financial Statements (Unaudited).

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### FLEXSTEEL INDUSTRIES, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) FOR THE PERIOD ENDED SEPTEMBER 30, 2011

1. The consolidated financial statements included herein have been prepared by Flexsteel Industries, Inc. and Subsidiaries (the Company or Flexsteel), without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). The information furnished in the consolidated financial statements includes normal recurring adjustments and reflects all adjustments, which are, in the opinion of management, necessary for a fair presentation of such consolidated financial statements. Operating results for the three-month period ended September 30, 2011 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2012. Certain information and footnote disclosures normally included in the consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to make the information presented not misleading. Except to the extent updated or described below, the significant accounting policies set forth in Note 1 to the consolidated financial statements in the Company's Annual Report on Form 10-K for the year ended June 30, 2011, appropriately represent, in all material respects, the current status of accounting policies and are incorporated by reference.

**DESCRIPTION OF BUSINESS** Flexsteel was incorporated in 1929 and is one of the oldest and largest manufacturers, importers and marketers of upholstered and wooden furniture products in the country. Product offerings include a wide variety of upholstered and wood furniture such as sofas, loveseats, chairs, reclining and rocker-reclining chairs, swivel rockers, sofa beds, convertible bedding units, occasional tables, desks, dining tables and chairs and bedroom furniture. The Company's products are intended for use in home, office, hospitality, health care and motor vehicle applications. Featured as a basic component in most of the upholstered furniture is a unique steel drop-in seat spring from which our name Flexsteel is derived. The Company distributes its products throughout the United States through the Company's sales force and various independent representatives to furniture dealers, department stores, recreational vehicle manufacturers, catalogs, hospitality and healthcare facilities. The Company's products are also sold to several national and regional chains, some of which sell on a private label basis.

#### 2. INVENTORIES

The Company values inventory at the lower of cost or market. Raw steel is valued on the last-in, first-out (LIFO) method. Other inventories are valued on the first-in, first-out (FIFO) method. Inventories valued on the LIFO method would have been approximately \$1.9 million higher at September 30, 2011 and June 30, 2011, if they had been valued on the FIFO method. At September 30, 2011 and June 30, 2011, the total value of LIFO inventory was \$2.0 million and \$1.5 million, respectively. A comparison of inventories is as follows (in thousands):

|                                    | September 30,<br>2011 | June 30,<br>2011 |
|------------------------------------|-----------------------|------------------|
| Raw materials                      | \$ 8,342              | \$ 9,235         |
| Work in process and finished parts | 4,186                 | 3,951            |
| Finished goods                     | 65,849                | 60,494           |
| Total                              | \$ 78,377             | \$ 73,680        |

#### 3. BORROWINGS AND CREDIT ARRANGEMENTS

The Company maintains a credit agreement which provides short-term working capital financing up to \$15.0 million with interest of LIBOR plus 1% including \$10.0 million of letters of credit availability. No amounts were outstanding at September 30, 2011 and June 30, 2011 under the working capital facility. The Company is contingently liable to insurance carriers under its comprehensive general, product, and vehicle liability policies, as well as some workers' compensation, and has provided letters of credit in the amount of \$3.0 million. The credit agreement contains financial covenants. The primary covenant is an interest coverage ratio of 3.0 to 1.0. The ratio is computed as net income plus interest expense and stock-based compensation expense less dividends, divided by interest expense. In addition, the Company must maintain working capital of \$60 million. At September 30, 2011, the Company was in compliance with all of the financial covenants contained in the credit agreement.

An officer of the Company is a director at a bank where the Company maintains an unsecured \$8.0 million line of credit at prime minus 1%, but not less than 2.5%, and where its routine daily banking transactions are processed. No amount was outstanding on the line of credit at September 30, 2011 and June 30, 2011. In addition, the Rabbi Trust assets of \$4.9 million are administered by this bank's trust department. The Company receives no special services or pricing on the services performed by the bank due to the directorship of this officer.

4. STOCK-BASED COMPENSATION

The Company has two stock-based compensation methods available when determining employee compensation.

- (1) Long-Term Management Incentive Compensation Plan The plan provides for shares of common stock and cash to be awarded to officers and key employees based on performance targets set by the Nominating and Compensation Committee of the Board of Directors (the Committee). The Company's shareholders approved 500,000 shares to be issued under the plan. As of September 30, 2011, 38,944 shares have been issued. The Committee selected consolidated operating results for organic net sales growth and fully-diluted earnings per share for the three-year performance periods beginning July 1, 2010 and ending on June 30, 2012, beginning July 1, 2011 and ending on June 30, 2013, and beginning July 1, 2012 and ending on June 30, 2014. The Committee has also specified that payouts, if any, for awards earned in these performance periods will be 60% stock and 40% cash. Awards will be paid to participants as soon as practicable following the end of the performance periods subject to Committee approval and verification of results. The compensation cost related to the number of shares to be granted under each performance period is fixed on the grant date, which is the date the performance period begins. The compensation cost related to the cash portion of the award is re-measured based on the equity award's estimated fair value at the end of each reporting period. The accrual is based on the probable outcomes of the performance conditions. The short-term portion of the recorded cash award payable is classified within current liabilities, payroll and related items, and the long-term portion of the recorded cash award payable is classified within other long-term liabilities in the Consolidated Balance Sheets. As of September 30, 2011 and June 30, 2011, the Company has recorded cash awards payable of \$0.6 million and \$0.4 million within current liabilities and \$0.2 million and \$0.7 million within long-term liabilities, respectively. At September 30, 2011 and September 30, 2010, the Company has recorded expense of \$0.3 million and \$0.4 million, respectively.

If the target performance goals would be achieved, the total amount of compensation cost recognized over the requisite service periods would be \$1.1 million (2010-2012), \$1.0 million (2011-2013) and \$0.9 million (2011-2014) based on the estimated fair values at September 30, 2011.

- (2) Stock Option Plans The stock option plans for key employees and directors provide for the granting of incentive and nonqualified stock options. Under the plans, options are granted at an exercise price equal to the fair market value of the underlying common stock at the date of grant, and may be exercisable for up to 10 years. All options are exercisable when granted.

At September 30, 2011, 423,950 shares were available for future grants. It is the Company's policy to issue new shares upon exercise of stock options. The Company accepts shares of the Company's common stock as payment for the exercise price of options. These shares received as payment are retired upon receipt.

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A summary of the status of the Company's stock option plans as of September 30, 2011, June 30, 2011 and 2010 and the changes during the periods then ended is presented below:

|   | Shares<br>(in<br>thousands) | Weighted<br>Average<br>Exercise<br>Price | Aggregate<br>Intrinsic Value<br>(in thousands) |
|---|-----------------------------|--|--|
| Outstanding and exercisable at June 30, 2010      | 1,052                       | \$ 12.70                                 | \$ 1,168                                       |
| Granted   | 88                          | 17.23                                    |  |
| Exercised   | (91)                        | 7.41                                     |  |
| Canceled  | (3)                         | 17.30                                    |  |
| Outstanding and exercisable at June 30, 2011      | 1,046                       | 13.56                                    | 2,271  |
| Granted   |                             |  |  |
| Exercised   | (13)                        | 6.81                                     |  |
| Canceled  |                             |  |  |
| Outstanding and exercisable at September 30, 2011 | 1,033                       | \$ 13.64                                 | \$ 2,397                                       |

The following table summarizes information for options outstanding and exercisable at September 30, 2011:

| Range of<br>Prices | Options<br>Outstanding<br>(in thousands) | Remaining<br>Life (Years) | Weighted Average  |       |
|--------------------|--|---------------------------|-------------------|-------|
|                    |  |                           | Exercise<br>Price | Price |
| \$ 6.81 - 10.75    | 241                                      | 7.7                       | \$                | 7.76  |
| 12.35 - 12.74      | 230                                      | 5.7                       |                   | 12.51 |
| 14.40 - 16.52      | 352                                      | 3.1                       |                   | 15.54 |
| 17.23 - 20.27      | 210                                      | 5.1                       |                   | 18.46 |
| \$ 6.81 - 20.27    | 1,033                                    | 5.2                       | \$                | 13.64 |

### 5. INCOME TAXES

In determining the quarterly provision for income taxes, the Company uses an estimated annual effective tax rate, which is based on the expected annual income, statutory tax rates and tax planning opportunities available to the Company in the various jurisdictions in which it operates. This includes recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns to the extent pervasive evidence exists that they will be realized in future periods. The deferred tax balances are adjusted to reflect tax rates by tax jurisdiction, based on currently enacted tax laws, which are expected to be in effect in the years in which the temporary differences are expected to reverse. In accordance with the Company's income tax policy, significant or unusual items are separately recognized in the quarter in which they occur.

The components of the gross liabilities related to unrecognized tax benefits and the related deferred tax assets are as follows (in thousands):

|  | September 30,<br>2011 | June 30,<br>2011 |
|--|-----------------------|------------------|
| Gross unrecognized tax benefits                        | \$ 920                | \$ 970           |
| Accrued interest and penalties                         | 340                   | 340              |
| Gross liabilities related to unrecognized tax benefits | \$ 1,260              | \$ 1,310         |
| Deferred tax assets                                    | \$ 320                | \$ 330           |



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The recognition of the above amounts would impact the Company's effective tax rate. The Company does not expect that there will be any positions for which it is reasonably possible that the total amounts of unrecognized tax benefits will significantly increase or decrease within twelve months. The Company records interest and penalties related to income taxes as income tax expense in the Consolidated Statements of Operations.

6. EARNINGS PER SHARE

Basic earnings per share (EPS) of common stock are based on the weighted-average number of common shares outstanding for each period. Diluted EPS of common stock includes the dilutive effect of potential common shares outstanding. The Company's potential common shares outstanding are stock options and shares associated with the long-term management incentive compensation plan, which resulted in a dilutive effect of 241,799 shares and 178,851 shares at September 30, 2011 and 2010, respectively. The Company calculates the dilutive effect of outstanding options using the treasury stock method. The Company calculates the dilutive effect of shares related to the long-term management incentive compensation plan based on the number of shares, if any, that would be issuable if the end of the fiscal year were the end of the contingency period. Options to purchase 424,150 shares and 493,150 shares of common stock were outstanding at September 30, 2011 and 2010, respectively, but were not included in the computation of diluted EPS as their exercise prices were greater than the average market price of the common shares.

7. LITIGATION

The Company has been named as one of several defendants in an Indiana civil lawsuit related to groundwater contamination. The lawsuit alleges that the contamination source is a property once owned by the Company. The Company does not believe that it caused or contributed to the contamination. This lawsuit is in its preliminary stages. Plaintiffs have not identified a dollar amount of their alleged damages and the status of insurance coverage has not been determined. We are unable to estimate a range of reasonably possible outcomes or losses at this time. Accordingly, no accrual related to this matter has been recorded in the September 30, 2011 financial statements. During the three months ended September 30, 2011, legal and other related expenses of \$0.5 million have been incurred responding to this lawsuit and are included in Selling, General and Administrative expense in the Consolidated Statement of Operations.

Other Proceedings From time to time, the Company is subject to various other legal proceedings, including lawsuits, which arise out of, and are incidental to, the conduct of the Company's business. The Company does not consider any of such other proceedings that are currently pending, individually or in the aggregate, to be material to its business or likely to result in a material effect on its consolidated operating results, financial condition, or cash flows.

8. ACCOUNTING DEVELOPMENTS

In June 2011, the FASB issued guidance on presentation of comprehensive income. The new guidance eliminates the current option to report other comprehensive income and its components in the statement of changes in equity. Instead, an entity will be required to present either a continuous statement of net income and other comprehensive income or in two separate but consecutive statements. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011, with early adoption permitted. The Company adopted this presentation of comprehensive income during the first quarter of fiscal 2012 and has presented a separate consolidated statement of comprehensive income.

In September 2011, the FASB issued ASU 2011-09 which pertains to employer's participation in multiemployer benefit plans, amending ASC 715-80. ASU 2011-09 enhances the disclosures about significant multiemployer plans in which an employer participates, the level of the employer's participation, the financial health of the plans and the nature of the employer's commitments to the plans. The new disclosure requirements are required for fiscal years ending after December 15, 2011 and there will be no financial impact on the Company.

9. FACILITY CLOSING COSTS

During the quarter ended September 30, 2010, the Company announced the planned closure of a manufacturing facility and recorded pre-tax charges for facility closing costs of \$1.0 million. The charges represented employee separation costs of \$0.6 million and other closing costs of \$0.4 million with no future benefit to the Company and are classified as Facility Closing Costs in the Consolidated Statements of Operations. The \$1.0 million was included in other current liabilities at September 30, 2010 and was fully paid as of June 30, 2011.

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### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

#### GENERAL:

The following analysis of the results of operations and financial condition of the Company should be read in conjunction with the consolidated financial statements and related notes included elsewhere in this quarterly report on Form 10-Q.

#### CRITICAL ACCOUNTING POLICIES:

There have been no material changes to our critical accounting policies and estimates from the information provided in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, included in our 2011 annual report on Form 10-K.

#### Overview

The following table has been prepared as an aid in understanding the Company's results of operations on a comparative basis for the three months ended September 30, 2011 and 2010. Amounts presented are percentages of the Company's net sales.

|                                     | Three Months Ended<br>September 30, |        |
|-------------------------------------|-------------------------------------|--------|
|                                     | 2011                                | 2010   |
| Net sales                           | 100%                                | 100.0% |
| Cost of goods sold                  | (76.7)                              | (77.5) |
| Gross margin                        | 23.3                                | 22.5   |
| Selling, general and administrative | (18.8)                              | (17.1) |
| Facility closing costs              |                                     | (1.2)  |
| Operating income                    | 4.5                                 | 4.2    |
| Other income                        | 0.1                                 | 0.1    |
| Income before income taxes          | 4.6                                 | 4.3    |
| Income tax expense                  | (1.7)                               | (1.6)  |
| Net income                          | 2.9%                                | 2.7%   |

#### Results of Operations for the Quarter Ended September 30, 2011 vs. 2010

The following table compares net sales in total and by area of application for the quarter ended September 30, 2011 to the prior year quarter.

| Area of Application | Net Sales (in thousands)            |                  | \$ Change<br>(in thousands) | % Change      |
|---------------------|-------------------------------------|------------------|-----------------------------|---------------|
|                     | Quarter Ended September 30,<br>2011 | 2010             |                             |               |
| Residential         | \$ 62,522                           | \$ 65,224        | \$ (2,702)                  | (4.1)%        |
| Commercial          | 18,998                              | 22,006           | (3,008)                     | (13.7)%       |
| <b>Total</b>        | <b>\$ 81,520</b>                    | <b>\$ 87,230</b> | <b>\$ (5,710)</b>           | <b>(6.5)%</b> |

Net sales for the quarter ended September 30, 2010 benefited from a longer than normal lag time on orders received in the spring of 2010, but not shipped to dealers until the quarter ended September 30, 2010. New orders received during the quarter ended September 30, 2011 were approximately 8.4% higher than the prior year period.

Gross margin for the quarter ended September 30, 2011 was 23.3% compared to 22.5% in the prior year quarter. The improvement in gross margin percentage is primarily due to lower ocean freight costs and lower fixed costs resulting from reductions in manufacturing capacity.

Selling, general and administrative expenses were \$15.3 million or 18.8% of net sales and \$14.9 million or 17.1% of net sales for the quarters ended September 30, 2011 and 2010, respectively. The increase in expenses is primarily due to support expenditures related to residential dealers converting or installing the Company's revised gallery format and higher legal and professional fees.

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Operating income for the current quarter was \$3.6 million compared to operating income of \$3.7 million in the prior year quarter reflecting the aforementioned factors.

The effective income tax expense rate for the current fiscal quarter was 36.7% compared to an income tax expense rate of 38.2% in the prior year fiscal quarter. The effective rates include the federal statutory rate as well as the effect of the various state taxing jurisdictions.

The above factors resulted in current quarter net income of \$2.4 million or \$0.34 per share, compared to net income of \$2.3 million or \$0.34 per share in the prior year quarter.

All earnings per share amounts are on a diluted basis.

### Liquidity and Capital Resources

#### Operating Activities:

Working capital (current assets less current liabilities) at September 30, 2011 was \$102.7 million. Net cash used in operating activities was \$3.0 million during the first quarter ended September 30, 2011. This use of cash was primarily related to increases in inventories of \$4.7 million and receivables of \$0.6 million.

The Company expects that due to the nature of our operations that there will be continuing fluctuations in accounts receivable, inventory, accounts payable, and cash flows from operations due to the following: (i) we purchase inventory from overseas suppliers with long lead times and depending on the timing of the delivery of those orders, inventory levels can be greatly impacted, and (ii) we have various customers that purchase large quantities of inventory periodically and the timing of those purchases can significantly impact inventory levels, accounts receivable, accounts payable and short-term borrowings. As discussed below, the Company believes it has adequate financing arrangements and access to capital to absorb these fluctuations in operating cash flow.

#### Investing Activities:

Net cash used in investing activities was \$0.4 million during the three-month period ended September 30, 2011. The Company expended \$0.6 million for the purchase of capital assets. The Company expects that capital expenditures will be approximately \$14.0 million for the remainder of the 2012 fiscal year including the cost to construct and furnish the new corporate office building.

#### Financing Activities:

Net cash used in financing activities was \$0.4 million during the three-month period ended September 30, 2011. Dividends of \$0.5 million were paid during the three-month period partially offset by cash received from the exercise of stock options.

Management believes that the Company has adequate cash and credit arrangements to meet its operating and capital requirements for fiscal year 2012. In the opinion of management, the Company's liquidity and credit resources provide it with the ability to react to opportunities as they arise, to pay quarterly dividends to its shareholders, and to purchase productive capital assets that enhance safety and improve operations.

### Outlook

The Company believes that top line growth will be modest through fiscal year 2012. Macroeconomic conditions, such as high unemployment, minimal job growth, a weak housing market and low levels of consumer confidence, continue to adversely impact our business. The commercial office industry is reporting improving order trends. While sales have benefited minimally from those improvements to date, we believe commercial sales volume will increase during fiscal year 2012. We anticipate increased orders for hospitality products during the remainder of fiscal year 2012 resulting from pent up demand caused by delays in typical refurbishing cycles for hotel properties.

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The Company remains committed to its core strategies, which include a wide range of quality product offerings and price points to the residential and commercial markets, combined with a conservative approach to business. We will maintain our focus on a strong balance sheet through emphasis on cash flow and improving profitability. We believe these core strategies are in the best interest of our shareholders.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

*General* Market risk represents the risk of changes in the value of a financial instrument, derivative or non-derivative, caused by fluctuations in interest rates, foreign exchange rates and equity prices. As discussed below, management of the Company does not believe that changes in these factors could cause material fluctuations in the Company's results of operations or cash flows. The ability to import furniture products can be adversely affected by political issues in the countries where suppliers are located, disruptions associated with shipping distances and negotiations with port employees. Other risks related to furniture product importation include government imposition of regulations and/or quotas; duties and taxes on imports; and significant fluctuation in the value of the U.S. dollar against foreign currencies. Any of these factors could interrupt supply, increase costs and decrease earnings.

*Foreign Currency Risk* During the three months ended September 30, 2011 and 2010, the Company did not have sales, purchases, or other expenses denominated in foreign currencies. As such, the Company is not exposed to material market risk associated with currency exchange rates and prices.

*Interest Rate Risk* The Company's primary market risk exposure with regard to financial instruments is changes in interest rates. The Company does not have any debt outstanding at September 30, 2011.

*Tariffs* The Company has exposure to actions by governments, including tariffs. Tariffs are a possibility on any imported or exported products.

*Inflation* Increased operating costs are reflected in product or services pricing with any limitations on price increases determined by the marketplace. Inflation or other pricing pressures could impact raw material costs, labor costs and interest rates which are important components of costs for the Company and could have an adverse effect on our profitability, especially where increases in these costs exceed price increases on finished products.

### Item 4. Controls and Procedures

(a) *Evaluation of disclosure controls and procedures.* Based on their evaluation as of the end of the period covered by this Quarterly Report on Form 10-Q, our chief executive officer and chief financial officer have concluded that 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) were effective as of September 30, 2011.

(b) *Changes in internal control over financial reporting.* During the quarter ended September 30, 2011, there were no significant changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934, as amended) that has materially affected, or is reasonably likely to materially affect the Company's internal control over financial reporting.

### **Cautionary Statement Relevant to Forward-Looking Information for the Purpose of Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995**

The Company and its representatives may from time to time make written or oral forward-looking statements with respect to long-term goals or anticipated results of the Company, including statements contained in the Company's filings with the Securities and Exchange Commission and in its reports to stockholders.

Statements, including those in this Quarterly Report on Form 10-Q, which are not historical or current facts, are forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. There are certain important factors that could cause our results to differ materially from those anticipated by some of the statements made herein. Investors are cautioned that all forward-looking statements involve risk and uncertainty. Some of the factors that could affect results are the cyclical nature of the furniture industry, supply chain disruptions, litigation, the effectiveness of new product introductions and distribution channels, the product mix of sales, pricing pressures, the cost of raw materials and fuel, retention and recruitment of key employees, actions by governments including laws, regulations, taxes and tariffs, inflation, the amount of sales generated and the profit margins thereon, competition (both U.S. and foreign), credit exposure with customers, participation in multi-employer pension plans and general economic conditions. For further information regarding these risks and uncertainties, see the Risk Factors section in Item 1A of our most recent Annual Report on Form 10-K.

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The Company specifically declines to undertake any obligation to publicly revise any forward-looking statements that have been made to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

### PART II OTHER INFORMATION

#### Item 1A. Risk Factors

There has been no material change in the risk factors set forth under Part 1, Item 1A Risk Factors in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2011.

#### Item 6. Exhibits

31.1 Certification

31.2 Certification

32 Certification by Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

#### 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.

FLEXSTEEL INDUSTRIES, INC.

Date: October 24, 2011

By: */s/ Timothy E. Hall*  
Timothy E. Hall  
Chief Financial Officer  
(Principal Financial & Accounting Officer)