

FLEXSTEEL INDUSTRIES INC  
Form 10-K  
August 19, 2011

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549  
**Form 10-K**

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the fiscal year ended **June 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**

**FLEXSTEEL INDUSTRIES, INC.**

(Exact name of registrant as specified in its charter)

|   |   |
|---|---|
| <b>Minnesota</b><br>(State or other jurisdiction of incorporation or<br>organization) | <b>42-0442319</b><br>(I.R.S. Employer Identification No.) |
| <b>3400 Jackson Street, Dubuque, Iowa</b><br>(Address of principal executive offices) | <b>52004-0877</b><br>(Zip Code)                           |
| Registrant's telephone number, including area code:                                   | <b>(563) 556-7730</b>                                     |

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

|   |  |
|---|--|
| Title of each class<br>Common Stock, \$1.00 Par Value | Name of each exchange on which registered<br>The NASDAQ Stock Market LLC |
|---|--|

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

None  
(Title of Class)

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes  No

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

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Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of 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 Act). Yes  No

The aggregate market value of the voting stock held by non-affiliates, computed by reference to the last sales price on December 31, 2010 (which was the last business day of the registrant's most recently completed second quarter) was \$74,061,443.

Indicate the number of shares outstanding of each of the registrant's classes of Common Stock, as of the latest practicable date. 6,715,612 Common Shares (\$1 par value) as of August 15, 2011.

### DOCUMENTS INCORPORATED BY REFERENCE

In Part III, portions of the registrant's 2011 Proxy Statement to be filed with the Securities and Exchange Commission within 120 days of the Registrant's fiscal year end.

**PART I****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 Annual Report on Form 10-K, 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 this 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.

**Item 1. Business**

## General

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 wooden 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 and other commercial 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. The Company's products are also sold to several national and regional chains, some of which sell on a private label basis. No single customer accounted for more than 10% of net sales.

The Company has one active wholly-owned subsidiary: DMI Furniture, Inc. (DMI), which is a Louisville, Kentucky-based, importer and marketer of residential and commercial office furniture with warehouses in Indiana and manufacturing sources in Asia; DMI's divisions are WYNWOOD, Homestyles and DMI Commercial Office Furniture.

The Company operates in one reportable operating segment, furniture products. Our furniture products business involves the distribution of manufactured and imported products consisting of a broad line of upholstered and wooden furniture for residential and commercial markets. Set forth below is information for the past three fiscal years showing the Company's net sales attributable to each of the areas of application (in thousands):

|             | <b>FOR THE YEARS ENDED JUNE 30,</b> |             |             |
|-------------|-------------------------------------|-------------|-------------|
|             | <b>2011</b>                         | <b>2010</b> | <b>2009</b> |
| Residential | \$ 258,095                          | \$ 246,041  | \$ 230,727  |
| Commercial  | 81,331                              | 80,425      | 93,431      |
|             | \$ 339,426                          | \$ 326,466  | \$ 324,158  |

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### *Manufacturing and Offshore Sourcing*

We integrate our manufactured products with finished products acquired from offshore suppliers who can meet our quality specification and scheduling requirements. We will continue to pursue and refine this blended strategy, offering customers manufactured goods, products manufactured utilizing imported component parts, and ready-to-deliver imported products. The Company believes that it best serves customers by offering products from each of these categories to assist customers in reaching specific consumers with varied price points, styles and product categories. This blended focus on products allows the Company to provide a wide range of options to satisfy customer requirements.

We operate manufacturing facilities that are located in Arkansas, California, Georgia, Iowa, Mississippi and Juarez, Mexico. These manufacturing operations are integral to our product offerings and distribution strategy by offering smaller and more frequent product runs of a wider product selection. We identify and eliminate manufacturing inefficiencies and adjust manufacturing schedules on a daily basis to meet customer requirements. We have established relationships with key suppliers to ensure prompt delivery of quality component parts. Our production includes the use of selected offshore component parts to enhance our product quality and value in the marketplace.

### *Competition*

The furniture industry is highly competitive and includes a large number of U.S. and foreign manufacturers and distributors, none of which dominates the market. Our competition includes foreign manufacturers, in countries such as China, and customers who obtain products directly from foreign manufacturers. The markets in which we compete include a large number of relatively small manufacturers; however, certain competitors have substantially greater sales volumes than we have. Our products compete based on style, quality, price, delivery, service and durability. We believe that our manufacturing capabilities, facility locations, commitment to customers, product quality and value and experienced production, marketing and management teams, aided by offshore sourced components and finished product, are our competitive advantages.

### *Seasonality*

The Company's business is not considered seasonal.

### *Foreign Operations*

The Company makes minimal export sales. At June 30, 2011, the Company had approximately 90 employees located in Asia to inspect and coordinate the delivery of purchased products.

### *Customer Backlog*

The approximate backlog of customer orders believed to be firm as of the end of the current fiscal year and the prior two fiscal years were as follows (in thousands):

| June 30, 2011 | June 30, 2010 | June 30, 2009 |
|---------------|---------------|---------------|
| \$35,700      | \$49,000      | \$35,200      |

### *Raw Materials*

The Company utilizes various types of wood, fabrics, leathers, upholstered filling material, high carbon spring steel, bar and wire stock, polyurethane and other raw materials in manufacturing furniture. While the Company purchases these materials from numerous outside suppliers, both U.S. and foreign, it is not dependent upon any single source of supply. The costs of certain raw materials fluctuate, but all continue to be readily available.

### *Working Capital Practices*

For a discussion of the Company's working capital practices, see *Liquidity and Capital Resources* in Item 7 of this Annual Report on Form 10-K.

### *Industry Factors*

The Company has exposure to actions by governments, including tariffs, see *Risk Factors* in Item 1A of this Annual Report on Form 10-K.

### *Government Regulations*

The Company is subject to various local, state, and federal laws, regulations and agencies that affect businesses generally, see *Risk Factors* in Item 1A of this Annual Report on Form 10-K.

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### *Environmental Matters*

The Company is subject to environmental laws and regulations with respect to product content and industrial waste, see *Risk Factors* in Item 1A and *Legal Proceedings* in Item 3 of this Annual Report on Form 10-K.

### *Trademarks and Patents*

The Company owns the American and Canadian improvement patents to its Flexsteel seat spring, as well as patents on convertible beds. The Company has patents and owns certain trademarks in connection with its furniture products, which are due to expire on dates ranging from 2011 to 2025. The Company does not consider its trademarks and patents material to its business.

It is not common in the furniture industry to obtain a patent for a furniture design. If a particular design of a furniture manufacturer is well accepted in the marketplace, it is common for other manufacturers to imitate the same design without recourse by the furniture manufacturer who initially introduced the design. Furniture products are designed by the Company's own design staff and through the services of independent designers. New models and designs of furniture, as well as new fabrics, are introduced continuously. In the last three fiscal years, these design activities involved the following expenditures (in thousands):

| <b>Fiscal Year Ended June 30,</b> | <b>Expenditures</b> |
|-----------------------------------|---------------------|
| 2011                              | \$2,190             |
| 2010                              | \$2,040             |
| 2009                              | \$2,680             |

### *Employees*

The Company had 1,300 employees as of June 30, 2011 including 250 employees that are covered by collective bargaining agreements. Management believes it has good relations with employees.

### *Website and Available Information*

Our website is located at [www.flexsteel.com](http://www.flexsteel.com). Information on the website does not constitute part of this Annual Report on Form 10-K.

A copy of the Company's Annual Report on Form 10-K, as filed with the Securities and Exchange Commission (SEC), other SEC reports filed or furnished and our *Guidelines for Business Conduct* are available, without charge, on the Company's website at [www.flexsteel.com](http://www.flexsteel.com) or by writing to the Office of the Secretary, Flexsteel Industries, Inc., P. O. Box 877, Dubuque, IA 52004-0877.

## **Item 1A. Risk Factors**

Our business is subject to a variety of risks. You should carefully consider the risk factors detailed below in conjunction with the other information contained in this Annual Report on Form 10-K. Should any of these risks actually materialize, our business, financial condition, and future prospects could be negatively impacted. These risks are not the only ones we face. There may be additional factors that are presently unknown to us or that we currently believe to be immaterial that could affect our business.

### **Our products are considered highly deferrable purchases for consumers during economic downturns. Prolonged negative economic conditions could impact our business.**

Home furnishings and commercial products are generally considered a deferrable purchase by most consumers and end-users. Economic downturns and prolonged negative economic conditions could affect consumer spending habits by decreasing the overall demand for home furnishings and commercial products. These events could impact retailers, hospitality, vehicle seating and healthcare businesses resulting in an impact on our business. A recovery in our sales could lag significantly behind a general economic recovery due to the deferrable nature and relatively significant cost of home furnishings and commercial products purchases.

### **Our future success depends on our ability to manage our global supply chain.**

We acquire raw materials, component parts and certain finished products from external suppliers, both U.S. and foreign. Many of these suppliers are dependent upon other suppliers in countries other than where they are located. This global interdependence within our supply chain is subject to delays in delivery, availability, quality and pricing (including tariffs) of products. The delivery of goods from these suppliers may be delayed by customs, labor issues, changes in political, economic and social conditions, laws and regulations. Unfavorable fluctuations in price, quality, delivery and availability of these products could negatively affect our ability to meet demands of our customers and have a negative impact on product margin.

**Competition from U.S. and foreign finished product manufacturers may adversely affect our business, operating results or financial condition.**

The furniture industry is very competitive and fragmented. We compete with U.S. and foreign manufacturers and distributors. As a result, we may not be able to maintain or raise the prices of our products in response to competitive pressures or increasing costs. Also, due to the large number of competitors and their wide range of product offerings, we may not be able to significantly differentiate our products (through styling, finish and other construction techniques) from those of our competitors. Our current and potential customers have the ability to obtain products direct from the manufacturers. As a result, we are continually subject to the risk of losing market share, which may lower our sales and earnings.

**Business failures of large dealers or a group of customers could impact our future sales and earnings.**

Our business practice has been to extend payment terms to our customers. As a result, we have a large amount of trade receivables. Although we have no customers that individually represent 10% or more of our annual net sales, business failures of a large customer or a group of customers could require us to record additional receivable reserves, which would decrease earnings. Receivables collection can be significantly impacted by economic conditions. Deterioration of the economy or a lack of economic recovery could cause further business failures of our customers, which could in turn require additional receivable reserves and lower our earnings.

**Our failure to anticipate or respond to changes in consumer tastes and fashions in a timely manner could adversely affect our business and decrease our sales and earnings.**

Furniture is a styled product and is subject to rapidly changing consumer and end-user trends and tastes and is highly fashion oriented, and if we are not able to acquire sufficient fabric variety, or if we are unable to predict or respond to changes in fashion trends, we may lose sales and have to sell excess inventory at reduced prices.

**Our success depends on our ability to recruit and retain key employees.**

Our success depends on our ability to recruit and retain key employees. If we are not successful in recruiting and retaining key employees or experience the unexpected loss of key employees, our operations may be negatively impacted.

**Future costs of complying with various laws and regulations may adversely impact future operating results.**

Our business is subject to various laws and regulations, such as the California Transparency in Supply Chains Act of 2010, Patient Protection and Affordable Care Act of 2010, the Pension Protection Act of 2006, the Lacey Act, as amended in 2008 to cover plants and trees, the Consumer Product Safety Improvement Act of 2008, the Security and Accountability for Every (SAFE) Port Act of 2006 and the Maritime Transportation Security Act of 2002 as well as many others. Partially in response to the financial markets crises and the global economic recession, regulatory initiatives have accelerated. These initiatives could have a significant impact on our operations and the cost to comply with such laws and regulations could adversely impact our financial position, results of operations and cash flows. In addition, failure to comply with such laws and regulations, even inadvertently, could produce negative consequences which could adversely impact our operations.

**Terms of collective bargaining agreements and labor disruptions could adversely impact our results of operations.**

We employ approximately 1,300 people, 250 of whom are covered by collective bargaining agreements. Terms of collective bargaining agreements that prevent us from competing effectively could adversely affect our financial condition, results of operations and cash flows. We are committed to working with those groups to resolve conflicts as they arise. However, there can be no assurance that these efforts will be successful.

**Due to our participation in multi-employer pension plans, we may have exposures under those plans that could extend beyond what our obligations would be with respect to our employees.**

We participate in, and make periodic contributions to, three multi-employer pension plans that cover 200 of our union employees. Multi-employer pension plans are managed by trustee boards comprised of participating employer and labor union representatives, and the employers participating in a multi-employer pension plan are jointly responsible for maintaining the plan's funding requirements. Based on the most recent information available to us, we believe that the present value of actuarially accrued liabilities in the multi-employer pension plans substantially exceeds the value of the assets held in trust to pay benefits. As a result of our participation, we could experience greater volatility in our overall pension funding obligations. Our obligations may be impacted by the funded status of the plans, the plans' investment performance, changes in the participant demographics, financial stability of contributing employers and changes in actuarial assumptions.

**Our future results may be affected by various legal proceedings and compliance risk, including those involving product liability, environmental, or other matters.**

We face the business risk of exposure to product liability claims in the event that the use of any of our products results in personal injury or property damage. In the event any of our products prove to be defective, we may be required to recall or redesign such products. We are also subject to various laws and regulations relating to environmental protection and the discharge of materials into the environment and we could incur substantial costs as a result of the noncompliance with, or liability for cleanup or other costs or damages under, environmental laws. See Note 11, **Litigation** within the Notes to Consolidated Financial Statements for a description of an existing environmental claim against the Company. Additionally, the Company is involved in various other kinds of commercial disputes. Given the inherent uncertainty of litigation, these various legal proceedings and compliance matters could have a material impact on our business, operating results or financial condition.

## **Item 1B. Unresolved Staff Comments**

None.

## **Item 2. Properties**

The Company owns the following facilities as of June 30, 2011:

| <b>Location</b>         | <b>Approximate<br/>Size (square feet)</b> | <b>Principal Operations</b>                       |
|-------------------------|---|---|
| Dubuque, Iowa           | 719,000                                   | Manufacturing, Distribution and Corporate Offices |
| Lancaster, Pennsylvania | 216,000                                   | Distribution                                      |
| Riverside, California   | 236,000                                   | Manufacturing and Distribution                    |
|                         | 69,000                                    | Distribution                                      |
| Dublin, Georgia         | 300,000                                   | Manufacturing                                     |
| Harrison, Arkansas      | 221,000                                   | Manufacturing                                     |
| Starkville, Mississippi | 349,000                                   | Manufacturing                                     |
| New Paris, Indiana      | 168,000                                   | Held for sale                                     |
| Huntingburg, Indiana    | 691,000                                   | Distribution                                      |

The Company leases the following facilities as of June 30, 2011:

| <b>Location</b>      | <b>Approximate<br/>Size (square feet)</b> | <b>Principal Operations</b> |
|----------------------|---|-----------------------------|
| Louisville, Kentucky | 15,000                                    | Administrative Offices      |
| Ferdinand, Indiana   | 101,000                                   | Distribution                |
| Juarez, Mexico       | 48,000                                    | Manufacturing               |

The Company's operating plants are well suited for their manufacturing purposes and have been updated and expanded from time to time as conditions warrant. Management believes there is adequate production and distribution capacity at the Company's facilities to meet present market demands.

The Company leases showrooms for displaying its products in the furniture markets in High Point, North Carolina and Las Vegas, Nevada.

**Item 3. Legal Proceedings**

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 June 30, 2011 financial statements. 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 fiscal year 2011 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.

**Item 4. Reserved**



**PART II****Item 5. Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

## Share Investment Performance

The following graph is based upon the SIC Code #251 Household Furniture Index as a peer group. It shows changes over the past five-year period in the value of \$100 invested in: (1) Flexsteel's common stock; (2) The NASDAQ Global Market; and (3) an industry peer group of the following: Bassett Furniture Ind., Chromcraft Revington Inc., Ethan Allen Interiors, Furniture Brands Intl., Hooker Furniture Corp., Kimball International, La-Z-Boy Inc., Natuzzi S.P.A., and Stanley Furniture Inc.

|            | 2006   | 2007   | 2008  | 2009  | 2010  | 2011   |
|------------|--------|--------|-------|-------|-------|--------|
| Flexsteel  | 100.00 | 115.82 | 93.64 | 73.16 | 97.88 | 132.62 |
| Peer Group | 100.00 | 87.04  | 62.64 | 31.24 | 39.52 | 48.76  |
| NASDAQ     | 100.00 | 122.72 | 93.36 | 71.02 | 79.93 | 105.32 |

The NASDAQ Global Market is the principal market on which the Company's common stock is traded.

|                | Sale Price of Common Stock * |          |             |         | Cash Dividends Per Share |             |
|----------------|------------------------------|----------|-------------|---------|--------------------------|-------------|
|                | Fiscal 2011                  |          | Fiscal 2010 |         | Fiscal 2011              | Fiscal 2010 |
|                | High                         | Low      | High        | Low     |                          |             |
| First Quarter  | \$ 15.84                     | \$ 10.08 | \$ 8.84     | \$ 6.64 | \$ 0.075                 | \$ 0.05     |
| Second Quarter | 18.75                        | 14.22    | 10.34       | 7.77    | 0.075                    | 0.05        |
| Third Quarter  | 19.69                        | 14.11    | 16.50       | 9.33    | 0.075                    | 0.05        |
| Fourth Quarter | 16.60                        | 13.80    | 15.74       | 10.75   | 0.075                    | 0.05        |

\* Reflects the market price as reported on The NASDAQ Global Market.

The Company estimates there were approximately 1,600 holders of common stock of the Company as of June 30, 2011.

There were no repurchases of the Company's common stock during the quarter ended June 30, 2011.

The payment of future cash dividends is within the discretion of our Board of Directors and will depend, among other factors, on our earnings, capital requirements and operating and financial condition.

**Item 6. Selected Financial Data**

The selected financial data presented below should be read in conjunction with the Company's consolidated financial statements and notes thereto included in Item 8 of this Annual Report on Form 10-K and with Management's Discussion and Analysis of Financial Condition and Results of Operations included in Item 7 of this Annual Report on Form 10-K. The selected consolidated statement of operations data of the Company is derived from the Company's consolidated financial statements.

**Five-Year Review**

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

|   | 2011       | 2010       | 2009       | 2008       | 2007       |
|---|------------|------------|------------|------------|------------|
| <b>SUMMARY OF OPERATIONS</b>                              |            |            |            |            |            |
| Net sales   | \$ 339,426 | \$ 326,466 | \$ 324,158 | \$ 405,655 | \$ 425,400 |
| Cost of goods sold  | 262,124    | 251,685    | 263,083    | 327,165    | 344,177    |
| Operating income (loss)                                   | 15,864     | 17,529     | (2,272)    | 7,596      | 14,699     |
| Interest and other income                                 | 343        | 361        | 661        | 469        | 1,277      |
| Interest expense  |            | 439        | 968        | 1,469      | 1,491      |
| Income (loss) before income taxes                         | 16,207     | 17,451     | (2,579)    | 6,596      | 14,484     |
| Income tax provision (benefit)                            | 5,790      | 6,650      | (1,070)    | 2,360      | 5,150      |
| Net income (loss) (1) (2) (3)                             | 10,417     | 10,801     | (1,509)    | 4,236      | 9,334      |
| Earnings (loss) per common share: (1)                     |            |            |            |            |            |
| (2) (3)   |            |            |            |            |            |
| Basic   | 1.56       | 1.63       | (0.23)     | 0.64       | 1.42       |
| Diluted   | 1.50       | 1.61       | (0.23)     | 0.64       | 1.42       |
| Cash dividends declared per common share                  | \$ 0.30    | \$ 0.20    | \$ 0.36    | \$ 0.52    | \$ 0.52    |
| <b>SELECTED DATA AS OF JUNE 30</b>                        |            |            |            |            |            |
| Average common shares outstanding:                        |            |            |            |            |            |
| Basic   | 6,693      | 6,608      | 6,576      | 6,574      | 6,568      |
| Diluted   | 6,929      | 6,697      | 6,576      | 6,611      | 6,583      |
| Total assets  | \$ 164,677 | \$ 157,670 | \$ 150,971 | \$ 179,906 | \$ 185,014 |
| Property, plant and equipment, net                        | 21,387     | 21,614     | 23,298     | 26,372     | 28,168     |
| Capital expenditures                                      | 2,573      | 1,251      | 1,203      | 1,228      | 10,839     |
| Long-term debt  |            |            |            | 20,811     | 21,336     |
| Working capital (current assets less current liabilities) | 100,683    | 90,800     | 78,416     | 100,920    | 97,902     |
| Shareholders' equity                                      | \$ 128,573 | \$ 117,612 | \$ 106,998 | \$ 112,752 | \$ 112,679 |
| <b>SELECTED RATIOS</b>                                    |            |            |            |            |            |
| Net income (loss), as a percent of sales                  | 3.1        | 3.3        | (0.5)      | 1.0        | 2.2        |
| Current ratio   | 4.6 to 1   | 3.9 to 1   | 3.2 to 1   | 3.5 to 1   | 3.2 to 1   |
| Return on ending shareholders' equity                     | 8.1        | 9.2        | (1.4)      | 3.8        | 8.3        |
| Average number of employees                               | 1,320      | 1,400      | 1,600      | 2,140      | 2,290      |

- (1) Fiscal 2011 net income and per share amounts include charges consisting of employee separation costs and inventory write down related to closing a manufacturing facility of \$1.0 million (after tax) or \$0.15 per share.
- (2) Fiscal 2009 net loss and per share amounts reflect facility consolidation and other costs (after tax) of \$1.5 million or \$0.23 per share.
- (3) Fiscal 2007 net income and per share amounts reflect the net gain (after tax) on sale of building of approximately \$2.5 million or \$0.37 per share, the gain on life insurance of \$0.6 million or \$0.08 per share and the net gain (after tax) on the sale of vacant land of approximately \$0.2 million or \$0.04 per share.

## Item 7. 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 Annual Report on Form 10-K.

#### Critical Accounting Policies

The discussion and analysis of the Company's consolidated financial statements and results of operations are based on consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America. Preparation of these consolidated financial statements requires the use of estimates and judgments that affect the reported results. The Company uses estimates based on the best information available in recording transactions and balances resulting from business operations. Estimates are used for such items as collectibility of trade accounts receivable and inventory valuation. Ultimate results may differ from these estimates under different assumptions or conditions.

Allowance for doubtful accounts – the Company establishes an allowance for doubtful accounts through review of open accounts, and historical collection and allowances amounts. The allowance for doubtful accounts is intended to reduce trade accounts receivable to the amount that reasonably approximates their net realizable value. The amount ultimately realized from trade accounts receivable may differ from the amount estimated in the consolidated financial statements based on collection experience.

Inventories – the Company values inventory at the lower of cost or market. A portion of our finished goods inventory is made to order and many of our raw material parts are interchangeable between products. Management assesses the inventory on hand and if necessary writes down the obsolete or excess inventory to market.

Revenue recognition – is upon delivery of product to our customer and when collectibility is reasonably assured. Delivery of product to our customer is evidenced through the shipping terms indicating when title and risk of loss is transferred. Our ordering process creates persuasive evidence of the sale arrangement and the sales amount is determined. The delivery of the goods to our customer completes the earnings process. Net sales consist of product sales and related delivery charge revenue, net of adjustments for returns and allowances. Shipping and handling costs are included in cost of goods sold.

#### Recently Issued Accounting Pronouncements

See Item 8. Note 1 to the Company's Consolidated Financial Statements.

#### Results of Operations

The following table has been prepared as an aid in understanding the Company's results of operations on a comparative basis for the fiscal years ended June 30, 2011, 2010 and 2009. Amounts presented are percentages of the Company's net sales.

|  | FOR THE YEARS ENDED JUNE 30, |        |        |
|--|------------------------------|--------|--------|
|  | 2011                         | 2010   | 2009   |
| Net sales                                | 100.0%                       | 100.0% | 100.0% |
| Cost of goods sold                       | (77.2)                       | (77.2) | (81.2) |
| Gross margin                             | 22.8                         | 22.8   | 18.8   |
| Selling, general and administrative      | (17.8)                       | (17.5) | (18.8) |
| Facility consolidation and other charges | (0.3)                        |        | (0.8)  |
| Operating income (loss)                  | 4.7                          | 5.3    | (0.8)  |
| Other income, net                        | 0.1                          | 0.0    | 0.0    |
| Income (loss) before income taxes        | 4.8                          | 5.3    | (0.8)  |
| Income tax (provision) benefit           | (1.7)                        | (2.0)  | 0.3    |
| Net income (loss)                        | 3.1%                         | 3.3%   | (0.5)% |

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### Fiscal 2011 Compared to Fiscal 2010

Net sales for fiscal 2011 were \$339.4 million compared to \$326.5 million in the prior fiscal year, an increase of 4%. For the fiscal year June 30, 2011, residential net sales were \$258.1 million compared to \$246.0 million for the year ended June 30, 2010, an increase of 4.9%. Commercial net sales were \$81.3 million for the year ended June 30, 2011, an increase of 1.1% from net sales of \$80.5 million for the year ended June 30, 2010.

Gross margin for the years ended June 30, 2011 and 2010 was 22.8%. The gross margin for the year ended June 30, 2011, includes the \$0.6 million inventory write-down related to facility closing offset by operational improvements.

For the fiscal years ended June 30, 2011 and 2010, selling, general and administrative expenses were 17.8% and 17.5% of net sales, respectively. The percentage increase for the year ended June 30, 2011 reflects higher legal and professional fees.

Operating income decreased by \$1.7 million in fiscal year 2011 in comparison to the prior year. During fiscal year 2011, the Company recorded pre-tax charges of \$1.6 million related to closing a manufacturing facility. Of these pre-tax charges, employee separation and other closing costs of \$1.0 million are reported as facility closing costs and an inventory write-down of \$0.6 million is reported as cost of goods sold.

The effective tax rate for the fiscal year ended June 30, 2011 was 35.7% compared to 38.1% for fiscal year 2010. The change in effective tax rate is primarily due to the change in provision for uncertain tax positions related to various state taxing jurisdictions, stock-based compensation and the benefit of the Domestic Manufacturing Deduction under Internal Revenue Code Section 199 (DMD), which provides a tax benefit on U.S. based manufacturing. The DMD tax benefit available in previous years was being phased in by statute and was therefore lower than the full DMD tax benefit for 2011.

The above factors resulted in net income for the fiscal year ended June 30, 2011 of \$10.4 million or \$1.50 per share compared to \$10.8 million or \$1.61 per share in fiscal 2010.

All earnings per share amounts are on a diluted basis.

### Fiscal 2010 Compared to Fiscal 2009

Net sales for fiscal 2010 were \$326.5 million compared to \$324.2 million in the prior fiscal year, an increase of 1%. Residential net sales were \$246.0 million compared to \$230.7 million in fiscal 2009, an increase of 7%. Commercial net sales were \$80.5 million for fiscal 2010, a decrease of 14% from net sales of \$93.5 million for fiscal 2009.

The Company's operating income improved by \$19.8 million in fiscal year 2010 in comparison to the prior year. The Company benefited from strategies implemented and actions taken during fiscal year 2009 including consolidation of manufacturing operations and workforce reductions that brought production capacity and fixed overhead more in line with current product demand. During the prior fiscal year, the Company recorded pre-tax charges of approximately \$2.6 million related to facility consolidation and employee separation costs. Company-wide employment was reduced approximately 30% through plant closures and workforce reductions and remains at these reduced levels. These factors contributed significantly to gross margin improvements and selling, general and administrative expense reductions.

Gross margin for fiscal year 2010 was 22.8% compared to 18.8% for the prior year period. The gross margin improvements for the year were greatly impacted by the operational changes discussed above. In addition, gross margin improved due to stability in material and product costs and lower ocean freight costs.

For the fiscal years ended 2010 and 2009, selling, general and administrative expenses were 17.5% and 18.8% of net sales, respectively. These percentage improvements are due to the operational changes discussed above, as well as, lower bad debt and advertising costs.

Interest expense decreased \$0.6 million to \$0.4 million for fiscal year 2010 due to lower borrowings.

The effective tax rate for the fiscal year ended June 30, 2010 was 38.1%. The effective income tax benefit rate was 41.5% for fiscal year 2009 due to losses or low level of earnings in various tax jurisdictions.

The above factors resulted in net income for the fiscal year ended June 30, 2010 of \$10.8 million or \$1.61 per share compared to a net loss of \$1.5 million or \$0.23 per share in fiscal 2009.

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All earnings per share amounts are on a diluted basis.

### Liquidity and Capital Resources

Working capital (current assets less current liabilities) at June 30, 2011 was \$100.7 million as compared to \$90.8 million at June 30, 2010. Significant changes in working capital from June 30, 2010 to June 30, 2011 included increased cash of \$9.6 million and decreased accruals of \$2.4 million offset by decreased accounts receivable of \$4.3 million. The decrease in receivables is due to timing of collections and lower shipment volume in the fourth fiscal quarter.

Net cash provided by operating activities was \$13.8 million for the fiscal year ended June 30, 2011 reflecting net income of \$10.4 million, changes in operating assets and liabilities of \$1.3 million and non-cash charges of \$4.7 million. The change in net cash provided by operating activities of \$19.1 million in fiscal year 2010 was comprised primarily of net income of \$10.8 million, changes in operating assets and liabilities of \$4.4 million and non-cash charges of \$3.9 million. Depreciation expense was \$2.7 million and \$3.0 million for the years ended June 30, 2011 and 2010, respectively.

Net cash used in investing activities was \$2.7 million in fiscal year 2011 compared to cash used by investing activities of \$1.6 million in fiscal year 2010. Net purchases of investments were \$0.3 million. Capital expenditures were \$2.6 million during fiscal year 2011.

Net cash used in financing activities was \$1.5 million in fiscal year 2011, primarily for the payment of dividends of \$1.8 million, compared to \$11.0 million in fiscal year 2010. For fiscal year 2010, the cash was used primarily to reduce borrowings by \$10.0 million and pay dividends of \$1.3 million.

The Company expects that capital expenditures will be approximately \$15.0 million in fiscal year 2012. The Company plans to invest approximately \$12 million to construct, furnish and equip a corporate office building in Dubuque, Iowa, and the balance of the expenditures on delivery and manufacturing equipment. Management believes that the Company has adequate cash and credit arrangements to meet its operating and capital requirements for fiscal year 2012, including the construction of a corporate office. 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.

At June 30, 2011, the Company has no long-term debt obligations and therefore, no contractual interest payments are included in the table below. The following table summarizes the Company's contractual obligations at June 30, 2011 and the effect these obligations are expected to have on the Company's liquidity and cash flow in the future (in thousands):

|                             | <b>Total</b> | <b>Less than<br/>1 Year</b> | <b>1 - 3<br/>Years</b> | <b>3 - 5<br/>Years</b> | <b>More than<br/>5 Years</b> |
|-----------------------------|--------------|-----------------------------|------------------------|------------------------|------------------------------|
| Operating lease obligations | \$ 4,082     | \$ 1,851                    | \$ 2,231               | \$                     | \$                           |

Contractual obligations associated with the Company's deferred compensation plans were excluded from the table above as the Company cannot predict when the events that trigger payment will occur. Total accumulated deferred compensation liabilities were \$5.3 million at June 30, 2011. At June 30, 2011 the Company had no capital lease obligations, and no purchase obligations for raw materials or finished goods. The purchase price on all open purchase orders was fixed and denominated in U.S. dollars. Additionally, the Company has excluded the tax contingency reserve from the above table, as the timing of payments, if any, cannot be reasonably estimated.

### Financing Arrangements

See Note 6 to the Consolidated Financial Statements of this Annual Report on Form 10-K.

## Outlook

We had modest gains in sales for the current year over the prior year partially due to a strong backlog entering the year. We enter fiscal year 2012 with lower backlogs and anticipate that first quarter fiscal year 2012 sales will be lower than first quarter fiscal year 2011. 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 macroeconomic environment tempers expectations of top line growth through the first part of fiscal year 2012. The commercial office industry is reporting improving order trends. While we have benefited minimally from those improvements to date, we believe we will see increased sales volume during fiscal year 2012. We anticipate increased orders for hospitality products during fiscal year 2012 resulting from pent up demand caused by delays in typical refurbishing cycles for hotel properties.

We remain committed to our 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 7A. 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 fiscal years 2011, 2010 and 2009, the Company did not have sales, purchases, or other expenses denominated in foreign currencies. As such, the Company is not directly exposed to 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 June 30, 2011, the Company does not have any debt outstanding.

### Item 8. Financial Statements and Supplementary Data

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### REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of Flexsteel Industries, Inc.

We have audited the accompanying consolidated balance sheets of Flexsteel Industries, Inc. and subsidiaries (the Company) as of June 30, 2011 and 2010, and the related consolidated statements of operations, changes in shareholders' equity, and cash flows for each of the three years in the period ended June 30, 2011. Our audits also included the financial statement schedule listed in the Index at Item 15. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Flexsteel Industries, Inc. and subsidiaries as of June 30, 2011 and 2010, and the results of their operations and their cash flows for each of the three years in the period ended June 30, 2011, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

DELOITTE & TOUCHE LLP  
Minneapolis, Minnesota  
August 19, 2011

**FLEXSTEEL INDUSTRIES, INC. AND SUBSIDIARIES****Consolidated Balance Sheets****(Amounts in thousands, except share and per share data)**

|  | JUNE 30,          |                   |
|--|-------------------|-------------------|
|  | 2011              | 2010              |
| <b>ASSETS</b>  |                   |                   |
| <b>CURRENT ASSETS:</b>   |                   |                   |
| Cash   | \$ 17,889         | \$ 8,278          |
| Trade receivables less allowance for doubtful accounts: 2011, \$2,000; 2010, \$2,020 | 31,451            | 35,748            |
| Inventories  | 73,680            | 72,637            |
| Deferred income taxes  | 3,700             | 4,050             |
| Other  | 1,633             | 1,076             |
| Total current assets   | 128,353           | 121,789           |
| <b>NONCURRENT ASSETS:</b>  |                   |                   |
| Property, plant and equipment, net   | 21,387            | 21,614            |
| Deferred income taxes  | 2,560             | 3,010             |
| Other assets   | 12,377            | 11,257            |
| <b>TOTAL</b>   | <b>\$ 164,677</b> | <b>\$ 157,670</b> |

**LIABILITIES AND SHAREHOLDERS EQUITY**

|                               |          |           |
|-------------------------------|----------|-----------|
| <b>CURRENT LIABILITIES:</b>   |          |           |
| Accounts payable trade        | \$ 9,899 | \$ 10,815 |
| <b>Accrued liabilities:</b>   |          |           |
| Payroll and related items     | 6,922    | 7,023     |
| Insurance                     | 5,645    | 6,192     |
| Other                         | 5,204    | 6,959     |
| Total current liabilities     | 27,670   | 30,989    |
| <b>LONG-TERM LIABILITIES:</b> |          |           |
| Deferred compensation         | 5,270    | 5,096     |
| Other liabilities             | 3,164    | 3,973     |
| Total liabilities             | 36,104   | 40,058    |

**COMMITMENTS AND CONTINGENCIES (Note 12)****SHAREHOLDERS EQUITY:**

|  |                   |                   |
|--|-------------------|-------------------|
| 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 2011, 6,710,612 shares; 2010, 6,645,532 shares | 6,711             | 6,646             |
| Additional paid-in capital   | 6,698             | 5,425             |
| Retained earnings  | 115,699           | 107,293           |
| Accumulated other comprehensive loss   | (535)             | (1,752)           |
| Total shareholders equity  | 128,573           | 117,612           |
| <b>TOTAL</b>   | <b>\$ 164,677</b> | <b>\$ 157,670</b> |

*See accompanying Notes to Consolidated Financial Statements.*



**FLEXSTEEL INDUSTRIES, INC. AND SUBSIDIARIES****Consolidated Statements of Operations**

(Amounts in thousands, except per share data)

|  | <b>FOR THE YEARS ENDED JUNE 30,</b> |             |             |
|--|-------------------------------------|-------------|-------------|
|  | <b>2011</b>                         | <b>2010</b> | <b>2009</b> |
| NET SALES                                  | \$ 339,426                          | \$ 326,466  | \$ 324,158  |
| COST OF GOODS SOLD                         | (262,124)                           | (251,685)   | (263,083)   |
| GROSS MARGIN                               | 77,302                              | 74,781      | 61,075      |
| SELLING, GENERAL AND ADMINISTRATIVE        | (60,422)                            | (57,252)    | (60,792)    |
| FACILITY CLOSING COSTS                     | (1,016)                             |             | (2,555)     |
| OPERATING INCOME (LOSS)                    | 15,864                              | 17,529      | (2,272)     |
| OTHER INCOME (EXPENSE):                    |                                     |             |             |
| Interest and other income                  | 343                                 | 361         | 661         |
| Interest expense                           |                                     | (439)       | (968)       |
| Total                                      | 343                                 | (78)        | (307)       |
| INCOME (LOSS) BEFORE INCOME TAXES          | 16,207                              | 17,451      | (2,579)     |
| INCOME TAX (PROVISION) BENEFIT             | (5,790)                             | (6,650)     | 1,070       |
| NET INCOME (LOSS)                          | \$ 10,417                           | \$ 10,801   | \$ (1,509)  |
| WEIGHTED AVERAGE NUMBER OF COMMON SHARES   |                                     |             |             |
| OUTSTANDING:                               |                                     |             |             |
| Basic                                      | 6,693                               | 6,608       | 6,576       |
| Diluted                                    | 6,929                               | 6,697       | 6,576       |
| EARNINGS (LOSS) PER SHARE OF COMMON STOCK: |                                     |             |             |
| Basic                                      | \$ 1.56                             | \$ 1.63     | \$ (0.23)   |
| Diluted                                    | \$ 1.50                             | \$ 1.61     | \$ (0.23)   |
| CASH DIVIDENDS DECLARED PER COMMON SHARE   | \$ 0.30                             | \$ 0.20     | \$ 0.36     |

*See accompanying Notes to Consolidated Financial Statements.*

**FLEXSTEEL INDUSTRIES, INC. AND SUBSIDIARIES**  
**Consolidated Statements of Changes in Shareholders' Equity**  
**(Amounts in thousands)**

|  | Total Par<br>Value of<br>Common<br>Shares (\$1 Par) | Additional<br>Paid-In<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>(Loss) Income | Total      |
|--|---|----------------------------------|----------------------|--|------------|
| Balance at July 1, 2008  | \$ 6,576  | \$ 4,256                         | \$ 101,692           | \$ 228   | \$ 112,752 |
| Unrealized loss on available for sale<br>investments, net of tax |   |                                  |                      | (1,022)  | (1,022)    |
| Stock-based compensation   |   | 114                              |                      |  | 114        |
| Interest rate swaps valuation adjustment,<br>net of tax          |   |                                  |                      | (1)  | (1)        |
| Minimum pension liability adjustment,<br>net of tax              |   |                                  |                      | (969)  | (969)      |
| Cash dividends declared  |   |                                  | (2,367)              |  | (2,367)    |
| Net loss   |   |                                  | (1,509)              |  | (1,509)    |
| Balance at June 30, 2009   | 6,576   | 4,370                            | 97,816               | (1,764)  | 106,998    |
| Issuance of common stock:  |   |                                  |                      |  |            |
| Stock options exercised, net                                     | 70  | 274                              |                      |  | 344        |
| Unrealized gain on available for sale<br>investments, net of tax |   |                                  |                      | 39   | 39         |
| Long-term incentive compensation                                 |   | 510                              |                      |  | 510        |
| Stock-based compensation   |   | 271                              |                      |  | 271        |
| Interest rate swaps valuation adjustment,<br>net of tax          |   |                                  |                      | 177  | 177        |
| Minimum pension liability adjustment,<br>net of tax              |   |                                  |                      | (204)  | (204)      |
| Cash dividends declared  |   |                                  | (1,324)              |  | (1,324)    |
| Net income   |   |                                  | 10,801               |  | 10,801     |
| Balance at June 30, 2010   | 6,646   | 5,425                            | 107,293              | (1,752)  | 117,612    |
| Issuance of common stock:  |   |                                  |                      |  |            |
| Stock options exercised, net                                     | 65  | 259                              |                      |  | 324        |
| Unrealized gain on available for sale<br>investments, net of tax |   |                                  |                      | 348  | 348        |
| Long-term incentive compensation                                 |   | 590                              |                      |  | 590        |
| Stock-based compensation   |   | 424                              |                      |  | 424        |
| Minimum pension liability adjustment,<br>net of tax              |   |                                  |                      | 869  | 869        |
| Cash dividends declared  |   |                                  | (2,011)              |  | (2,011)    |
| Net income   |   |                                  | 10,417               |  | 10,417     |
| Balance at June 30, 2011   | \$ 6,711  | \$ 6,698                         | \$ 115,699           | \$ (535)   | \$ 128,573 |

*See accompanying Notes to Consolidated Financial Statements.*

**FLEXSTEEL INDUSTRIES, INC. AND SUBSIDIARIES****Consolidated Statements of Cash Flows**

(Amounts in thousands)

|  | <b>FOR THE YEARS ENDED JUNE 30,</b> |             |             |
|--|-------------------------------------|-------------|-------------|
|  | <b>2011</b>                         | <b>2010</b> | <b>2009</b> |
| <b>OPERATING ACTIVITIES:</b>   |                                     |             |             |
| Net income (loss)  | \$ 10,417                           | \$ 10,801   | \$ (1,509)  |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: |                                     |             |             |
| Depreciation   | 2,690                               | 2,986       | 3,733       |
| Deferred income taxes  | 54                                  | (963)       | 449         |
| Stock-based compensation expense   | 1,014                               | 781         | 114         |
| Provision for losses on accounts receivable  | 870                                 | 920         | 1,240       |
| Other non-cash, net  | 224                                 | 218         | 14          |
| Gain on disposition of capital assets  | (185)                               | (9)         | (252)       |
| Gain on sale of investments  |                                     |             | (462)       |
| Impairment of long-lived assets  |                                     |             | 138         |
| Changes in operating assets and liabilities:   |                                     |             |             |
| Trade receivables  | 3,427                               | (5,386)     | 11,261      |
| Inventories  | (1,043)                             | 1,207       | 11,947      |
| Other current assets   | (557)                               | 2,837       | (781)       |
| Other assets   | (270)                               | (18)        | (288)       |
| Accounts payable - trade   | (841)                               | 994         | (4,849)     |
| Accrued liabilities  | (2,541)                             | 3,618       | (2,918)     |
| Other long-term liabilities  | 367                                 | 1,028       | (178)       |
| Deferred compensation  | 174                                 | 105         | (352)       |
| Net cash provided by operating activities  | 13,800                              | 19,119      | 17,307      |
| <b>INVESTING ACTIVITIES:</b>   |                                     |             |             |
| Purchases of investments   | (698)                               | (721)       | (520)       |
| Proceeds from sales of investments   | 410                                 | 359         | 1,460       |
| Proceeds from sale of capital assets   | 187                                 | 34          | 676         |
| Capital expenditures   | (2,573)                             | (1,251)     | (1,203)     |
| Net cash (used in) provided by investing activities  | (2,674)                             | (1,579)     | 413         |
| <b>FINANCING ACTIVITIES:</b>   |                                     |             |             |
| (Repayments of) proceeds from short-term borrowings, net   |                                     | (10,000)    | 4,857       |
| Repayment of long-term borrowings  |                                     |             | (20,811)    |
| Dividends paid   | (1,839)                             | (1,320)     | (2,893)     |
| Proceeds from issuance of common stock   | 324                                 | 344         |             |
| Net cash used in financing activities  | (1,515)                             | (10,976)    | (18,847)    |
| Increase (decrease) in cash and cash equivalents   | 9,611                               | 6,564       | (1,127)     |
| Cash and cash equivalents at beginning of year   | 8,278                               | 1,714       | 2,841       |
| Cash and cash equivalents at end of year   | \$ 17,889                           | \$ 8,278    | \$ 1,714    |

|   | <b>FOR THE YEARS ENDED JUNE 30,</b> |             |             |
|---|-------------------------------------|-------------|-------------|
|   | <b>2011</b>                         | <b>2010</b> | <b>2009</b> |
| <b>SUPPLEMENTAL INFORMATION CASH PAID DURING THE PERIOD</b> |                                     |             |             |
| <b>FOR:</b>   |                                     |             |             |
| Interest  | \$                                  | \$ 439      | \$ 979      |
| Income taxes paid (refunded)                                | \$ 7,647                            | \$ 3,587    | \$ (62)     |

See accompanying Notes to Consolidated Financial Statements.



**FLEXSTEEL INDUSTRIES, INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**DESCRIPTION OF BUSINESS** Flexsteel Industries, Inc. and subsidiaries (the Company) is one of the oldest and largest manufacturers, importers and marketers of residential and commercial upholstered and wooden furniture products in the United States. The Company's furniture products include a broad line of quality upholstered and wooden furniture for residential and commercial use. 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, bedroom furniture and home and commercial office furniture. The Company has one active wholly-owned subsidiary: DMI Furniture, Inc. (DMI), which is a Louisville, Kentucky-based, importer and marketer of residential and commercial office furniture with warehouses in Indiana and manufacturing sources in Asia; DMI's divisions are WYNWOOD, Homestyles and DMI Commercial Office Furniture.

**PRINCIPLES OF CONSOLIDATION** the consolidated financial statements include the accounts of Flexsteel Industries, Inc. and its wholly owned subsidiaries. All intercompany transactions and accounts have been eliminated in consolidation.

**USE OF ESTIMATES** the preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Ultimate results could differ from those estimates.

**FAIR VALUE** 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 requires 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.

**ALLOWANCE FOR DOUBTFUL ACCOUNTS** the Company establishes an allowance for doubtful accounts through review of open accounts, and historical collection and allowances amounts. The allowance for doubtful accounts is intended to reduce trade accounts receivable to the amount that reasonably approximates their net realizable value. The amount ultimately realized from trade accounts receivable may differ from the amount estimated in the consolidated financial statements based on collection experience.

**INVENTORIES** are stated at the lower of cost or market. Steel products are valued on the last-in, first-out (LIFO) method. Other inventories are valued on the first-in, first-out (FIFO) method.

**PROPERTY, PLANT AND EQUIPMENT** is stated at cost and depreciated using the straight-line method over the estimated useful lives of the assets. For internal use software, the Company's policy is to capitalize external direct costs of materials and services, directly related internal payroll and payroll-related costs, and interest costs. These costs are amortized using the straight-line method over the useful lives.

**VALUATION OF LONG LIVED ASSETS** the Company periodically reviews the carrying value of long-lived assets and estimated depreciable or amortizable lives for continued appropriateness. This review is based upon projections of anticipated future cash flows and is performed whenever events or changes in circumstances indicate that asset carrying values may not be recoverable or that the estimated depreciable or amortizable lives may have changed.

**WARRANTY** the Company estimates the amount of warranty claims on sold product that may be incurred based on current and historical data. The actual warranty expense could differ from the estimates made by the Company based on product performance.

**REVENUE RECOGNITION** is upon delivery of product to the Company's customer and collectibility is reasonably assured. The Company's ordering process creates persuasive evidence of the sale arrangement and the sales amount is determined. The delivery of the goods to the customer completes the earnings process. Net sales consist of product sales and related delivery charge revenue, net of adjustments for returns and allowances. Shipping and handling costs are included in cost of goods sold.

**ADVERTISING COSTS** are charged to selling, general and administrative expense in the periods incurred. The Company conducts no direct-response advertising programs and there are no assets related to advertising recorded on the consolidated balance sheet. Advertising expenditures, primarily shared customer advertising in which an identifiable benefit is received and national trade-advertising programs, were approximately \$4.5 million, \$4.1 million and \$4.5 million in fiscal 2011, 2010 and 2009, respectively.

**DESIGN, RESEARCH AND DEVELOPMENT COSTS** are charged to selling, general and administrative expense in the periods incurred. Expenditures for design, research and development costs were approximately \$2.2 million, \$2.0 million and \$2.7 million in fiscal 2011, 2010 and 2009, respectively.

**INSURANCE** the Company is self-insured for health care and most workers' compensation up to predetermined amounts above which third party insurance applies. The Company purchases specific stop-loss insurance for individual health care claims in excess of \$150,000 per plan year. For workers' compensation the Company retains the first \$350,000 per claim and purchases excess coverage up to the statutory limits for amounts in excess of the retention limit. Losses are accrued based upon the Company's estimates of the aggregate liability for claims incurred using certain actuarial assumptions followed in the insurance industry and based on Company experience. The Company records these insurance accruals within the accrued liabilities insurance account on the consolidated balance sheets.

**INCOME TAXES** the Company uses the liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company recognizes in its financial statements the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position.

**EARNINGS (LOSS) PER SHARE** basic earnings (loss) per share of common stock is based on the weighted-average number of common shares outstanding during each fiscal year. 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, which resulted in a dilutive effect of 236,082 shares and 89,403 shares in fiscal 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. The dilutive effect of 42,539 shares of stock options is excluded in fiscal 2009 because the net loss caused the effect of the options to be anti-dilutive. Options to purchase 424,150 shares, 716,939 shares and 759,689 shares of common stock were outstanding in fiscal 2011, 2010 and 2009, respectively, but were not included in the computation of diluted earnings per share as their exercise prices were greater than the average market price of the common shares.

**STOCK BASED COMPENSATION** the Company recognizes compensation expense related to the cost of employee services received in exchange for Company equity interests based on the award's fair value at the date of grant. See Note 8 Stock-Based Compensation.

**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. Early adoption of the new guidance is permitted and full retrospective application is required. We will be required to adopt this guidance beginning with our first quarter of fiscal 2013.

**2. INVENTORIES**

Inventories valued on a LIFO basis (steel) would have been approximately \$1.9 million and \$1.7 million higher at June 30, 2011 and 2010, respectively, if they had been valued on a FIFO basis. At June 30, 2011 and 2010 the total value of LIFO inventory was \$1.5 million and \$2.3 million, respectively. There was no material liquidation of LIFO inventory in 2011 and 2010. A comparison of inventories is as follows (in thousands):

|                                    | June 30,  |           |
|------------------------------------|-----------|-----------|
|                                    | 2011      | 2010      |
| Raw materials                      | \$ 9,235  | \$ 9,696  |
| Work in process and finished parts | 3,951     | 4,943     |
| Finished goods                     | 60,494    | 57,998    |
| Total                              | \$ 73,680 | \$ 72,637 |

**3. PROPERTY, PLANT AND EQUIPMENT**

| (in thousands)                | Estimated<br>Life (Years) | June 30,  |           |
|-------------------------------|---------------------------|-----------|-----------|
|                               |                           | 2011      | 2010      |
| Land                          |                           | \$ 3,984  | \$ 3,984  |
| Buildings and improvements    | 5-39                      | 39,851    | 40,248    |
| Machinery and equipment       | 3-7                       | 26,513    | 28,251    |
| Delivery equipment            | 3-5                       | 18,180    | 18,269    |
| Furniture and fixtures        | 3-7                       | 4,000     | 4,291     |
| Construction in progress      |                           | 366       |           |
| Total                         |                           | 92,894    | 95,043    |
| Less accumulated depreciation |                           | (71,507)  | (73,429)  |
| Net                           |                           | \$ 21,387 | \$ 21,614 |

**4. OTHER NONCURRENT ASSETS**

| (in thousands)                  | June 30,  |           |
|---------------------------------|-----------|-----------|
|                                 | 2011      | 2010      |
| Cash value of life insurance    | \$ 6,815  | \$ 6,560  |
| Rabbi Trust assets (see Note 9) | 5,533     | 4,683     |
| Other                           | 29        | 14        |
| Total                           | \$ 12,377 | \$ 11,257 |

**5. ACCRUED LIABILITIES OTHER**

| (in thousands) | June 30, |          |
|----------------|----------|----------|
|                | 2011     | 2010     |
| Dividends      | \$ 504   | \$ 332   |
| Income taxes   |          | 1,445    |
| Advertising    | 1,873    | 2,200    |
| Warranty       | 970      | 980      |
| Other          | 1,857    | 2,002    |
| Total          | \$ 5,204 | \$ 6,959 |





**6. 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 \$5.0 million of letters of credit availability. No amounts were outstanding at June 30, 2011 and 2010 under the working capital facility. 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 (loss) 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 June 30, 2011, the Company was in compliance with all of the covenants contained in the credit agreement. 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 at June 30, 2011.

An officer of the Company is a director at a bank where the Company maintains an additional unsecured \$5.0 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 June 30, 2011 and 2010. In addition, the Rabbi Trust assets (Note 9) 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.

**7. INCOME TAXES**

In determining the provision for income taxes, the Company uses an estimated annual effective tax rate that is based on the annual income (loss), statutory tax rates and permanent differences between book and tax. 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 when they occur.

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

|  | <b>June 30,</b> |             |
|--|-----------------|-------------|
|  | <b>2011</b>     | <b>2010</b> |
| Gross unrecognized tax benefits                        | \$ 970          | \$ 995      |
| Accrued Interest and penalties                         | 340             | 215         |
| Gross liabilities related to unrecognized tax benefits | \$ 1,310        | \$ 1,210    |
| Deferred tax assets                                    | \$ 330          | \$ 230      |

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (in thousands):

|  |        |
|--|--------|
| Balance at June 30, 2009                   | \$ 404 |
| Additions for tax positions of prior years | 591    |
| Balance at June 30, 2010                   | 995    |
| Reduction for tax positions of prior years | (25)   |
| Balance at June 30, 2011                   | \$ 970 |

The Company records interest and penalties related to income taxes as income tax expense in the Consolidated Statements of Operations. The total income tax provision in fiscal years 2011, 2010 and 2009 was 35.7%, 38.1% and 41.5%, respectively, of income (loss) before income taxes. 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 the next twelve months.

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The income tax provision (benefit) is as follows for the years ended June 30 (in thousands):

|                 | 2011     | 2010     | 2009       |
|-----------------|----------|----------|------------|
| Federal current | \$ 5,313 | \$ 6,630 | \$ (1,410) |
| State current   | 423      | 975      | (110)      |
| Deferred        | 54       | (955)    | 450        |
| Total           | \$ 5,790 | \$ 6,650 | \$ (1,070) |

A reconciliation between the U.S. federal statutory tax rate and the effective tax rate is as follows for the years ended June 30:

|                                    | 2011  | 2010  | 2009  |
|------------------------------------|-------|-------|-------|
| Federal statutory tax rate         | 35.0% | 35.0% | 34.0% |
| State taxes, net of federal effect | 2.6   | 3.7   | 2.7   |
| Other                              | (1.9) | (0.6) | 4.8   |
| Effective tax rate                 | 35.7% | 38.1% | 41.5% |

The effective tax rate for the fiscal year ended June 30, 2011 was 35.7% compared to 38.1% for fiscal year 2010. The change in effective tax rate is primarily due to the change in provision for uncertain tax positions related to various state taxing jurisdictions, stock-based compensation and the benefit of the Domestic Manufacturing Deduction under Section 199 (DMD), which provides a tax benefit on U.S. based manufacturing. The DMD tax benefit available in previous years was being phased in by statute and was therefore lower than the full DMD tax benefit for 2011.

Although the Company's effective full year tax expense rate has historically ranged from 35% to 39%, fiscal year ended June 30, 2009 reflects an effective income tax benefit rate of 41.5% due to losses or low level of earnings in various tax jurisdictions.

The primary components of deferred tax assets and (liabilities) are as follows (in thousands):

|                               | June 30, 2011 |           | June 30, 2010 |           |
|-------------------------------|---------------|-----------|---------------|-----------|
|                               | Current       | Long-term | Current       | Long-term |
| Accounts receivable           | \$ 740        | \$        | \$ 750        | \$        |
| Inventory                     | 1,360         |           | 1,100         |           |
| Self insurance                | 620           |           | 690           |           |
| Employee benefits             | 360           |           | 680           |           |
| Accrued expenses              | 620           |           | 830           |           |
| Property, plant and equipment |               | (760)     |               | (340)     |
| Deferred compensation         |               | 2,520     |               | 2,280     |
| Other                         |               | 800       |               | 1,070     |
| Total                         | \$ 3,700      | \$ 2,560  | \$ 4,050      | \$ 3,010  |

The Company is subject to U.S. federal income tax as well as income tax of multiple state and foreign jurisdictions. Generally, tax years 2008-2011 remain open to examination by the Internal Revenue Service or other taxing jurisdictions to which we are subject.

### 8. 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. The Committee

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selected consolidated operating results for organic net sales growth and fully-diluted earnings per share for the three-year performance periods beginning July 1, 2008 and ending on June 30, 2011, beginning July 1, 2009 and ending on June 30, 2012, and beginning July 1, 2010 and ending on June 30, 2013. The Committee has also specified that payouts, if any, for awards earned under the fiscal years 2009-2011, 2010-2012 and 2011-2013 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 June 30, 2011, the Company has recorded cash awards payable of \$0.4 million within current liabilities and \$0.7 million within long-term liabilities. As of June 30, 2010, the Company recorded cash awards payable of \$0.4 million within long-term liabilities. There have been no awards related to any of the performance periods as of June 30, 2011.

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The aggregate number of shares and cash that could be awarded to key executives if the minimum, target and maximum performance goals are met, based upon the fair market value at June 30, 2011, is as follows (in thousands):

| Performance Period |      | Minimum |        | Target |        | Maximum |        |
|--------------------|------|---------|--------|--------|--------|---------|--------|
|                    |      | Shares  | Cash   | Shares | Cash   | Shares  | Cash   |
| Fiscal Year 2009   | 2011 | 16      | \$ 152 | 45     | \$ 435 | 71      | \$ 696 |
| Fiscal Year 2010   | 2012 | 20      | \$ 198 | 58     | \$ 567 | 93      | \$ 907 |
| Fiscal Year 2011   | 2013 | 17      | \$ 162 | 48     | \$ 463 | 76      | \$ 741 |

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 (2009-2011), \$1.1 million (2010-2012) and \$1.0 million (2011-2013) based on the estimated fair values at June 30, 2011. The Company recorded compensation expense of \$1.3 million, \$0.9 million, and \$0 during fiscal years 2011, 2010 and 2009, respectively.

- (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.

In fiscal years 2011, 2010 and 2009, the Company issued options for 87,500, 165,000 and 265,000 common shares at weighted average exercise prices of \$17.23, \$8.43 and \$6.82 (the fair market value on the date of grant), respectively. The options were immediately available for exercise and may be exercised for a period of 10 years. The Company recorded compensation expense of \$0.4 million, \$0.3 million and \$0.1 million during fiscal years 2011, 2010 and 2009, respectively. The assumptions used in determining the compensation expense are discussed below.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants in fiscal 2011, 2010 and 2009, respectively; dividend yield of 1.2%, 2.4% and 7.6%, expected volatility of 33.4%, 25.3% and 21.8%; risk-free interest rate of 1.5%, 2.2% and 1.6%; and an expected life of 5, 5 and 6 years, respectively. The expected volatility and expected life are determined based on historical data.

The weighted-average grant date fair value of stock options granted during fiscal years 2011, 2010 and 2009 was \$4.84, \$1.64 and \$0.45, respectively. The cash proceeds, income tax benefit and aggregate intrinsic value of options (the amount by which the market price of the stock on the date of exercise exceeded the market price of stock on the date of grant) exercised during the fiscal years ended June 30, 2011, 2010 and 2009, respectively, were not material.

At June 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 June 30, 2011, 2010 and 2009 and the changes during the years then ended is presented below:

|  | Shares<br>(in thousands) | Weighted Average<br>Exercise Price | Aggregate<br>Intrinsic Value<br>(in thousands) |
|--|--------------------------|------------------------------------|--|
| Outstanding and exercisable at June 30, 2009 | 1,020                    | \$ 12.94                           | \$ 407   |
| Granted                                      | 165                      | 8.43                               |  |
| Exercised                                    | (99)                     | 7.52                               |  |
| Canceled                                     | (34)                     | 13.40                              |  |
| 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                                       |

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

| Range of<br>Prices | Options Outstanding<br>(in thousands) | Weighted Average<br>Remaining |                   |
|--------------------|---------------------------------------|-------------------------------|-------------------|
|                    |                                       | Life<br>(Years)               | Exercise<br>Price |
| \$ 6.81 - 10.75    | 254                                   | 8.0                           | \$ 7.71           |
| 12.35 - 12.74      | 230                                   | 6.0                           | 12.51             |
| 14.40 - 16.52      | 352                                   | 3.4                           | 15.54             |
| 17.23 - 20.27      | 210                                   | 5.3                           | 18.46             |
| \$ 6.81 - 20.27    | 1,046                                 | 5.4                           | \$ 13.56          |

### 9. BENEFIT AND RETIREMENT PLANS

The Company sponsors various defined contribution pension and retirement plans, which cover substantially all employees, other than employees covered by multi-employer pension plans under collective bargaining agreements. Total pension and retirement plan expense was \$1.7 million, \$1.5 million and \$1.8 million in fiscal years 2011, 2010 and 2009. The amounts include \$0.5 million in fiscal year 2011, \$0.4 million in fiscal 2010 and \$0.5 million in fiscal years 2009, for the Company's matching contribution to retirement savings plans. The Company's cost for pension plans is generally determined as 2% - 6% of each covered employee's wages. The Company's matching contribution for the retirement savings plans is generally 25% - 50% of employee contributions (up to 4% of employee earnings).

In addition to the above, amounts charged to pension expense and contributed to multi-employer defined benefit pension plans administered by others under collective bargaining agreements were \$0.5 million in fiscal years 2011, 2010 and 2009, respectively. The cumulative cost to exit the Company's multi-employer plans was approximately \$7.2 million on June 30, 2011.

The Company has unfunded deferred compensation plans with executive officers. The plans require various annual contributions for the participants based upon compensation levels and age. All participants are fully vested. For fiscal 2011, 2010 and 2009, the benefit obligation was increased by interest expense of \$0.2 million, \$0.2 million and \$0.1 million, service costs of \$0.4 million, \$0.3 million and \$0.2 million, and decreased by payments of \$0.4 million, \$0.4 million and \$0.6 million, respectively. At June 30, 2011 and 2010, the deferred compensation liability was \$5.3 and \$5.1 million, respectively. Funds of the deferred compensation plans 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 June 30, 2011, the Company's deferred compensation plan assets, held in the Rabbi Trust, were invested in stock and bond funds. As of June 30, 2011 and 2010, the fair market value of the assets held in the Rabbi Trust were \$5.5 million and \$4.7 million, respectively, and are classified as "Other Assets" in the Consolidated Balance Sheets. These assets are classified as Level 2 in accordance with fair value accounting as discussed in Note 1.

Under provisions of the Company's Voluntary Deferred Compensation Plan, executive officers may defer common stock awards received as part of incentive compensation plans until retirement. Under the plan, no shares were deferred during the fiscal years ended June 30, 2011 and 2010. At June 30, 2011 and 2010, 36,867 shares and 42,094 shares with an award date value of \$0.5 million and \$0.6 million, respectively, had been deferred and are being held on behalf of the employees. Under the plan, 5,227 shares and 5,228 shares were distributed in fiscal years 2011 and 2010, respectively.

As of June 30, 2011, the Company's defined benefit pension plan has no active employees of DMI and is frozen. There are a total of 444 participants in the plan. Retirement benefits are based on years of credited service multiplied by a dollar amount negotiated under collective bargaining agreements. The Company's policy is to fund normal costs and amortization of prior service costs at a level that is equal to or greater than the minimum required under the Employee Retirement Income Security Act of 1974 (ERISA). As of June 30, 2011 and 2010, the Company recorded an accrued benefit liability related to the funded status of the defined benefit pension plan recognized on the Company's consolidated balance sheets in other long-term liabilities of \$1.1 million and \$2.4 million, respectively. The accumulated benefit obligation was \$6.2 million and \$6.6 million at fiscal years ended June 30, 2011 and 2010, respectively. The Company recorded expense of \$0.2 million, \$0.2 million and \$0 during fiscal years 2011, 2010 and 2009, respectively, related to the plan.

## 10. COMPREHENSIVE INCOME (LOSS)

The components of comprehensive income (loss), net of income taxes, for the years ended June 30, were as follows (in thousands):

|   | 2011      | 2010      | 2009       |
|---|-----------|-----------|------------|
| Net income (loss)   | \$ 10,417 | \$ 10,801 | \$ (1,509) |
| Other comprehensive income (loss) (OCI):  |           |           |            |
| Change in fair value of derivatives, net of income taxes of \$0, \$(109) and \$5, respectively                      |           | 177       | (1)        |
| Change in fair value of available-for-sale, Securities, net of income taxes of \$(214), \$(24), \$631, respectively | 348       | 39        | (1,022)    |
| Change in minimum pension liability, net of income taxes of \$(532), \$124 and \$595, respectively                  | 869       | (204)     | (969)      |
| Total other comprehensive income (loss)   | 1,217     | 12        | (1,992)    |
| Total comprehensive income (loss)   | \$ 11,634 | \$ 10,813 | \$ (3,501) |

The components of accumulated other comprehensive loss, net of income taxes, are as follows (in thousands):

|   | June 30, |            |
|---|----------|------------|
|   | 2011     | 2010       |
| Available-for-sale securities                         | \$ 337   | \$ (11)    |
| Pension and other post-retirement benefit adjustments | (872)    | (1,741)    |
| Total accumulated other comprehensive loss            | \$ (535) | \$ (1,752) |

## 11. 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 June 30, 2011 financial statements. 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 fiscal year 2011 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.

## 12. COMMITMENTS AND CONTINGENCIES

**FACILITY LEASES** the Company leases certain facilities and equipment under various operating leases. These leases require the Company to pay the lease cost, operating costs, including property taxes, insurance, and maintenance. Total lease expense related to the various operating leases was approximately \$2.7 million, \$3.4 million and \$4.3 million in fiscal 2011, 2010 and 2009, respectively.

Expected future minimum commitments under operating leases as of June 30, 2011 were as follows (in thousands):

|            | <b>Fiscal Year Ended June 30,</b> |       |
|------------|-----------------------------------|-------|
| 2012       | \$                                | 1,851 |
| 2013       |                                   | 1,315 |
| 2014       |                                   | 751   |
| 2015       |                                   | 165   |
| 2016       |                                   |       |
| Thereafter | \$                                | 4,082 |

## 13. FACILITY CLOSING COSTS

During the fiscal year 2011, the Company closed a manufacturing facility and recorded pre-tax charges for facility closing costs of \$1.0 million. The charges represent employee separation costs of \$0.6 million and other closing costs of \$0.4 million and were classified as Facility Closing Costs in the Consolidated Statements of Operations and June 30, 2011. At June 30, 2011, the closure is completed and there were no facility consolidation liabilities remaining.

## 14. SEGMENT REPORTING

The Company operates in one reportable operating segment, furniture products. Our operations involve the distribution of manufactured and imported furniture for residential and commercial markets. The Company's furniture products are sold primarily throughout the United States by the Company's internal sales force and various independent representatives. The Company makes minimal export sales. No single customer accounted for more than 10% of net sales.

Set forth below is information for the past three fiscal years showing the Company's net sales attributable to each of the areas of application (in thousands):

|             | <b>FOR THE YEARS ENDED JUNE 30,</b> |             |             |
|-------------|-------------------------------------|-------------|-------------|
|             | <b>2011</b>                         | <b>2010</b> | <b>2009</b> |
| Residential | \$ 258,095                          | \$ 246,041  | \$ 230,727  |
| Commercial  | 81,331                              | 80,425      | 93,431      |
|             | \$ 339,426                          | \$ 326,466  | \$ 324,158  |

**15. SUPPLEMENTARY QUARTERLY FINANCIAL INFORMATION UNAUDITED**

| (in thousands, except per share amounts) | FOR THE QUARTER ENDED |             |           |           |
|--|-----------------------|-------------|-----------|-----------|
|  | September 30          | December 31 | March 31  | June 30   |
| <b>Fiscal 2011:</b>                      |                       |             |           |           |
| Net sales                                | \$ 87,230             | \$ 82,821   | \$ 85,175 | \$ 84,200 |
| Gross margin                             | 19,606                | 18,825      | 18,207    | 20,664    |
| Net income (1)                           | 2,343                 | 2,131       | 2,455     | 3,488     |
| Earnings per share:                      |                       |             |           |           |
| Basic                                    | \$ 0.35               | \$ 0.32     | \$ 0.37   | \$ 0.52   |
| Diluted                                  | \$ 0.34               | \$ 0.31     | \$ 0.35   | \$ 0.50   |

- (1) The quarter ended September 30, 2010 includes facility closing costs after-tax of \$1.0 million or \$0.15 per share, respectively.

| (in thousands, except per share amounts) | FOR THE QUARTER ENDED |             |           |           |
|--|-----------------------|-------------|-----------|-----------|
|  | September 30          | December 31 | March 31  | June 30   |
| <b>Fiscal 2010:</b>                      |                       |             |           |           |
| Net sales                                | \$ 75,941             | \$ 83,524   | \$ 81,451 | \$ 85,550 |
| Gross margin                             | 16,556                | 20,041      | 18,033    | 20,151    |
| Net income                               | 1,380                 | 2,964       | 2,320     | 4,137     |
| Earnings per share:                      |                       |             |           |           |
| Basic                                    | \$ 0.21               | \$ 0.45     | \$ 0.35   | \$ 0.62   |
| Diluted                                  | \$ 0.21               | \$ 0.45     | \$ 0.34   | \$ 0.61   |

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

None.

**Item 9A. Controls and Procedures**

Evaluation of disclosure controls and procedures Based on their evaluation as of the end of the period covered by this Annual Report on Form 10-K, the Company's Chief Executive Officer (CEO) and Chief Financial Officer (CFO) have concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e)) under the Securities Act of 1934, as amended) were effective as of June 30, 2011.

Changes in internal control over financial reporting During the year-ended June 30, 2011, there was no change in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934) that has materially affected, or is reasonably likely to materially affect the Company's internal control over financial reporting.

Management's Annual Report on Internal Control Over Financial Reporting Management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rules 13a-15(f) or 15d-15(f) of the Securities Exchange Act of 1934, as amended. We performed an evaluation under the supervision and with the participation of our management, including the CEO and CFO, to assess the effectiveness of the design and operation of our disclosure controls and procedures under the Exchange Act as of June 30, 2011. In making this assessment, we used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control - Integrated Framework*. Based on those criteria, management concluded that the internal control over financial reporting is effective as of June 30, 2011.

**Item 9B. Other Information**

None.





**PART III****Item 10. Directors, Executive Officers and Corporate Governance**

The information contained in the Company's 2011 definitive proxy statement to be filed with the Securities and Exchange Commission under the sections captioned Proposal 1 Election of Directors, Corporate Governance Audit and Ethics Committee, Corporate Governance Nomination Matters and Section 16(a) Beneficial Ownership Reporting Compliance is incorporated herein by reference.

The Company has adopted a code of ethics called the *Guidelines for Business Conduct* that applies to the Company's employees, including the principal executive officer, principal financial officer, principal accounting officer or controller, and persons performing similar functions. A copy of the code of ethics is posted on our website at [www.flexsteel.com](http://www.flexsteel.com).

The executive officers of the Company, their ages, positions (in each case as of June 30, 2011), and the year they were first elected or appointed an officer of the registrant, are as follows:

| <b>Name (age)</b>         | <b>Position (date first became officer)</b>  |
|---------------------------|--|
| Ronald J. Klosterman (63) | President & Chief Executive Officer (1989)   |
| James R. Richardson (67)  | Senior Vice President of Residential Sales and Marketing (1979)                      |
| Thomas D. Burkart (68)    | Senior Vice President of Vehicle Seating (1984)                                      |
| Patrick M. Crahan (63)    | Senior Vice President of Commercial Seating (1989)                                   |
| Jeffrey T. Bertsch (56)   | Senior Vice President of Corporate Services (1989)                                   |
| Donald D. Dreher (61)     | Senior Vice President (2004), President & CEO of DMI Furniture, Inc. (1986)          |
| James E. Gilbertson (61)  | Senior Vice President of Vehicle Seating (1989)                                      |
| Timothy E. Hall (53)      | Senior Vice President-Finance, Chief Financial Officer, Secretary & Treasurer (2000) |

**Item 11. Executive Compensation**

The information contained in the Company's 2011 definitive proxy statement to be filed with the Securities and Exchange Commission under the sections captioned Executive Compensation, and Director Compensation, is incorporated herein by reference.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

The information contained in the Company's 2011 definitive proxy statement to be filed with the Securities and Exchange Commission under the sections captioned Ownership of Stock By Directors and Executive Officers, Ownership of Stock by Certain Beneficial Owners, and Equity Compensation Plan Information is incorporated herein by reference.

**Item 13. Certain Relationships and Related Transactions, and Director Independence**

This information contained under the sections Interest of Management and Others in Certain Transactions and Corporate Governance Board of Directors in the Company's 2011 definitive proxy statement to be filed with the Securities and Exchange Commission is incorporated herein by reference.

**Item 14. Principal Accountant Fees and Services**

Deloitte & Touche LLP was the Company's independent registered public accounting firm in fiscal 2011. In addition to performing the audit of the Company's consolidated financial statements, Deloitte & Touche LLP provided various audit-related services during fiscal 2011.

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The Audit and Ethics Committee pre-approves both the type of services to be provided by Deloitte & Touche LLP and the estimated fees related to these services. The Audit and Ethics Committee reviewed professional services and the possible effect on Deloitte & Touche LLP's independence was considered. The Audit and Ethics Committee has considered and found the provision of services for non-audit services compatible with maintaining Deloitte & Touche LLP's independence. All services provided by Deloitte & Touche LLP during fiscal 2011 were pre-approved by the Audit and Ethics Committee.

|                | 2011       | 2010       |
|----------------|------------|------------|
| Audit Fees (1) | \$ 357,500 | \$ 376,000 |
| Tax Fees (2)   | 15,000     |            |
|                | \$ 372,500 | \$ 376,000 |

- (1) Professional fees and expenses for the audit of financial statements for fiscal 2011 and fiscal 2010 consisted of (i) audit of the Company's annual consolidated financial statements; (ii) reviews of the Company's quarterly consolidated financial statements; (iii) employee benefit plan audits; (iv) consents and other services related to Securities and Exchange Commission matters; and (v) consultations on financial accounting and reporting matters arising during the course of the audit and reviews. Fiscal 2010 also included internal control over financial reporting services.
- (2) Professional fees and expenses for tax services billed in fiscal 2011 consisted of tax planning and advice services totaling \$15,000 and consisted of (i) tax advice related to structuring certain proposed transactions; and (ii) general tax planning matters.

#### PART IV

### Item 15. Exhibits, Financial Statement Schedules, and Reports on Form 8-K

- (a) (1) Financial Statements

The financial statements of the Company are set forth above in Item 8.

- (2) Schedules

The following financial statement schedules for the years ended June 30, 2011, 2010 and 2009 are submitted herewith:

#### SCHEDULE II

#### RESERVES

*For the Years Ended June 30, 2011, 2010 and 2009*

| Description                      | Balance at<br>Beginning of<br>Year | Additions<br>Charged to<br>Income | Deductions<br>from<br>Reserves | Balance at<br>End of Year |
|----------------------------------|------------------------------------|-----------------------------------|--------------------------------|---------------------------|
| Allowance for Doubtful Accounts: |                                    |                                   |                                |                           |
| 2011                             | \$ 2,020,000                       | \$ 870,000                        | \$ (890,000)                   | \$ 2,000,000              |
| 2010                             | \$ 1,760,000                       | \$ 920,000                        | \$ (660,000)                   | \$ 2,020,000              |
| 2009                             | \$ 2,110,000                       | \$ 1,240,000                      | \$ (1,590,000)                 | \$ 1,760,000              |

Other schedules are omitted because they are not required or are not applicable or because the required information is included in the financial statements.

- (3) Exhibit No.

- 3.1 Amended and Restated Articles of Incorporation of the Company incorporated by reference to Form 8-K, as filed with the Securities and Exchange Commission on December 8, 2010.
- 3.2 Amended and Restated Bylaws of the Company incorporated by reference to Form 8-K, as filed with the Securities and Exchange Commission on December 8, 2010.
- 10.1 1995 Stock Option Plan incorporated by reference from the 1995 Flexsteel definitive proxy statement. \*



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- 10.2 1999 Stock Option Plan incorporated by reference from the 1999 Flexsteel definitive proxy statement. \*
- 10.3 Flexsteel Industries, Inc. Voluntary Deferred Compensation Plan (incorporated by reference to Exhibit No. 10.5 to the Annual Report on Form 10-K for the fiscal year ended June 30, 2001). \*
- 10.4 Flexsteel Industries, Inc. Restoration Retirement Plan (incorporated by reference to Exhibit No. 10.6 to the Annual Report on Form 10-K for the fiscal year ended June 30, 2001). \*
- 10.5 Flexsteel Industries, Inc. Senior Officer Supplemental Retirement Plan (incorporated by reference to Exhibit No. 10.7 to the Annual Report on Form 10-K for the fiscal year ended June 30, 2001). \*
- 10.6 2002 Stock Option Plan (incorporated by reference to Appendix A from the 2002 Flexsteel definitive proxy statement). \*
- 10.7 Agreement and Plan of Merger, dated as of August 12, 2003, by and among Flexsteel, Churchill Acquisition Corp. and DMI (incorporated by reference to Exhibit 99(d)(1) of Flexsteel Industries, Inc.'s Tender Offer Statement on Schedule TO filed with the Securities and Exchange Commission on August 20, 2003).
- 10.8 Flexsteel Industries, Inc. 2006 Stock Option Plan (incorporated by reference to Appendix C from the 2006 Flexsteel Proxy Statement filed with the Securities and Exchange Commission on October 31, 2006).
- 10.9 Employment Agreement dated October 1, 2006 between Flexsteel Industries, Inc. and Donald D. Dreher (incorporated by reference to Exhibit 10.1 to Flexsteel's Form 8-K filed with the Securities and Exchange Commission on October 5, 2006). \*
- 10.10 Amendment to Employment Agreement dated June 27, 2008 between Flexsteel Industries, Inc. and Donald D. Dreher (incorporated by reference to Exhibit 10.3 to Flexsteel's Form 8-K filed with the Securities and Exchange Commission on June 27, 2008).\*
- 10.11 Flexsteel Industries, Inc. 2007 Long-Term Management Compensation Plan (incorporated by reference to Appendix C to the Definitive Proxy Statement on Schedule 14A filed with the Commission on November 1, 2007). \*
- 10.12 2009 Stock Option Plan (incorporated by reference to Appendix A from the 2009 Flexsteel definitive proxy statement). \*
- 10.13 Credit Agreement dated June 7, 2011 between Flexsteel Industries, Inc. and Wells Fargo Bank, N. A. (incorporated by reference to Form 8-K filed with the Securities and Exchange Commission on June 9, 2011).
- 10.14 Revolving Line of Credit Note dated June 7, 2011 between Flexsteel Industries, Inc. and Wells Fargo Bank, N. A. (incorporated by reference to Form 8-K filed with the Securities and Exchange Commission on June 9, 2011).
- 21.1 Subsidiaries of the Company. Filed herewith.
- 23 Consent of Independent Registered Public Accounting Firm. Filed herewith.
- 31.1 Certification. Filed herewith.
- 31.2 Certification. Filed herewith.
- 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. Filed herewith.

\*Management contracts, compensatory plans and arrangements required to be filed as an exhibit to this report.

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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.

Date: August 19, 2011

FLEXSTEEL INDUSTRIES, INC.

By: */s/ Ronald J. Klosterman*  
**Ronald J. Klosterman**  
*Chief Executive Officer*  
and  
*Principal Executive Officer*

By: */s/ Timothy E. Hall*  
**Timothy E. Hall**  
*Chief Financial Officer*  
and  
*Principal Financial and Accounting Officer*

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Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

|       |                 |  |
|-------|-----------------|--|
| Date: | August 19, 2011 | <i>/s/ L. Bruce Boylen</i><br>L. Bruce Boylen<br><i>Chairman of the Board of Directors</i> |
| Date: | August 19, 2011 | <i>/s/ Ronald J. Klosterman</i><br>Ronald J. Klosterman<br><i>Director</i>                 |
| Date: | August 19, 2011 | <i>/s/ Jeffrey T. Bertsch</i><br>Jeffrey T. Bertsch<br><i>Director</i>                     |
| Date: | August 19, 2011 | <i>/s/ Mary C. Bottie</i><br>Mary C. Bottie<br><i>Director</i>                             |
| Date: | August 19, 2011 | <i>/s/ Patrick M. Crahan</i><br>Patrick M. Crahan<br><i>Director</i>                       |
| Date: | August 19, 2011 | <i>/s/ Lynn J. Davis</i><br>Lynn J. Davis<br><i>Director</i>                               |
| Date: | August 19, 2011 | <i>/s/ Robert E. Deignan</i><br>Robert E. Deignan<br><i>Director</i>                       |
| Date: | August 19, 2011 | <i>/s/ Thomas E. Holloran</i><br>Thomas E. Holloran<br><i>Director</i>                     |
| Date: | August 19, 2011 | <i>/s/ Thomas M. Levine</i><br>Thomas M. Levine<br><i>Director</i>                         |
| Date: | August 19, 2011 | <i>/s/ Robert J. Maricich</i><br>Robert J. Maricich<br><i>Director</i>                     |
| Date: | August 19, 2011 | <i>/s/ Eric S. Rangen</i><br>Eric S. Rangen<br><i>Director</i>                             |
| Date: | August 19, 2011 | <i>/s/ James R. Richardson</i><br>James R. Richardson<br><i>Director</i>                   |
| Date: | August 19, 2011 | <i>/s/ Nancy E. Uridil</i><br>Nancy E. Uridil<br><i>Director</i>                           |