

FLEXSTEEL INDUSTRIES INC  
Form 10-Q  
April 23, 2015

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D. C. 20549

**FORM 10-Q**

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

For the quarterly period ended March 31, 2015

or

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

For the transition period from                      to

Commission file number **0-5151**

FLEXSTEEL INDUSTRIES, INC.

(Exact Name of Registrant as Specified in Its Charter)

Incorporated in State of Minnesota 42-0442319

Edgar Filing: FLEXSTEEL INDUSTRIES INC - Form 10-Q

(State or other Jurisdiction of Incorporation or Organization) (I.R.S. Identification No.)

385 BELL STREET

DUBUQUE, IOWA 52001-0877

(Address of Principal Executive Offices) (Zip Code)

(563) 556-7730

(Registrant's Telephone Number, Including Area Code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

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

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

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

Yes  No

Common Stock - \$1.00 Par Value 7,441,031

Shares Outstanding as of April 15, 2015

## PART I FINANCIAL INFORMATION

## Item 1. Financial Statements

## FLEXSTEEL INDUSTRIES, INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS (UNAUDITED)

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

	March 31, 2015	June 30, 2014
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash	\$5,728	\$22,176
Trade receivables – less allowances: March 31, 2015, \$1,363; June 30, 2014, \$1,370	46,688	38,536
Inventories	108,112	97,940
Deferred income taxes	4,530	4,230
Other	3,985	2,528
Total current assets	169,043	165,410
<b>NON-CURRENT ASSETS:</b>		
Property, plant and equipment, net	64,096	31,900
Deferred income taxes	1,800	2,170
Other assets	10,214	10,733
<b>TOTAL</b>	<b>\$245,153</b>	<b>\$210,213</b>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable – trade	\$22,465	\$15,818
Accrued liabilities:		
Payroll and related items	7,572	8,452
Insurance	4,614	4,602
Other	8,307	7,894
Total current liabilities	42,958	36,766
<b>LONG-TERM LIABILITIES:</b>		
Notes payable	14,745	—
Supplemental retirement plans	2,924	3,396
Other liabilities	3,291	3,316
Total liabilities	63,918	43,478
<b>SHAREHOLDERS EQUITY:</b>		
Cumulative preferred stock – \$50 par value; authorized 60,000 shares; outstanding – none		

Edgar Filing: FLEXSTEEL INDUSTRIES INC - Form 10-Q

Undesignated (subordinated) stock – \$1 par value; authorized 700,000 shares; outstanding – none		
Common stock – \$1 par value; authorized 15,000,000 shares; outstanding March 31, 2015, 7,436,031 shares; outstanding June 30, 2014, 7,370,735 shares	7,436	7,371
Additional paid-in capital	17,391	15,386
Retained earnings	157,743	145,234
Accumulated other comprehensive loss	(1,335 )	(1,256 )
Total shareholders equity	181,235	166,735
TOTAL	\$245,153	\$210,213

See accompanying Notes to Consolidated Financial Statements (Unaudited).

## FLEXSTEEL INDUSTRIES, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(Amounts in thousands, except per share data)

	Three Months Ended		Nine Months Ended	
	March 31,		March 31,	
	2015	2014	2015	2014
NET SALES	\$122,530	\$110,532	\$345,581	\$327,414
COST OF GOODS SOLD	(92,862 )	(85,488 )	(263,300)	(252,666)
GROSS MARGIN	29,668	25,044	82,281	74,748
SELLING, GENERAL AND ADMINISTRATIVE	(18,709 )	(18,455 )	(56,691 )	(55,014 )
LITIGATION SETTLEMENT REIMBURSEMENTS (COSTS)	250	—	250	(6,250 )
OPERATING INCOME	11,209	6,589	25,840	13,484
OTHER INCOME (EXPENSE):				
Interest and other income	131	471	837	1,394
Interest expense	(54 )	—	(89 )	—
Total	77	471	748	1,394
INCOME BEFORE INCOME TAXES	11,286	7,060	26,588	14,878
INCOME TAX PROVISION	(4,330 )	(2,640 )	(10,070 )	(5,520 )
NET INCOME	\$6,956	\$4,420	\$16,518	\$9,358
WEIGHTED AVERAGE NUMBER OF COMMON SHARES				
OUTSTANDING:				
Basic	7,436	7,265	7,408	7,198
Diluted	7,702	7,675	7,681	7,546
EARNINGS PER SHARE OF COMMON STOCK:				
Basic	\$0.94	\$0.61	\$2.23	\$1.30
Diluted	\$0.90	\$0.58	\$2.15	\$1.24
DIVIDENDS DECLARED PER COMMON SHARE	\$0.18	\$0.15	\$0.54	\$0.45

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

	Three Months		Nine Months	
	Ended		Ended	
	March 31,		March 31,	
	2015	2014	2015	2014
NET INCOME	\$6,956	\$4,420	\$16,518	\$9,358
OTHER COMPREHENSIVE (LOSS) INCOME:				
	93	67	171	574

Edgar Filing: FLEXSTEEL INDUSTRIES INC - Form 10-Q

UNREALIZED GAIN ON SECURITIES IN SUPPLEMENTAL RETIREMENT PLANS				
RECLASSIFICATION OF REALIZED GAIN ON SUPPLEMENTAL RETIREMENT PLANS TO OTHER INCOME	(100 )	(431 )	(299 )	(1,238)
OTHER COMPREHENSIVE LOSS BEFORE TAXES	(7 )	(364 )	(128 )	(664 )
INCOME TAX BENEFIT RELATED TO SUPPLEMENTAL RETIREMENT PLANS LOSS	3	138	49	253
OTHER COMPREHENSIVE LOSS, NET OF TAX	(4 )	(226 )	(79 )	(411 )
COMPREHENSIVE INCOME	\$6,952	\$4,194	\$16,439	\$8,947

See accompanying Notes to Consolidated Financial Statements (Unaudited).

## FLEXSTEEL INDUSTRIES, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(Amounts in thousands)

	Nine Months Ended	
	March 31, 2015	2014
<b>OPERATING ACTIVITIES:</b>		
Net income	\$16,518	\$9,358
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	3,362	3,088
Deferred income taxes	119	(57 )
Stock-based compensation expense	1,595	1,135
Excess tax expense (benefit) from stock-based payment arrangements	41	(425 )
Provision for losses on accounts receivable	(7 )	1
Gain on disposition of capital assets	(113 )	(22 )
Changes in operating assets and liabilities:		
Trade receivables	(8,145 )	(4,319 )
Inventories	(10,172)	317
Other current assets	(1,125 )	(558 )
Other assets	(102 )	109
Accounts payable – trade	4,830	(61 )
Accrued liabilities	(1,094 )	2,134
Supplemental retirement plans	382	312
Other long-term liabilities	(24 )	573
Net cash provided by operating activities	6,065	11,585
<b>INVESTING ACTIVITIES:</b>		
Purchases of investments	(1,855 )	(4,285 )
Proceeds from sales of investments	1,526	3,957
Proceeds from sale of capital assets	124	31
Capital expenditures	(33,752)	(3,830 )
Net cash used in investing activities	(33,957)	(4,127 )
<b>FINANCING ACTIVITIES:</b>		
Proceeds from long-term notes payable, net	14,745	—
Dividends paid	(3,778 )	(3,226 )
Proceeds from issuance of common stock	518	1,714
Excess tax (expense) benefit from stock-based payment arrangements	(41 )	425
Net cash provided by (used in) financing activities	11,444	(1,087 )



(Decrease) increase in cash	(16,448)	6,371
Cash at beginning of period	22,176	10,934
Cash at end of period	\$5,728	\$17,305

SUPPLEMENTAL INFORMATION

(Amounts in thousands)

	Nine Months Ended March 31,	
	2015	2014
Income taxes paid, net	\$9,810	\$4,990
Capital expenditures in accounts payable	1,852	20
Interest paid	89	—

See accompanying Notes to Consolidated Financial Statements (Unaudited).

## FLEXSTEEL INDUSTRIES, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

FOR THE PERIOD ENDED MARCH 31, 2015

The consolidated financial statements included herein have been prepared by Flexsteel Industries, Inc. and Subsidiaries (the Company or Flexsteel), without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). The information furnished in the consolidated financial statements includes normal recurring adjustments and reflects all adjustments, which are, in the opinion of management, necessary for a fair presentation of such consolidated financial statements. Operating results for the three and nine month periods ended March 31, 2015, are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2015. Certain information and footnote disclosures normally included in the consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to make the information presented not misleading. Except to the extent updated or described below, the significant accounting policies set forth in Note 1 to the consolidated financial statements in the Company's Annual Report on Form 10-K for the year ended June 30, 2014, appropriately represent, in all material respects, the current status of accounting policies and are incorporated by reference.

DESCRIPTION OF BUSINESS – Flexsteel Industries, Inc. and Subsidiaries (the Company) was incorporated in 1929 and is one of the oldest and largest manufacturers, importers and marketers of residential and commercial upholstered and wood furniture products in the United States. Product offerings include a wide variety of upholstered and wood furniture such as sofas, loveseats, chairs, reclining and rocker-reclining chairs, swivel rockers, sofa beds, convertible bedding units, occasional tables, desks, dining tables and chairs and bedroom furniture. The Company's products are intended for use in home, office, hotel, healthcare and other commercial applications. A featured component in most of the upholstered furniture is a unique steel drop-in seat spring from which our name Flexsteel is derived. The Company distributes its products throughout the United States through the Company's sales force and various independent representatives.

## 2. INVENTORIES

The Company values inventory at the lower of cost or net realizable value. Raw steel is valued on the last-in, first-out (LIFO) method. Other inventories are valued on the first-in, first-out (FIFO) method. Inventories valued on the LIFO method would have been approximately \$1.6 million and \$1.4 million higher at March 31, 2015 and June 30, 2014, respectively, if they had been valued on the FIFO method. At March 31, 2015 and June 30, 2014, the total value of LIFO inventory was \$2.9 million and \$2.7 million, respectively. A comparison of inventories is as follows:

(in thousands)	March 31,	June 30, 2014
----------------	--------------	------------------

	2015	
Raw materials	\$11,985	\$11,603
Work in process and finished parts	5,794	5,470
Finished goods	90,333	80,867
Total	\$108,112	\$97,940

### 3. FAIR VALUE MEASUREMENTS

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

The Company maintains supplemental retirement plans, collectively referred to as the Supplemental Plan, which provides for additional annual defined contributions toward retirement benefits to certain of the Company's executive officers. Funds of the Supplemental Plan are held in a Rabbi Trust. The assets held in the Rabbi Trust are not available for general corporate purposes. The Rabbi Trust is subject to creditor claims in the event of insolvency, but otherwise must be used only for purposes of providing benefits under the plans. As of March 31, 2015, the Company's Supplemental Plan assets, held in the Rabbi Trust, were invested in stock and bond funds and are recorded in the Consolidated Balance Sheets at fair market value. As of March 31, 2015, the Supplemental Plan Assets were \$3.5 million, with \$1.0 million of the Supplemental Plan assets classified as other current assets and \$2.5 million as other assets in the Consolidated Balance Sheets. As of June 30, 2014, the Supplemental Plan assets were \$3.8 million, with \$0.7 million classified as other current assets and \$3.1 million classified as other assets in the Consolidated Balance Sheets. These assets are classified as Level 2 in accordance with fair value accounting as described above.

#### 4. CREDIT ARRANGEMENTS

The Company maintains a credit agreement which was amended on January 12, 2015, and provides working capital financing up to \$65.0 million with interest of LIBOR plus 1% (1.18% at March 31, 2015), including up to \$4.0 million of letters of credit. The amendment increased the borrowing availability from \$25.0 to \$65.0 million and added a total funded debt to EBITDA covenant of not greater than 2.5 to 1.0 on a rolling twelve-month basis. Letters of credit outstanding at March 31, 2015 totaled \$2.9 million. The Company utilized \$14.7 million of borrowing availability under the credit facility during the period, which is classified as notes payable in the Consolidated Balance Sheets, long-term liabilities, in addition to the aforementioned letters of credit, leaving borrowing availability of \$47.4 million. The credit agreement expires December 31, 2016. At March 31, 2015, the Company was in compliance with all of the financial covenants contained in the credit agreement.

An officer of the Company is a director at a bank where the Company maintains an additional unsecured \$10.0 million line of credit, with interest at prime minus 2% (1.25% at March 31, 2015), and where its routine banking transactions are processed. Effective January 1, 2015, the line of credit increased from \$8.0 to \$10.0 million. No amount was outstanding on the line of credit at March 31, 2015. This line of credit matures December 31, 2015. In addition, the Supplemental Plan assets, held in a Rabbi Trust, of \$3.5 million are administered by this bank's trust department. The Company receives no special services or pricing on the services performed by the bank due to the directorship of this officer.

Fair value of the Company's debt approximates the carrying value.

#### 5. STOCK BASED COMPENSATION

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

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

##### **Long-Term Incentive Compensation Plan**

The long-term incentive compensation plan provides for shares of common stock to be awarded to officers and key employees based on performance targets set by the Nominating and Compensation Committee of the Board of Directors (the Committee). In December 2013, the Company's shareholders approved 700,000 shares to be issued under the plan. As of March 31, 2015, no shares have been issued. The Committee selected fully-diluted earnings per share as the performance goal for the three-year performance periods July 1, 2014 – June 30, 2017 and July 1, 2013 –

June 30, 2016. Stock awards will be issued to participants as soon as practicable following the end of the performance periods subject to Committee approval and verification of results. The compensation cost related to the number of shares to be granted under each performance period is fixed on the grant date, which is the date the performance period begins.

The Company recorded expense of \$0.3 million for the quarter ended March 31, 2015. For the nine month period ended March 31, 2015, the Company has recorded expense of \$0.9 million. If the target performance goals would be achieved, the total amount of compensation cost recognized over the requisite service periods (2015-2017) and (2014-2016) would be \$1.1 million for each service period.

### **2007 Long-Term Management Incentive Plan (2007 Plan)**

The plan provides for shares of common stock and cash to be awarded to officers and key employees based on performance targets set by the Nominating and Compensation Committee of the Board of Directors (the Committee). The Company's shareholders approved 500,000 shares to be issued under the plan. Due to the adoption of the Long-Term Incentive Compensation Plan in December 2013, no additional shares can be awarded under the 2007 Plan. As of March 31, 2015, 215,082 shares have been issued. The Committee selected consolidated operating results for organic net sales growth and fully-diluted earnings per share as the performance goal for the three-year performance period beginning July 1, 2012 and ending on June 30, 2015. The Committee has also specified that payouts, if any, for awards earned in these performance periods will be 60% stock and 40% cash. Awards will be paid to participants as soon as practicable following the end of the performance periods subject to Committee approval and verification of results. The compensation cost related to the number of shares to be granted under each performance period is fixed on the grant date, which is the date the performance period begins. The compensation cost related to the cash portion of the award is re-measured based on the equity award's estimated fair value at the end of each reporting period. The accrual is based on the probable outcomes of the performance conditions. The short-term portion of the recorded cash award payable is classified within current liabilities, payroll and related items, and the long-term portion of the recorded cash award payable is classified within other long-term liabilities in the Consolidated Balance Sheets. As of March 31, 2015 and June 30, 2014, the Company has recorded cash awards payable of \$0.5 million and \$0.7 million within current liabilities and \$0.0 million and \$0.4 million within long-term liabilities, respectively. During the quarters ended March 31, 2015 and 2014, the Company recorded expense of \$0.1 million and \$0.4 million, respectively. For the nine month periods ended March 31, 2015 and 2014, the Company recorded expense of \$0.3 million and \$1.0 million, respectively.

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

### **(2) Stock Plans**

#### **Omnibus Stock Plan**

The Omnibus Stock Plan is for key employees, officers and directors and provides for the granting of incentive and nonqualified stock options, restricted stock, restricted stock units, stock appreciation rights and performance units. In December 2013, the Company's shareholders approved 700,000 shares to be issued under the plan. The options are exercisable up to 10 years from the date of grant. It is the Company's policy to issue new shares upon exercise of stock options. The Company accepts shares of the Company's common stock as payment for the exercise price of options. These shares received as payment are retired upon receipt.

At March 31, 2015, 594,900 shares were available for future grants. During the quarters ended March 31, 2015 and 2014, the Company recorded no expense related to this plan. During the nine months ended March 31, 2015 and 2014, the Company recorded expense of \$0.4 million in each period.

### **2006 and 2009 Stock Option Plans**

The stock option plans were for key employees, officers and directors and provided for granting incentive and nonqualified stock options. Under the plans, options were granted at an exercise price equal to the fair market value of the underlying common stock at the date of grant and exercisable for up to 10 years. All options were exercisable when granted. No additional options can be granted under the 2006 and 2009 stock option plans.

There were no options granted and no expense was recorded under these Plans during the three and nine months ended March 31, 2014 and March 31, 2015.

A summary of the status of the Company's stock plans as of March 31, 2015, June 30, 2014 and 2013 and the changes during the periods then ended is presented below:

	Shares (in thousands)	Weighted Average Exercise Price	Aggregate Intrinsic Value (in thousands)
Outstanding and exercisable at June 30, 2013	787	\$ 14.71	\$ 7,609
Granted	58	27.49	
Exercised	(292 )	15.55	
Canceled	(29 )	19.35	
Outstanding and exercisable at June 30, 2014	524	15.39	9,403
Granted	49	31.48	
Exercised	(46 )	16.28	
Canceled	(6 )	15.96	
Outstanding and exercisable at March 31, 2015	521	\$ 16.78	\$ 7,572

The following table summarizes information for options outstanding and exercisable at March 31, 2015:

Range of Prices	Options Outstanding and Exercisable (in thousands)	Weighted Average Remaining Exercise Life (Years)	Price
\$6.81 – 12.35	141	3.7	\$ 9.33
12.45 – 14.40	154	2.7	13.61
17.23 – 20.50	120	6.7	18.76
22.82 – 32.13	106	4.7	29.07
\$6.81 – 32.13	521	4.3	\$ 16.78

## 6. EARNINGS PER SHARE

Basic earnings per share (EPS) of common stock are based on the weighted-average number of common shares outstanding during each period. Diluted earnings per share of common stock include the dilutive effect of potential common shares outstanding. The Company's potential common shares outstanding are stock options, shares associated with the long-term management incentive compensation plan and non-vested shares. The Company calculates the dilutive effect of outstanding options using the treasury stock method. Anti-dilutive shares are not included in the computation of diluted EPS when their exercise price is greater than the average closing market price of the common



Edgar Filing: FLEXSTEEL INDUSTRIES INC - Form 10-Q

shares. The Company calculates the dilutive effect of shares related to the long-term management incentive compensation plan based on the number of shares, if any, that would be issuable if the end of the fiscal period were the end of the contingency period.

In computing EPS for the quarters and nine months ended March 2015 and 2014, net income as reported for each respective period is divided by the fully diluted weighted average number of shares outstanding:

(in thousands)	Three Months Ended March 31,		Nine Months Ended March 31,	
	2015	2014	2015	2014
Basic shares	7,436	7,265	7,408	7,198
Potential common shares:				
Stock options	237	383	252	325
Long-term incentive plan	21	20	14	16
Non-vested shares	8	7	7	7
	266	410	273	348
Diluted shares	7,702	7,675	7,681	7,546
Anti-dilutive shares	49	—	—	—

## 7. LITIGATION

Indiana Civil Litigation – During the quarter ended December 31, 2013, the Company entered into an agreement to settle the Indiana Civil Litigation for \$6.3 million. During the quarter ended March 31, 2015, the Company received \$0.3 million for recovery of litigation settlement costs from insurers. This amount is recorded as litigation settlement reimbursements (costs) in the Consolidated Statements of Income.

During the quarter ended March 31, 2015, the Company recorded \$0.2 million of legal expenses incurred pursuing insurance coverage which was offset by reimbursements of \$0.2 million from insurers. During the quarter ended March 31, 2014, the Company incurred legal defense costs of \$0.2 million which was offset by reimbursements of \$0.4 million from insurers. During the nine months ended March 31, 2015, the Company recorded \$0.4 million of legal expenses which was offset by reimbursements of \$0.2 million from insurers. During the nine month period ended March 31, 2014, the Company incurred legal defense costs of \$2.0 million which was offset by reimbursements of \$2.1 million from insurers. These expenses and reimbursements are included in selling, general and administrative (SG&A) expense in the Consolidated Statements of Income.

The Company will continue to pursue the recovery of additional defense and settlement costs from insurance carriers. Based on policy language and jurisdiction, insurance coverage is in question. The Iowa District Court dismissed litigation filed by the Company's insurance carriers in Iowa after the Iowa Court of Appeals found that Indiana law applied to the insurance policies in question and the Iowa Supreme Court denied further review. However, that dismissal has been appealed by the insurance carriers to the Iowa Supreme Court. Concurrently, coverage litigation is proceeding against the insurance carriers in Indiana.

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

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

### GENERAL:

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

CRITICAL ACCOUNTING POLICIES:

There have been no material changes to our critical accounting policies and estimates from the information provided in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, included in our 2014 annual report on Form 10-K.

Overview

The following table has been prepared as an aid in understanding the Company's results of operations on a comparative basis for the three and nine months ended March 31, 2015 and 2014. Amounts presented are percentages of the Company's net sales.

	Three Months Ended		Nine Months Ended	
	March 31,		March 31	
	2015	2014	2015	2014
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of goods sold	(75.8)	(77.3)	(76.2)	(77.2)
Gross margin	24.2	22.7	23.8	22.8
Selling, general and administrative	(15.3)	(16.7)	(16.4)	(16.8)
Litigation settlement reimbursements (costs)	0.2	—	0.1	(1.9)
Operating income	9.1	6.0	7.5	4.1
Other income and expense, net	0.1	0.4	0.2	0.4
Income before income taxes	9.2	6.4	7.7	4.5
Income tax provision	(3.5)	(2.4)	(2.9)	(1.7)
Net income	5.7%	4.0%	4.8%	2.8%

The following table compares net sales for the quarter ended March 31, (in millions):

	2015	2014	\$ Change	% Change
Residential	\$103.9	\$90.7	\$13.2	14.6%
Commercial	18.6	19.8	(1.2)	(6.1)%
Total	\$122.5	\$110.5	\$12.0	10.9%

Results of Operations for the Quarter Ended March 31, 2015 vs. 2014

Net sales for the quarter ended March 31, 2015 were \$122.5 million, a 10.9% increase compared to \$110.5 million in the prior year quarter. Residential net sales were \$103.9 million in the current quarter, an increase of 14.6% from the prior year quarter of \$90.7 million, which primarily reflects increased demand for upholstered and ready-to-assemble products. Commercial net sales were \$18.6 million in the current quarter, a decrease of 6.1% compared to \$19.8 million in the prior year quarter.

Gross margin as a percent of net sales for the quarters ended March 31, 2015 and 2014 was 24.2% and 22.7%, respectively. The improvement in gross margin in the current period is primarily driven by declining inventory write downs.

Selling, general and administrative (SG&A) expenses for the quarters ended March 31, 2015 and 2014 were 15.3% and 16.7% of net sales, respectively. The current quarter includes \$0.2 million pre-tax in legal expenses and \$0.2 million in reimbursements related to pursuing insurance coverage related to the Indiana civil litigation compared to a net reimbursement of \$0.2 million in the prior year quarter. The improvement in SG&A expenses as a percentage of net sales reflects fixed cost leverage on higher sales volume.

During the quarter ended March 31, 2015, the Company received \$0.3 million for recovery of Indiana civil litigation settlement costs from insurers. This amount is recorded as "litigation settlement reimbursements" in the Consolidated Statements of Income.

The effective income tax expense rate for the current quarter was 38.4% compared to an income tax expense rate of 37.4% in the prior year quarter. The effective rates include the federal statutory rate as well as the effect of the various state taxing jurisdictions.

The above factors resulted in net income for the quarter ended March 31, 2015 of \$7.0 million or \$0.90 per share compared to \$4.4 million or \$0.58 per share in the prior year quarter.

All earnings per share amounts are on a diluted basis.

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

	2015	2014	\$	%	
			Change	Change	
Residential	\$290.2	\$266.1	\$ 24.1	9.1	%
Commercial	55.4	61.3	(5.9 )	(9.6 )	%
Total	\$345.6	\$327.4	\$ 18.2	5.5	%

#### Results of Operations for the Nine Months Ended March 31, 2015 vs. 2014

Net sales for the nine months ended March 31, 2015 were \$345.6 million, a 5.5% increase compared to \$327.4 million in the prior year nine month period. Residential net sales were \$290.2 million in the current nine month period, an increase of 9.1% from the prior year period of \$266.1 million, which primarily reflects increased demand for upholstered and ready-to-assemble products. Commercial net sales were \$55.4 million in the current nine month period, a decrease of 9.6% compared to \$61.3 million in the prior year period.

Gross margin as a percent of net sales for the nine months ended March 31, 2015 was 23.8% of net sales compared to 22.8% of net sales in the prior year nine month period. The improvement in gross margin in the current year period is primarily driven by declining inventory write downs.

SG&A expenses for the nine month period ended March 31, 2015 were 16.4% of net sales compared to 16.8% of net sales in the prior year nine month period. The current nine month period includes \$0.4 million in legal expenses offset by \$0.2 million in reimbursements related to pursuing insurance coverage related to the Indiana civil litigation compared to the prior year period which had \$2.0 million in defense costs which were offset by reimbursements of \$2.1 million from insurers. The improvement in SG&A expenses in the current nine month period as a percentage of net sales reflects fixed cost leverage on higher sales volume.

During the quarter ended March 31, 2015, the Company received \$0.3 million for recovery of Indiana civil litigation settlement costs from insurers. During the nine months ended March 31, 2014, the Company entered into an agreement to settle the Indiana Civil Litigation for \$6.3 million. These amounts are recorded as litigation settlement reimbursements (costs) in the Consolidated Statements of Income.

The effective income tax expense rate for the current nine month period was 37.9% compared to an income tax expense rate of 37.1% in the prior year period. The effective rates include the federal statutory rate as well as the effect of the various state taxing jurisdictions.

The above factors resulted in net income for the nine months ended March 31, 2015 of \$16.5 million or \$2.15 per share compared to \$9.4 million or \$1.24 per share for the prior year period.

All earnings per share amounts are on a diluted basis.

### Liquidity and Capital Resources

During the current fiscal year, the Company utilized cash and borrowings to acquire and ready a distribution center in Edgerton, Kansas. The increase in inventory is primarily due to West coast port congestion and to support anticipated increased sales volume in upholstered and case goods product categories. The increase in accounts receivable is due to the increase in sales volume and timing of collections. The increase in accounts payable is due to timing of payments.

During the nine months ended March 31, 2015, cash decreased \$16.4 million and the Company borrowed \$14.7 million. Capital expenditures were \$33.8 million and dividend payments totaled \$3.8 million for the current nine month period.

The Company maintains a credit agreement which was amended on January 12, 2015, and provides working capital financing up to \$65.0 million with interest of LIBOR plus 1% (1.18% at March 31, 2015), including up to \$4.0 million of letters of credit. The amendment increased the borrowing availability from \$25.0 million to \$65.0 million and added a total funded debt to EBITDA covenant of not greater than 2.5 to 1.0 on a rolling twelve-month basis. Letters of credit outstanding at March 31, 2015 totaled \$2.9 million. The Company utilized \$14.7 million of borrowing availability under the credit facility during the period, which is classified as notes payable in the Consolidated Balance Sheets, long-term liabilities, in addition to the aforementioned letters of credit, leaving borrowing availability of \$47.4 million. The credit agreement expires December 31, 2016. At March 31, 2015, the Company was in compliance with all of the financial covenants contained in the credit agreement.

An officer of the Company is a director at a bank where the Company maintains an additional unsecured \$10.0 million line of credit, with interest at prime minus 2% (1.25% at March 31, 2015), and where its routine banking transactions are processed. Effective January 1, 2015, the line of credit increased from \$8.0 to \$10.0 million. No amount was outstanding on the line of credit at March 31, 2015. This line of credit matures December 31, 2015. In addition, the Supplemental Plan assets, held in a Rabbi Trust, of \$3.5 million are administered by this bank's trust department. The Company receives no special services or pricing on the services performed by the bank due to the directorship of this officer.

Net cash provided by operating activities of \$6.1 million in the nine months ended March 31, 2015 was comprised primarily of net income of \$16.5 million and increases in accounts receivable of \$8.1 million, inventory of \$10.2 million and accounts payable of \$4.8 million and depreciation of \$3.4 million. Net cash provided by operating activities in the nine months ended March 31, 2014 was \$11.6 million.

Net cash used in investing activities was \$34.0 million and \$4.1 million in the nine months ended March 31, 2015 and 2014, respectively. Capital expenditures were \$33.8 million and \$3.8 million during the nine months ended March 31, 2015 and 2014, respectively.

Net cash provided by financing activities was \$11.4 million in the nine months ended March 31, 2015 primarily from proceeds from long term borrowings of \$14.7 million partially offset by dividends paid of \$3.8 million. Net cash used in financing activities was \$1.1 million in the nine months ended March 31, 2014, due to proceeds from the issuance of stock options of \$2.1 million offset by dividends paid of \$3.2 million.

During the current nine month period, the Company has invested \$30.4 million and estimates an additional \$1.5 million will be incurred during the remainder of fiscal 2015 to complete interior construction and to equip the Edgerton distribution facility. The timing and level of additional investment required for the logistics strategy will be evaluated as the project progresses. Other operating capital expenditures are estimated to be \$1.5 million for the remainder of fiscal 2015. Management believes that the Company has adequate cash flows from operations and credit arrangements to meet its operating and capital requirements for fiscal year 2015. In the opinion of management, the Company's liquidity and credit resources provide it with the ability to react to opportunities as they arise, to pay quarterly dividends to its shareholders, and to purchase productive capital assets that enhance safety and improve operations.

#### Contractual Obligations

As of March 31, 2015, there have been no material changes to our contractual obligations presented in our Annual Report on Form 10-K for the year ended June 30, 2014.



Outlook

Due to existing strong order backlog and positive order trends the Company expects top line growth will continue during the fourth quarter of fiscal year 2015. Residential growth is expected from existing customers and products, and through expanding our product portfolio and customer base. The Company believes this growth will be led by increased demand for upholstered, ready-to-assemble, and case goods products. The Company anticipates sales of commercial products consistent with the nine month results. The Company is confident in its ability to take advantage of market opportunities.

The Company continues to progress in two multi-year initiatives, designed to enhance customer experience and increase shareholder value. Consistent with the logistics strategy, the Company began operations in April 2015, as planned, at its Edgerton distribution facility investing \$30.4 million with approximately an additional \$1.5 million to complete interior construction and equip the facility. We continue to develop our business information system requirements and have expensed \$0.6 million during the current nine month period. The timing and level of additional investment required for these initiatives will be evaluated as the projects progress. Other operating capital expenditures are estimated to be \$1.5 million for the remainder of fiscal 2015. The Company believes it has adequate working capital and borrowing capabilities to meet these requirements.

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

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

*Foreign Currency Risk* – During the three and nine months ended March 31, 2015 and 2014, the Company did not have sales and has minimal purchases and other expenses denominated in foreign currencies. As such, the Company is not exposed to material market risk associated with currency exchange rates and prices.

*Interest Rate Risk* – The Company's primary market risk exposure with regard to financial instruments is changes in interest rates.

Item 4. Controls and Procedures

(a) *Evaluation of disclosure controls and procedures.* Based on their evaluation as of the end of the period covered by this Quarterly Report on Form 10-Q, our chief executive officer and chief financial officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) were effective as of March 31, 2015.

(b) *Changes in internal control over financial reporting.* During the quarter ended March 31, 2015, there were no significant changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934, as amended) that have materially affected, or are reasonably likely to materially affect the Company's internal control over financial reporting.

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

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

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

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

PART II OTHER INFORMATION

Item 1A. Risk Factors

There has been no material change in the risk factors set forth under Part 1, Item 1A Risk Factors in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2014.

Item 6. Exhibits

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

- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema Document
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- 101.LAB XBRL Taxonomy Extension Labels Linkbase Document
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

**SIGNATURES**

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

FLEXSTEEL  
INDUSTRIES, INC.

Date: April 23, 2015      By: */s/ Timothy E. Hall*  
Timothy E. Hall  
Chief Financial  
Officer  
(Principal Financial &  
Accounting Officer)

