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 December 31, 2017

or

☐ **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the transition period from to

Commission file number **0-5151**

FLEXSTEEL INDUSTRIES, INC.
(Exact Name of Registrant as Specified in Its Charter)

Incorporated in State of Minnesota	42-0442319
(State or other Jurisdiction of 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, a smaller reporting company, or an emerging growth company. See definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act (check one).
Large accelerated filer ☐ Accelerated filer ☑ Non-accelerated filer ☐ Smaller reporting company ☐
Emerging growth company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☑

Common Stock - $1.00 Par Value	
Shares Outstanding as of January 25, 2018	7,852,420

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)

	December 31, 2017	June 30, 2017
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 17,579	$ 28,874
Investments	19,943	17,958
Trade receivables – less allowances:		
December 31, 2017, $1,125; June 30, 2017, $1,200	47,451	42,362
Inventories	110,224	99,397
Other	7,050	6,659
Total current assets	202,247	195,250
NON-CURRENT ASSETS:		
Property, plant and equipment, net	75,657	70,661
Deferred income taxes	1,025	1,740
Other assets	2,526	2,394
TOTAL	$ 281,455	$ 270,045
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable – trade	$ 18,427	$ 16,758
Accrued liabilities:		
Payroll and related items	5,627	6,255
Insurance	5,882	5,423
Other	9,416	8,759
Total current liabilities	39,352	37,195
LONG-TERM LIABILITIES:		
Other liabilities	2,308	2,090
Total liabilities	41,660	39,285
SHAREHOLDERS' EQUITY:		
Common stock – $1 par value; authorized 15,000,000 shares; outstanding December 31, 2017, 7,850,820 shares; outstanding June 30, 2017, 7,822,080 shares	7,851	7,822
Additional paid-in capital	26,249	26,186
Retained earnings	207,413	198,465
Accumulated other comprehensive loss	(1,718)	(1,713)
Total shareholders' equity	239,795	230,760
TOTAL	$ 281,455	$ 270,045

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 December 31,		Six Months Ended December 31,	
	2017	2016	2017	2016
Net sales	$ 129,392	$ 118,530	$ 249,226	$ 230,580
Cost of goods sold	(101,990)	(91,782)	(195,684)	(177,202)
Gross margin	27,402	26,748	53,542	53,378
Selling, general and administrative	(19,679)	(18,332)	(37,915)	(37,258)
Gain on sale of facility	—	—	1,835	—
Operating income	7,723	8,416	17,462	16,120
Other income	158	103	299	151
Income before income taxes	7,881	8,519	17,761	16,271
Income tax provision	(1,660)	(3,130)	(5,360)	(6,130)
Net income	$ 6,221	$ 5,389	$ 12,401	$ 10,141
Weighted average number of common shares outstanding:				
Basic	7,847	7,779	7,839	7,752
Diluted	7,937	7,906	7,931	7,865
Earnings per share of common stock:				
Basic	$ 0.79	$ 0.69	$ 1.58	$ 1.31
Diluted	$ 0.78	$ 0.68	$ 1.56	$ 1.29

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Amounts in thousands)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2017	2016	2017	2016
Net income	$ 6,221	$ 5,389	$ 12,401	$ 10,141
Other comprehensive (loss) income:				
Unrealized (loss) gain on securities	(59)	(105)	(84)	(44)
Reclassification of realized gain (loss) on securities to other income	40	84	75	104
Other comprehensive (loss) income before taxes	(19)	(21)	(9)	60
Income tax benefit (expense) related to securities gain (loss)	8	8	4	(23)
Other comprehensive (loss) gain, net of tax	(11)	(13)	(5)	37
Comprehensive income	$ 6,210	$ 5,376	$ 12,396	$ 10,178

See accompanying Notes to Consolidated Financial Statements (Unaudited).

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

	Six Months Ended December 31, 2017	Six Months Ended December 31, 2016
OPERATING ACTIVITIES:		
Net income	$ 12,401	$ 10,141
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	3,633	4,058
Deferred income taxes	720	617
Stock-based compensation expense	592	925
Excess tax benefit from share-based payments	—	(1,182)
Change in provision for losses on accounts receivable	(75)	(40)
Gain on disposition of capital assets	(1,794)	(143)
Changes in operating assets and liabilities:		
Trade receivables	(5,014)	604
Inventories	(10,827)	(10,379)
Other current assets	(391)	1,063
Other assets	—	(73)
Accounts payable – trade	1,584	6,676
Accrued liabilities	325	437
Other long-term liabilities	146	(585)
Net cash provided by operating activities	1,300	12,119
INVESTING ACTIVITIES:		
Purchases of investments	(20,099)	(1,699)
Proceeds from sales of investments	18,045	1,600
Proceeds from sale of capital assets	6,152	143
Capital expenditures	(12,902)	(6,005)
Net cash used in investing activities	(8,804)	(5,961)
FINANCING ACTIVITIES:		
Dividends paid	(3,290)	(2,941)
Proceeds from issuance of common stock	51	770
Shares issued to employees, net of shares withheld	(552)	(1,132)
Excess tax benefit from share-based payment	—	1,182
Net cash used in financing activities	(3,791)	(2,121)
(Decrease) increase in cash and cash equivalents	(11,295)	4,037
Cash and cash equivalents at beginning of period	28,874	36,780
Cash and cash equivalents at end of period	$ 17,579	$ 40,817

SUPPLEMENTAL INFORMATION
(Amounts in thousands)

	Six Months Ended December 31, 2017	Six Months Ended December 31, 2016
Income taxes paid, net	$ 5,050	$ 2,440
Capital expenditures in accounts payable	1,826	2,388

See accompanying Notes to Consolidated Financial Statements (Unaudited).

1. The consolidated financial statements included herein have been prepared by Flexsteel Industries, Inc. and Subsidiaries (the “Company” or “Flexsteel”), without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). The information furnished in the consolidated financial statements includes normal recurring adjustments and reflects all adjustments, which are, in the opinion of management, necessary for a fair presentation of such consolidated financial statements. Operating results for the three and six months ended December 31, 2017, are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2018. Certain information and footnote disclosures normally included in the consolidated financial statements prepared in accordance with generally accepted accounting principles (“GAAP”) in the United States of America 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, 2017, appropriately represent, in all material respects, the current status of accounting policies and are incorporated by reference.

   DESCRIPTION OF BUSINESS – Flexsteel was incorporated in 1929 and is one of the oldest and largest manufacturers, importers and marketers of residential and contract 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 contract 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

   A comparison of inventories is as follows:

(in thousands)	December 31, 2017	June 30, 2017
Raw materials	$ 15,151	$ 15,043
Work in process and finished parts	7,652	7,047
Finished goods	87,421	77,307
Total	$ 110,224	$ 99,397

3. FAIR VALUE MEASUREMENTS

   The Company’s cash and cash equivalents, investments, accounts receivable, other current assets, accounts payable, notes payable and certain accrued liabilities are carried at amounts which reasonably approximate their fair value due to their short-term nature. GAAP 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 purchases available-for-sale securities, U.S. Treasury bills and U.S. Agencies, which are recorded at fair market value. These securities are classified as “Investments” in the consolidated balance sheets. Unrealized gains or losses are recorded in “Accumulated other comprehensive loss” in the consolidated balance sheets. As of December 31, 2017, the fair market value and book value of the investments were $19.9 million. As of June 30, 2017, the fair market value and book value of the investments were $18.0 million. These assets are classified as Level 1 in accordance with fair value measurements described above.

4. CREDIT ARRANGEMENTS

The Company maintains an unsecured credit agreement that provides short-term working capital financing up to $10.0 million with interest of LIBOR plus 1% (2.56% at December 31, 2017), including up to $4.0 million of letters of credit. Letters of credit outstanding at December 31, 2017, totaled $1.3 million. Other than the outstanding letters of credit, the Company did not utilize borrowing availability under the credit facility, leaving borrowing availability of $8.7 million as of December 31, 2017. The credit agreement expires June 30, 2018. At December 31, 2017, the Company was in compliance with all of the financial covenants contained in the credit agreement.

The Company maintains an additional unsecured $10.0 million line of credit, with interest at prime minus 2% (2.50% at December 31, 2017). No amount was outstanding on the line of credit at December 31, 2017. This line of credit matures December 31, 2018.

5. INCOME TAXES

On December 22, 2017, the Tax Cuts and Jobs Act (“Tax Reform”), was enacted, which, among numerous provisions reduced the federal statutory corporate tax rate from 35% to 21%. Based on the provisions of the Tax Reform, the Company remeasured its deferred tax assets and liabilities and adjusted its estimated annual federal income tax rate to incorporate the lower corporate tax rate into the tax provision for the current quarter ended December 31, 2017.

During the quarter ended December 31, 2017, the Company applied the newly enacted corporate federal income tax rate, resulting in a reduction of approximately $1.3 million of the income tax provision, which is reflected in the Company’s consolidated statements of income. The revaluation of deferred tax assets and liabilities at the lower enacted corporate tax rate resulted in an immaterial change of income tax expense. The change represents a discrete item for purposes of income tax accounting. The final impact of the Tax Reform may differ due to changes in interpretations, assumptions made by the Company and the issuance of additional guidance.

6. STOCK BASED COMPENSATION

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

(1) 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 Compensation Committee of the Board of Directors (the “Committee”). The Company’s shareholders previously approved 700,000 shares to be issued under the plan. As of December 31, 2017, 92,508 shares have been issued. The Committee selected fully-diluted earnings per share as the performance goal for the three-year performance periods July 1, 2015 – June 30, 2018 (2016-2018), July 1, 2016 – June 30, 2019 (2017-2019) and July 1, 2017 – June 30, 2020 (2018-2020). The Committee also selected total shareholder return as a performance goal for the executive officers for the three-year performance periods 2017-2019 and 2018-2020. Stock awards will be issued to participants as soon as practicable following the end of the performance periods subject to verification of results and Committee approval. 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.

During the quarter and six months ended December 31, 2017, the Company recorded no plan expense. During the quarter and six months ended December 31, 2016, the Company recorded plan expense of $0.2 million and $0.4 million, respectively. If the target performance goals for 2016-2018, 2017-2019 and 2018-2020 plans would be achieved, the total amount of compensation cost recognized over the requisite performance periods would be $1.0 million, $0.9 million and $0.8 million, respectively.

(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. The Company’s shareholders previously approved 700,000 shares to be issued under the plan.

Under the plan, 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. 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. Shares received as payment are retired upon receipt. During the quarters ended December 31, 2017 and 2016, no expense was recorded related to this plan. During the six months ended December 31, 2017 and 2016, the Company issued options for 21,439 and 24,317 common shares and recorded expense of $0.2 million and $0.3 million related to stock option grants, respectively.

Under the plan, the Company issued 1,701 and 1,783 shares to non-executive directors as compensation and recorded expense of $0.1 million during the quarters ended December 31, 2017 and 2016, respectively. The Company issued 3,564 and 3,561 shares to non-executive directors as compensation and recorded expense of $0.2 million during the six months ended December 31, 2017 and 2016, respectively.

At December 31, 2017, 511,843 shares were available for future grants under the plan.

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.

A summary of the status of the Company's stock plans as of December 31, 2017, June 30, 2017 and 2016 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, 2016	270	$ 22.85	$ 4,638
Granted	24	47.45	
Exercised	(98)	20.57	
Canceled	(9)	20.51	
Outstanding and exercisable at June 30, 2017	187	27.21	5,039
Granted	21	45.21	
Exercised	(4)	12.89	
Canceled	(16)	21.26	
Outstanding and exercisable at December 31, 2017	188	$ 30.07	$ 3,159

The following table summarizes information for options outstanding and exercisable at December 31, 2017:

Range of Prices	Options Outstanding and Exercisable (in thousands)	Weighted Average: Remaining Life (years)	Weighted Average: Exercise Price
$ 6.96 – 13.90	23	3.2	$ 11.89
17.23 – 19.77	34	4.0	18.54
20.50 – 27.57	39	5.6	25.69
31.06 – 32.13	32	6.9	31.62
43.09 – 47.45	60	8.7	45.42
$ 6.96 – 47.45	188	6.2	$ 30.07

In March 2016, the FASB issued *Improvements to Employee Share-Based Payment Accounting (ASU 2016-09)*, which amends ASC Topic 718, Compensation – Stock Compensation. ASU 2016-09 simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. During the quarter ended September 30, 2017, the Company adopted ASU 2016-09. Excess tax benefits from share-based compensation are included within net income and accrued liabilities as part of operating activities in the statement of cash flows and are no longer included as a financing activity. This change is applied prospectively. The standard allows for an accounting policy election to account for forfeitures as an estimate or to account for forfeitures as they occur. The Company elected to continue estimating the number of awards expected to be forfeited and adjust the estimate on an ongoing basis.

For the quarter ended December 31, 2017, the Company recognized net tax benefits related to share-based compensation awards of $0.1 million in income tax expense in the consolidated statements of income. The impact of this change for the quarter ended December 31, 2016 would have been a reduction of income tax expense of $0.2 million.

For the six months ended December 31, 2017, the Company recognized net tax benefits related to share-based compensation awards of $0.2 million as a reduction of income tax expense in the consolidated statements of income. The impact of this change for the six months ended December 31, 2016 would have been a reduction of income tax expense of $1.2 million.

Prior to adoption, these items were recorded in "Additional paid-in capital" in the consolidated balance sheets.

7. 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 includes the dilutive effect of potential common shares outstanding. The Company's potential common shares outstanding are stock options, shares associated with the Long-Term 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 shares. The Company calculates the dilutive effect of shares related to the Long-Term Incentive Compensation Plan and non-vested shares 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 ended December 31, 2017 and 2016, net income as reported for each respective period is divided by the fully diluted weighted-average number of shares outstanding:

	Three Months Ended December 31,		Six Months Ended December 31,	
(in thousands)	2017	2016	2017	2016
Basic shares	7,847	7,779	7,839	7,752
Potential common shares:				
Stock options	73	113	75	106
Long-term incentive plan	14	12	15	5
Non-vested shares	3	2	2	2
	90	127	92	113
Diluted shares	7,937	7,906	7,931	7,865
Anti-dilutive shares	—	—	—	—

Cash dividends declared per common share were $0.22 and $0.20 for the quarters ended December 31, 2017 and 2016, respectively. Cash dividends declared per common share were $0.44 and $0.40 for the six months ended December 31, 2017 and 2016, respectively.

8. LITIGATION

<u>Environmental Matters</u> – In March 2016, the Company received a General Notice Letter for the Lane Street Groundwater Superfund Site located in Elkhart, Indiana from the United States Environmental Protection Agency (EPA). In April 2016, the EPA issued their proposed clean-up plan for groundwater pollution and request for public comment. The Company responded to the request for public comment in May 2016. The EPA issued a Record of Decision selecting a remedy in August 2016 and estimated total costs to remediate of $3.6 million. In July 2017, the EPA issued a Special Notice Letter to the Company demanding that the Company perform the remedy selected and pay for the remediation cost and past response costs of $5.5 million. On October 12, 2017, the Company, after consultation with its insurance carriers, offered an amount, fully reimbursable by insurance coverage, to the EPA to resolve this matter. On November 6, 2017, the settlement offer extended on October 12, 2017 was rejected. As of the filing of this Form 10-Q, no agreement has been reached. As a result, the current liability and current asset recorded in the September 30, 2017 financial statements is no longer recorded. Based on extensive sampling investigation performed on behalf of the Company, the Company believes that the source of the ground water contamination is upgradient of the site formerly owned by the Company. The Company continues to believe that it did not cause or contribute to the contamination.

<u>Other Proceedings</u> – 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.

9. SUBSEQUENT EVENTS

As of January 26, 2018, there were no subsequent events.

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 2017 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 quarters ended December 31, 2017 and 2016. Amounts presented are percentages of the Company's net sales.

	Three Months Ended December 31,		Six Months Ended December 31,	
	2017	2016	2017	2016
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of goods sold	(78.8)	(77.4)	(78.5)	(76.9)
Gross margin	21.2	22.6	21.5	23.1
Selling, general and administrative	(15.2)	(15.5)	(15.2)	(16.1)
Gain on sale of facility	—	—	0.7	—
Operating income	6.0	7.1	7.0	7.0
Other (expense) income, net	0.1	—	0.1	0.1
Income before income taxes	6.1	7.1	7.1	7.1
Income tax provision	(1.3)	(2.6)	(2.1)	(2.7)
Net income	4.8%	4.5%	5.0%	4.4%

Results of Operations for the Quarter Ended December 31, 2017 vs. 2016

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

	2017	2016	$ Change	% Change
Residential	$ 110.8	$ 100.5	$ 10.3	10.2%
Contract	18.6	18.0	0.6	3.3%
Total	$ 129.4	$ 118.5	$ 10.9	9.2%

Net sales were $129.4 million for the quarter ended December 31, 2017, compared to $118.5 million in the prior year quarter, an increase of 9.2%. Higher residential net sales are primarily due to increased sales volume and to a lesser extent new customers. Higher contract net sales are primarily due to increased volume offset by the previously disclosed intentional decrease in sales to certain customers.

Gross margin as a percent of net sales for the quarter ended December 31, 2017 was 21.2%, compared to 22.6% for the prior year quarter. The decrease in gross margin as a percentage of net sales is primarily due to increased labor and raw material costs partially offset by volume leverage on fixed costs.

Selling, general and administrative (SG&A) expenses were 15.2% of net sales in the current year quarter, compared to 15.5% of net sales in the prior year quarter. The current year quarter includes improved fixed cost leverage.

The effective income tax rate was 21.1% and 36.7% for the quarter ended December 31, 2017 and 2016, respectively. The current quarter rates were positively impacted by the passage of the Tax Reform resulting in a $0.16 per share increase in net income. Beginning in fiscal year 2019, the Company expects the effective tax rate to be between 25% and 27%.

The above factors resulted in net income of $6.2 million or $0.78 per share for the quarter ended December 31, 2017, compared to $5.3 million or $0.68 per share in the prior year quarter.

All earnings per share amounts are on a diluted basis.

Results of Operations for the Six Months Ended December 31, 2017 vs. 2016

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

	2017	2016	$ Change	% Change
Residential	$ 212.6	$ 194.2	$ 18.4	9.5%
Contract	36.6	36.4	0.2	0.5%
Total	$ 249.2	$ 230.6	$ 18.6	8.1%

Net sales were $249.2 million for the six months ended December 31, 2017, compared to $230.6 million in the prior year six-month period, an increase of 8.1%. Higher residential net sales are primarily due to increased volume and to a lesser extent new customers. Higher contract net sales are primarily due to increased volume offset by the previously disclosed intentional decrease in sales to certain customers.

Gross margin as a percent of net sales for the six months ended December 31, 2017 was 21.5%, compared to 23.1% for the prior year six months. The decrease in gross margin as a percentage of net sales is primarily due to increased labor and raw material costs partially offset by volume leverage on fixed costs.

Selling, general and administrative (SG&A) expenses were 15.2% of net sales in the current year six-month period, compared to 16.1% of net sales in the prior year six-month period. The current year six-month period is primarily due to improved fixed cost leverage.

During the current fiscal year, the Company completed a $6.5 million sale of a facility and recognized a pre-tax gain of $1.8 million. On an after-tax basis, the gain represents $1.3 million or $0.16 per share.

The effective income tax rate was 30.2% and 37.7% for the six months ended December 31, 2017 and 2016, respectively. The current year rates were positively impacted by the passage of the Tax Reform resulting in a $0.16 per share increase in net income. Beginning in fiscal year 2019, the Company expects the effective tax rate to be between 25% and 27%.

The above factors resulted in net income of $12.4 million or $1.56 per share for the six months ended December 31, 2017, compared to $10.1 million or $1.29 per share in the prior year period.

All earnings per share amounts are on a diluted basis.

Liquidity and Capital Resources

Working capital (current assets less current liabilities) at December 31, 2017 was $162.9 million compared to $158.1 million at June 30, 2017. Primary changes in working capital include increases of $10.8 million in inventory, $5.1 million in accounts receivable, $2.0 million in investments and $1.7 million in accounts payable and decreases in cash and cash equivalents of $11.3 million. Accounts receivable increased due to increased sales volume. Inventory increased to improve service levels.

For the six months ended December 31, 2017, capital expenditures were $12.9 million including $6.8 million invested to upgrade the business information system and $3.7 million for the construction of a new manufacturing facility. For the six months ended December 31, 2016, the Company paid $6.0 million for capital expenditures including $4.6 million invested to upgrade the business information system. Dividend payments were $3.3 million during the six months ended December 31, 2017, compared to $2.9 million during the prior year period.

The Company maintains a credit agreement which provides unsecured short-term working capital financing up to $10.0 million with interest of LIBOR plus 1% (2.56% at December 31, 2017), including up to $4.0 million of letters of credit. Letters of credit outstanding at December 31, 2017 totaled $1.3 million, leaving borrowing availability of $8.7 million. The credit agreement expires June 30, 2018.

The Company maintains an additional unsecured $10.0 million line of credit, with interest at prime minus 2% (2.50% at December 31, 2017). No amount was outstanding on the line of credit at December 31, 2017. This line of credit matures December 31, 2018.

Net cash provided by operating activities of $1.3 million for the six months ended December 31, 2017 was comprised primarily of net income of $12.4 million, depreciation of $3.6 million, and increases in inventory of $10.8 million, accounts receivable of $5.0 million and accounts payable of $1.6 million. Net cash provided by operating activities for the six months ended December 31, 2016 was $12.1 million.

Net cash used in investing activities was $8.8 million for the six months ended December 31, 2017 compared to net cash used in investing activities of $6.0 million for the six months ended December 31, 2016. Capital expenditures were $12.9 million and $6.0 million during the six months ended December 31, 2017 and 2016, respectively.

Net cash used in financing activities was $3.8 million for the six months ended December 31, 2017 primarily due to dividends paid of $3.3 million. Net cash used in financing activities was $2.1 million for the six months ended December 31, 2016 primarily due to dividends paid of $2.9 million.

Capital expenditures are estimated to be $14 million for the remainder of fiscal 2018. 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 December 31, 2017, 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, 2017.

Outlook

During the remainder of fiscal year 2018, the Company expects high single digit revenue growth including the previously disclosed intentional decrease in sales to certain contract customers. The Company expects continued inflationary pressure on certain raw materials and moderating labor cost increases. The Company is focused on gross margin expansion through targeted sales price increases, enhanced service levels and driving operational efficiencies.

For the balance of the fiscal year, the Company expects to capitalize $2 million related to business information system software and development, $10 million for the construction of a manufacturing facility and $2 million for operations. 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 contract markets, combined with a conservative approach to business. The Company will maintain its focus on a strong balance sheet through emphasis on cash flow and increasing profitability. The Company believes these core strategies are in the best interest of its shareholders.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

Foreign Currency Risk – During the three and six months ended December 31, 2017 and 2016, the Company did not have sales, but has purchases and other expenses denominated in foreign currencies. The market risk associated with currency exchange rates and prices is not considered significant.

Interest Rate Risk – The Company's primary market risk exposure with regard to financial instruments is changes in interest rates. At December 31, 2017, the Company did not have any debt outstanding.

Item 4. Controls and Procedures

(a) *Evaluation of disclosure controls and procedures.* Based on their evaluation as of the end of the period covered by this Quarterly Report on Form 10-Q, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) were effective as of December 31, 2017.

(b) *Changes in internal control over financial reporting.* During the quarter ended December 31, 2017, 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, 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, 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, 2017.

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: January 30, 2018

By: */S/ Marcus D. Hamilton*
Marcus D. Hamilton
Chief Financial Officer
(Principal Financial & Accounting Officer)

EXHIBIT 31.1

CERTIFICATION

I, Karel K. Czanderna, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Flexsteel Industries, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;

4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:

   a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) disclosed in this report any changes in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and

5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the Audit and Ethics Committee of the Registrant's Board of Directors (or persons performing the equivalent functions):

   a) all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Date: January 30, 2018

By: */S/ Karel K. Czanderna*
Karel K. Czanderna
Chief Executive Officer

EXHIBIT 31.2

CERTIFICATION

I, Marcus D. Hamilton, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Flexsteel Industries, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;

4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:

   a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) disclosed in this report any changes in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and

5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the Audit and Ethics Committee of the Registrant's Board of Directors (or persons performing the equivalent functions):

   a) all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Date: January 30, 2018

By: */S/ Marcus D. Hamilton*
Marcus D. Hamilton
Chief Financial Officer

EXHIBIT 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

In connection with the Quarterly Report of Flexsteel Industries, Inc. (the "Company") on Form 10-Q for the quarter ended December 31, 2017 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), we, Karel K. Czanderna, Chief Executive Officer, and Marcus D. Hamilton, Chief Financial Officer, of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and;

(2) The information contained in the Report fairly presents, in all material respects, the consolidated financial condition and results of operations of the Company.

Date: January 30, 2018

By: */S/ Karel K. Czanderna*
Karel K. Czanderna
Chief Executive Officer

By: */S/ Marcus D. Hamilton*
Marcus D. Hamilton
Chief Financial Officer