

FLEXSTEEL INDUSTRIES INC  
Form 10-Q  
April 22, 2014

**UNITED  
STATES  
SECURITIES  
AND  
EXCHANGE  
COMMISSION**  
WASHINGTON, D.  
C. 20549

**FORM 10-Q**

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

For the quarterly period ended March 31, 2014

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**

**FLEXSTEEL INDUSTRIES, INC.**

(Exact Name of Registrant as Specified in Its Charter)

Incorporated in State of Minnesota 42-0442319  
(State or other Jurisdiction of            (I.R.S. Identification No.)  
Incorporation or Organization)

385 BELL STREET  
DUBUQUE, IOWA 52001-0877  
(Address of Principal Executive Offices) (Zip Code)

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

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

o.

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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 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 March 31, 2014 7,311,756

## PART I FINANCIAL INFORMATION

## Item 1. Financial Statements

FLEXSTEEL INDUSTRIES, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS

(Amounts in thousands, except share and per share data)

|  | March 31,<br>2014<br>(UNAUDITED) | June 30,<br>2013  |
|--|----------------------------------|-------------------|
| <b>ASSETS</b>  |                                  |                   |
| <b>CURRENT ASSETS:</b>   |                                  |                   |
| Cash   | \$ 17,305                        | \$ 10,934         |
| Trade receivables less allowances: March 31, 2014, \$1,479; June 30, 2013, \$1,560 | 40,393                           | 36,075            |
| Inventories  | 92,100                           | 92,417            |
| Deferred income taxes  | 4,380                            | 4,970             |
| Other  | 2,729                            | 4,805             |
| Total current assets   | 156,907                          | 149,201           |
| <b>NON-CURRENT ASSETS:</b>   |                                  |                   |
| Property, plant and equipment, net   | 32,637                           | 32,145            |
| Deferred income taxes  | 2,090                            | 1,190             |
| Other assets   | 10,466                           | 10,003            |
| <b>TOTAL</b>   | <b>\$ 202,100</b>                | <b>\$ 192,539</b> |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>   |                                  |                   |
| <b>CURRENT LIABILITIES:</b>  |                                  |                   |
| Accounts payable trade   | \$ 13,625                        | \$ 13,927         |
| Accrued liabilities:   |                                  |                   |
| Payroll and related items  | 8,366                            | 7,836             |
| Insurance  | 5,024                            | 4,667             |
| Other  | 7,581                            | 9,072             |
| Total current liabilities  | 34,596                           | 35,502            |
| <b>LONG-TERM LIABILITIES:</b>  |                                  |                   |
| Supplemental retirement plans  | 3,344                            | 2,414             |
| Other liabilities  | 3,959                            | 3,386             |
| Total liabilities  | 41,899                           | 41,302            |
| <b>SHAREHOLDERS EQUITY:</b>  |                                  |                   |
| Cumulative preferred stock \$50 par value; authorized 60,000 shares; outstanding   |                                  |                   |

none

Undesignated (subordinated)

stock \$1 par value;  
authorized 700,000 shares;  
outstanding none

Common stock \$1 par  
value; authorized  
15,000,000 shares;  
outstanding March 31, 2014,  
7,311,756 shares;  
outstanding June 30, 2013,  
7,106,723 shares

|   |            |            |
|---|------------|------------|
|   | 7,312      | 7,107      |
| Additional paid-in capital              | 13,684     | 10,615     |
| Retained earnings                       | 140,707    | 134,606    |
| Accumulated other<br>comprehensive loss | (1,502 )   | (1,091 )   |
| Total shareholders' equity              | 160,201    | 151,237    |
| TOTAL                                   | \$ 202,100 | \$ 192,539 |

See accompanying Notes to Consolidated Financial Statements (Unaudited).

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

|   | Three Months Ended |                | Nine Months Ended |                |
|---|--------------------|----------------|-------------------|----------------|
|   | March 31, 2014     | March 31, 2013 | March 31, 2014    | March 31, 2013 |
| NET SALES   | \$110,532          | \$98,351       | \$327,414         | \$284,178      |
| COST OF GOODS SOLD  | (85,488)           | (75,512)       | (252,666)         | (217,491)      |
| GROSS MARGIN  | 25,044             | 22,839         | 74,748            | 66,687         |
| SELLING, GENERAL AND ADMINISTRATIVE LITIGATION SETTLEMENT COSTS | (18,455)           | (17,971)       | (55,014)          | (52,831)       |
| OPERATING INCOME  | 6,589              | 4,868          | 13,484            | 13,856         |
| INTEREST AND OTHER INCOME                                       | 471                | 140            | 1,394             | 365            |
| INCOME BEFORE INCOME TAXES                                      | 7,060              | 5,008          | 14,878            | 14,221         |
| INCOME TAX PROVISION  | (2,640)            | (1,890)        | (5,520)           | (5,310)        |
| NET INCOME  | \$4,420            | \$3,118        | \$9,358           | \$8,911        |
| WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING:           |                    |                |                   |                |
| Basic   | 7,265              | 7,090          | 7,198             | 7,019          |
| Diluted   | 7,675              | 7,408          | 7,546             | 7,297          |
| EARNINGS PER SHARE OF COMMON STOCK:                             |                    |                |                   |                |
| Basic   | \$0.61             | \$0.44         | \$1.30            | \$1.27         |
| Diluted   | \$0.58             | \$0.42         | \$1.24            | \$1.22         |
| DIVIDENDS DECLARED PER COMMON SHARE                             | \$0.15             | \$0.15         | \$0.45            | \$0.45         |

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)  
(Amounts in thousands)

|   | Three Months Ended |                | Nine Months Ended |                |
|---|--------------------|----------------|-------------------|----------------|
|   | March 31, 2014     | March 31, 2013 | March 31, 2014    | March 31, 2013 |
| NET INCOME  | \$4,420            | \$3,118        | \$9,358           | \$8,911        |
| OTHER COMPREHENSIVE (LOSS) INCOME:  |                    |                |                   |                |
| UNREALIZED GAIN ON SECURITIES IN SUPPLEMENTAL RETIREMENT PLANS                            | 67                 | 185            | 574               | 114            |
| RECLASSIFICATION OF REALIZED (GAIN) LOSS ON SUPPLEMENTAL RETIREMENT PLANS TO OTHER INCOME | (431)              | 65             | (1,238)           | 157            |
| OTHER COMPREHENSIVE (LOSS) INCOME BEFORE TAXES  | (364)              | 250            | (664)             | 271            |
| INCOME TAX BENEFIT (EXPENSE) RELATED TO SUPPLEMENTAL RETIREMENT PLANS (LOSS) GAIN         | 138                | (95)           | 253               | (103)          |
| OTHER COMPREHENSIVE (LOSS) INCOME, NET OF TAX   | (226)              | 155            | (411)             | 168            |
| COMPREHENSIVE INCOME  | \$4,194            | \$3,273        | \$8,947           | \$9,079        |

See accompanying Notes to Consolidated Financial Statements (Unaudited).



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

|   | Nine Months<br>Ended<br>March 31,<br>2014    2013 |          |
|---|---|----------|
| <b>OPERATING ACTIVITIES:</b>  |   |          |
| Net income  | \$9,358   | \$8,911  |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: |   |          |
| Depreciation  | 3,088   | 2,792    |
| Deferred income taxes   | (57 )   | (68 )    |
| Stock-based compensation expense  | 1,135   | 1,119    |
| Excess tax benefit from stock-based payment arrangements                                    | (425 )  |          |
| Provision for losses on accounts receivable   | 1   | 120      |
| Gain on disposition of capital assets   | (22 )   | (20 )    |
| Changes in operating assets and liabilities:  |   |          |
| Trade receivables   | (4,319 )  | (3,516 ) |
| Inventories   | 317   | (3,343 ) |
| Other current assets  | (558 )  | (908 )   |
| Other assets  | 109   | (53 )    |
| Accounts payable - trade  | (61 )   | 1,419    |
| Accrued liabilities   | 2,134   | (754 )   |
| Supplemental retirement plans   | 312   | 569      |
| Other long-term liabilities   | 573   | (90 )    |
| Net cash provided by operating activities   | 11,585  | 6,178    |
| <b>INVESTING ACTIVITIES:</b>  |   |          |
| Purchases of investments  | (4,285 )  | (844 )   |
| Proceeds from sales of investments  | 3,957   | 166      |
| Proceeds from sale of capital assets  | 31  | 20       |
| Capital expenditures  | (3,830 )  | (5,652 ) |
| Net cash used in investing activities   | (4,127 )  | (6,310 ) |
| <b>FINANCING ACTIVITIES:</b>  |   |          |
| Dividends paid  | (3,226 )  | (3,148 ) |
| Proceeds from issuance of common stock  | 1,714   | 1,047    |
| Excess tax benefit from stock-based payment arrangements                                    | 425   |          |
| Net cash used in financing activities   | (1,087 )  | (2,101 ) |
| Increase (decrease) in cash   | 6,371   | (2,233 ) |
| Cash at beginning of period   | 10,934  | 13,970   |
| Cash at end of period   | \$17,305  | \$11,737 |

**SUPPLEMENTAL INFORMATION**

(Amounts in thousands)

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Nine Months  
Ended  
March 31,  
2014 2013

|  |         |         |
|--|---------|---------|
| Income taxes paid, net                   | \$4,990 | \$6,120 |
| Capital expenditures in accounts payable | 20      | 60      |

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 MARCH 31, 2014

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 and nine month periods ended March 31, 2014 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2014. 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, 2013, appropriately represent, in all material respects, the current status of accounting policies and are incorporated by reference.

**ACCOUNTING DEVELOPMENTS** In February 2013, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) 2013-02, which requires additional disclosures on the effect of significant reclassifications out of accumulated other comprehensive income. The ASU requires a company that reports other comprehensive income to present (either on the face of the statement where net income is presented or in the notes) the effects on the line items of net income of significant amounts reclassified out of accumulated other comprehensive income. For other amounts that are not required to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference to other required disclosures that provide additional details about those amounts. This ASU is effective for fiscal years beginning after December 15, 2012, and was adopted by the Company on July 1, 2013. The Company's adoption of this ASU resulted in additional disclosure within the Company's consolidated statements of comprehensive income.

**DESCRIPTION OF BUSINESS** Flexsteel Industries, Inc. and Subsidiaries (the Company) was incorporated in 1929 and is one of the oldest and largest manufacturers, importers and marketers of residential and commercial upholstered and wood furniture products in the United States. 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, hotel, healthcare and other commercial applications. A featured 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.

## 2. INVENTORIES

The Company values inventory at the lower of cost or net realizable value. 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 \$1.5 million and \$1.7 million higher at March 31, 2014 and June 30, 2013, respectively, if they had been valued on the FIFO method. At March 31, 2014 and June 30, 2013, the total value of LIFO inventory was \$2.9 million and \$2.6 million, respectively. A comparison of inventories is as follows:

| (in thousands)                     | March       |                  |
|------------------------------------|-------------|------------------|
|                                    | 31,<br>2014 | June 30,<br>2013 |
| Raw materials                      | \$11,028    | \$10,684         |
| Work in process and finished parts | 5,479       | 5,410            |
| Finished goods                     | 75,593      | 76,323           |
| Total                              | \$92,100    | \$92,417         |

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### 3. FAIR VALUE MEASUREMENTS

The Company's cash, accounts receivable, other current assets, accounts payable and certain accrued liabilities are carried at amounts which reasonably approximate their fair value due to their short-term nature. Generally accepted accounting principles on fair value measurement for certain financial assets and liabilities require that each asset and liability carried at fair value be classified into one of the following categories: Level 1: Quoted market prices in active markets for identical assets and liabilities; Level 2: Observable market based inputs or unobservable inputs that are corroborated by market data; or Level 3: Unobservable inputs that are not corroborated by market data. The Company has not changed its valuation techniques in measuring the fair value of any financial assets and liabilities during the period.

The Company maintains supplemental retirement plans, collectively referred to as the Supplemental Plan, which provides for additional annual defined contributions toward retirement benefits to certain of the Company's executive officers. Funds of the Supplemental Plan are held in a Rabbi Trust. The assets held in the Rabbi Trust are not available for general corporate purposes. The Rabbi Trust is subject to creditor claims in the event of insolvency, but otherwise must be used only for purposes of providing benefits under the plans. As of March 31, 2014, the Company's Supplemental Plan assets, held in the Rabbi Trust, were invested in stock and bond funds and are recorded in the Consolidated Balance Sheets at fair market value. As of March 31, 2014, the Supplemental Plan Assets were \$3.7 million, with \$0.6 million of the Supplemental Plan assets classified as Other Current Assets and \$3.1 million as Other Assets in the Consolidated Balance Sheets. As of June 30, 2013, the Supplemental Plan assets were \$5.8 million, with \$3.3 million classified as Other Current Assets and \$2.5 million classified as Other Assets in the Consolidated Balance Sheets. These assets are classified as Level 2 in accordance with fair value accounting as described above.

### 4. CREDIT ARRANGEMENTS

The Company maintains a credit agreement which provides short-term working capital financing up to \$10.0 million with interest of LIBOR plus 1%, including up to \$4.0 million of letters of credit. Letters of credit outstanding at March 31, 2014 totaled \$2.7 million, leaving borrowing availability of \$7.3 million. The Company did not utilize any borrowing availability under the credit facility during the period other than the aforementioned letters of credit. The credit agreement expires on June 30, 2014. At March 31, 2014, the Company was in compliance with all of the financial covenants contained in the credit agreement.

The Company maintains an unsecured \$8.0 million line of credit, with interest at prime minus 2%, with a maturity date of February 13, 2015 and where its routine banking transactions are processed. The Company did not utilize any borrowing availability during the period and no amount was outstanding on the line of credit at March 31, 2014.

### 5. STOCK-BASED COMPENSATION

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

#### (1) Long-Term Incentive Compensation Plans

##### Long-Term Incentive Compensation Plan

The long-term incentive compensation plan provides for shares of common stock 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). In December 2013, the Company's shareholders approved 700,000 shares to be

issued under the plan. As of March 31, 2014, no shares have been issued. The Committee selected fully-diluted earnings per share as the performance goal for the three-year performance period July 1, 2013 – June 30, 2016. 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 Company recorded expense of \$0.1 million for the quarter ended March 31, 2014. For the nine month period ended March 31, 2014 the Company has recorded expense of \$0.3 million. If the target performance goals would be achieved, the total amount of compensation cost recognized over the requisite service periods (2014-2016) would be \$1.1 million.

#### 2007 Long-Term Management Incentive Plan (2007 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. Due to the adoption of the Long-Term Incentive Compensation Plan in December 2013, no additional shares can be awarded under the 2007 Plan. As of March 31, 2014, 189,030 shares have been issued. The Committee selected consolidated operating results for organic net sales growth and fully-diluted earnings per share as the performance goal for the three-year performance periods beginning July 1, 2011 and ending on June 30, 2014 and beginning July 1, 2012 and ending on June 30, 2015. 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 March 31, 2014 and June 30, 2013, the Company has recorded cash awards payable of \$0.7 million and \$0.6 million within current liabilities and \$0.4 million and \$0.4 million within long-term liabilities, respectively. During the quarters ended March 31, 2014 and 2013, the Company recorded expense of \$0.4 million and \$0.4 million, respectively. For the nine month periods ended March 31, 2014 and 2013, the Company recorded expense of \$1.0 million and \$1.1 million, respectively.

If the target performance goals would be achieved, the total amount of compensation cost recognized over the requisite service periods would be \$0.9 million (2012-2014) and \$1.0 million (2013-2015) based on the estimated fair values at March 31, 2014.

#### (2) Stock Plans

##### Omnibus Stock Plan

The Omnibus Stock Plan is for key employees, officers and directors and provides for the granting of incentive and nonqualified stock options, restricted stock, restricted stock units, stock appreciation rights and performance units. In December 2013, the Company s shareholders approved 700,000 shares to be issued under the plan. The options are exercisable up to 10 years from the date of grant. 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.

At March 31, 2014, 641,550 shares were available for future grants. During the quarter ended March 31, 2014 the Company recorded no expense related to this plan. During the nine months ended March 31, 2014, the Company recorded expense of \$0.4 million.

##### 2006 and 2009 Stock Option Plans

The stock option plans were for key employees, officers and directors and provided for granting incentive and nonqualified stock options. Under the plans, options were granted at an exercise price equal to the fair market value of the underlying common stock at the date of grant and exercisable for up to 10 years. All options were

exercisable when granted. Due to the adoption of the Omnibus Stock Plan in December 2013, no additional options can be granted under the 2006 and 2009 stock option plans.

There were no options granted and no expense was recorded under these Plans during the three and nine months ended March 31, 2014. During the quarter ended March 31, 2013, no expense was recorded for these plans. For the nine month periods ended March 31, 2013, the Company recorded expense of \$0.5 million.

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A summary of the status of the Company's stock plans as of March 31, 2014, June 30, 2013 and 2012 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<br>Value<br>(in<br>thousands) |
|---|-----------------------------|--|--|
| Outstanding and exercisable at June 30, 2012  | 818                         | \$ 13.94                                 | \$ 4,783   |
| Granted                                       | 89                          | 20.31                                    |  |
| Exercised                                     | (110 )                      | 13.38                                    |  |
| Canceled                                      | (10 )                       | 16.09                                    |  |
| Outstanding and exercisable at June 30, 2013  | 787                         | 14.71                                    | \$ 7,609   |
| Granted                                       | 58                          | 27.49                                    |  |
| Exercised                                     | (227 )                      | 16.03                                    |  |
| Canceled                                      | (29 )                       | 19.35                                    |  |
| Outstanding and exercisable at March 31, 2014 | 589                         | \$ 15.22                                 | \$ 15,786  |

The following table summarizes information for options outstanding and exercisable at March 31, 2014:

| Range of<br>Prices |       | Options<br>Outstanding<br>and<br>Exercisable<br>(in<br>thousands) | Weighted<br>Average<br>Remaining<br>Life Exercise<br>Price<br>(Years) |
|--------------------|-------|---|---|
| \$6.81             | 8.55  | 107   | 5.2 \$ 7.68   |
| 12.35              | 13.90 | 173   | 4.5 12.89   |
| 14.40              | 17.23 | 173   | 3.1 15.87   |
| 19.72              | 27.57 | 136   | 9.0 23.35   |
| \$6.81             | 27.57 | 589   | 5.3 \$ 15.22  |

## 6. EARNINGS PER SHARE

Basic earnings per share (EPS) of common stock is based on the weighted-average number of common shares outstanding during each period. Diluted earnings per share 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. The Company calculates the dilutive effect of outstanding options using the treasury stock method. Anti-dilutive shares are not included in the computation of diluted EPS when their exercise price is greater than the average closing market price of the common shares. 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 period were the end of the

contingency period.

In computing EPS for the quarters and nine months ended March 31, 2014 and 2013, net income as reported for each respective period is divided by the fully diluted weighted average number of shares outstanding:

| (in thousands)           | Three Months Ended |                | Nine Months Ended |                |
|--------------------------|--------------------|----------------|-------------------|----------------|
|                          | March 31, 2014     | March 31, 2013 | March 31, 2014    | March 31, 2013 |
| Basic shares             | 7,265              | 7,090          | 7,198             | 7,019          |
| Potential common shares: |                    |                |                   |                |
| Stock options            | 383                | 293            | 325               | 250            |
| Long-term incentive plan | 20                 | 25             | 16                | 28             |
| Non-vested shares        | 7                  |                | 7                 |                |
|                          | 410                | 318            | 348               | 278            |
| Diluted shares           | 7,675              | 7,408          | 7,546             | 7,297          |
| Anti-dilutive shares     |                    |                |                   | 10             |

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## 7. LITIGATION

Indiana Civil Litigation In December 2013, the Company entered into a confidential agreement to settle the Indiana Civil Litigation. The Company paid \$6.3 million to Plaintiffs to settle the matter without admission of wrongdoing. The Company continues to believe that it did not cause or contribute to the contamination. This settlement is recorded as Litigation Settlement Costs in the Consolidated Statements of Income.

During the three months ended March 31, 2014 and 2013, the Company recorded \$0.2 million and \$0.6 million, respectively, in legal and other related expenses that were incurred responding to the lawsuits and pursuing insurance coverage. During the nine months ended March 31, 2014 and 2013, the Company recorded \$2.0 million and \$1.7 million, respectively, in legal and other related expenses. These expenses are included in Selling, General and Administrative (SG&A) expense in the Consolidated Statements of Income.

During the three and nine months ended March 31, 2014, the Company received approximately \$0.4 million and \$2.1 million, respectively, from insurance carriers to reimburse the Company for certain legal defense costs. These reimbursement amounts are recorded in SG&A as a reduction of legal expenses. The Company will continue to pursue the recovery of additional defense and settlement costs from insurance carriers. Based on policy language and jurisdiction, insurance coverage is in question.

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.

## 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 2013 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 and nine months ended March 31, 2014 and 2013. Amounts presented are percentages of the Company's net sales.

|  | Three Months<br>Ended | Nine Months<br>Ended |
|--|-----------------------|----------------------|
|--|-----------------------|----------------------|

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|                                     | March 31, |         | March 31, |         |
|-------------------------------------|-----------|---------|-----------|---------|
|                                     | 2014      | 2013    | 2014      | 2013    |
| Net sales                           | 100.0%    | 100.0%  | 100.0%    | 100.0%  |
| Cost of goods sold                  | (77.3 )   | (76.8 ) | (77.2 )   | (76.5 ) |
| Gross margin                        | 22.7      | 23.2    | 22.8      | 23.5    |
| Selling, general and administrative | (16.7 )   | (18.3 ) | (16.8 )   | (18.6 ) |
| Litigation settlement costs         |           |         | (1.9 )    |         |
| Operating income                    | 6.0       | 4.9     | 4.1       | 4.9     |
| Interest and other income           | 0.4       | 0.1     | 0.4       | 0.1     |
| Income before income taxes          | 6.4       | 5.0     | 4.5       | 5.0     |
| Income tax provision                | (2.4 )    | (1.8 )  | (1.7 )    | (1.9 )  |
| Net income                          | 4.0       | % 3.2   | % 2.8     | % 3.1   |

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The following table compares net sales for the quarters ended March 31, 2014 and 2013 (in millions):

|             | 2014      | 2013     | \$<br>Change | %<br>Change |   |
|-------------|-----------|----------|--------------|-------------|---|
| Residential | \$90,727  | \$79,917 | \$10,810     | 13.5        | % |
| Commercial  | 19,805    | 18,434   | 1,371        | 7.4         | % |
| Total       | \$110,532 | \$98,351 | \$12,181     | 12.4        | % |

Results of Operations for the Quarter Ended March 31, 2014 vs. 2013

Net sales for the quarter ended March 31, 2014 were \$110.5 million, a 12.4% increase compared to \$98.4 million in the prior year quarter. Residential net sales were \$90.7 million in the current quarter, an increase of 13.5% from the prior year quarter of \$79.9 million, primarily due to increased demand for upholstered and, to a lesser extent, ready-to-assemble products. Commercial net sales were approximately \$19.8 million in the current quarter, an increase of 7.4% compared to \$18.4 million in the prior year quarter. The increase in commercial sales for the quarter ended March 31, 2014 is primarily from hospitality products.

Gross margin for the quarters ended March 31, 2014 and 2013 was 22.7% and 23.2%, respectively. The decrease in the current year period was primarily due to price discounting on certain case goods to address changing customer requirements.

Selling, general and administrative (SG&A) expense for the quarters ended March 31, 2014 and 2013 were 16.7% and 18.3% of net sales, respectively. The Company incurred approximately \$0.2 million of legal defense costs during the three month period ended March 31, 2014 which has been recorded in SG&A expense. The Company has received reimbursements of legal defense costs of approximately \$0.4 million from insurers and this has been reflected as a reduction in selling, general and administrative (SG&A) expenses for the three months ended March 31, 2014. The prior year quarter includes \$0.6 million in legal defense costs and \$0.3 million in executive transition costs.

Operating income for the quarter ended March 31, 2014 was \$6.6 million compared to operating income of \$4.9 million.

The effective income tax expense rate for the current quarter was 37.4% compared to an income tax expense rate of 37.7% in the prior year period. The effective rates include the federal statutory rate as well as the effect of the various state taxing jurisdictions.

The above factors resulted in net income for the quarter ended March 31, 2014 of \$4.4 million or \$0.58 per share compared to \$3.1 million or \$0.42 per share for the prior year quarter. All earnings per share amounts are on a diluted basis.

The following table compares net sales for the nine months ended March 31, 2014 and 2013 (in millions):

|             | 2014      | 2013      | \$<br>Change | %<br>Change |   |
|-------------|-----------|-----------|--------------|-------------|---|
| Residential | \$266,125 | \$228,864 | \$37,261     | 16.3        | % |
| Commercial  | 61,289    | 55,314    | 5,975        | 10.8        | % |
| Total       | \$327,414 | \$284,178 | \$43,236     | 15.2        | % |

Results of Operations for the Nine Months Ended March 31, 2014 vs. 2013

Net sales for the nine months ended March 31, 2014 were \$327.4 million, a 15.2% increase compared to \$284.2 million in the prior year nine month period. Residential net sales were \$266.1 million in the current nine month

period, an increase of 16.3% from the prior year period of \$228.9 million, primarily due to increased demand for upholstered and, to a lesser extent, ready-to-assemble products. Commercial net sales were approximately \$61.3 million in the current nine month period, an increase of 10.8% compared to \$55.3 million in the prior year period. The increase in commercial sales for the quarter ended March 31, 2014 is primarily from hospitality and vehicle seating products.

Gross margin for the nine months ended March 31, 2014 was 22.8% of net sales compared to 23.5% of net sales in the prior year nine month period. The decrease in the current year period was primarily due to price discounting on certain case goods to address changing customer requirements.

In December 2013, the Company entered into an agreement to settle Indiana civil litigation in order to eliminate the ongoing costs and distraction of the litigation. In February 2014, the Company contributed \$6.3 million to the settlement as part of an agreement whose terms are otherwise confidential. In reaching the agreement, the Company does not admit any wrongdoing and believes that it did not cause or contribute to the contamination at issue. This amount is recorded as litigation settlement costs in the Consolidated Statements of Income. The cost to defend the Company in this litigation, net of amounts reimbursed by insurance companies, is recorded as SG&A expense in the financial statements. The Company continues to pursue recovery of defense and settlement costs from insurance carriers.

SG&A expense for the nine month period ended March 31, 2014 was 16.8% of net sales compared to 18.6% of net sales, respectively. The nine month period ended March 31, 2014 includes a \$1.0 million increase in supplemental retirement plan expense as compared to the prior year period. The Company incurred approximately \$2.0 million of legal defense costs during the nine month period ended March 31, 2014 which has been recorded in SG&A expense. The Company has received reimbursements of legal defense costs of approximately \$2.1 million from insurers and this has been reflected as a reduction in selling, general and administrative (SG&A) expenses for the nine months ended March 31, 2014. SG&A expense for the prior nine month period ended March 31, 2013 includes legal defense costs related to the Indiana civil litigation of \$1.7 million and executive transition costs of \$1.3 million.

Operating income for the nine months ended March 31, 2014 was \$13.5 million compared to operating income of \$13.9 million in the prior year period.

Interest and other income for the nine month period ended March 31, 2014 increased \$1.0 million compared to the prior year nine month period. The increase reflects realized gains of \$1.2 million resulting from the sale of investments held for the purpose of funding the Supplemental Retirement Plans.

The effective income tax expense rate for the current nine month period was 37.1% compared to an income tax expense rate of 37.3% in the prior year period. The effective rates include the federal statutory rate as well as the effect of the various state taxing jurisdictions.

The above factors resulted in net income for the nine months ended March 31, 2014 of \$9.4 million or \$1.24 per share compared to \$8.9 million or \$1.22 per share for the prior year period. All earnings per share amounts are on a diluted basis.

### Liquidity and Capital Resources

Working capital (current assets less current liabilities) at March 31, 2014 was \$122.3 million compared to \$113.7 million at June 30, 2013. Primary changes in working capital from June 30, 2013 to March 31, 2014 include increases in cash of \$6.4 million and accounts receivable of \$4.3 million. The increase in accounts receivable is due to increased sales volume and timing of related shipments and collections.

The Company's main source of liquidity is cash and cash flows from operations. As of March 31, 2014 and June 30, 2013, the Company had cash totaling \$17.3 million and \$10.9 million, respectively. The Company maintains a credit agreement which provides short-term working capital financing up to \$10.0 million with interest of LIBOR plus 1%, including up to \$4.0 million of letters of credit. Letters of credit outstanding at March 31, 2014 totaled \$2.7 million, leaving borrowing availability of \$7.3 million. The Company did not utilize any borrowing availability under the credit facility during the period other than the aforementioned letters of credit. The credit agreement expires on June 30, 2015. At March 31, 2014, the Company was in compliance with all of the financial covenants contained in the credit agreement.

The Company maintains an unsecured \$8.0 million line of credit, with interest at prime minus 2%, with a maturity date of February 13, 2015 and where its routine banking transactions are processed. The Company did not utilize any

borrowing availability during the period and no amount was outstanding on the line of credit at March 31, 2014.

Net cash provided by operating activities of \$11.6 million in the nine months ended March 31, 2014 was comprised primarily of net income of \$9.4 million, changes in operating assets and liabilities of \$1.5 million. Net cash provided by operating activities in the nine months ended March 31, 2013 was \$6.2 million.

Net cash used in investing activities was \$4.1 million and \$6.3 million in the nine months ended March 31, 2014 and 2013, respectively. Net purchases of investments were \$0.3 million and \$0.7 million for the nine months ended March 31, 2014 and 2013, respectively. Capital expenditures were \$3.8 million and \$5.6 million during the nine months ended March 31, 2014 and 2013, respectively.

Net cash used in financing activities was \$1.1 million and \$2.1 million in the nine months ended March 31, 2014 and 2013, respectively, primarily for the payment of dividends of \$3.2 million compared to \$3.1 million in the nine months ended March 31, 2014 and 2013, respectively. Proceeds from issuance of common stock were \$2.1 million and \$1.0 million in the nine months ended March 31, 2014 and 2013, respectively.

The Company expects that capital expenditures for the remainder of fiscal year 2014 will be approximately \$0.5 million. Management believes that the Company has adequate cash, cash flows from operations and credit arrangements to meet its operating and capital requirements for fiscal year 2014. 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.

#### Contractual Obligations

As of March 31, 2014, there have been no material changes to our contractual obligations presented in our Annual Report on Form 10-K for the year ended June 30, 2013.

#### Outlook

Due to existing strong order backlog and positive order trends the Company expects top line growth will continue for the fourth quarter of fiscal year 2014. The Company's order backlog of \$51 million at March 31, 2014 is up 16% from March 31, 2013. Residential growth is expected from existing customers and products, and through expanding our product portfolio and customer base. The Company believes this growth will be led by increased demand for upholstered and ready to assemble products. The Company anticipates sales of commercial products to moderately increase for the fiscal year 2014 fourth quarter. The Company is confident in its ability to take advantage of market opportunities.

The Company has started two multi-year initiatives designed to enhance customer experience and increase shareholder value. In anticipation of future growth we completed a logistics strategy, and are assessing our business information requirements. The timing and level of investment required for these initiatives will be determined as the projects progress.

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 increasing 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.

*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.

*Foreign Currency Risk* During the three and nine months ended March 31, 2014 and 2013, the Company did not have sales denominated in foreign currencies and has minimal 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. At March 31, 2014, the Company does not have any debt outstanding.



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 March 31, 2014.

(b) *Changes in internal control over financial reporting.* During the quarter ended March 31, 2014, 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, including expenses relating to the Indiana civil 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.

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 1. Legal Proceedings

*Indiana Civil Litigation* In December 2013, the Company entered into a confidential agreement to settle the Indiana Civil Litigation. The Company paid \$6.3 million to Plaintiffs to settle the matter without admission of wrongdoing. The Company continues to believe that it did not cause or contribute to the contamination.

The Company will continue to pursue the recovery of defense and settlement costs from insurance carriers. Based on policy language and jurisdiction, insurance coverage is in question. The Company has filed an appeal to the Iowa Supreme Court regarding two adverse opinions of an Iowa District Court regarding coverage issues.

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, 2013.

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.

101.INS XBRL Instance Document

101.SCH XBRL Taxonomy Extension Schema Document

101.CALXBRL Taxonomy Extension Calculation Linkbase Document

101.LABXBRL Taxonomy Extension Labels Linkbase Document

101.DEF XBRL Taxonomy Extension Definition Linkbase Document

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

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: April 21, 2014 By: /s/ Timothy E. Hall  
Timothy E. Hall  
Chief Financial Officer  
(Principal Financial &  
Accounting Officer)

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