

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

Annual Report Pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934
For the fiscal year ended **June 30, 2006**

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)

Minnesota (State or other jurisdiction of incorporation or organization)	42-0442319 (I.R.S. Employer Identification No.)
P.O. Box 877, Dubuque, Iowa (Address of principal executive offices)	52004-0877 (Zip Code)
Registrant's telephone number, including area code:	(563) 556-7730

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

Title of each class Common Stock, \$1.00 Par Value	Name of each exchange on which registered The NASDAQ Stock Market LLC
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Securities registered pursuant to Section 12(g) of the Act:
None
(Title of Class)

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of "accelerated filer" and "large accelerated filer" in Rule 12b-2 of the Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

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

The aggregate market value of the voting stock held by non-affiliates, computed by reference to the last sales price on December 31, 2005 (which was the last business day of the registrant's most recently completed second quarter) was \$55,420,517.

Indicate the number of shares outstanding of each of the registrant's classes of Common Stock, as of the latest practicable date. **6,563,750 Common Shares (\$1 par value) as of August 18, 2006.**

DOCUMENTS INCORPORATED BY REFERENCE

In Part III, portions of the registrant's 2006 Proxy Statement to be filed with the Securities and Exchange Commission within 120 days of the Registrant's fiscal year end.

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 shareholders.

Statements, including those in this Annual Report on Form 10-K, which are not historical or current facts are “forward-looking statements” made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. There are certain important factors that could cause 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, the effectiveness of new product introductions and distribution channels, the product mix of sales, pricing pressures, the cost of raw materials and fuel, foreign currency valuations, actions by governments including taxes and tariffs, the amount of sales generated and the profit margins thereon, competition (both foreign and domestic), changes in interest rates, credit exposure with customers and general economic conditions. For further information regarding these risks and uncertainties, see the “Risk Factors” section in Item 1A of this Annual Report on Form 10-K.

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

Item 1. Business

General

Flexsteel Industries, Inc. and Subsidiaries (the “Company”) was incorporated in 1929 and is one of the oldest and largest manufacturers, importers and marketers of residential, recreational vehicle and commercial upholstered and wooden furniture products in the country. Product offerings include a wide variety of upholstered and wood furniture such as sofas, loveseats, chairs, reclining and rocker-reclining chairs, swivel rockers, sofa beds, convertible bedding units, occasional tables, desks, dining tables and chairs and bedroom furniture. The Company’s products are intended for use in home, office, motor home, travel trailer, yacht, health care and hotel applications. Featured as a basic component in most of the upholstered furniture is a unique drop-in seat spring. The Company primarily distributes its products throughout the United States through the Company’s sales force to furniture dealers, department stores, recreational vehicle manufacturers, and hospitality and healthcare facilities. The Company’s products are also sold to several national and regional chains, some of which sell on a private label basis.

The Company has two active wholly-owned subsidiaries: (1) DMI Furniture, Inc. (“DMI”), acquired effective September 17, 2003, which is a Louisville, Kentucky-based, vertically integrated manufacturer, importer and marketer of residential and commercial office furniture with manufacturing plants and warehouses in Indiana and manufacturing sources in Asia; DMI’s divisions are WYNWOOD, Homestyles and DMI Commercial Office Furniture, and (2) Desert Dreams, Inc., which owns a commercial building that it leases to an unrelated entity. A third wholly-owned subsidiary, Four Seasons, Inc. is no longer active.

The Company operates in one reportable operating segment, furniture products. Our furniture products business involves the distribution of manufactured and imported products consisting of a broad line of upholstered and wooden furniture for residential, recreational vehicle, and commercial markets. The Company’s furniture products are sold primarily throughout the United States by the Company’s internal sales force and various independent representatives. The Company makes minimal export sales. No single customer accounted for more than 10% of net sales.

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The Company’s furniture products have three primary areas of application – residential, recreational vehicle and commercial. Set forth below is information for the past three fiscal years showing the Company’s net sales attributable to each of the areas of application (in thousands):

	FOR THE YEARS ENDED JUNE 30,		
	2006	2005	2004
Residential	\$ 267,714	\$ 261,900	\$ 266,251
Recreational Vehicle	71,981	78,838	85,421
Commercial	86,713	69,284	49,550
	<u>\$ 426,408</u>	<u>\$ 410,022</u>	<u>\$ 401,222</u>

Domestic Manufacturing and Offshore Sourcing

There has been a significant change in recent years in the manner by which we acquire products to be introduced to the market. We have traditionally been a domestic furniture manufacturer, however with the changes occurring within the furniture industry our blended strategy now combines offshore sourcing of finished and component parts with our domestically manufactured products.

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

We integrate our domestic manufactured products with finished products acquired from a limited number of offshore suppliers who can meet our quality specification and scheduling requirements. We have approximately 120 employees located in Asia to inspect and coordinate the delivery of these products.

We will continue to pursue and refine this blended strategy, offering customers domestically manufactured goods, products manufactured utilizing imported component parts, and ready-to-deliver imported products. The Company believes that it best serves customers by offering products from each of these categories

to assist customers in reaching specific consumers with varied price points, styles and product categories. This blended focus on products allows the Company to provide a wide range of options to satisfy customer requirements.

Competition

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

Seasonality

The Company's business is not considered seasonal.

Foreign Operations

The Company makes minimal export sales. The Company has no foreign manufacturing operations. At June 30, 2006, the Company had approximately 120 employees located in Asia to inspect and coordinate the delivery of purchased products.

Customer Backlog

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

June 30, 2006	June 30, 2005	June 30, 2004
\$50,600 *	\$48,600	\$44,700

* This entire amount is expected to be filled in the fiscal year ending June 30, 2007.

Raw Materials

The Company's domestically manufactured furniture products utilize various types of wood, fabrics, leathers, upholstered filling material, high carbon spring steel, bar and wire stock, polyurethane and other raw materials in manufacturing furniture. While the Company purchases these materials from numerous outside suppliers, both domestic and offshore, it is not dependent upon any single source of supply. The costs of certain raw materials are increasing, but all continue to be readily available.

Industry Factors

The Company has exposure to actions by governments, including tariffs. Tariffs are a possibility on any imported or exported products. Tariff expense on wooden bedroom furniture imported from China is based on the most current rates published by the Department of Commerce. These rates are potentially subject to an administrative review process starting approximately one year after the publication date. The final amounts will depend on whether administrative reviews are performed and the outcome of those reviews, if any, on the vendors we purchase from. The Company continues to review alternate sources of product supply to minimize the impact of the tariffs. The tariffs currently apply to less than 3% of the Company's net sales.

Government Regulations

The Company is subject to various local, state, and federal laws, regulations and agencies that affect businesses generally. These include regulations promulgated by federal and state environmental and health agencies, the federal Occupational Safety and Health Administration, and laws pertaining to the hiring, treatment, safety, and discharge of employees.

Environmental Matters

The Company is subject to environmental laws and regulations, particularly with respect to industrial waste. Compliance with these laws and regulations has not had a material impact on our capital expenditures, earnings, or competitive position.

Trademarks, Patents and Licenses

The Company owns the American and Canadian improvement patents to its Flexsteel seat spring, as well as patents on convertible beds and various other recreational vehicle seating products. The Company owns certain trademarks in connection with its furniture products, which trademarks are due to expire on dates ranging from 2007 to 2018. The Company does not consider its trademarks, patents and licenses material to its business.

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

Fiscal Year Ended June 30,	Expenditures
2006	\$2,990
2005	\$2,910
2004	\$2,800

Employees

The Company had approximately 2,400 employees as of June 30, 2006, including approximately 700 employees that are covered by collective bargaining agreements and approximately 120 employees located in Asia. Management believes it has good relations with employees.

Website and Available Information

Our website is located at www.flexsteel.com. Information on the website does not constitute part of this Annual Report on Form 10-K.

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

Item 1A – Risk Factors

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

We may lose market share due to competition, which would decrease our future sales and earnings.

The furniture industry is very competitive and fragmented. We compete with many domestic and foreign manufacturers. Some competitors have greater financial resources than we have and often offer extensively advertised, well-recognized, branded products. Additionally, competition from foreign producers has increased dramatically in the past few years. These foreign producers typically have lower selling prices due to their lower operating costs. As a result, we may not be able to maintain or to raise the prices of our products in response to such competitive pressures or increasing costs. Also due to the large number of competitors and their wide range of product offerings, we may not be able to differentiate our products (through styling, finish and other construction techniques) from those of our competitors. Large retail furniture dealers have the ability to obtain offshore sourcing on their own. As a result, we are continually subject to the risk of losing market share, which may lower our sales and earnings.

We have been increasing our offshore capabilities to provide flexibility in product offerings and pricing to meet competitive pressures, but this approach may adversely affect our ability to service customers, which could lower future sales and earnings.

Our sourcing vendors may not supply goods that meet our manufacturing, quality or safety specifications, in a timely manner and at an acceptable price. We may reject goods that do not meet our specifications and either manufacture internally or find alternative vendors potentially at a higher cost, or may be forced to discontinue the product. Also, delivery of goods from our foreign sourcing vendors may be delayed for reasons not typically encountered with domestic manufacturing or sourcing, such as shipment delays caused by customs or labor issues.

Changes in political, economic, and social conditions, as well as laws and regulations in the other countries from which we source products could adversely affect us. This could make it more difficult for us to service our customers. International trade policies of the United States and countries from which we source products could adversely affect us. Imposition of trade sanctions relating to imports, taxes, import duties and other charges on imports could increase our costs and decrease our earnings. Also, significant fluctuations of foreign exchange rates against the value of the U.S. dollar could increase costs and decrease earnings.

Efforts to realign manufacturing could decrease our near-term earnings.

We continually review our domestic manufacturing operations and offshore sourcing capabilities. As a result, we sometimes realign those operations and capabilities and institute cost savings programs. These programs can include the consolidation and integration of facilities, functions, systems and procedures. We also may shift certain products to or from domestic manufacturing to offshore sourcing. These realignments and cost savings programs generally involve some initial cost and can result in decreases in our near-term earnings until we achieve the expected cost reductions. We may not always accomplish these actions as quickly as anticipated, and we may not fully achieve the expected cost reductions.

An economic downturn could adversely affect our business and decrease our sales and earnings.

Economic downturns could affect consumer-spending habits by decreasing the overall demand for home furnishings, recreational vehicles and commercial products and adversely affect our business. Interest rates, consumer confidence, housing starts, and geopolitical factors that affect many other businesses are particularly significant to us because our products are consumer goods.

If we experience fluctuations in the price, availability and quality of raw materials, this could cause manufacturing delays, adversely affect our ability to provide goods to our customers and increase our costs, any of which could decrease our sales and earnings.

We use various types of wood, fabrics, leathers, upholstered filling material, high carbon spring steel, bar and wire stock and other raw materials in manufacturing furniture. Because we are dependent on outside suppliers for all of our raw material needs, we must obtain sufficient quantities of quality raw materials from our suppliers at acceptable prices and in a timely manner. We have no long-term supply contracts with our suppliers. Unfavorable fluctuations in the price, quality and availability of these raw materials could negatively affect our ability to meet demands of our customers. The inability to meet our customers' demands could result in the loss of future sales, and we may not always be able to pass along price increases to our customers due to competitive and marketing pressures.

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

Furniture is a styled product and is subject to rapidly changing consumer trends and tastes. If we are unable to predict or respond to changes in these trends and tastes in a timely manner, we may lose sales and have to sell excess inventory at reduced prices. This could lower our sales and earnings.

If we experience the loss of large customers through business failures (or for other reasons), any extended business interruptions at our manufacturing facilities, or problems with our fabric suppliers, this could decrease our future sales and earnings.

Although we have no customers that individually represent 10% or more of our net sales, the possibility of business failures by, or the loss of, large customers could decrease our future sales and earnings. Lost sales may be difficult to replace and any amounts owed to us may become uncollectible. Our

inability to fill customer orders during an extended business interruption could negatively impact existing customer relationships resulting in market share decreases.

The financial condition of some of our domestic and foreign fabric suppliers could impede their ability to provide these products to us in a timely matter. We have seen the number of domestic suppliers declining, and a majority of those larger suppliers that remain are experiencing financial difficulties. In addition, upholstered furniture is highly fashion oriented, and if we are not able to acquire sufficient fabric variety, or if we are unable to predict or respond to changes in fashion trends, we may lose sales and have to sell excess inventory at reduced prices.

At times it is necessary we discontinue certain relationships with customers (retailers) who do not meet our growth and profitability standards. Until realignment is established, there can be a decrease in near-term sales and earnings. We continually review relationships with our customers (retailers) and future realignments are possible based upon such ongoing reviews.

We are, and may in the future be, a party to legal proceedings and claims, including those involving product liability or environmental matters, some of which claim significant damages and could adversely affect our business, operating results and financial condition.

We face the business risk of exposure to product liability claims in the event that the use of any of our products results in personal injury or property damage. In the event any of our products prove to be defective, we may be required to recall or redesign such products. We maintain insurance against product liability claims, but there can be no assurance such coverage will continue to be available on terms acceptable to us or that such coverage will be adequate for liabilities actually incurred.

Given the inherent uncertainty of litigation, we can offer no assurance future litigation will not have a material adverse impact on our business, operating results or financial condition. We are also subject to various laws and regulations relating to environmental protection and the discharge of materials into the environment and we could incur substantial costs as a result of the noncompliance with, or liability for cleanup or other costs or damages under, environmental laws.

We may engage in acquisitions and investments in businesses, which could dilute our earnings per share and decrease the value of our common stock.

As part of our business strategy, we may make acquisitions and investments in businesses that offer complementary products. Risks commonly encountered in acquisitions include the possibility that we pay more than the acquired company or assets are worth, the difficulty of assimilating the operations and personnel of the acquired business, the potential disruption of our ongoing business and the distraction of our management from ongoing business. Consideration paid for future acquisitions could be in the form of cash or stock or a combination thereof. Dilution to existing stockholders and to earnings per share may result in connection with any such future acquisition.

We may experience impairment of our long-lived assets, which would decrease our earnings and net worth.

Accounting rules require that long-lived assets be tested for impairment at least annually. We have substantial long-lived assets, consisting primarily of property, plant and equipment, which based upon the outcome of the annual test, could result in the write-down of all or a portion of these assets.

Restrictive covenants in our existing credit facilities may restrict our ability to pursue our business strategies.

Our existing credit facilities limit our ability, among other things, to: incur additional indebtedness; make investments; consolidate, merge, sell or otherwise dispose of all or substantially all of our assets; and create liens.

The restrictions contained in our credit facilities could: limit our ability to plan for or react to market conditions or meet capital needs or otherwise restrict our activities or business plans; and adversely affect our ability to finance our operations, strategic acquisitions, investments or alliances or other capital needs or to engage in other business activities that would be in our best interest.

A breach of any of these restrictive covenants or our inability to comply with the required financial ratios could result in a default under our credit facilities. If a default occurs, the lender under our credit agreement may elect to declare all borrowings outstanding, together with accrued interest and other fees, to be immediately due and payable which would result in an event of default under our outstanding notes. The lender will also have the right in these circumstances to terminate any commitments they have to provide further borrowings. If we are unable to repay outstanding borrowings when due, the lender will also have the right to initiate collection proceedings against us. If the indebtedness under our credit facilities were to be accelerated, we cannot assure you that our assets would be sufficient to repay in full the indebtedness under the credit facilities and our other indebtedness.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

The Company owns the following facilities:

Location	Approximate Size (square feet)	Principal Operations
Dubuque, Iowa	853,000	Upholstered Furniture – Recreational Vehicle – Metal Working and Corporate Offices
Lancaster, Pennsylvania	216,000	Upholstered Furniture
Riverside, California	236,000	Upholstered Furniture – Recreational Vehicle
Dublin, Georgia	300,000	Upholstered Furniture
Harrison, Arkansas	221,000	Upholstered Furniture – Woodworking
Starkville, Mississippi	349,000	Upholstered Furniture – Woodworking

New Paris, Indiana	168,000	Recreational Vehicle – Metal Working
Huntingburg, Indiana	612,000	Case Goods Production and Assembly – Woodworking – Warehouse
Ferdinand, Indiana	47,000	Woodworking

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The Company leases the following facilities:

Location	Approximate Size (square feet)	Principal Operations
Riverside, California	30,000	Warehouse and Distribution
Vancouver, Washington	16,000	Warehouse and Distribution
Louisville, Kentucky	15,000	Corporate Offices
Ferdinand, Indiana	57,000	Warehouse and Distribution
Jasper, Indiana	123,000	Warehouse and Distribution

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

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

One of the Company's wholly-owned subsidiaries, Desert Dreams, Inc., owns a commercial building in Phoenix, Arizona, that it leases to an unrelated entity.

Item 3. Legal Proceedings

From time to time, the Company is subject to various 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 proceedings that are currently pending, individually or in the aggregate, to be material to its business or likely to result in a material adverse effect on its consolidated operating results, financial condition, or cash flows.

Item 4. Submission of Matters to a Vote of Security Holders

During the quarter ended June 30, 2006 no matter was submitted to a vote of security holders.

PART II

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

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

	Sale Price of Common Stock *				Cash Dividends Per Share	
	Fiscal 2006		Fiscal 2005		Fiscal 2006	Fiscal 2005
	High	Low	High	Low		
First Quarter	\$ 15.51	\$ 14.00	\$ 23.50	\$ 17.54	\$ 0.13	\$ 0.13
Second Quarter	15.47	13.56	18.50	16.00	0.13	0.13
Third Quarter	14.84	13.67	17.99	15.02	0.13	0.13
Fourth Quarter	14.10	12.01	16.78	13.65	0.13	0.13

* Reflects the market price as quoted by the National Association of Securities Dealers, Inc. or reported by The NASDAQ Global Market.

The Company estimates there were approximately 1,700 holders of common stock of the Company as of June 30, 2006.

There were no repurchases of the Company's common stock during the quarter ended June 30, 2006.

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Item 6. Selected Financial Data

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

Five-Year Review

(Amounts in thousands, except per share data)

FOR THE YEARS ENDED JUNE 30,

	2006	2005	2004 (4)	2003	2002
SUMMARY OF OPERATIONS					
Net sales	\$ 426,408	\$ 410,023	\$ 401,222	\$ 291,977	\$ 279,671
Cost of goods sold	345,068	333,170	318,047	226,438	218,151
Operating income	8,561	9,066	16,602	13,284	8,129
Interest and other income	775	628	977	1,084	1,052
Interest expense	1,557	990	839	127	22
Income before income taxes	7,778	8,704	16,740	14,241	9,160
Provision for income taxes (3)	3,060	2,660	6,610	5,950	3,500
Net income (1) (2) (5)	4,718	6,044	10,130	8,291	5,660
Earnings per common share: (1) (2) (5)					
Basic	0.72	0.93	1.57	1.33	0.93
Diluted	0.72	0.92	1.55	1.30	0.92
Cash dividends declared per common share	\$ 0.52	\$ 0.52	\$ 0.52	\$ 0.52	\$ 0.52
STATISTICAL SUMMARY					
Average common shares outstanding:					
Basic	6,558	6,531	6,440	6,255	6,095
Diluted	6,577	6,601	6,530	6,367	6,159
Total assets	\$ 183,326	\$ 166,658	\$ 169,519	\$ 120,700	\$ 119,159
Property, plant and equipment, net	24,158	26,141	30,327	20,378	20,558
Capital expenditures	3,411	3,347	6,030	5,100	1,100
Long-term debt	21,846	12,800	17,583	—	—
Working capital (current assets less current liabilities)	96,987	85,388	83,352	67,666	62,228
Shareholders' equity	\$ 107,502	\$ 104,798	\$ 101,612	\$ 93,753	\$ 87,717
SELECTED RATIOS					
Net income as percent of sales	1.1%	1.5%	2.5%	2.8%	2.0%
Current ratio	3.0 to 1	3.0 to 1	2.9 to 1	4.0 to 1	3.3 to 1
Return on ending shareholders' equity	4.4%	5.8%	10.0%	8.8%	6.5%
Return on beginning shareholders' equity	4.5%	6.0%	10.8%	9.5%	6.7%
Average number of employees	2,400	2,460	2,610	2,320	2,260

- (1) Fiscal 2006 net income and per share amounts reflect the recording of stock-based compensation expense, as required by Statement of Financial Accounting Standard No. 123 (Revised), of \$0.4 million (after tax) or \$0.06 per share.
- (2) Fiscal 2005 net income and per share amounts reflect a net gain (after tax) on the sale of facilities of approximately \$0.5 million or \$0.08 per share.
- (3) During the fiscal year ended June 30, 2005, an examination by the Internal Revenue Service of the Company's federal income tax returns for the fiscal years ended June 30, 2003 and 2004 was completed. Due to the favorable settlement results, the Company reduced its estimate of accrued tax liabilities by \$0.7 million. The decrease resulted in an income tax rate of 30.6% for the fiscal year ending June 30, 2005.
- (4) The Company acquired DMI Furniture, Inc. ("DMI") in a business combination accounted for as a purchase on September 17, 2003. The amounts herein include the operations of DMI since that date.
- (5) Fiscal 2002 net income and per share amounts reflect a net loss (after tax) related to restructuring costs of approximately \$1.3 million or \$0.21 per share.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

General

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

Critical Accounting Policies

The discussion and analysis of the Company's consolidated financial statements and results of operations are based on consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America. Preparation of these consolidated financial statements requires the use of estimates and judgments that affect the reported results. Ultimate results may differ from these estimates under different assumptions or conditions.

Use of estimates – the Company uses estimates based on the best information available in recording transactions and balances resulting from business operations. Estimates are used for such items as collectability of trade accounts receivable, inventory valuation, depreciable lives, self-insurance programs, warranty costs and income taxes.

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

Inventories – the Company values inventory at the lower of cost or market. Raw steel, lumber and wood frame parts are valued on the last-in, first-out ("LIFO") method. Other inventories are valued on the first-in, first-out ("FIFO") method. Changes in the market conditions could require a write down of inventory.

Valuation of long-lived assets – the Company periodically reviews the carrying value of long-lived assets and estimated depreciable or amortizable lives for continued appropriateness. This review is based upon projections of anticipated future cash flows and is performed whenever events or changes in circumstances indicate that asset carrying values may not be recoverable or that the estimated depreciable or amortizable lives may have changed. These evaluations could result in a change in estimated useful lives in future periods.

Self-insurance programs – the Company is self-insured for health care and most workers’ compensation up to predetermined amounts above which third party insurance applies. The Company purchases specific stop-loss insurance for individual health care claims in excess of \$150,000 per plan year, with a \$1.0 million individual lifetime maximum. For workers’ compensation the Company retains the first \$350,000 per claim and purchases excess coverage up to the statutory limits for amounts in excess of the retention limit. The Company is contingently liable to insurance carriers under its comprehensive general, product, and vehicle liability policies, as well as some workers’ compensation. Losses are accrued based upon the Company’s estimates of the aggregate liability of claims incurred using certain actuarial assumptions followed in the insurance industry and based on Company experience. The actual claims experience could differ from the estimates made by the Company.

Warranty – the Company has warranty coverage with respect to the original purchases of our products that range from three months to lifetime. The Company estimates the amount of warranty claims on sold product that may be incurred based on current and historical data. The actual warranty expense could differ from the estimates made by the Company based on product performance.

Income taxes – the Company accounts for income taxes in accordance with the provisions of Statement of Financial Accounting Standards (SFAS) No. 109, Accounting for Income Taxes. In the preparation of the Company’s consolidated financial statements, management calculates income taxes. This includes estimating the Company’s current tax liability as well as assessing temporary differences resulting from different treatment of items for tax and book accounting purposes. These differences result in deferred tax assets and liabilities, which are recorded on the balance sheet. These assets and liabilities are analyzed regularly and management assesses the likelihood that deferred tax assets will be realized from future taxable income.

Revenue recognition – is upon delivery of product to our customer. Our ordering process creates persuasive evidence of the sale arrangement and the sales amount is determined. The delivery of the goods to our customer completes the earnings process. Net sales consist of product sales and related delivery charge revenue, net of adjustments for returns and allowances. Shipping and handling costs are included in cost of goods sold.

Accounting Developments

In December 2004, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards (“SFAS”) No. 123 (R) (revised 2004), “Share-Based Payment”, which amends SFAS No. 123 and became effective for the Company in the fiscal year ended June 30, 2006 (“fiscal 2006”). See Note 10 in Item 8 for the effects of the adoption.

In November 2004, the Financial Accounting Standards Board (“FASB”) issued SFAS No. 151, *Inventory Costs, an amendment of ARB No. 43, Chapter 4*. This Statement amends the guidance in Accounting Research Bulletin (“ARB”) No. 43, Chapter 4, *Inventory Pricing*, to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). Paragraph 5 of ARB No. 43, Chapter 4, previously stated that “...under some circumstances, items such as idle facility expense, excessive spoilage, double freight, and rehandling costs may be so abnormal as to require treatment as current period charges...” SFAS No. 151 requires that those items be recognized as current-period charges regardless of whether they meet the criterion of “so abnormal.” In addition, this Statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. The adoption of SFAS No. 151 on July 1, 2005 did not have a material impact on the Company’s financial position or results of operations.

FASB Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109*, was issued by the FASB in June 2006. FIN No. 48 clarifies the accounting for uncertain tax positions in accordance with SFAS 109, *Accounting for Income Taxes*. The Company will be required to recognize in its financial statements the largest tax benefit of a tax position that is “more-likely-than-not” to be sustained on audit based solely on the technical merits of the position as of the reporting date. The term “more-likely-than-not” means a likelihood of more than 50 percent. Interpretation No. 48 also provides guidance on new disclosure requirements, reporting and accrual of interest and penalties, accounting in interim periods and transition. FIN No. 48 is effective as of the beginning of the first fiscal year after December 15, 2006. Only tax positions that meet the “more-likely-than-not” threshold at that date may be recognized. The cumulative effect of initially applying FIN No. 48 will be recognized as a change in accounting principle as of the end of the period in which FIN No. 48 is adopted. The Company is currently evaluating the impact of applying this interpretation as of July 1, 2007, which will be the effective date of FIN No. 48 for the Company.

Results of Operations

The following table has been prepared as an aid in understanding the Company’s results of operations on a comparative basis for the fiscal years ended June 30, 2006, 2005 and 2004. Amounts presented are percentages of the Company’s net sales.

	FOR THE YEARS ENDED JUNE 30,		
	2006	2005	2004
Net sales	100.0%	100.0%	100.0%
Cost of goods sold	(80.9)	(81.3)	(79.3)
Gross margin	19.1	18.7	20.7
Selling, general and administrative	(17.1)	(16.7)	(16.6)
Gain on sale of facilities	—	0.2	—
Operating income	2.0	2.2	4.1
Other (expense) income, net	(0.2)	(0.1)	—
Income before income taxes	1.8	2.1	4.1

Provision for income taxes	(0.7)	(0.6)	(1.6)
Net income	1.1%	1.5%	2.5%

Fiscal 2006 Compared to Fiscal 2005

Net sales for the fiscal year ended June 30, 2006 were \$426.4 million compared to \$410.0 million in the prior fiscal year, an increase of 4.0%. Residential net sales of \$267.7 million were up 2.2% from residential net sales of \$261.9 million in the prior year. Recreational vehicle net sales decreased 8.7% to \$72.0 million, compared to \$78.8 million in the fiscal year ended June 30, 2005. The fiscal year decline in recreational vehicle net sales is due to a generally soft wholesale market environment for recreational vehicles. Net sales of commercial products increased from \$69.3 million to \$86.7 million, for the fiscal year ended June 30, 2006. This approximate 25.2% increase in commercial net sales for the fiscal year ended June 30, 2006 is primarily due to expanded commercial office product offerings and improved industry performance of hospitality products.

Gross margin for the fiscal year ended June 30, 2006 was 19.1% compared to 18.7% for the prior fiscal year. Gross margin for the fiscal year ended June 30, 2006 was adversely affected by cost increases for steel, petroleum based products and poly foam when compared to the fiscal year ended June 30, 2005. Gross margin improvement for the year is a result of a greater percentage of shipments being commercial office, hospitality and foreign sourced products whose margins were not as significantly impacted by raw material cost increases.

Selling, general and administrative expenses were 17.1% and 16.7% of net sales for the fiscal year ended June 30, 2006 and 2005, respectively. Year-to-date percentage increase in SG&A expenses reflects the recording of stock-based compensation expense of \$0.4 million (after tax) with the balance primarily related to an increase in marketing related costs.

During the fiscal year ended June 30, 2005, the Company recorded a pre-tax gain on the sale of facilities of \$0.8 million.

The effective income tax rate was 39.3% for the fiscal year ended June 30, 2006. During the fiscal year ended June 30, 2005, an examination by the Internal Revenue Service of the Company's federal income tax returns for the fiscal years ended June 30, 2003 and 2004 was completed. Due to the favorable settlement results, the Company reduced its estimate of accrued tax liabilities by \$0.7 million. The decrease resulted in an income tax rate of 30.6% for the fiscal year ended June 30, 2005.

The above factors resulted in net income for the fiscal year ended June 30, 2006 of \$4.7 million or \$0.72 per share compared to \$6.0 million or \$0.92 per share for the fiscal year ended June 30, 2005, a decrease of 21.9%.

All earnings per share amounts are on a diluted basis.

Fiscal 2005 Compared to Fiscal 2004

The Company acquired DMI in a business combination accounted for as a purchase as of September 17, 2003. The accompanying discussion of results of operations includes the operations of DMI for the period September 18, 2003 through June 30, 2005.

Net sales for the fiscal year ended June 30, 2005 ("fiscal 2005") increased by \$8.8 million or 2.2% compared to the fiscal year ended June 30, 2004 ("fiscal 2004"). Residential net sales decreased \$4.4 million or 1.6% in fiscal 2005. Recreational vehicle net sales decreased \$6.6 million or 7.7% in fiscal 2005. Commercial net sales increased \$19.7 million or 39.8% in fiscal 2005. The increase in net sales for fiscal 2005 reflects improved industry performance for commercial products in addition to the inclusion of DMI net sales for the entire fiscal year.

Gross margin decreased \$6.3 million to \$76.9 million, or 18.7% of net sales, in fiscal 2005, from \$83.2 million, or 20.7% of net sales in fiscal 2004. The decreased gross margin percentage in fiscal 2005 reflects increased costs for steel and component parts that have steel content. Costs were also higher for petroleum products and poly foam. The cost of these materials has increased faster than the Company has been able to pass these costs onto consumers through higher selling prices. During fiscal 2005, the quantities of LIFO inventory (steel and lumber) were reduced, resulting in a favorable impact on gross margin of 0.3%.

Selling, general and administrative expenses as a percentage of sales were 16.7% and 16.6% for fiscal 2005 and fiscal 2004, respectively. During fiscal 2005, the Company incurred costs in excess of \$0.4 million, including approximately 5,700 employee hours related to planning, documenting and performing testing and walkthroughs of internal controls over accounting and information systems in preparation for the fiscal 2005 implementation of Section 404 of the Sarbanes-Oxley Act of 2002. Additionally, the Company expected to incur higher audit and audit-related fees and expenses in future fiscal years. These types of expenses, included in selling, general, and administrative expenses in the accompanying consolidated statements of income, are expected to repeat in future fiscal years.

During the fiscal year 2005, the Company recorded pre-tax gains of \$0.8 million on the sale of former manufacturing facilities.

The effective tax rate in fiscal 2005 was 30.6% compared to 39.5% in fiscal 2004. During fiscal year 2005, an examination by the Internal Revenue Service of the Company's federal income tax returns for the fiscal years ended June 30, 2003 and 2004 was completed. Due to the favorable settlement results, the Company reduced its estimate of accrued tax liabilities resulting in a \$0.7 million reduction in the tax expenses during the quarter ended March 31, 2005.

The above factors resulted in fiscal 2005 net income of \$6.0 million, or \$0.92 per share, compared to \$10.1 million, or \$1.55 per share, in fiscal 2004, a decrease of \$4.1 million or \$0.63 per share.

All earnings per share amounts are on a diluted basis.

Liquidity and Capital Resources

Working capital (current assets less current liabilities) at June 30, 2006 was \$97.0 million compared to \$85.4 million at June 30, 2005. Net cash used by operating activities was \$7.3 million in fiscal year 2006. Cash used by operating activities included increased inventory from the expansion of import programs, including commercial office product offerings, and increased accounts receivable due the higher sales volumes in the fourth quarter. The Company does not expect significant future increases in inventory related to our import programs. The available credit facilities were adequate to provide the additional cash required to support the Company's operations.

Capital expenditures were \$3.4 million (including a non-cash acquisition of \$2.6 million for delivery equipment financed by long-term debt), \$3.3 million and \$6.0 million in fiscal 2006, 2005 and 2004, respectively. Fiscal 2006 expenditures were incurred for delivery and manufacturing equipment. Projected capital spending for fiscal 2007 is \$4.0 million and will be used for delivery and manufacturing equipment. Cash generated from operations and available lines of credit are expected to provide funds necessary for projected capital expenditures.

Financing activities provided net cash of \$7.6 million in fiscal year 2006 and utilized \$12.0 million and \$0.8 million in fiscal 2005 and 2004, respectively. For fiscal year 2006, borrowings were used to pay for the expansion of inventory programs and accounts receivable and the payment of dividends.

Management believes that the Company has adequate cash, cash equivalents, and credit arrangements to meet its operating and capital requirements for fiscal 2007. In the opinion of management, the Company's liquidity and credit resources provide it with the ability to react to opportunities as they arise, the ability to pay quarterly dividends to its shareholders, and ensures that productive capital assets that enhance safety and improve operations are purchased as needed.

The following table summarizes the Company's contractual obligations at June 30, 2006 and the effect these obligations are expected to have on the Company's liquidity and cash flow in the future (in thousands):

	Total	Less than 1 Year	1 - 3 Years	3 - 5 Years	More than 5 Years
Long-term debt obligations	\$ 31,313	\$ 9,447	\$ 1,023	\$ 20,843	\$ —
Interest on long-term debt obligations	5,711	1,619	2,312	1,780	—
Operating lease obligations	5,290	2,023	2,003	819	445
Total contractual cash obligations	\$ 42,314	\$ 13,089	\$ 5,338	\$ 23,442	\$ 445

At June 30, 2006 the Company had no capital lease obligations, and no purchase obligations for raw materials or finished goods extending more than six months. The purchase price on all open purchase orders was fixed and denominated in U.S. dollars.

Financing Arrangements

The Company has lines of credit of \$52.0 million with banks, with borrowings at differing rates based on the date and type of financing utilized.

In June 2006, the Company extended its primary credit agreement for long-term availability of \$20.0 million to October 2010, and extended its existing short-term facility to June 29, 2007. The credit agreement provides for a \$48.0 million unsecured credit facility and provides the Company with flexibility between long-term and short-term financing. The short-term portion of the credit facility provides working capital financing up to \$20.0 million, of which \$9.0 million was outstanding at June 30, 2006, with interest selected at the option of the Company at prime (8.0% at June 30, 2006) or LIBOR (5.35% at June 30, 2006) plus 0.75%. The short-term portion also provides overnight credit when required for operations at prime minus 1.0%. The long-term portion of the credit facility provides up to \$20.0 million, of which \$20.0 million was outstanding at June 30, 2006. Variable interest is set monthly at the option of the Company at prime or LIBOR plus 0.75%. The credit facility also provides \$8.0 million to support letters of credit issued by the Company of which \$2.6 million were outstanding as of June 30, 2006. All interest rates are adjusted monthly, except for the overnight portion of the short-term line of credit, which varies daily at the prime rate minus 1.0%. The Company has effectively fixed the interest rates at 4.3% on approximately \$16.6 million of its long-term debt through the use of interest rate swaps. See *Interest Rate Risk* in Item 7A. below.

The credit agreement contains certain restrictive covenants that require the Company, among other things, to maintain an interest coverage ratio, leverage ratio, and limitations on capital disposals, all as defined in the credit agreement. At June 30, 2006, the Company was in compliance with all financial covenants contained in the credit agreement.

The Company financed the purchase of delivery equipment in December 2005 through a five-year fixed rate note at 4.99%. The note requires payments through December 2010. The delivery equipment purchased with the note proceeds secures the note.

Increased operating costs are reflected in product or services pricing with any limitations on price increases determined by the marketplace. The impact of inflation on the Company has not been significant during the past three years because of the relatively low rates of inflation experienced in the United States. Raw material costs, labor costs and interest rates are important components of costs for the Company. Any or all of these components could be impacted by inflation or other pricing pressures, with a possible adverse effect on our profitability, especially where increases in these costs exceed price increases on finished products. In recent years, the Company has faced strong inflationary and other pricing pressures with respect to steel, fuel and health care costs, which have been partially mitigated by pricing adjustments.

Other than operating leases, the Company does not have any off balance sheet arrangements.

Outlook

Flexsteel Industries, Inc. and the other U.S. furniture manufacturers continue to be impacted by the increases in interest rates and geopolitical issues leading to increased energy costs and consumer uncertainty. At the same time, the U.S. furniture industry continues to evolve and globalize at a staggering rate. U.S. manufacturers are faced with increases in the cost of raw materials, labor and overhead costs, including fuel, accompanied by an increased flow of competing product from all over the world generally produced with lower manufacturing costs all of which added to product pricing pressures. Additionally, the distribution channels are changing and increasingly include non-traditional customers such as mass merchandisers, wholesale clubs and specialty retail chains in addition to e-commerce opportunities.

For the fiscal year ended June 30, 2006, residential net sales were weaker than anticipated and we expect that this softness will continue through the first half of fiscal year 2007 due to the uncertainties described above. Net sales of vehicle seating products have fallen off due to a weak wholesale market environment. While vehicle seating product net sales during the fourth quarter of fiscal 2006 showed an increase over the prior year quarter, a sustained improvement in demand has not yet been confirmed. Additionally, the volatility and high cost of fuel may temper the favorable longer-term demographics that exist in the recreational vehicle industry. Our commercial marketing channels provide an opportunity to expand distribution and increase net sales for fiscal 2007. Commercial office furniture net sales are expected to benefit from a continued general increase in demand for these products and we have expanded our product offerings to capitalize on this market area. Hospitality occupancy rates continue strong which has led to an increase in construction and renovation activity. These activities have increased the demand for the hospitality products we offer.

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The increased cost of raw materials, component parts and fuel created continued pressures on margins through all of fiscal year 2006 and we expect these pressures to continue into fiscal year 2007. During fiscal year 2006, we were able to maintain our margins through cost controls, the implementation of a fuel surcharge on product delivery and selected product sale price increases. We expect that fuel costs will continue to rise and to negatively impact the cost of bringing raw materials, component parts and sourced finished products into our facilities as well as the cost of delivering products to our customers. We anticipate that petroleum prices will remain volatile and at record or near record levels for the foreseeable future. The result will be continuing cost increases and we believe a factor in keeping consumers on the sideline for furniture purchases, negatively affecting demand for residential and vehicle seating products.

Flexsteel continues to take actions to address the above concerns including: new product introductions, refining existing product offerings, adjusting selling and delivery prices, adjusting production levels and implementing cost control measures for inventory and capital expenditures. These actions occur regularly regardless of operating performance, but will continue to receive additional attention under current business conditions. Management believes that Flexsteel is also in a unique position to take advantage of the rapid change that is affecting most of the markets we serve. We have had a successful introduction of our complete new line of Wrangler Home® Collection. We continue to develop products for the marine industry to augment our vehicle seating products. We believe that our commercial office product lineup is strong and expanded to continue to take advantage as demand for this product increases. We believe that our hospitality team is poised to deliver the needed products as this market expansion continues.

We continue to believe that our strategy of providing furniture from a wide selection of domestically manufactured and imported products is sound business practice. This blended strategy gives Flexsteel the opportunity to successfully participate in all the important avenues of furniture distribution in the United States.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

General – Market risk represents the risk of changes in the value of a financial instrument, derivative or non-derivative, caused by fluctuations in interest rates, foreign exchange rates and equity prices. As discussed below, management of the Company does not believe that changes in these factors could cause material fluctuations in the Company’s results of operations or cash flows. The ability to import furniture products can be adversely affected by political issues in the countries where suppliers are located and disruptions associated with shipping distances. 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.

Impairment of long-lived assets – Accounting rules require that long-lived assets be evaluated for impairment at least annually. We have substantial long-lived assets, consisting mainly of property, plant and equipment, which based upon the outcome of the annual evaluation could result in the write-down of all or a portion of these assets and a corresponding reduction in our earnings and net worth. At June 30, 2006, no impairment of long-lived assets has been identified.

Foreign Currency Risk – During fiscal 2006, 2005 and 2004, the Company did not have sales, purchases, or other expenses denominated in foreign currencies, nor did it have any active subsidiaries located in foreign countries. As such, the Company is not exposed to market risk associated with currency exchange rates and prices.

Interest Rate Risk – The Company’s primary market risk exposure with regard to financial instruments is changes in interest rates. At June 30, 2006, a hypothetical 100 basis point increase in short-term interest rates would decrease annual pre-tax earnings by approximately \$120,000, assuming no change in the volume or composition of debt. The Company has effectively fixed the interest rates at 4.3% on approximately \$16.6 million of its long-term debt through the use of interest rate swaps, and the above estimated earnings reduction takes these swaps into account. As of June 30, 2006, the fair value of these swaps is an asset of approximately \$0.3 million and is included in other assets.

Tariffs – The Company has exposure to actions by governments, including tariffs. Tariffs are a possibility on any imported or exported products. Tariff expense on wooden bedroom furniture imported from China, which represents less than 3% of the Company’s net sales, is based on the most current rates published by the Department of Commerce. These rates are potentially subject to an administrative review process starting approximately one year after the publication date. The final amounts will depend on whether administrative reviews are performed and the outcome of those reviews, if any, on the vendors we purchase from. The Company continues to review alternate sources of product supply to minimize the impact of the tariffs.

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Item 8. Financial Statements and Supplementary Data

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MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

To the Shareholders of Flexsteel Industries, Inc.

As Flexsteel Industries, Inc.'s Chief Executive Officer and Chief Financial Officer, we are responsible for the presentation, accuracy, and objectivity of the information contained in our financial statements. Flexsteel Industries, Inc. has enjoyed a long-standing reputation for integrity, candor, and high quality earnings. We intend to protect the reputation. To that end, we employ a formal system of corporate conduct, internal control and audit, external audit, and Board of Directors oversight.

- We promote a strong ethical climate and encourage employees to conduct the Company's business according to high personal corporate standards. Our Guidelines for Business Conduct, which is distributed annually, requires employees to comply with all applicable laws, protect the Company's assets, keep proprietary information confidential, and disclose potential conflicts of interest.
- Our internal control and audit systems are designed to provide reasonable assurance that financial reports are reliable, and are prepared in accordance with generally accepted accounting principles. Our report on internal control appears in Section 9A.
- Deloitte & Touche LLP, an independent registered public accounting firm, audits the Company's consolidated financial statements.
- The Board of Directors, through its Audit and Ethics Committee, meets with Management and Deloitte & Touche LLP to ensure that each is performing its responsibilities properly. Deloitte & Touche LLP has open and direct access to the Audit and Ethics Committee, without Management present, to discuss the results of their work, including internal accounting controls and the quality of financial reporting.

Accordingly, we are confident that the consolidated financial statements in this Annual Report on Form 10-K have been prepared in accordance with generally accepted accounting principles. Financial information elsewhere in this Annual Report on Form 10-K is consistent with the information in the financial statements.

K. Bruce Lauritsen
Chief Executive Officer

Timothy E. Hall
Chief Financial Officer

August 28, 2006

REPORT OF THE INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders of Flexsteel Industries, Inc.

We have audited the accompanying consolidated balance sheets of Flexsteel Industries, Inc. and Subsidiaries (the "Company") as of June 30, 2006 and 2005, and the related consolidated statements of income, changes in shareholders' equity, and cash flows for each of the three years in the period ended June 30, 2006. We also have audited management's assessment, included in the accompanying Management's Report On Internal Controls Over Financial Reporting that the Company maintained effective internal control over financial reporting as of June 30, 2006, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on these financial statements, an opinion on management's assessment, and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audit of financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel 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. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of June 30, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended June 30, 2006, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, management's assessment that the Company maintained effective internal control over financial reporting as of June 30, 2006, is fairly stated, in all material respects, based on the criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of June 30, 2006, based on the criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

FLEXSTEEL INDUSTRIES, INC. AND SUBSIDIARIES**Consolidated Balance Sheets**

	JUNE 30,	
	2006	2005
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 1,985,768	\$ 1,706,584
Investments	817,618	1,508,751
Trade receivables – less allowance for doubtful accounts: 2006, \$2,820,000; 2005, \$3,060,000	51,179,791	48,355,070
Inventories	84,769,972	69,945,400
Deferred income taxes	4,620,000	4,430,000
Other	2,014,121	1,851,869
Total current assets	145,387,270	127,797,674
NONCURRENT ASSETS:		
Property, plant and equipment, net	24,158,041	26,140,914
Deferred income taxes	2,210,000	1,830,000
Other assets	11,570,393	10,889,090
TOTAL	\$ 183,325,704	\$ 166,657,678
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable – trade	\$ 15,768,435	\$ 16,259,905
Notes payable	9,466,643	5,000,000
Accrued liabilities:		
Payroll and related items	7,720,173	7,278,474
Insurance	7,651,109	7,622,551
Other	7,793,645	6,248,403
Total current liabilities	48,400,005	42,409,333
LONG-TERM LIABILITIES:		
Long-term debt	21,846,386	12,800,000
Deferred compensation	5,207,176	5,061,951
Other liabilities	369,812	1,588,674
Total liabilities	75,823,379	61,859,958
COMMITMENTS AND CONTINGENCIES (Note 15)		
SHAREHOLDERS' EQUITY:		
Cumulative preferred stock – \$50 par value; authorized 60,000 shares; outstanding – none		
Undesignated (subordinated) stock – \$1 par value; authorized 700,000 shares; outstanding – none		
Common stock – \$1 par value; authorized 15,000,000 shares; outstanding 2006, 6,563,750 shares; 2005, 6,541,436 shares.	6,563,750	6,541,436
Additional paid-in capital	3,670,152	2,954,398
Retained earnings	96,502,311	95,196,022
Accumulated other comprehensive income	766,112	105,864
Total shareholders' equity	107,502,325	104,797,720
TOTAL	\$ 183,325,704	\$ 166,657,678

See accompanying Notes to Consolidated Financial Statements.

FOR THE YEARS ENDED JUNE 30,

	2006	2005	2004
NET SALES	\$ 426,407,585	\$ 410,022,809	\$ 401,221,510
COST OF GOODS SOLD	(345,068,305)	(333,170,329)	(318,046,939)
GROSS MARGIN	81,339,280	76,852,480	83,174,571
SELLING, GENERAL AND ADMINISTRATIVE	(72,778,577)	(68,595,788)	(66,572,362)
GAIN ON SALE OF FACILITIES	—	809,022	—
OPERATING INCOME	8,560,703	9,065,714	16,602,209
OTHER INCOME (EXPENSE):			
Interest and other income	774,783	627,996	976,918
Interest expense	(1,557,303)	(989,754)	(838,870)
Total	(782,520)	(361,758)	138,048
INCOME BEFORE INCOME TAXES	7,778,183	8,703,956	16,740,257
PROVISION FOR INCOME TAXES	(3,060,000)	(2,660,000)	(6,610,000)
NET INCOME	\$ 4,718,183	\$ 6,043,956	\$ 10,130,257
AVERAGE NUMBER OF COMMON SHARES OUTSTANDING:			
Basic	6,558,440	6,531,293	6,440,298
Diluted	6,577,278	6,600,905	6,529,813
EARNINGS PER SHARE OF COMMON STOCK:			
Basic	\$ 0.72	\$ 0.93	\$ 1.57
Diluted	\$ 0.72	\$ 0.92	\$ 1.55
CASH DIVIDENDS DECLARED PER COMMON SHARE	\$ 0.52	\$ 0.52	\$ 0.52

See accompanying Notes to Consolidated Financial Statements.

FLEXSTEEL INDUSTRIES, INC. AND SUBSIDIARIES

Consolidated Statements of Changes in Shareholders' Equity

	Common Stock		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total
	Shares	Par Value				
Balance at June 30, 2003	6,294,639	\$ 6,294,639	\$ 1,353,639	\$ 85,787,823	\$ 317,226	\$ 93,753,327
Issuance of common stock	199,589	199,589	757,838	—	—	957,427
Investment valuation adjustment, net of tax	—	—	—	—	219,197	219,197
Interest rate swaps valuation adjustment, net of tax	—	—	—	—	140,884	140,884
Minimum pension liability adjustment, net of tax	—	—	—	—	(223,315)	(223,315)
Cash dividends	—	—	—	(3,366,035)	—	(3,366,035)
Net income	—	—	—	10,130,257	—	10,130,257
Balance at June 30, 2004	6,494,228	6,494,228	2,111,477	92,552,045	453,992	101,611,742
Issuance of common stock	47,208	47,208	842,921	—	—	890,129
Investment valuation adjustment, net of tax	—	—	—	—	209,352	209,352
Interest rate swaps valuation adjustment, net of tax	—	—	—	—	(6,810)	(6,810)
Minimum pension liability adjustment, net of tax	—	—	—	—	(550,670)	(550,670)
Cash dividends	—	—	—	(3,399,979)	—	(3,399,979)

Net income	—	—	—	6,043,956	—	6,043,956
Balance at June 30, 2005	6,541,436	6,541,436	2,954,398	95,196,022	105,864	104,797,720
Issuance of common stock	22,314	22,314	288,754	—	—	311,068
Investment valuation adjustment, net of tax	—	—	—	—	(221)	(221)
Stock-based compensation	—	—	427,000	—	—	427,000
Interest rate swaps valuation adjustment, net of tax	—	—	—	—	116,910	116,910
Minimum pension liability adjustment, net of tax	—	—	—	—	543,559	543,559
Cash dividends	—	—	—	(3,411,894)	—	(3,411,894)
Net income	—	—	—	4,718,183	—	4,718,183
Balance at June 30, 2006	6,563,750	\$ 6,563,750	\$ 3,670,152	\$ 96,502,311	\$ 766,112	\$ 107,502,325

See accompanying Notes to Consolidated Financial Statements.

FLEXSTEEL INDUSTRIES, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

FOR THE YEARS ENDED JUNE 30,

	2006	2005	2004
OPERATING ACTIVITIES:			
Net income	\$ 4,718,183	\$ 6,043,956	\$ 10,130,257
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	5,485,884	5,785,354	5,680,391
Deferred income taxes	(948,000)	(1,150,000)	2,554,813
Stock-based compensation expense	427,000	—	—
Gain on disposition of capital assets	(55,504)	(879,462)	(94,456)
Changes in operating assets and liabilities, net of acquisition:			
Trade receivables	(2,824,721)	(185,290)	(6,316,462)
Inventories	(14,824,572)	(1,065,282)	(9,261,855)
Other current assets	(162,251)	1,079,110	294,024
Other assets	(582,112)	(472,751)	(22,569)
Accounts payable – trade	(491,470)	3,987,500	8,024,639
Accrued liabilities	3,076,331	(325,542)	(3,413,992)
Other long-term liabilities	(1,218,862)	(132,318)	(313,657)
Deferred compensation	145,225	38,347	233,378
Net cash (used in) provided by operating activities	(7,254,869)	12,723,622	7,494,511
INVESTING ACTIVITIES:			
Purchases of investments	(1,118,446)	(860,312)	(4,126,310)
Proceeds from sales of investments	1,773,698	584,981	12,049,572
Payments received from customers on notes receivable	—	—	320,371
Proceeds from sale of capital assets	89,786	2,121,083	115,859
Capital expenditures	(850,444)	(3,346,984)	(6,029,968)
Acquisition of DMI Furniture, Inc., net of cash acquired	—	—	(19,322,174)
Net cash used in investing activities	(105,406)	(1,501,232)	(16,992,650)
FINANCING ACTIVITIES:			
Proceeds from (repayments of) short-term borrowings, net	4,000,000	(4,022,090)	(9,877,910)
Repayment of long-term borrowings	(247,441)	(6,683,333)	(9,125,705)
Proceeds from long-term borrowings	7,200,000	1,899,997	20,062,430
Dividends paid	(3,408,994)	(3,393,842)	(2,521,785)
Proceeds from issuance of common stock	95,894	206,941	626,245
Net cash provided by (used in) financing activities	7,639,459	(11,992,327)	(836,725)
Increase (decrease) in cash and cash equivalents	279,184	(769,937)	(10,334,864)
Cash and cash equivalents at beginning of year	1,706,584	2,476,521	12,811,385
Cash and cash equivalents at end of year	\$ 1,985,768	\$ 1,706,584	\$ 2,476,521

	2006	2005	2004
SUPPLEMENTAL INFORMATION			
CASH PAID DURING THE PERIOD FOR:			
Interest	\$ 1,598,000	\$ 1,087,000	\$ 1,026,000
Income taxes	\$ 3,244,000	\$ 2,228,000	\$ 6,636,000

See accompanying Notes to Consolidated Financial Statements.

FLEXSTEEL INDUSTRIES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

DESCRIPTION OF BUSINESS – Flexsteel Industries, Inc. and Subsidiaries (the “Company”) is one of the oldest and largest manufacturers and marketers, as well as an importer, of residential, recreational vehicle, hospitality and healthcare upholstered and wooden furniture products in the country. The Company’s furniture products include a broad line of quality upholstered and wooden furniture for residential, recreational vehicle and commercial use. Furniture products include sofas, love seats, chairs, reclining and rocker-reclining chairs, swivel rockers, sofa beds, convertible bedding units, bedroom, dining room, occasional tables, and home and commercial office furniture. The Company has two active wholly-owned subsidiaries: (1) DMI Furniture, Inc. (“DMI”), a Louisville, Kentucky-based, vertically integrated manufacturer, importer and marketer of residential and commercial furniture with manufacturing plants and warehouses in Indiana and manufacturing sources in Asia; DMI’s divisions are WYNWOOD, Homestyles and DMI Commercial Office Furniture and (2) Desert Dreams, Inc., which owns a commercial building leased to an unrelated entity. A third wholly-owned subsidiary, Four Seasons, Inc., is no longer active.

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

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

FAIR VALUE – the Company’s cash, investments, accounts receivable, other assets, accounts payable, accrued liabilities, notes payable, interest rate swaps and other liabilities are carried at amounts, which reasonably approximate their fair value due to their short-term nature. Fair values of investments in debt and equity securities are disclosed in Note 3.

CASH EQUIVALENTS – the Company considers highly liquid investments with original maturities of three months or less as the equivalent of cash.

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

INVENTORIES – are stated at the lower of cost or market. Raw steel, lumber and wood frame parts are valued on the last-in, first-out (“LIFO”) method. Other inventories are valued on the first-in, first-out (“FIFO”) method.

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

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

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

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

ADVERTISING COSTS – are charged to selling, general and administrative expense in the periods incurred. The Company conducts no direct-response advertising programs and there are no assets related to advertising recorded on the consolidated balance sheet. Advertising expenditures, primarily shared customer advertising and national trade-advertising programs, were approximately \$4,450,000, \$5,390,000 and \$4,680,000 in fiscal 2006, 2005 and 2004, respectively.

DESIGN, RESEARCH AND DEVELOPMENT COSTS – are charged to selling, general and administrative expense in the periods incurred. Expenditures for research and development costs were approximately \$2,990,000, \$2,910,000 and \$2,800,000 in fiscal 2006, 2005 and 2004, respectively.

DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES – the Company utilizes interest rate swaps to hedge against adverse changes in interest rates relative to its variable rate debt. The notional principal amounts of the outstanding interest rate swaps totaled \$16.6 million with a weighted average fixed rate of 4.3% at June 30, 2006. The interest rate swaps are not utilized to take speculative positions. The Board of Directors established the Company's policies with regards to activities involving derivative instruments. Management, along with the Board of Directors, periodically reviews those policies, along with the actual derivative related results. The Company recorded the fair market value of its interest rate swaps as cash flow hedges on its balance sheet and has marked them to fair value through other comprehensive income. The fair values of the swaps were an asset of approximately \$350,000 as of June 30, 2006 and are reflected as noncurrent other assets on the accompanying consolidated balance sheet. All of the derivatives used by the Company in its risk management are highly effective hedges because all of the critical terms of the derivative instruments match those of the hedged item.

INSURANCE – the Company is self-insured for health care and most workers' compensation up to predetermined amounts above which third party insurance applies. The Company purchases specific stop-loss insurance for individual health care claims in excess of \$150,000 per plan year, with a \$1.0 million individual lifetime maximum. For workers' compensation the Company retains the first \$350,000 per claim and purchases excess coverage up to the statutory limits for amounts in excess of the retention limit. The Company is contingently liable to insurance carriers under its comprehensive general, product, and vehicle liability policies, as well as some workers' compensation, and has provided letters of credit in the amount of \$4.9 million. Losses are accrued based upon the Company's estimates of the aggregate liability for claims incurred using certain actuarial assumptions followed in the insurance industry and based on Company experience.

INCOME TAXES – deferred income taxes result from temporary differences between the tax basis of an asset or liability and its reported amount in the consolidated financial statements.

EARNINGS PER SHARE – basic earnings per share of common stock is based on the weighted-average number of common shares outstanding during each fiscal year. Diluted earnings per share of common stock includes the dilutive effect of potential common shares outstanding. The Company's only potential common shares outstanding are stock options, which resulted in a dilutive effect of 18,838 shares, 69,612 shares and 89,515 shares in fiscal 2006, 2005 and 2004, respectively. The Company calculates the dilutive effect of outstanding options using the treasury stock method. Options to purchase 420,201 shares and 147,895 shares of common stock were outstanding in fiscal 2006 and 2005, respectively, but were not included in the computation of diluted earnings per share as their exercise prices were greater than the average market price of the common shares. No options to purchase common stock were excluded in the computation of diluted earnings per share in fiscal 2004, as their exercise prices were less than the average market price of the common shares.

STOCK-BASED COMPENSATION

Accounting Principles Applied – Prior to July 1, 2005, the Company had elected to apply Accounting Principles Board ("APB") Opinion No. 25 and related interpretations in accounting for its stock option plans, as permitted under Statement of Financial Accounting Standards (SFAS) No. 123 "Accounting for Stock-Based Compensation" and SFAS No. 148 "Accounting for Stock-Based Compensation-Transition and Disclosure". Accordingly, no compensation cost was recognized for its stock option plans, as the exercise price was equal to the market price of the Company's stock on the date of grant.

On July 1, 2005, the Company adopted the fair value recognition provisions of SFAS No. 123 (revised 2004), "Share-Based Payment" (123(R)), requiring the Company to recognize expense related to the fair value of stock-based compensation. The modified prospective transition method was used as allowed under SFAS No. 123(R). Under this method, the stock-based compensation expense includes: (a) compensation expense for all stock-based compensation awards granted prior to, but not yet vested as of July 1, 2005, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, "Accounting for Stock-Based Compensation"; and (b) compensation expense for all stock-based compensation awards granted subsequent to July 1, 2005, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123(R). See Note 10 Stock-Based Compensation.

ACCOUNTING DEVELOPMENTS – In December 2004, the Financial Accounting Standards Board ("FASB") issued SFAS No. 123 (R), which amends SFAS No. 123 and became effective for the Company in fiscal 2006. See Note 10 for the effects of adoption.

In November 2004, the FASB issued SFAS No. 151, *Inventory Costs, an amendment of ARB No. 43, Chapter 4*. This Statement amends the guidance in Accounting Research Bulletin ("ARB") No. 43, Chapter 4, *Inventory Pricing*, to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). Paragraph 5 of ARB No. 43, Chapter 4, previously stated "...under some circumstances, items such as idle facility expense, excessive spoilage, double freight, and rehandling costs may be so abnormal as to require treatment as current period charges..." SFAS No. 151 requires that those items be recognized as current-period charges regardless of whether they meet the criterion of "so abnormal." In addition, this Statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. The adoption of SFAS No. 151 on July 1, 2005 did not have a material impact on the Company's financial position or results of operations.

FASB Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109*, was issued by the FASB in June 2006. FIN No. 48 clarifies the accounting for uncertain tax positions in accordance with SFAS 109, *Accounting for Income Taxes*. The Company will be required to recognize in its financial statements the largest tax benefit of a tax position that is "more-likely-than-not" to be sustained on audit based solely on the technical merits of the position as of the reporting date. The term "more-likely-than-not" means a likelihood of more than 50 percent. Interpretation No. 48 also provides guidance on new disclosure requirements, reporting and accrual of interest and penalties, accounting in interim periods and transition. FIN No. 48 is effective as of the beginning of the first fiscal year after December 15, 2006. Only tax positions that meet the "more-likely-than-not" threshold at that date may be recognized. The cumulative effect of initially applying FIN No. 48 will be recognized as a change in accounting principle as of the end of the period in which FIN No. 48 is adopted. The Company is currently evaluating of the impact of applying this interpretation as of July 1, 2007, which will be the effective date of FIN No. 48 for the Company.

2. ACQUISITION

On September 17, 2003, the Company effectively acquired 100% of the outstanding common stock of DMI for \$3.30 per share in cash. The results of DMI's operations have been included in the consolidated financial statements of the Company since that date. The aggregate purchase price was \$54.9 million. The purchase price consisted of \$16.7 million in cash paid to the shareholders of DMI, \$2.8 million in acquisition costs paid by the Company, and the assumption of all DMI liabilities totaling \$35.4 million, including \$25.5 million of long-term debt.

The unaudited pro forma financial information below assumes that DMI had been acquired at July 1, 2003 and includes the effect of amortization of the customer relationships intangible asset, additional depreciation expense, additional interest expense, reduction in interest income, and the related income tax effects. This pro forma financial information is presented for informational purposes only and is not necessarily indicative of the results of operations that would have been achieved had the acquisition taken place at the beginning of fiscal 2004. Pro forma information follows (in thousands, except per share amounts):

	Fiscal 2004
Net sales	\$ 422,214
Net income	10,496
Earnings per share of common stock:	
Basic	1.63
Diluted	1.61

3. INVESTMENTS

Debt and equity securities are included in Investments and in Other Assets (designated for deferred compensation plans), at fair value based on quoted market prices, and are classified as available for sale. Available-for-sale securities consist of debt and equity securities that will be held for indefinite periods of time, including securities that may be sold in response to changes in market interest or prepayment rates, needs for liquidity, or changes in the availability or yield of alternative investments. These securities are valued at current market value, with the resulting unrealized holding gains and losses excluded from earnings and reported, net of tax, as a separate component of shareholders' equity until realized. Available-for-sale securities are included in current assets if they are available to fund current operations. Investments designated for deferred compensation are included within long-term other assets. A summary of the carrying values and fair values of the Company's investments is as follows:

	June 30, 2006			
	Cost Basis	Gross Unrealized		Recorded Basis
		Gains	Losses	
Debt securities	\$ 2,116,943	\$ —	\$ (65,728)	\$ 2,051,215
Equity securities	2,532,679	1,268,238	—	3,800,917
	\$ 4,649,622	\$ 1,268,238	\$ (65,728)	\$ 5,852,132

	June 30, 2005			
	Cost Basis	Gross Unrealized		Recorded Basis
		Gains	Losses	
Debt securities	\$ 2,268,210	\$ 70	\$ (33,879)	\$ 2,234,401
Equity securities	3,036,530	1,236,673	—	4,273,203
	\$ 5,304,740	\$ 1,236,743	\$ (33,879)	\$ 6,507,604

	June 30, 2006		June 30, 2005	
	Investments	Other Assets	Investments	Other Assets
Debt securities	\$ —	\$ 2,051,215	\$ 297,375	\$ 1,937,026
Equity securities	817,618	2,983,299	1,211,376	3,061,827
	\$ 817,618	\$ 5,034,514	\$ 1,508,751	\$ 4,998,853

As of June 30, 2006, all debt securities mature within one year.

4. INVENTORIES

Inventories valued on the LIFO method would have been approximately \$3.3 million and \$3.6 million higher at June 30, 2006 and 2005, respectively, if they had been valued on the FIFO method. At June 30, 2006 and 2005 the total value of LIFO inventory was \$3.8 million and \$3.3 million, respectively. During the fiscal year 2005, inventory quantities for steel and wood were reduced. This reduction resulted in a liquidation of LIFO inventory quantities carried at lower costs prevailing in prior years as compared with the cost of 2005 purchases, the effect of which decreased cost of goods sold by approximately \$1.1 million and increased net income by approximately \$0.7 million. There was no liquidation of LIFO inventory during fiscal 2006 or fiscal 2004. A comparison of inventories is as follows:

	June 30,	
	2006	2005
Raw materials	\$ 19,637,832	\$ 19,720,319
Work in process and finished parts	8,708,949	8,292,502
Finished goods	56,423,191	41,932,579
Total	<u>\$ 84,769,972</u>	<u>\$ 69,945,400</u>

5. PROPERTY, PLANT AND EQUIPMENT

	Estimated Life (Years)	June 30,	
		2006	2005
Land		\$ 2,370,959	\$ 2,370,959
Buildings and improvements	3-39	36,784,785	36,633,896
Machinery and equipment	3-20	35,136,851	36,107,997
Delivery equipment	3-10	19,439,976	17,758,539
Furniture and fixtures	3-5	5,077,841	5,281,564
Total		98,810,412	98,152,955
Less accumulated depreciation		(74,652,371)	(72,012,041)
Net		<u>\$ 24,158,041</u>	<u>\$ 26,140,914</u>

6. OTHER ASSETS

	June 30,	
	2006	2005
Cash value of life insurance	\$ 6,011,959	\$ 5,550,679
Investments designated for deferred compensation plans	5,034,514	4,998,853
Other	523,920	339,558
Total	<u>\$ 11,570,393</u>	<u>\$ 10,889,090</u>

7. ACCRUED LIABILITIES – OTHER

	June 30,	
	2006	2005
Dividends	\$ 853,287	\$ 850,387
Advertising	1,209,808	1,536,823
Warranty	1,140,000	1,151,000
Income taxes payable	829,607	10,174
Other	3,760,943	2,700,019
Total	<u>\$ 7,793,645</u>	<u>\$ 6,248,403</u>

8. BORROWINGS AND CREDIT ARRANGEMENTS

At June 30, 2006, borrowings and credit arrangements consisted of the following:

Current:	
Current maturities of long-term debt	\$ 466,643
Overnight borrowing interest rate at prime minus 1%; unsecured	—
\$20.0 million working capital line of credit through June 29, 2007; interest rate at LIBOR + 0.75%; unsecured	9,000,000
Long-Term:	
\$20.0 million revolving note; expires October 31, 2010; interest rate at LIBOR + 0.75%; unsecured	20,000,000
\$2.6 million fixed rate note; requiring payments through December 2010; interest rate at 4.99%; secured by certain delivery equipment; net of current portion	1,846,386
Total	\$ 31,313,029

The Company has credit facilities of \$52.0 million with banks, with borrowings at differing rates based on the date and type of financing utilized.

In June 2006, the Company extended its primary credit agreement for long-term availability of \$20.0 million to October 2010, and extended its existing short-term facility to June 29, 2007. The credit agreement provides for a \$48.0 million unsecured credit facility and provides the Company with flexibility between long-term and short-term financing. The short-term portion of the credit facility provides working capital financing up to \$20.0 million, of which \$9.0 million was outstanding at June 30, 2006, with interest selected at the option of the Company at prime (8.0% at June 30, 2006) or LIBOR (5.35% at June 30, 2006) plus 0.75%. The short-term portion also provides overnight credit when required for operations at prime minus 1.0%. The long-term portion of the credit facility provides up to \$20.0 million, of which \$20.0 million was outstanding at June 30, 2006. Variable interest is set monthly at the option of the Company at prime or LIBOR plus 0.75%. The credit facility also provides \$8.0 million to support letters of credit issued by the Company of which \$2.6 million was used related to outstanding letters of credit at June 30, 2006. All interest rates are adjusted monthly, except for the overnight portion of the short-term line of credit, which varies daily at the prime rate minus 1.0%. The Company has effectively fixed the interest rates at 4.3% on approximately \$16.6 million of its long-term debt through the use of interest rate swaps.

The credit agreement contains certain restrictive covenants that require the Company, among other things, to maintain an interest coverage ratio, leverage ratio, and limitations on capital disposals, all as defined in the credit agreement. At June 30, 2006, the Company was in compliance with all financial covenants contained in the credit agreement.

The Company financed the purchase of delivery equipment through a five-year fixed rate note at 4.99%. The note requires payments through December 2010. The delivery equipment purchased with the note proceeds secures the note.

An officer of the Company is a director at one of the banks where the Company maintains a \$4.0 million line of credit and where its routine daily banking transactions are processed. The Company receives no special services or pricing on the services performed by the bank due to the directorship of this officer. No amounts were outstanding on this line of credit at June 30, 2006.

9. INCOME TAXES

The provision for income taxes is as follows for the years ended June 30:

	2006	2005	2004
Federal – current	\$ 2,140,000	\$ 1,050,000	\$ 4,220,000
State – current	350,000	460,000	800,000
Deferred	570,000	1,150,000	1,590,000
Total	\$ 3,060,000	\$ 2,660,000	\$ 6,610,000

The total income tax provision in fiscal 2006, 2005 and 2004 was 39.3%, 30.6% and 39.5%, respectively, of income before income taxes. During fiscal 2005, an examination by the Internal Revenue Service of the Company's federal income tax returns for the fiscal years ended June 30, 2003 and 2004 was completed. Due to the favorable settlement results, the Company reduced its estimate of accrued tax liabilities resulting in a \$0.7 million reduction in tax expense. The effect of such settlement is included in "Other" in the table below. Amounts accrued for potential federal and state assessments totaled \$0.5 million at June 30, 2006 and \$0.2 million at June 30, 2005. These accruals are for federal, state and international tax issues. A reconciliation between the U.S. federal statutory tax rate and the effective tax rate is as follows for the years ended June 30:

	2006	2005	2004
Federal statutory tax rate	34.0%	34.0%	34.0%
State taxes, net of federal effect	2.8	3.5	3.1
Other	2.5	(6.9)	2.4
Effective tax rate	39.3%	30.6%	39.5%

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

	June 30, 2006		June 30, 2005	
	Current	Long-term	Current	Long-term
Investments	\$ (460,000)	\$ —	\$ (460,000)	\$ —
Accounts receivable	1,070,000	—	1,160,000	—
Inventory	1,080,000	—	670,000	—
Self insurance	1,150,000	—	1,200,000	—
Employee benefits	600,000	—	800,000	—
Accrued expenses	1,200,000	—	1,060,000	—
Other current accruals and allowances	(20,000)	—	—	—
Property, plant and equipment	—	210,000	—	(520,000)
Deferred compensation	—	2,130,000	—	2,530,000
Other long-term accruals and allowances	—	(130,000)	—	(180,000)
Total	\$ 4,620,000	\$ 2,210,000	\$ 4,430,000	\$ 1,830,000

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10. STOCK-BASED COMPENSATION

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

(1) Management Incentive Plan – This plan provides for shares of common stock to be awarded to key employees based on targeted rate of earnings to common equity as established by the Board of Directors. Shares awarded to employees are subject to the restriction of continued employment, with one-third of the stock received by the employee on the award date and the remaining shares vested after one and two years. Under the plan no shares were awarded during the fiscal year ended June 30, 2006. Under the plan, 15,239 and 38,620 shares were awarded, and the amount charged to income was \$215,000 and \$680,000 in fiscal 2005 and 2004, respectively. As of June 30, 2006, there were 17,771 unvested shares outstanding with a total grant date fair value of \$300,000. Compensation cost related to these awards was not material during the fiscal year ended June 30, 2006 and is not expected to be material over the weighted average remaining life of 0.2 years. The Company expects forfeitures under this plan to be nominal and there were no forfeitures in the fiscal years ended June 30, 2006 and 2005. At June 30, 2006, 69,357 shares were available for future grants.

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

Accounting Principles Applied – Prior to July 1, 2005, the Company had elected to apply APB Opinion No. 25 and related interpretations in accounting for its stock option plans, as permitted under SFAS No. 123 "Accounting for Stock-Based Compensation" and SFAS No. 148 "Accounting for Stock-Based Compensation-Transition and Disclosure". Accordingly, no compensation cost was recognized for its stock option plans, as the exercise price was equal to the market price of the Company's stock on the date of grant.

On July 1, 2005, the Company adopted the fair value recognition provisions of SFAS No. 123 (R), requiring the Company to recognize expense related to the fair value of stock-based compensation. The modified prospective transition method was used as allowed under SFAS No. 123(R). Under this method, the stock-based compensation expense includes: (a) compensation expense for all stock-based compensation awards granted prior to, but not yet vested as of July 1, 2005, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, "Accounting for Stock-Based Compensation"; and (b) compensation expense for all stock-based compensation awards granted subsequent to July 1, 2005, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123(R).

In December 2005 the Company issued options for 159,500 common shares at an exercise price of \$14.40 (the fair market value on the date of grant). The options were immediately available for exercise and may be exercised for a period of 10 years. In accordance with the provisions of SFAS No. 123(R) the Company recorded compensation expense of \$0.4 million. The Company also recorded a reduction of its income tax expense of \$0.1 million related to the issuance of these options. There were no unvested options outstanding at July 1, 2004 (as all options are fully vested upon grant). The assumptions used in determining the compensation expense and related income tax impacts are discussed below.

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Had the compensation expense for the Company's incentive stock option plans been determined based on the fair value at the grant dates for awards under those plans consistent with the fair-value methodology of SFAS No. 123, the Company's net income and earnings per share would have been reduced to the following pro forma amounts:

	2005	2004
Net income, as reported	\$ 6,043,956	\$ 10,130,257
Deduct: Total stock-based employee compensation expense determined under fair value method for all awards, net of related tax effects	(301,000)	(427,000)
Pro forma net income	\$ 5,742,956	\$ 9,703,257
Earnings per share:		
Basic – as reported	\$ 0.93	\$ 1.57
Basic – pro forma	0.88	1.51

Diluted – as reported	\$	0.92	\$	1.55
Diluted – pro forma		0.87		1.49

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants in fiscal 2006, 2005 and 2004, respectively; dividend yield of 3.6%, 3.2% and 2.7%; expected volatility of 23.3%, 22.2% and 25.8%; risk-free interest rate of 4.5%, 4.2% and 4.3%; and an expected life of 5 years on all options. The expected volatility is determined based on historical data. The expected life is based on the “simplified” method described in the SEC Staff Accounting Bulletin, Topic 14: Share-Based Payment.

The weighted-average grant date fair value of stock options granted during the fiscal years ended June 30, 2006, 2005 and 2004, was \$2.93, \$3.04 and \$4.91, respectively. The cash proceeds, income tax benefit and aggregate intrinsic value of options (the amount by which the market price of the stock on the date of exercise exceeded the market price of stock on the date of grant) exercised during the fiscal years ended June 30, 2006, 2005 and 2004, respectively, was not material.

At June 30, 2006, 126,000 shares were available for future grants. It is the Company’s policy to issue new shares upon exercise of stock options. The Company accepts shares of the Company’s common stock as payment for exercise of options. These shares received as payment are retired upon receipt.

A summary of the status of the Company’s stock option plans as of June 30, 2006, 2005 and 2004 and the changes during the years then ended is presented below:

	Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value (in millions)
Outstanding and exercisable at June 30, 2003	557,845	\$ 12.70	\$ 2.1
Granted	162,126	19.27	
Exercised	(362,361)	11.89	
Canceled	(1,969)	21.68	
Outstanding and exercisable at June 30, 2004	355,641	16.47	2.5
Granted	153,450	16.49	
Exercised	(4,595)	12.68	
Canceled	(895)	20.26	
Outstanding and exercisable at June 30, 2005	503,601	16.50	0.2
Granted	159,500	14.40	
Exercised	(2,000)	11.25	
Canceled	—	—	
Outstanding and exercisable at June 30, 2006	661,101	\$ 16.01	\$ 0.1

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The following table summarizes information for options outstanding and exercisable at June 30, 2006:

Range of Prices	Options Outstanding	Remaining Life (Years)	Weighted Average Exercise Price
\$ 10.30 – 11.44	26,200	4.5	\$ 10.65
12.66 – 13.59	55,200	3.1	13.18
14.40 – 16.52	431,806	8.2	15.56
19.21 – 20.27	147,895	7.4	19.32
\$ 10.30 – 22.35	661,101	7.5	\$ 16.01

11. ACCRUED WARRANTY COSTS

The following table presents the changes in the Company’s product warranty liability for the years ended June 30:

	2006	2005
Accrued warranty costs at beginning of year	\$ 1,151,000	\$ 1,190,000
Payments made for warranty and related costs	(3,441,000)	(3,526,000)
Accrual for product warranty and related costs	3,430,000	3,487,000
Accrued warranty costs at end of year	\$ 1,140,000	\$ 1,151,000

12. BENEFIT AND RETIREMENT PLANS

The Company sponsors various defined contribution pension and retirement plans, which cover substantially all employees, other than employees

covered by multi-employer pension plans under collective bargaining agreements. It is the Company's policy to fund all pension costs accrued. Total pension and retirement plan expense was \$1,966,000, \$2,007,000 and \$2,026,000 in fiscal 2006, 2005, 2004, respectively. The amounts include \$517,000, \$518,000 and \$513,000 in fiscal 2006, 2005 and 2004, respectively, for the Company's matching contribution to retirement savings plans. The Company's cost for pension plans is generally determined as 2% - 6% of each covered employee's wages. The Company's matching contribution for the retirement savings plans is generally 25% - 50% of employee contributions (up to 4% of employee earnings). In addition to the above, amounts charged to pension expense and contributed to multi-employer defined benefit pension plans administered by others under collective bargaining agreements were \$976,000, \$1,166,000 and \$1,286,000 in fiscal 2006, 2005 and 2004, respectively.

The Company has unfunded post-retirement benefit and deferred compensation plans with executive officers. The plans require various annual contributions for the participants based upon compensation levels and age. All participants are fully vested. For fiscal 2006, 2005 and 2004, the benefit obligation was increased by interest expense of \$228,000, \$151,000 and \$134,000, service costs of \$296,000, \$440,000 and \$413,000, and decreased by payments of \$445,000, \$298,000 and \$338,000, respectively. At June 30, 2006, the benefit obligation was \$5,044,000, including \$470,000 for defined benefits.

Under provisions of the Company's Voluntary Deferred Compensation Plan, executive officers may defer common stock awards received as participants of the Management Incentive Plan until retirement. Under the plan, no shares were awarded during the fiscal year ended June 30, 2006. In fiscal 2005 and 2004, the Company awarded 7,117 and 18,507 shares with an award value of \$100,000 and \$330,000, respectively, based on quoted market prices at the applicable award dates that have been deferred by the plan participants. At June 30, 2006 and 2005, 68,131 and 70,181 shares with an award value of \$990,000 and \$1,010,000, respectively, had been deferred and are being held in trust on behalf of the employees. Under the plan, 2,050 shares were redeemed in both fiscal 2006 and fiscal 2005.

The Company's defined benefit pension plan covers 84 active hourly production employees of DMI. There are a total of 502 participants in the plan. Retirement benefits are based on years of credited service multiplied by a dollar amount negotiated under collective bargaining agreements. The Company's policy is to fund normal costs and amortization of prior service costs at a level that is equal to or greater than the minimum required under the Employee Retirement Income Security Act of 1974 (ERISA). According to an agreement reached with the collective bargaining unit, all benefits and participants are fixed. Future benefits will accrue to current participants; however, new participants cannot be added to the plan. As of June 30, 2006 and June 30, 2005, the accrued benefit liability related to the defined benefit pension plan recognized on the Company's consolidated balance sheet was \$0.4 million and \$1.6 million, respectively. The accumulated benefit obligation was \$4.8 and \$5.5 at fiscal years ended June 30, 2006 and 2005, respectively.

13. COMPREHENSIVE INCOME

The components of comprehensive income, net of income taxes, for the years ended June 30, were as follows:

	2006	2005	2004
Net income	\$ 4,718,183	\$ 6,043,956	\$ 10,130,257
Other comprehensive income (OCI):			
Change in fair value of derivatives, net of income taxes of \$(73,000), \$(5,000) and \$(93,000), respectively	116,910	(6,810)	140,884
Change in fair value of available-for-sale, securities, net of income taxes of \$136, \$(126,863) and \$(143,112), respectively	(221)	209,352	219,197
Change in minimum pension liability, net of income taxes of \$(305,468), \$323,410 and \$145,800, respectively	543,559	(550,670)	(223,315)
Total other comprehensive income	660,248	(348,128)	136,766
Total comprehensive income	\$ 5,378,431	\$ 5,695,828	\$ 10,267,023

The components of accumulated other comprehensive income, net of income taxes, are as follows:

	June 30,	
	2006	2005
Available-for-sale securities	\$ 757,580	\$ 757,801
Interest rate swaps	(254,638)	(371,548)
Minimum pension liability	263,170	(280,389)
Total accumulated other comprehensive income	\$ 766,112	\$ 105,864

14. LITIGATION

From time to time, the Company is subject to various 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 proceedings that are currently pending, individually or in the aggregate, to be material to its business or likely to result in a material adverse effect on its consolidated operating results, financial condition, or cash flows.

15. COMMITMENTS AND CONTINGENCIES

FACILITY LEASES – the Company leases certain facilities and equipment under various operating leases. These leases require the Company to pay the lease cost, operating costs, including property taxes, insurance, and maintenance. Total lease expense related to the various operating leases was approximately \$3,390,000, \$2,790,000 and \$2,370,000 in fiscal 2006, 2005 and 2004, respectively.

Expected future minimum commitments under operating leases and lease guarantee as of June 30, 2006 were as follows (in thousands):

Fiscal Year Ended June 30	
2007	\$ 2,023
2008	1,137
2009	866
2010	565
2011	254
Thereafter	445
	\$ 5,290

GUARANTEE – the Company has guaranteed the future lease payments of a third party ending August 2007. The annual minimum lease payments are approximately \$230,000, and the remaining minimum payments are approximately \$270,000 at June 30, 2006. The Company has not been required to make any payments under the guarantee.

16. SUPPLEMENTAL CASH FLOW INFORMATION

Non-Cash Financing Activities – During fiscal 2006, the Company purchased delivery equipment of \$2.6 million financed by a note payable.

Non-Cash Investing Activities – In September 2003, the Company purchased all of the common stock of DMI for \$19.5 million (including acquisition costs of \$2.8 million). In conjunction with the acquisition, liabilities were assumed as follows:

Fair value of assets acquired	\$ 54,945,000
Cash paid for common stock	19,496,000
	\$ 35,449,000

17. SEGMENTS

The Company operates in one reportable operating segment, furniture products. Our operations involve the distribution of manufactured and imported products consisting of a broad line 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 for residential, recreational vehicle, and commercial markets. The Company's furniture products are sold primarily throughout the United States by the Company's internal sales force and various independent representatives. The Company makes minimal export sales. No single customer accounted for more than 10% of net sales. The Company has no foreign manufacturing operations and all of our long-lived assets are located within the United States.

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

	FOR THE YEARS ENDED JUNE 30,		
	2006	2005	2004
Residential	\$ 267,714	\$ 261,900	\$ 266,251
Recreational Vehicle	71,981	78,838	85,421
Commercial	86,713	69,284	49,550
	\$ 426,408	\$ 410,022	\$ 401,222

18. SUPPLEMENTARY QUARTERLY FINANCIAL INFORMATION – UNAUDITED

(in thousands of dollars, except per share amounts)

	FOR THE QUARTER ENDED			
	September 30	December 31	March 31	June 30
Fiscal 2006:				
Net sales	\$ 97,435	\$ 106,301	\$ 110,346	\$ 112,326

Gross margin	19,143	19,703	21,366	21,127
Net income (1)	985	489	1,762	1,482
Earnings per share:				
Basic	0.15	0.07	0.27	0.23
Diluted	0.15	0.07	0.27	0.23

FOR THE QUARTER ENDED

	<u>September 30</u>	<u>December 31</u>	<u>March 31</u>	<u>June 30</u>
Fiscal 2005:				
Net sales	\$ 97,856	\$ 105,051	\$ 101,348	\$ 105,768
Gross margin	17,855	20,400	18,173	20,424
Net income (2) (3) (4)	1,200	1,605	1,699	1,540
Earnings per share:				
Basic	0.18	0.25	0.26	0.24
Diluted	0.18	0.24	0.26	0.23

The sum of the per share amounts for the quarters may not equal the total for the year due to the treasury stock method.

- (1) The quarter ended December 31, 2005 includes the recording of stock-based compensation expense of \$0.4 million (after tax) for stock options under SFAS No. 123 (R) or \$0.06 per share.
- (2) The quarter ended September 30, 2004 includes a net gain (after tax) on the sale of a facility of approximately \$0.4 million or \$0.06 per share.
- (3) The quarter ended March 31, 2005 includes a net gain (after tax) on the sale of a facility of approximately \$0.1 million or \$0.02 per share.
- (4) During the quarter ended March 31, 2005, an examination by the Internal Revenue Service of the Company's federal income tax returns for the fiscal years ended June 30, 2003 and 2004 was completed. Due to the favorable settlement results, the Company reduced its estimate of accrued tax liabilities by \$0.7 million.

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

None.

Item 9A. Controls and Procedures

Evaluation of disclosure controls and procedures – Based on their evaluation as of the end of the period covered by this Annual Report on Form 10-K, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e)) under the Securities Exchange Act of 1934, as amended) were effective as of the date of such evaluation to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

Changes in internal control over financial reporting – During the quarter ended June 30, 2006, there were no significant changes in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934) that has materially affected, or is reasonably likely to materially affect the Company's internal control over financial reporting.

Management's Annual Report on Internal Control Over Financial Reporting – Management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rules 13a-15(f) or 15d-15(f) of the Securities Exchange Act of 1934, as amended. Under the supervision and with the participation of management (including our Chief Executive Officer and Chief Financial Officer), we conducted an evaluation of the effectiveness of our internal control over financial reporting as of June 30, 2006, based on the criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under this framework, management concluded that the internal control over financial reporting was effective as of June 30, 2006. Deloitte & Touche LLP, the independent registered public accounting firm that audited the consolidated financial statements included in this Annual Report on Form 10-K, has issued an attestation report on management's assessment of the effectiveness of our internal control over financial reporting as of June 30, 2006 which is included in Item 8 of this Annual Report on Form 10-K.

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our internal control over financial reporting will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. Our internal control over financial reporting, however, is designed to provide reasonable assurance that the objectives of internal control over financial reporting are met.

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Item 9B. Other Information

None.

Item 10. Directors and Executive Officers of the Registrant

The information identifying directors of the Company and Section 16(a) beneficial ownership reporting compliance, will be contained in the Company's fiscal 2006 definitive proxy statement to be filed with the Securities and Exchange Commission under the sections captioned "Proposal 1 Election of Directors" and "Compliance with Section 16(A) of the Securities Exchange Act of 1934" and are incorporated herein by reference.

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

The executive officers of the Company, their ages, positions (in each case as of June 30, 2006), and the month and year they were first elected or appointed an officer of the registrant, are as follows:

Name (age)	Position (date first became officer)
K. Bruce Lauritsen (63)	Vice Chairman & Chief Executive Officer (November 1979)
Ronald J. Klosterman (58)	President & Chief Operating Officer (June 1989)
James R. Richardson (62)	Senior Vice President of Residential Sales and Marketing (November 1979)
Thomas D. Burkart (63)	Senior Vice President of Vehicle Seating (February 1984)
Patrick M. Crahan (58)	Senior Vice President of Commercial Seating (June 1989)
Jeffrey T. Bertsch (51)	Senior Vice President of Corporate Services (June 1989)
Donald D. Dreher (57)	Senior Vice President, President & CEO of DMI Furniture, Inc. (December 2004)
James E. Gilbertson (56)	Vice President of Vehicle Seating (June 1989)
Timothy E. Hall (48)	Vice President-Finance, Chief Financial Officer & Secretary (December 2000)

Each named executive officer has held the same office or an executive or management position with the Company for at least five years except Mr. Dreher who has served as President and CEO of DMI Furniture, Inc. from 1986 to present.

Item 11. Executive Compensation

The information identifying executive compensation will be contained in the Company's fiscal 2006 definitive proxy statement to be filed with the Securities and Exchange Commission under the sections captioned "Summary Compensation Table," "Stock Options/SAR Option Grants in Last Fiscal Year," "Option Exercises and Fiscal Year-end Values," "Long-Term Incentive Plan Awards Table," "Nominating and Compensation Committee Report concerning Flexsteel's Executive Compensation Policy," "Compensation Committee Interlocks and Insider Participation," and "Certain Information concerning Board and Outside Directors' Compensation" and are incorporated herein by reference.

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

The information identifying beneficial ownership of stock and supplementary data will be contained in the Company's fiscal 2006 definitive proxy statement to be filed with the Securities and Exchange Commission under the sections captioned "Ownership of Stock By Directors and Executive Officers," "Ownership of Stock by Certain Beneficial Owners," and "Equity Compensation Plan Information" and are incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions

This information will be contained under the heading "Certain Relationships and Related Transactions" in the Company's fiscal 2006 definitive proxy statement to be filed with the Securities and Exchange Commission and is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services

Deloitte & Touche LLP was the Company's independent registered public accounting firm in fiscal 2006. In addition to performing the audit of the Company's consolidated financial statements, Deloitte & Touche LLP provided various audit-related and tax services during fiscal 2006.

The Audit and Ethics Committee pre-approves both the type of services to be provided by Deloitte & Touche LLP and the estimated fees related to these services. The Audit and Ethics Committee reviewed professional services and the possible effect on Deloitte & Touche LLP's independence was considered. The Audit and Ethics Committee has considered and found the provision of services for non-audit services compatible with maintaining Deloitte & Touche LLP's independence. The services provided by Deloitte & Touche LLP during fiscal 2006 were 100% pre-approved by the Audit and Ethics Committee during fiscal 2006.

The aggregate fees billed for each of the past two fiscal years ended June 30 for each of the following categories of services are set forth below:

	2006	2005
Audit Fees ⁽¹⁾	\$ 375,000	\$ 452,000
Audit Related Fees ⁽²⁾	15,000	70,000
Tax Services ⁽³⁾	10,000	77,000
All Other Fees ⁽⁴⁾	-	-
Total	\$ 400,000	\$ 599,000

(1) Professional fees and expenses for audit of financial statements and internal control over financial reporting services billed in fiscal 2006 and 2005

consisted of (i) audit of the Company's annual consolidated financial statements; (ii) reviews of the Company's quarterly consolidated financial statements; (iii) consents and other services related to Securities and Exchange Commission matters; and (iv) consultations on financial accounting and reporting matters arising during the course of the audit and reviews.

- (2) Professional fees and expenses for audit-related services billed in fiscal 2006 and 2005 consisted of (i) Sarbanes-Oxley Act Section 404 advisory services and internal accounting controls related services, \$0 and \$49,000, respectively; and (ii) employee benefit plan audits, \$15,000 and \$22,000, respectively.
- (3) Professional fees and expenses for tax services billed in fiscal 2006 and 2005 consisted of tax compliance and tax planning and advice. Tax compliance services totaled \$0 and \$65,000 in fiscal 2006 and 2005, respectively, and consisted of (i) tax return assistance; (ii) assistance with tax return filings in certain foreign jurisdictions; (iii) assistance with tax audits and appeals; and (iv) preparation of expatriate tax returns. Tax planning and advice services totaled \$10,000 and \$12,000 in fiscal 2006 and 2005, respectively, and consisted of (i) tax advice related to structuring certain proposed transactions; and (ii) general tax planning matters.
- (4) No other professional services were provided during fiscal 2006 and 2005.

PART IV

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

- (a) (1) Financial Statements

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

- (2) Schedules

The following financial statement schedules for the years ended June 30, 2006, 2005 and 2004 are submitted herewith:

SCHEDULE II

RESERVES

For the Years Ended June 30, 2006, 2005 and 2004

Description	Balance at Beginning of Year	Additions Charged to Income	Deductions from Reserves (Note)	Balance at End of Year
Allowance for Doubtful Accounts:				
2006	\$ 3,060,000	\$ 850,000	\$ (1,090,000)	\$ 2,820,000
2005	\$ 2,820,000	\$ 1,140,000	\$ (900,000)	\$ 3,060,000
2004	\$ 2,110,000	\$ 880,000	\$ (170,000)	\$ 2,820,000

NOTE 3/4 In fiscal 2004, uncollectible accounts charged against reserve less recoveries of \$900,000 and purchase accounting adjustment of \$730,000.

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

- (3) Exhibit No.
- 3.1 Restated Article of Incorporation by reference to Exhibit No. 8 to the Registrant's Annual Report on Form 10-K for the fiscal year ended June 30, 1988.
- 3.2 Amendment to Restated Article of Incorporation filed on January 15, 1993. Filed herewith.
- 3.3 Bylaws of the Registrant incorporated by reference to Exhibit No. 7 to the Annual Report on Form 10-K for the fiscal year ended June 30, 1993.
- 10.1 1995 Stock Option Plan incorporated by reference from the 1995 Flexsteel definitive proxy statement.*
- 10.2 Management Incentive Plan incorporated by reference from the 1980 Flexsteel definitive proxy statement - commission file #0-5151.*
- 10.3 1999 Stock Option Plan incorporated by reference from the 1999 Flexsteel definitive proxy statement.*
- 10.4 Flexsteel Industries, Inc. Voluntary Deferred Compensation Plan incorporated by reference to Exhibit No. 10.5 to the Annual Report on

10.5 Flexsteel Industries, Inc. Restoration Retirement Plan incorporated by reference to Exhibit No. 10.6 to the Annual Report on Form 10-K for the fiscal year ended June 30, 2001.*

10.6 Flexsteel Industries, Inc. Senior Officer Supplemental Retirement Plan incorporated by reference to Exhibit No. 10.7 to the Annual Report on Form 10-K for the fiscal year ended June 30, 2001.*

10.7 2002 Stock Option Plan incorporated by reference to Appendix A from the 2002 Flexsteel definitive proxy statement.*

10.8 Agreement and Plan of Merger, dated as of August 12, 2003, by and among Flexsteel, Churchill Acquisition Corp. and DMI (incorporated by reference to Exhibit 99(d)(1) of Flexsteel Industries, Inc.'s Tender Offer Statement on Schedule TO filed with the Securities and Exchange Commission on August 20, 2003) incorporated by reference to Form 8-K and Amendments No. 1 to Form 8-K, as filed with Securities and Exchange Commission on October 2, 2003.

10.9 Credit Facility Agreement dated June 30, 2004 as amended or modified on June 10, 2005, August 19, 2005, December 23, 2005, January 3, 2006 and May 19, 2006. Filed herewith.

21.1 Subsidiaries of the Company. Filed herewith.

23 Consent of Independent Registered Public Accounting Firm. Filed herewith.

31.1 Certification by Chief Executive Officer Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. Filed herewith.

31.2 Certification by Chief Financial Officer Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. Filed herewith.

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

99.1 Report of Independent Registered Public Accounting Firm. Filed herewith.

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

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: September 7, 2006

FLEXSTEEL INDUSTRIES, INC.

By: /S/ K. Bruce Lauritsen

K. Bruce Lauritsen
Chief Executive Officer
and
Principal Executive Officer

By: /S/ Timothy E. Hall

Timothy E. Hall
Chief Financial Officer
and
Principal Financial Officer

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

Date: September 7, 2006

/S/ K. Bruce Lauritsen

K. Bruce Lauritsen
Vice Chairman

Date: September 7, 2006

/S/ James R. Richardson

James R. Richardson
Director

Date:	September 7, 2006	<i>/S/ Jeffrey T. Bertsch</i>
		Jeffrey T. Bertsch <i>Director</i>
Date:	September 7, 2006	<i>/S/ L. Bruce Boylen</i>
		L. Bruce Boylen <i>Director</i>
Date:	September 7, 2006	<i>/S/ Patrick M. Crahan</i>
		Patrick M. Crahan <i>Director</i>
Date:	September 7, 2006	<i>/S/ Lynn J. Davis</i>
		Lynn J. Davis <i>Director</i>
Date:	September 7, 2006	<i>/S/ Thomas E. Holloran</i>
		Thomas E. Holloran <i>Director</i>
Date:	September 7, 2006	<i>/S/ Robert E. Deignan</i>
		Robert E. Deignan <i>Director</i>
Date:	September 7, 2006	<i>/S/ Eric S. Rangen</i>
		Eric S. Rangen <i>Director</i>
Date:	September 7, 2006	<i>/S/ Mary C. Bottie</i>
		Mary C. Bottie <i>Director</i>
Date:	September 7, 2006	<i>/S/ R. J. Klosterman</i>
		Ronald J. Klosterman <i>Director</i>

State of Minnesota
Office of the Secretary of State

[MINNESOTA STATE SEAL]

AMENDMENT OF ARTICLES OF INCORPORATION

> READ INSTRUCTIONS AT BOTTOM OF PAGE BEFORE COMPLETING THIS FORM

CORPORATE NAME
Flexsteel Industries, Inc.

This amendment is effective on the day it is filed with the Secretary of State, unless you indicate another date no later than 30 days after filing with the Secretary of State, in this box:

N/A

The following amendments of articles or modifications to the statutory requirements regulating the above corporation were adopted: (Insert full text of newly amended or modified article(s) indicating which article(s) is/are being amended or added. If the full text of the amendment will not fit in the space provided, please do not use this form. Instead, retype the amendment on a separate sheet or sheets using this format.)

V Subsection A

ARTICLE _____

The Restated Articles of Incorporation are hereby amended by deleting in Article V Subsection A the wording "The number of directors shall be set by the Board but shall not be less than three (3) nor more than ten (10)." with the following language. "The number of directors shall be set by the Board but shall not be less than three (3) nor more than eleven (11)."

This amendment has been approved pursuant to chapter 302A. Minnesota Statutes.

I certify that I am authorized to execute this amendment and I further certify that I understand that by signing this amendment, I am subject to the penalties of perjury as set forth in section 609.48 as if I had signed this amendment under oath.

/s/ R. J. Klosterman
(Signature of Authorized Person)

R. J. Klosterman, Treasurer

INSTRUCTIONS

1. Type or print with dark black ink.
2. Filing fee: \$35.00.
3. Make check payable to Secretary of State.
4. Mail or bring completed forms to:

Secretary of State
Business Services Division
180 State Office Building
Saint Paul, MN 55155
(612) 296-2803

SC 9175 03 (9/88)

FOR USE BY THE SECRETARY OF STATE

[STATE OF MINNESOTA
DEPARTMENT OF STATE
FILED
JAN 15 1993
/s/ Joan Anderson Growe

Secretary of State]


Note Modification Agreement

This agreement is dated as of May 19, 2006 (the "Agreement Date"), by and between Flexsteel Industries, Inc. (the "Borrower") and JPMorgan Chase Bank, N.A., as successor by merger to Bank One, NA, with its main office in Chicago, Illinois (the "Bank"). The provisions of this agreement are effective on the date that this agreement has been executed by all of the signers and delivered to the Bank (the "Effective Date").

WHEREAS, the Borrower executed a Line of Credit Note as evidence of indebtedness in the original face amount of Twenty Million and 00/100 Dollars (\$20,000,000.00), dated June 10, 2005 owing by the Borrower to the Bank, as same may have been amended or modified from time to time (the "Note"), which Note has at all times been, and is now, continuously and without interruption outstanding in favor of the Bank; and,

WHEREAS, the Borrower has requested and the Bank has agreed that the Note be modified to the limited extent as hereinafter set forth;

NOW THEREFORE, in mutual consideration of the agreements contained herein and for other good and valuable consideration, the parties agree as follows:

1. **ACCURACY OF RECITALS.** The Borrower acknowledges the accuracy of the Recitals stated above.

2. **MODIFICATION OF NOTE.**

2.1 From and after the Effective Date, the provisions in the Note captioned "**Due**", "**Promise to Pay**" and "**Principal Payments**" are hereby amended by deleting the date of June 29, 2006 contained therein and replacing it with the date of June 29, 2007.

2.2 Each of the Related Documents is modified to provide that it shall be a default or an event of default thereunder if the Borrower shall fail to comply with any of the covenants of the Borrower herein or if any representation or warranty by the Borrower herein or by any guarantor in any Related Documents is materially incomplete, incorrect, or misleading as of the date hereof. As used in this agreement, the "Related Documents" shall include the Note and all loan agreements, credit agreements, reimbursement agreements, security agreements, mortgages, deeds of trust, pledge agreements, assignments, guaranties, or any other instrument or document executed in connection with the Note or in connection with any other obligations of the Borrower to the Bank.

2.3 Each reference in the Related Documents to any of the Related Documents shall be a reference to such document as modified herein.

3. **RATIFICATION OF RELATED DOCUMENTS AND COLLATERAL.** The Related Documents are ratified and reaffirmed by the Borrower and shall remain in full force and effect as they may be modified herein. All real or personal property described as security in the Related Documents shall remain as security for the Note and the obligations of the Borrower in the Related Documents.

4. **BORROWER REPRESENTATIONS AND WARRANTIES.** The Borrower represents and warrants to the Bank that each of the following representations and warranties made in the Note and Related Documents are true and will remain true until maturity of the Note, termination of the other Related Documents and payment and performance in full of all liabilities, obligations and debt evidenced by the Note and other Related Documents:

4.1 No default or event of default under any of the Related Documents as modified hereby, nor any event, that, with the giving of notice or the passage of time or both, would be a default or an event of default under the Related Documents as modified herein has occurred and is continuing.

4.2 There has been no material adverse change in the business, assets, affairs, prospects or financial condition of the Borrower or any Guarantor or any subsidiary of the Borrower.

4.3 Each and all representations and warranties of the Borrower in the Related Documents are accurate on the date hereof.

4.4 The Borrower has no claims, counterclaims, defenses, or setoffs with respect to the loan evidenced by the Note or with respect to the Related Documents as modified herein.

4.5 The Note and the Related Documents as modified herein are the legal, valid, and binding obligations of the Borrower, enforceable against the Borrower in accordance with their terms:

4.6 The Borrower, other than any Borrower who is a natural person, is validly existing under the laws of the State of its formation or organization. The Borrower has the requisite power and authority to execute and deliver this agreement and to perform the obligations described in the Related Documents as modified herein. The execution and delivery of this agreement and the performance of the obligations described in the Related Documents as modified herein have been duly authorized by all requisite action by or on behalf of the Borrower. This agreement has been duly executed and delivered by or on behalf of the Borrower.

5. **BORROWER COVENANTS.** The Borrower covenants with the Bank:

5.1 The Borrower shall execute, deliver, and provide to the Bank such additional agreements, documents, and instruments as reasonably required by the Bank to effectuate the intent of this agreement.

5.2 The Borrower fully, finally, and forever releases and discharges the Bank and its successors, assigns, directors, officers, employees, agents, and representatives from any and all causes of action, claims, debts, demands, and liabilities, of whatever kind or nature, in law or equity, of the Borrower, whether

now known or unknown to the Borrower, (i) in respect of the loan evidenced by the Note and the Related Documents, or of the actions or omissions of the Bank in any manner related to the loan evidenced by the Note or the Related Documents and (ii) arising from events occurring prior to the date of this agreement.

5.3 The Borrower shall pay to the Bank:

5.3.1 All the internal and external costs and expenses incurred (or charged by internal allocation) by the Bank in connection with this agreement (including, without limitation, inside and outside attorneys, appraisal, appraisal review, processing, title, filing, and recording costs, expenses, and fees).

6. **EXECUTION AND DELIVERY OF AGREEMENT BY THE BANK.** The Bank shall not be bound by this agreement until (i) the Bank has executed this agreement and (ii) the Borrower performed all of the obligations of the Borrower under this agreement to be performed contemporaneously with the execution and delivery of this agreement.

7. **INTEGRATION, ENTIRE AGREEMENT, CHANGE, DISCHARGE, TERMINATION, OR WAIVER.** The Note and the Related Documents as modified herein contain the complete understanding and agreement of the Borrower and the Bank in respect of the loan and supersede all prior representations, warranties, agreements, arrangements, understandings, and negotiations. No provision of the Note or the Related Documents as modified herein may be changed, discharged, supplemented, terminated, or waived except in a writing signed by the party against whom it is being enforced.

8. **GOVERNING LAW AND VENUE.** This agreement shall be governed by and construed in accordance with the laws of the State of Indiana (without giving effect to its laws of conflicts). The Borrower agrees that any legal action or proceeding with respect to any of its obligations under the Note or this agreement may be brought by the Bank in any state or federal court located in the State of Indiana, as the Bank in its sole discretion may elect. By the execution and delivery of this agreement, the Borrower submits to and accepts, for itself and in respect of its property, generally and unconditionally, the non-exclusive jurisdiction of those courts. The Borrower waives any claim that the State of Indiana is not a convenient forum or the proper venue for any such suit, action or proceeding. This agreement binds the Borrower and its successors, and benefits the Bank, its successors and assigns. The Borrower shall not, however, have the right to assign the Borrower's rights under this agreement or any interest therein, without the prior written consent of the Bank.

9. **COUNTERPART EXECUTION.** This agreement may be executed in multiple counterparts, each of which, when so executed, shall be deemed an original, but all such counterparts, taken together, shall constitute one and the same agreement.

THE REMAINDER OF THIS PAGE IS INTENTIONALLY LEFT BLANK

10. **NOT A NOVATION.** This agreement is a modification only and not a novation. In addition to all amounts hereafter due under the Note and the Related Documents as they may be modified herein, all accrued interest evidenced by the Note being modified by this agreement and all accrued amounts due and payable under the Related Documents shall continue to be due and payable until paid. Except for the above-quoted modification(s), the Note, any Related Documents, and all the terms and conditions thereof, shall be and remain in full force and effect with the changes herein deemed to be incorporated therein. This agreement is to be considered attached to the Note and made a part thereof. This agreement shall not release or affect the liability of any guarantor, surety or endorser of the Note or release any owner of collateral securing the Note. The validity, priority and enforceability of the Note shall not be impaired hereby. References to the Related Documents and to other agreements shall not affect or impair the absolute and unconditional obligation of the Borrower to pay the principal and interest on the Note when due. The Bank reserves all rights against all parties to the Note.

Borrower:

Address: 3400 Jackson St.
Dubuque, IA 52001

Flexsteel Industries, Inc.

By: /s/ Timothy E. Hall

Timothy E. Hall, VP & CFO
Printed Name Title

Date Signed: May 26, 2006

BANK'S ACCEPTANCE

The foregoing agreement is hereby agreed to and acknowledged.

Bank:

JPMorgan Chase Bank, N.A.

By: /s/ John C. Otteson

John C. Otteson, VP
Printed Name Title



Note Modification Agreement

This agreement is dated as of May 19, 2006 (the "Agreement Date"), by and between Flexsteel Industries, Inc. (the "Borrower") and JPMorgan Chase Bank, N.A., as successor by merger to Bank One, NA, with its main office in Chicago, Illinois (the "Bank"). The provisions of this agreement are effective on the date that this agreement has been executed by all of the signers and delivered to the Bank (the "Effective Date").

WHEREAS, the Borrower executed a Line of Credit Note as evidence of indebtedness in the original face amount of Twenty Million and 00/100 Dollars (\$20,000,000.00), dated June 30, 2004 owing by the Borrower to the Bank, as same may have been amended or modified from time to time (the "Note"), which Note has at all times been, and is now, continuously and without interruption outstanding in favor of the Bank; and,

WHEREAS, the Borrower has requested and the Bank has agreed that the Note be modified to the limited extent as hereinafter set forth;

NOW THEREFORE, in mutual consideration of the agreements contained herein and for other good and valuable consideration, the parties agree as follows:

1. **ACCURACY OF RECITALS.** The Borrower acknowledges the accuracy of the Recitals stated above.

2. **MODIFICATION OF NOTE.**

2.1 From and after the Effective Date, the provisions in the Note captioned "**Due**", "**Promise to Pay**" and "**Principal Payments**" are hereby amended by deleting the date of September 30, 2007 contained therein and replacing it with the date of October 31, 2010.

2.2 Each of the Related Documents is modified to provide that it shall be a default or an event of default thereunder if the Borrower shall fail to comply with any of the covenants of the Borrower herein or if any representation or warranty by the Borrower herein or by any guarantor in any Related Documents is materially incomplete, incorrect, or misleading as of the date hereof. As used in this agreement, the "Related Documents" shall include the Note and all loan agreements, credit agreements, reimbursement agreements, security agreements, mortgages, deeds of trust, pledge agreements, assignments, guaranties, or any other instrument or document executed in connection with the Note or in connection with any other obligations of the Borrower to the Bank.

2.3 Each reference in the Related Documents to any of the Related Documents shall be a reference to such document as modified herein.

3. **RATIFICATION OF RELATED DOCUMENTS AND COLLATERAL.** The Related Documents are ratified and reaffirmed by the Borrower and shall remain in full force and effect as they may be modified herein. All real or personal property described as security in the Related Documents shall remain as security for the Note and the obligations of the Borrower in the Related Documents.

4. **BORROWER REPRESENTATIONS AND WARRANTIES.** The Borrower represents and warrants to the Bank that each of the following representations and warranties made in the Note and Related Documents are true and will remain true until maturity of the Note, termination of the other Related Documents and payment and performance in full of all liabilities, obligations and debt evidenced by the Note and other Related Documents:

4.1 No default or event of default under any of the Related Documents as modified hereby, nor any event, that, with the giving of notice or the passage of time or both, would be a default or an event of default under the Related Documents as modified herein has occurred and is continuing.

4.2 There has been no material adverse change in the business, assets, affairs, prospects or financial condition of the Borrower or any Guarantor or any subsidiary of the Borrower.

4.3 Each and all representations and warranties of the Borrower in the Related Documents are accurate on the date hereof.

4.4 The Borrower has no claims, counterclaims, defenses, or setoffs with respect to the loan evidenced by the Note or with respect to the Related Documents as modified herein.

4.5 The Note and the Related Documents as modified herein are the legal, valid, and binding obligations of the Borrower, enforceable against the Borrower in accordance with their terms.

4.6 The Borrower, other than any Borrower who is a natural person, is validly existing under the laws of the State of its formation or organization. The Borrower has the requisite power and authority to execute and deliver this agreement and to perform the obligations described in the Related Documents as modified herein. The execution and delivery of this agreement and the performance of the obligations described in the Related Documents as modified herein have been duly authorized by all requisite action by or on behalf of the Borrower. This agreement has been duly executed and delivered by or on behalf of the Borrower.

5. **BORROWER COVENANTS.** The Borrower covenants with the Bank:

5.1 The Borrower shall execute, deliver, and provide to the Bank such additional agreements, documents, and instruments as reasonably required by the Bank to effectuate the intent of this agreement.

5.2 The Borrower fully, finally, and forever releases and discharges the Bank and its successors, assigns, directors, officers, employees, agents, and representatives from any and all causes of action, claims, debts, demands, and liabilities, of whatever kind or nature, in law or equity, of the Borrower, whether now known or unknown to the Borrower, (i) in respect of the loan evidenced by the Note and the Related Documents, or of the actions or omissions of the Bank in any manner related to the loan evidenced by the Note or the Related Documents and (ii) arising from events occurring prior to the date of this agreement.

5.3 The Borrower shall pay to the Bank:

5.3.1 All the internal and external costs and expenses incurred (or charged by internal allocation) by the Bank in connection with this agreement (including, without limitation, inside and outside attorneys, appraisal, appraisal review, processing, title, filing, and recording costs, expenses, and fees).

6. **EXECUTION AND DELIVERY OF AGREEMENT BY THE BANK.** The Bank shall not be bound by this agreement until (i) the Bank has executed this agreement and (ii) the Borrower performed all of the obligations of the Borrower under this agreement to be performed contemporaneously with the execution and delivery of this agreement.

7. **INTEGRATION, ENTIRE AGREEMENT, CHANGE, DISCHARGE, TERMINATION, OR WAIVER.** The Note and the Related Documents as modified herein contain the complete understanding and agreement of the Borrower and the Bank in respect of the loan and supersede all prior representations, warranties, agreements, arrangements, understandings, and negotiations. No provision of the Note or the Related Documents as modified herein may be changed, discharged, supplemented, terminated, or waived except in a writing signed by the party against whom it is being enforced.

8. **GOVERNING LAW AND VENUE.** This agreement shall be governed by and construed in accordance with the laws of the State of Indiana (without giving effect to its laws of conflicts). The Borrower agrees that any legal action or proceeding with respect to any of its obligations under the Note or this agreement may be brought by the Bank in any state or federal court located in the State of Indiana, as the Bank in its sole discretion may elect. By the execution and delivery of this agreement, the Borrower submits to and accepts, for itself and in respect of its property, generally and unconditionally, the non-exclusive jurisdiction of those courts. The Borrower waives any claim that the State of Indiana is not a convenient forum or the proper venue for any such suit, action or proceeding. This agreement binds the Borrower and its successors, and benefits the Bank, its successors and assigns. The Borrower shall not, however, have the right to assign the Borrower's rights under this agreement or any interest therein, without the prior written consent of the Bank.

9. **COUNTERPART EXECUTION.** This agreement may be executed in multiple counterparts, each of which, when so executed, shall be deemed an original, but all such counterparts, taken together, shall constitute one and the same agreement.

THE REMAINDER OF THIS PAGE IS INTENTIONALLY LEFT BLANK

10. **NOT A NOVATION.** This agreement is a modification only and not a novation. In addition to all amounts hereafter due under the Note and the Related Documents as they may be modified herein, all accrued interest evidenced by the Note being modified by this agreement and all accrued amounts due and payable under the Related Documents shall continue to be due and payable until paid. Except for the above-quoted modification(s), the Note, any Related Documents, and all the terms and conditions thereof, shall be and remain in full force and effect with the changes herein deemed to be incorporated therein. This agreement is to be considered attached to the Note and made a part thereof. This agreement shall not release or affect the liability of any guarantor, surety or endorser of the Note or release any owner of collateral securing the Note. The validity, priority and enforceability of the Note shall not be impaired hereby. References to the Related Documents and to other agreements shall not affect or impair the absolute and unconditional obligation of the Borrower to pay the principal and interest on the Note when due. The Bank reserves all rights against all parties to the Note.

Address: 3400 Jackson St.
Dubuque, IA 52001

Borrower:

Flexsteel Industries, Inc.

By: /s/ Timothy E. Hall

Timothy E. Hall,

VP & CFO

Printed Name

Title

Date Signed: May 26, 2006

BANK'S ACCEPTANCE

The foregoing agreement is hereby agreed to and acknowledged.

Bank:

JPMorgan Chase Bank, N.A.

By: /s/ John C. Otteson

John C. Otteson,

VP

Printed Name

Title

Date Signed: May 30, 2006



Amendment to Credit Agreement

This agreement is dated as of May 19, 2006, by and between Flexsteel Industries, Inc. (the "Borrower") and JPMorgan Chase Bank, N.A., as successor by merger to Bank One, NA, with its main office in Chicago, Illinois (the "Bank"), and its successors and assigns. The provisions of this agreement are effective on the date that this agreement has been executed by all of the signers and delivered to the Bank (the "Effective Date").

WHEREAS, the Borrower and the Bank entered into a credit agreement dated June 30, 2004, as amended (if applicable) (the "Credit Agreement"); and

WHEREAS, the Borrower has requested and the Bank has agreed to amend the Credit Agreement as set forth below;

NOW, THEREFORE, in mutual consideration of the agreements contained herein and for other good and valuable consideration, the parties agree as follows:

- DEFINED TERMS.** Capitalized terms not defined herein shall have the meaning ascribed in the Credit Agreement.
- MODIFICATION OF CREDIT AGREEMENT.** The Credit Agreement is hereby amended as follows:
 - From and after the Effective Date, Section 1.4 of the Credit Agreement captioned "**Letters of Credit**" is hereby amended by deleting the date of "September 30, 2007" contained therein and replacing it with the date of "October 31, 2010".
- RATIFICATION.** The Borrower ratifies and reaffirms the Credit Agreement and the Credit Agreement shall remain in full force and effect as modified herein.
- BORROWER REPRESENTATIONS AND WARRANTIES.** The Borrower represents and warrants that (a) the representations and warranties contained in the Credit Agreement are true and correct in all material respects as of the date of this agreement, (b) no condition, act or event which could constitute an event of default under the Credit Agreement or any promissory note or credit facility executed in reference to the Credit Agreement exists, and (c) no condition, event, act or omission has occurred, which, with the giving of notice or passage of time, would constitute an event of default under the Credit Agreement or any promissory note or credit facility executed in reference to the Credit Agreement.
- FEES AND EXPENSES.** The Borrower agrees to pay all fees and out-of-pocket disbursements incurred by the Bank in connection with this agreement, including legal fees incurred by the Bank in the preparation, consummation, administration and enforcement of this agreement.
- EXECUTION AND DELIVERY.** This agreement shall become effective only after it is fully executed by the Borrower and the Bank.
- ACKNOWLEDGEMENTS OF BORROWER.** The Borrower acknowledges that as of the date of this agreement it has no offsets with respect to all amounts owed by the Borrower to the Bank arising under or related to the Credit Agreement on or prior to the date of this agreement. The Borrower fully, finally and forever releases and discharges the Bank and its successors, assigns, directors, officers, employees, agents and representatives from any and all claims, causes of action, debts and liabilities, of whatever kind or nature, in law or in equity, of the Borrower, whether now known or unknown to the Borrower, which may have arisen in connection with the Credit Agreement or the actions or omissions of the Bank related to the Credit Agreement on or prior to the date hereof. The Borrower acknowledges and agrees that this agreement is limited to the terms outlined above, and shall not be construed as an agreement to change any other terms or provisions of the Credit Agreement. This agreement shall not establish a course of dealing or be construed as evidence of any willingness on the Bank's part to grant other or future agreements, should any be requested.
- NOT A NOVATION.** This agreement is a modification only and not a novation. Except for the above-quoted modification(s), the Credit Agreement, any loan agreements, credit agreements, reimbursement agreements, security agreements, mortgages, deeds of trust, pledge agreements, assignments, guaranties, instruments or documents executed in connection with the Credit Agreement, and all the terms and conditions thereof, shall be and remain in full force and effect with the changes herein deemed to be incorporated therein. This agreement is to be considered attached to the Credit Agreement and made a part thereof. This agreement shall not release or affect the liability of any guarantor of any promissory note or credit facility executed

in reference to the Credit Agreement or release any owner of collateral granted as security for the Credit Agreement. The validity, priority and enforceability of the Credit Agreement shall not be impaired hereby. To the extent that any provision of this agreement conflicts with any term or condition set forth in the Credit Agreement, or any document executed in conjunction therewith, the provisions of this agreement shall supersede and control. The Bank expressly reserves all rights against all parties to the Credit Agreement.

Borrower:

Flexsteel Industries, Inc.

By: /s/ Timothy E. Hall

Timothy E. Hall,

VP & CFO

Printed Name

Title

Date Signed: May 26, 2006

Bank:

JPMorgan Chase Bank, N.A.

By: /s/ John C. Otteson

John C. Otteson,

VP

Printed Name

Title

Date Signed: May 30, 2006



Note Modification Agreement

This agreement is dated as of January 3, 2006 (the "Agreement Date"), by and between Flexsteel Industries, Inc. (the "Borrower") and JPMorgan Chase Bank, N.A. as successor by merger to Bank One, NA (the "Bank"). The provisions of this agreement are effective on the date that this agreement has been executed by all of the signers and delivered to the Bank (the "Effective Date").

WHEREAS, the Borrower executed a Line of Credit Note as evidence of indebtedness in the original face amount of Twenty Million and 00/100 Dollars (\$20,000,000.00), dated June 30, 2004 owing by the Borrower to the Bank, as same may have been amended or modified from time to time (the "Note"), which Note has at all times been, and is now, continuously and without interruption outstanding in favor of the Bank; and,

WHEREAS, the Borrower has requested and the Bank has agreed that the Note be modified to the limited extent as hereinafter set forth;

NOW THEREFORE, in mutual consideration of the agreements contained herein and for other good and valuable consideration, the parties agree as follows:

1. **ACCURACY OF RECITALS.** The Borrower acknowledges the accuracy of the Recitals stated above.

2. **MODIFICATION OF NOTE.**

2.1 From and after the Effective Date, the amount of the Note, and the maximum principal amount that may at any time be outstanding thereunder, is hereby increased to Twenty Million and 00/100 Dollars (\$20,000,000.00).

2.2 Each of the Related Documents is modified to provide that it shall be a default or an event of default thereunder if the Borrower shall fail to comply with any of the covenants of the Borrower herein or if any representation or warranty by the Borrower herein or by any guarantor in any Related Documents is materially incomplete, incorrect, or misleading as of the date hereof. As used in this agreement, the "Related Documents" shall include the Note and all loan agreements, credit agreements, reimbursement agreements, security agreements, mortgages, deeds of trust, pledge agreements, assignments, guaranties, or any other instrument or document executed in connection with the Note or in connection with any other obligations of the Borrower to the Bank.

2.3 Each reference in the Related Documents to any of the Related Documents shall be a reference to such document as modified herein.

3. **RATIFICATION OF RELATED DOCUMENTS AND COLLATERAL.** The Related Documents are ratified and reaffirmed by the Borrower and shall remain in full force and effect as they may be modified herein. All real or personal property described as security in the Related Documents shall remain as security for the Note and the obligations of the Borrower in the Related Documents.

4. **BORROWER REPRESENTATIONS AND WARRANTIES.** The Borrower represents and warrants to the Bank that each of the following representations and warranties made in the Note and Related Documents are true and will remain true until maturity of the Note, termination of the other Related Documents and payment and performance in full of all liabilities, obligations and debt evidenced by the Note and other Related Documents:

4.1 No default or event of default under any of the Related Documents as modified hereby, nor any event, that, with the giving of notice or the passage of time or both, would be a default or an event of default under the Related Documents as modified herein has occurred and is continuing.

4.2 There has been no material adverse change in the business, assets, affairs, prospects or financial condition of the Borrower or any Guarantor or any subsidiary of the Borrower.

4.3 Each and all representations and warranties of the Borrower in the Related Documents are accurate on the date hereof.

4.4 The Borrower has no claims, counterclaims, defenses, or setoffs with respect to the loan evidenced by the Note or with respect to the Related Documents as modified herein.

4.5 The Note and the Related Documents as modified herein are the legal, valid, and binding obligations of the Borrower, enforceable against the Borrower in accordance with their terms.

4.6 The Borrower, other than any Borrower who is a natural person, is validly existing under the laws of the State of its formation or organization. The Borrower has the requisite power and authority to execute and deliver this agreement and to perform the obligations described in the Related Documents as modified herein. The execution and delivery of this agreement and the performance of the obligations described in the Related Documents as modified herein have been duly authorized by all requisite action by or on behalf of the Borrower. This agreement has been duly executed and delivered by or on behalf of the Borrower.

5. **BORROWER COVENANTS.** The Borrower covenants with the Bank:

5.1 The Borrower shall execute, deliver, and provide to the Bank such additional agreements, documents, and instruments as reasonably required by the Bank to effectuate the intent of this agreement.

5.2 The Borrower fully, finally, and forever releases and discharges the Bank and its successors, assigns, directors, officers, employees, agents, and representatives from any and all causes of action, claims, debts, demands, and liabilities, of whatever kind or nature, in law or equity, of the Borrower, whether now known or unknown to the Borrower, (i) in respect of the loan evidenced by the Note and the Related Documents, or of the actions or omissions of the Bank in any manner related to the loan evidenced by the Note or the Related Documents and (ii) arising from events occurring prior to the date of this agreement.

5.3 The Borrower shall pay to the Bank:

5.3.1 All the internal and external costs and expenses incurred (or charged by internal allocation) by the Bank in connection with this agreement (including, without limitation, inside and outside attorneys, appraisal, appraisal review, processing, title, filing, and recording costs, expenses, and fees).

6. **EXECUTION AND DELIVERY OF AGREEMENT BY THE BANK.** The Bank shall not be bound by this agreement until (i) the Bank has executed this agreement and (ii) the Borrower performed all of the obligations of the Borrower under this agreement to be performed contemporaneously with the execution and delivery of this agreement.

7. **INTEGRATION, ENTIRE AGREEMENT, CHANGE, DISCHARGE, TERMINATION, OR WAIVER.** The Note and the Related Documents as modified herein contain the complete understanding and agreement of the Borrower and the Bank in respect of the loan and supersede all prior representations, warranties, agreements, arrangements, understandings, and negotiations. No provision of the Note or the Related Documents as modified herein may be changed, discharged, supplemented, terminated, or waived except in a writing signed by the party against whom it is being enforced.

8. **GOVERNING LAW AND VENUE.** This agreement shall be governed by and construed in accordance with the laws of the State of Indiana (without giving effect to its laws of conflicts). The Borrower agrees that any legal action or proceeding with respect to any of its obligations under the Note or this agreement may be brought by the Bank in any state or federal court located in the State of Indiana, as the Bank in its sole discretion may elect. By the execution and delivery of this agreement, the Borrower submits to and accepts, for itself and in respect of its property, generally and unconditionally, the non-exclusive jurisdiction of those courts. The Borrower waives any claim that the State of Indiana is not a convenient forum or the proper venue for any such suit, action or proceeding. This agreement binds the Borrower and its successors, and benefits the Bank, its successors and assigns. The Borrower shall not, however, have the right to assign the Borrower's rights under this agreement or any interest therein, without the prior written consent of the Bank.

9. **COUNTERPART EXECUTION.** This agreement may be executed in multiple counterparts, each of which, when so executed, shall be deemed an original, but all such counterparts, taken together, shall constitute one and the same agreement.

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10. **NOT A NOVATION.** This agreement is a modification only and not a novation. In addition to all amounts hereafter due under the Note and the Related Documents as they may be modified herein, all accrued interest evidenced by the Note being modified by this agreement and all accrued amounts due and payable under the Related Documents shall continue to be due and payable until paid. Except for the above-quoted modification(s), the Note, any Related Documents, and all the terms and conditions thereof, shall be and remain in full force and effect with the changes herein deemed to be incorporated therein. This agreement is to be considered attached to the Note and made a part thereof. This agreement shall not release or affect the liability of any guarantor, surety or endorser of the Note or release any owner of collateral securing the Note. The validity, priority and enforceability of the Note shall not be impaired hereby. References to the Related Documents and to other agreements shall not affect or impair the absolute and unconditional obligation of the Borrower to pay the principal and interest on the Note when due. The Bank reserves all rights against all parties to the Note.

Address: 3400 Jackson St.
Dubuque, IA 52001

Borrower:
Flexsteel Industries, Inc.

By: /s/ Timothy E. Hall

Timothy E. Hall,

VP & CFO

Printed Name

Title

Date Signed: January 4, 2006

BANK'S ACCEPTANCE

The foregoing agreement is hereby agreed to and acknowledged.

Bank:

JPMorgan Chase Bank, N.A.

By: /s/ John C. Otteson

John C. Otteson,

VP

Printed Name

Title

Date Signed: January 5, 2006



Amendment to Credit Agreement

This agreement is dated as of January 3, 2006, by and between Flexsteel Industries, Inc. (the "Borrower") and JPMorgan Chase Bank, N.A. as successor by merger to Bank One, NA (the "Bank"), and its successors and assigns. The provisions of this agreement are effective on the date that this agreement has been executed by all of the signers and delivered to the Bank (the "Effective Date").

WHEREAS, the Borrower and the Bank entered into a credit agreement dated June 30, 2004, as amended (if applicable) (the "Credit Agreement"); and

WHEREAS, the Borrower has requested and the Bank has agreed to amend the Credit Agreement as set forth below;

NOW, THEREFORE, in mutual consideration of the agreements contained herein and for other good and valuable consideration, the parties agree as follows:

1. **DEFINED TERMS.** Capitalized terms not defined herein shall have the meaning ascribed in the Credit Agreement.
2. **MODIFICATION OF CREDIT AGREEMENT.** The Credit Agreement is hereby amended as follows:
 - 2.1 From and after the Effective Date, the following provision in the Credit Agreement under Section 1.2 captioned "**Facility A. (Line of Credit)**" is hereby amended as follows: The language now reading "The Bank has approved a credit facility to the Borrower in the principal sum not to exceed \$13,000,000.00 in the aggregate at any one time outstanding (Facility A)", is replaced with the following:

The Bank has approved a credit facility to the Borrower in the principal sum not to exceed \$20,000,000.00 in the aggregate at any one time outstanding ("Facility A").
3. **RATIFICATION.** The Borrower ratifies and reaffirms the Credit Agreement and the Credit Agreement shall remain in full force and effect as modified herein.
4. **BORROWER REPRESENTATIONS AND WARRANTIES.** The Borrower represents and warrants that (a) the representations and warranties contained in the Credit Agreement are true and correct in all material respects as of the date of this agreement, (b) no condition, act or event which could constitute an event of default under the Credit Agreement or any promissory note or credit facility executed in reference to the Credit Agreement exists, and (c) no condition, event, act or omission has occurred, which, with the giving of notice or passage of time, would constitute an event of default under the Credit Agreement or any promissory note or credit facility executed in reference to the Credit Agreement.
5. **FEES AND EXPENSES.** The Borrower agrees to pay all fees and out-of-pocket disbursements incurred by the Bank in connection with this agreement, including legal fees incurred by the Bank in the preparation, consummation, administration and enforcement of this agreement.
6. **EXECUTION AND DELIVERY.** This agreement shall become effective only after it is fully executed by the Borrower and the Bank, and the Bank shall have received from the Borrower the following documents: Note Modification Agreement.
7. **ACKNOWLEDGEMENTS OF BORROWER.** The Borrower acknowledges that as of the date of this agreement it has no offsets with respect to all amounts owed by the Borrower to the Bank arising under or related to the Credit Agreement on or prior to the date of this agreement. The Borrower fully, finally and forever releases and discharges the Bank and its successors, assigns, directors, officers, employees, agents and representatives from any and all claims, causes of action, debts and liabilities, of whatever kind or nature, in law or in equity, of the Borrower, whether now known or unknown to the Borrower, which may have arisen in connection with the Credit Agreement or the actions or omissions of the Bank related to the Credit Agreement on or

prior to the date hereof. The Borrower acknowledges and agrees that this agreement is limited to the terms outlined above, and shall not be construed as an agreement to change any other terms or provisions of the Credit Agreement. This agreement shall not establish a course of dealing or be construed as evidence of any willingness on the Bank's part to grant other or future agreements, should any be requested.

8. **NOT A NOVATION.** This agreement is a modification only and not a novation. Except for the above-quoted modification(s), the Credit Agreement, any loan agreements, credit agreements, reimbursement agreements, security agreements, mortgages, deeds of trust, pledge agreements, assignments, guaranties, instruments or documents executed in connection with the Credit Agreement, and all the terms and conditions thereof, shall be and remain in full force and effect with the changes herein deemed to be incorporated therein. This agreement is to be considered attached to the Credit

Agreement and made a part thereof. This agreement shall not release or affect the liability of any guarantor of any promissory note or credit facility executed in reference to the Credit Agreement or release any owner of collateral granted as security for the Credit Agreement. The validity, priority and enforceability of the Credit Agreement shall not be impaired hereby. To the extent that any provision of this agreement conflicts with any term or condition set forth in the Credit Agreement, or any document executed in conjunction therewith, the provisions of this agreement shall supersede and control. The Bank expressly reserves all rights against all parties to the Credit Agreement.

Borrower:

Flexsteel Industries, Inc.

By: /s/ Timothy E. Hall

Timothy E. Hall,

VP & CFO

Printed Name

Title

Date Signed: January 4, 2006

Bank:

JPMorgan Chase Bank, N.A.

By: /s/ John C. Otteson

John C. Otteson,

VP

Printed Name

Title

Date Signed: January 5, 2006



Note Modification Agreement

This agreement is dated as of December 23, 2005 (the "Agreement Date"), by and between Flexsteel Industries, Inc. (the "Borrower") and JPMorgan Chase Bank, N.A., as successor by merger to Bank One, NA, (the "Bank"). The provisions of this agreement are effective on December 9, 2005 (the "Effective Date").

WHEREAS, the Borrower executed a Line of Credit Note as evidence of indebtedness in the original face amount of Twenty Million and 00/100 Dollars (\$20,000,000.00), dated June 30, 2004 owing by the Borrower to the Bank, as same may have been amended or modified from time to time (the "Note"), which Note has at all times been, and is now, continuously and without interruption outstanding in favor of the Bank; and,

WHEREAS, the Borrower has requested and the Bank has agreed that the Note be modified to the limited extent as hereinafter set forth;

NOW THEREFORE, in mutual consideration of the agreements contained herein and for other good and valuable consideration, the parties agree as follows:

1. **ACCURACY OF RECITALS.** The Borrower acknowledges the accuracy of the Recitals stated above.
2. **MODIFICATION OF NOTE.**

2.1 From and after the Effective Date, the pricing grid in the provision in the Note captioned "**Applicable Margin**" is hereby amended and restated to read as follows:

Applicable Margin

Leverage Ratio	Prime Rate Advance	Eurodollar Advance
Greater than or equal to 3.00 to 1.00	1.00%	1.50%
Less than 3.00 to 1.00 but greater than or equal to 2.50 to 1.00	1.00%	1.25%
Less than 2.50 to 1.00 but greater than or equal to 2.00 to 1.00	1.00%	1.00%
Less than 2.00 to 1.00 but greater than or equal to 1.50 to 1.00	1.00%	0.75%
Less than 1.50 to 1.00 but greater than or equal to 1.00 to 1.00	1.00%	0.75%
Less than or equal to 1.00 to 1.00	1.00%	0.75%

2.2 From and after the Effective Date, the provisions in the Note captioned “Interest Rates” and “Default Rate of Interest” is hereby amended and restated to read as follows:

Interest Rates. The Advance(s) evidenced by this Note may be drawn down and remain outstanding as up to five (5) Eurodollar Advances and/or a Prime Rate Advance. The Borrower shall pay interest to the Bank on the outstanding and unpaid principal amount of each Prime Rate Advance at the greater of (a) the Prime Rate minus the Applicable Margin, or (b) 0.00% per annum, and each Eurodollar Advance at the Eurodollar Rate. Interest shall be calculated on the basis of the actual number of days elapsed in a year of 360 days. In no event shall the interest rate applicable to any Advance exceed the maximum rate allowed by law. Any interest payment which would for any reason be deemed unlawful under applicable law shall be applied to principal.

Default Rate of Interest. After a default has occurred under this Note, whether or not the Bank elects to accelerate the maturity of this Note because of such default, all Advances outstanding under this Note, including all Eurodollar Advances, shall bear interest at a per annum rate equal to the Prime Rate, plus three percent (3.00%) from the date the Bank elects to impose such rate. Imposition of this rate shall not affect any limitations contained in this Note on the Borrower’s right to repay principal on any Eurodollar Advance before the expiration of the Interest Period for that Advance.

2.3 Each of the Related Documents is modified to provide that it shall be a default or an event of default thereunder if the Borrower shall fail to comply with any of the covenants of the Borrower herein or if any representation or warranty by the Borrower herein or by any guarantor in any Related Documents is materially incomplete, incorrect, or misleading as of the date hereof. As used

in this agreement, the “Related Documents” shall include the Note and all loan agreements, credit agreements, reimbursement agreements, security agreements, mortgages, deeds of trust, pledge agreements, assignments, guaranties, or any other instrument or document executed in connection with the Note or in connection with any other obligations of the Borrower to the Bank.

2.4 Each reference in the Related Documents to any of the Related Documents shall be a reference to such document as modified herein.

3. RATIFICATION OF RELATED DOCUMENTS AND COLLATERAL. The Related Documents are ratified and reaffirmed by the Borrower and shall remain in full force and effect as they may be modified herein. All real or personal property described as security in the Related Documents shall remain as security for the Note and the obligations of the Borrower in the Related Documents.

4. BORROWER REPRESENTATIONS AND WARRANTIES. The Borrower represents and warrants to the Bank that each of the following representations and warranties made in the Note and Related Documents are true and will remain true until maturity of the Note, termination of the other Related Documents and payment and performance in full of all liabilities, obligations and debt evidenced by the Note and other Related Documents:

4.1 No default or event of default under any of the Related Documents as modified hereby, nor any event, that, with the giving of notice or the passage of time or both, would be a default or an event of default under the Related Documents as modified herein has occurred and is continuing.

4.2 There has been no material adverse change in the business, assets, affairs, prospects or financial condition of the Borrower or any Guarantor or any subsidiary of the Borrower.

4.3 Each and all representations and warranties of the Borrower in the Related Documents are accurate on the date hereof.

4.4 The Borrower has no claims, counterclaims, defenses, or setoffs with respect to the loan evidenced by the Note or with respect to the Related Documents as modified herein.

4.5 The Note and the Related Documents as modified herein are the legal, valid, and binding obligations of the Borrower, enforceable against the Borrower in accordance with their terms.

4.6 The Borrower, other than any Borrower who is a natural person, is validly existing under the laws of the State of its formation or organization. The Borrower has the requisite power and authority to execute and deliver this agreement and to perform the obligations described in the Related Documents as modified herein. The execution and delivery of this agreement and the performance of the obligations described in the Related Documents as modified herein have been duly authorized by all requisite action by or on behalf of the Borrower. This agreement has been duly executed and delivered by or on behalf of the Borrower.

5. BORROWER COVENANTS. The Borrower covenants with the Bank:

5.1 The Borrower shall execute, deliver, and provide to the Bank such additional agreements, documents, and instruments as reasonably required by the Bank to effectuate the intent of this agreement.

5.2 The Borrower fully, finally, and forever releases and discharges the Bank and its successors, assigns, directors, officers, employees, agents, and representatives from any and all causes of action, claims, debts, demands, and liabilities, of whatever kind or nature, in law or equity, of the Borrower, whether now known or unknown to the Borrower, (i) in respect of the loan evidenced by the Note and the Related Documents, or of the actions or omissions of the Bank in any manner related to the loan evidenced by the Note or the Related Documents and (ii) arising from events occurring prior to the date of this agreement.

5.3 The Borrower shall pay to the Bank:

5.3.1 All the internal and external costs and expenses incurred (or charged by internal allocation) by the Bank in connection with this agreement (including, without limitation, inside and outside attorneys, appraisal, appraisal review, processing, title, filing, and recording costs, expenses, and fees).

6. EXECUTION AND DELIVERY OF AGREEMENT BY THE BANK. The Bank shall not be bound by this agreement until (i) the Bank has executed this agreement and (ii) the Borrower performed all of the obligations of the Borrower under this agreement to be performed contemporaneously with the execution and delivery of this agreement.

7. INTEGRATION, ENTIRE AGREEMENT, CHANGE, DISCHARGE, TERMINATION, OR WAIVER. The Note and the Related Documents as modified herein contain the complete understanding and agreement of the Borrower and the Bank in respect of the loan and supersede all prior representations, warranties, agreements, arrangements, understandings, and negotiations. No provision

of the Note or the Related Documents as modified herein may be changed, discharged, supplemented, terminated, or waived except in a writing signed by the party against whom it is being enforced.

8. GOVERNING LAW AND VENUE. This agreement shall be governed by and construed in accordance with the laws of the State of Indiana (without giving effect to its laws of conflicts). The Borrower agrees that any legal action or proceeding with respect to any of its obligations under the Note or this agreement may be brought by the Bank in any state or federal court located in the State of Indiana, as the Bank in its sole discretion may elect. By the execution and delivery of this agreement, the Borrower submits to and accepts, for itself and in respect of its property, generally and unconditionally, the non-exclusive jurisdiction of those courts. The Borrower waives any claim that the State of Indiana is not a convenient forum or the proper venue for any such suit, action or proceeding. This agreement binds the Borrower and its successors, and benefits the Bank, its successors and assigns. The Borrower shall not, however, have the right to assign the Borrower's rights under this agreement or any interest therein, without the prior written consent of the Bank.

9. COUNTERPART EXECUTION. This agreement may be executed in multiple counterparts, each of which, when so executed, shall be deemed an original, but all such counterparts, taken together, shall constitute one and the same agreement.

10. NOT A NOVATION. This agreement is a modification only and not a novation. In addition to all amounts hereafter due under the Note and the Related Documents as they may be modified herein, all accrued interest evidenced by the Note being modified by this agreement and all accrued amounts due and payable under the Related Documents shall continue to be due and payable until paid. Except for the above-quoted modification(s), the Note, any Related Documents, and all the terms and conditions thereof, shall be and remain in full force and effect with the changes herein deemed to be incorporated therein. This agreement is to be considered attached to the Note and made a part thereof. This agreement shall not release or affect the liability of any guarantor, surety or endorser of the Note or release any owner of collateral securing the Note. The validity, priority and enforceability of the Note shall not be impaired hereby. References to the Related Documents and to other agreements shall not affect or impair the absolute and unconditional obligation of the Borrower to pay the principal and interest on the Note when due. The Bank reserves all rights against all parties to the Note.

Address: 3400 Jackson St.
Dubuque, IA 52001

Borrower:

Flexsteel Industries, Inc.

By: /s/ Timothy E. Hall

Timothy E. Hall,

VP & CFO

Printed Name

Title

Date Signed: December 29, 2005

BANK'S ACCEPTANCE

The foregoing agreement is hereby agreed to and acknowledged.

Bank:

JPMorgan Chase Bank, N.A.

By: /s/ Robert E. McElwain

Robert E. McElwain,

SVP

Printed Name

Title

Date Signed: December 31, 2005



This agreement is dated as of December 23, 2005 (the "Agreement Date"), by and between Flexsteel Industries, Inc. (the "Borrower") and JPMorgan Chase Bank, N.A., as successor by merger to Bank One, NA, (the "Bank"). The provisions of this agreement are effective on December 9, 2005 (the "Effective Date").

WHEREAS, the Borrower executed a Line of Credit Note as evidence of indebtedness in the original face amount of Twenty Million and 00/100 Dollars (\$20,000,000.00), dated June 10, 2005 owing by the Borrower to the Bank, as same may have been amended or modified from time to time (the "Note"), which Note has at all times been, and is now, continuously and without interruption outstanding in favor of the Bank; and,

WHEREAS, the Borrower has requested and the Bank has agreed that the Note be modified to the limited extent as hereinafter set forth;

NOW THEREFORE, in mutual consideration of the agreements contained herein and for other good and valuable consideration, the parties agree as follows:

1. **ACCURACY OF RECITALS.** The Borrower acknowledges the accuracy of the Recitals stated above.

2. **MODIFICATION OF NOTE.**

2.1 From and after the Effective Date, the pricing grid in the provision in the Note captioned "**Applicable Margin**" is hereby amended and restated to read as follows:

Leverage Ratio	Applicable Margin	
	Prime Rate Advance	Eurodollar Advance
Greater than or equal to 3.00 to 1.00	1.00%	1.25%
Less than 3.00 to 1.00 but greater than or equal to 2.50 to 1.00	1.00%	1.00%
Less than 2.50 to 1.00 but greater than or equal to 2.00 to 1.00	1.00%	0.875%
Less than 2.00 to 1.00 but greater than or equal to 1.50 to 1.00	1.00%	0.75%
Less than 1.50 to 1.00 but greater than or equal to 1.00 to 1.00	1.00%	0.625%
Less than or equal to 1.00 to 1.00	1.00%	0.50%

2.2 From and after the Effective Date, the provisions in the Note captioned "**Interest Rates**" and "**Default Rate of Interest**" is hereby amended and restated to read as follows:

Interest Rates. The Advance(s) evidenced by this Note may be drawn down and remain outstanding as up to five (5) Eurodollar Advances and/or a Prime Rate Advance. The Borrower shall pay interest to the Bank on the outstanding and unpaid principal amount of each Prime Rate Advance at the greater of (a) the Prime Rate minus the Applicable Margin, or (b) 0.00% per annum, and each Eurodollar Advance at the Eurodollar Rate. Interest shall be calculated on the basis of the actual number of days elapsed in a year of 360 days. In no event shall the interest rate applicable to any Advance exceed the maximum rate allowed by law. Any interest payment which would for any reason be deemed unlawful under applicable law shall be applied to principal.

Default Rate of Interest. After a default has occurred under this Note, whether or not the Bank elects to accelerate the maturity of this Note because of such default, all Advances outstanding under this Note, including all Eurodollar Advances, shall bear interest at a per annum rate equal to the Prime Rate, plus three percent (3.00%) from the date the Bank elects to impose such rate. Imposition of this rate shall not affect any limitations contained in this Note on the Borrower's right to repay principal on any Eurodollar Advance before the expiration of the Interest Period for that Advance.

2.3 Each of the Related Documents is modified to provide that it shall be a default or an event of default thereunder if the Borrower shall fail to comply with any of the covenants of the Borrower herein or if any representation or warranty by the Borrower herein or by any guarantor in any Related Documents is materially incomplete, incorrect, or misleading as of the date hereof. As used

in this agreement, the "Related Documents" shall include the Note and all loan agreements, credit agreements, reimbursement agreements, security agreements, mortgages, deeds of trust, pledge agreements, assignments, guaranties, or any other instrument or document executed in connection with the Note or in connection with any other obligations of the Borrower to the Bank.

2.4 Each reference in the Related Documents to any of the Related Documents shall be a reference to such document as modified herein.

3. **RATIFICATION OF RELATED DOCUMENTS AND COLLATERAL.** The Related Documents are ratified and reaffirmed by the Borrower and shall remain in full force and effect as they may be modified herein. All real or personal property described as security in the Related Documents shall remain as security for the Note and the obligations of the Borrower in the Related Documents.

4. **BORROWER REPRESENTATIONS AND WARRANTIES.** The Borrower represents and warrants to the Bank that each of the following representations and warranties made in the Note and Related Documents are true and will remain true until maturity of the Note, termination of the other Related Documents and payment and performance in full of all liabilities, obligations and debt evidenced by the Note and other Related Documents:

4.1 No default or event of default under any of the Related Documents as modified hereby, nor any event, that, with the giving of notice or the passage of time or both, would be a default or an event of default under the Related Documents as modified herein has occurred and is continuing.

4.2 There has been no material adverse change in the business, assets, affairs, prospects or financial condition of the Borrower or any Guarantor or any subsidiary of the Borrower.

4.3 Each and all representations and warranties of the Borrower in the Related Documents are accurate on the date hereof,

4.4 The Borrower has no claims, counterclaims, defenses, or setoffs with respect to the loan evidenced by the Note or with respect to the Related Documents as modified herein.

4.5 The Note and the Related Documents as modified herein are the legal, valid, and binding obligations of the Borrower, enforceable against the Borrower in accordance with their terms.

4.6 The Borrower, other than any Borrower who is a natural person, is validly existing under the laws of the State of its formation or organization. The Borrower has the requisite power and authority to execute and deliver this agreement and to perform the obligations described in the Related Documents as modified herein. The execution and delivery of this agreement and the performance of the obligations described in the Related Documents as modified herein have been duly authorized by all requisite action by or on behalf of the Borrower. This agreement has been duly executed and delivered by or on behalf of the Borrower.

5. **BORROWER COVENANTS.** The Borrower covenants with the Bank:

5.1 The Borrower shall execute, deliver, and provide to the Bank such additional agreements, documents, and instruments as reasonably required by the Bank to effectuate the intent of this agreement.

5.2 The Borrower fully, finally, and forever releases and discharges the Bank and its successors, assigns, directors, officers, employees, agents, and representatives from any and all causes of action, claims, debts, demands, and liabilities, of whatever kind or nature, in law or equity, of the Borrower, whether now known or unknown to the Borrower, (i) in respect of the loan evidenced by the Note and the Related Documents, or of the actions or omissions of the Bank in any manner related to the loan evidenced by the Note or the Related Documents and (ii) arising from events occurring prior to the date of this agreement.

5.3 The Borrower shall pay to the Bank:

5.3.1 All the internal and external costs and expenses incurred (or charged by internal allocation) by the Bank in connection with this agreement (including, without limitation, inside and outside attorneys, appraisal, appraisal review, processing, title, filing, and recording costs, expenses, and fees).

6. **EXECUTION AND DELIVERY OF AGREEMENT BY THE BANK.** The Bank shall not be bound by this agreement until (i) the Bank has executed this agreement and (ii) the Borrower performed all of the obligations of the Borrower under this agreement to be performed contemporaneously with the execution and delivery of this agreement.

7. **INTEGRATION, ENTIRE AGREEMENT, CHANGE, DISCHARGE, TERMINATION, OR WAIVER.** The Note and the Related Documents as modified herein contain the complete understanding and agreement of the Borrower and the Bank in respect of the loan and supersede all prior representations, warranties, agreements, arrangements, understandings, and negotiations. No provision

of the Note or the Related Documents as modified herein may be changed, discharged, supplemented, terminated, or waived except in a writing signed by the party against whom it is being enforced.

8. **GOVERNING LAW AND VENUE.** This agreement shall be governed by and construed in accordance with the laws of the State of Indiana (without giving effect to its laws of conflicts). The Borrower agrees that any legal action or proceeding with respect to any of its obligations under the Note or this agreement may be brought by the Bank in any state or federal court located in the State of Indiana, as the Bank in its sole discretion may elect. By the execution and delivery of this agreement, the Borrower submits to and accepts, for itself and in respect of its property, generally and unconditionally, the non-exclusive jurisdiction of those courts. The Borrower waives any claim that the State of Indiana is not a convenient forum or the proper venue for any such suit, action or proceeding. This agreement binds the Borrower and its successors, and benefits the Bank, its successors and assigns. The Borrower shall not, however, have the right to assign the Borrower's rights under this agreement or any interest therein, without the prior written consent of the Bank.

9. **COUNTERPART EXECUTION.** This agreement may be executed in multiple counterparts, each of which, when so executed, shall be deemed an original, but all such counterparts, taken together, shall constitute one and the same agreement.

10. **NOT A NOVATION.** This agreement is a modification only and not a novation. In addition to all amounts hereafter due under the Note and the Related Documents as they may be modified herein, all accrued interest evidenced by the Note being modified by this agreement and all accrued amounts due and payable under the Related Documents shall continue to be due and payable until paid. Except for the above-quoted modification(s), the Note, any Related Documents, and all the terms and conditions thereof, shall be and remain in full force and effect with the changes herein deemed to be incorporated therein. This agreement is to be considered attached to the Note and made a part thereof. This agreement shall not release or affect the liability of any guarantor, surety or endorser of the Note or release any owner of collateral securing the Note. The validity, priority and enforceability of the Note shall not be impaired hereby. References to the Related Documents and to other agreements shall not affect or impair the absolute and unconditional obligation of the Borrower to pay the principal and interest on the Note when due. The Bank reserves all rights against all parties to the Note.

Address: 3400 Jackson St.
Dubuque, IA 52001

Borrower:

Flexsteel Industries, Inc.

By: /s/ Timothy E. Hall

Date Signed: December 29, 2005

BANK'S ACCEPTANCE

The foregoing agreement is hereby agreed to and acknowledged.

Bank:

JPMorgan Chase Bank, N.A.

By: /s/ Robert E. McElwain

Robert E. McElwain,

SVP

Printed Name

Title

Date Signed: December 31, 2005

**Amendment to Credit Agreement**

This agreement is dated as of December 23, 2005, by and between Flexsteel Industries, Inc. (the "Borrower") and JPMorgan Chase Bank, N.A., as successor by merger to Bank One, NA, (the "Bank"), and its successors and assigns. . The provisions of this agreement are effective on December 9, 2005 (the "Effective Date").

WHEREAS, the Borrower and the Bank entered into a credit agreement dated June 30, 2004, as amended (if applicable) (the "Credit Agreement"); and

WHEREAS, the Borrower has requested and the Bank has agreed to amend the Credit Agreement as set forth below;

NOW, THEREFORE, in mutual consideration of the agreements contained herein and for other good and valuable consideration, the parties agree as follows:

1. **DEFINED TERMS.** Capitalized terms not defined herein shall have the meaning ascribed in the Credit Agreement.
2. **MODIFICATION OF CREDIT AGREEMENT.** The Credit Agreement is hereby amended as follows:
 - 2.1 From and after the Effective Date, the pricing grid in Section 1.2 and Section 1.4 of the Credit Agreement under the Sections captioned "**Non Usage Fee**" are hereby amended and restated to read as follows:

Funded Debt to EBITDA Ratio	Non-usage Fee
Greater than or equal to 3.00 to 1.00	20 bp
Less than 3.00 to 1.00 but greater than or equal to 2.50 to 1.00	20 bp
Less than 2.50 to 1.00 but greater than or equal to 2.00 to 1.00	10 bp
Less than 2.00 to 1.00 but greater than or equal to 1.50 to 1.00	10 bp
Less than 1.50 to 1.00 but greater than or equal to 1.00 to 1.00	10 bp
Less than or equal to 1.00 to 1.00	10 bp

- 2.2 From and after the Effective Date, the pricing grid in Section 1.4 of the Credit Agreement under the Section captioned "**Letters of Credit**" is hereby amended and restated to read as follows:

Funded Debt to EBITDA Ratio	Letter of Credit Fee
Greater than or equal to 3.00 to 1.00	1.50%
Less than 3.00 to 1.00 but greater than or equal to 2.50 to 1.00	1.25%
Less than 2.50 to 1.00 but greater than or equal to 2.00 to 1.00	1.00%
Less than 2.00 to 1.00 but greater than or equal to 1.50 to 1.00	0.75%

Less than 1.50 to 1.00 but greater than or equal to 1.00 to 1.00	0.75%
Less than or equal to 1.00 to 1.00	0.75%

2.3 From and after the Effective Date, Section 4.2 of the Credit Agreement captioned “**J. EBITDA/Interest Ratio**” and “**K. Funded Debt to EBITDA Ratio**” are hereby amended and restated to read as follows:

J. EBITDA/Interest Ratio. Permit as of any fiscal quarter end, its ratio determined on a consolidated basis for Borrower and its Subsidiaries, of (i) net income, plus amortization, depreciation, interest expense, income taxes, and the aggregate amount of all expenses related to options, (employee stock option plans or employee stock purchase plans which reduce net income), all computed for the twelve month period then ending, to (ii) interest expense, computed for the same such period, to be less than 3.00 to 1.00.

K. Funded Debt to EBITDA Ratio. Permit as of any fiscal quarter end, its “**Funded Debt to EBITDA Ratio**” to be greater than 3.50 to 1.00. As used herein, “**Funded Debt to EBITDA Ratio**” means the ratio, determined on a consolidated basis for Borrower and its Subsidiaries, of (i) total liabilities excluding (a) accounts arising from the purchase of goods and services in the ordinary course of business, (b) accrued expenses or losses, and (c) deferred revenues or gains, all computed as of the end of the fiscal quarter for which this ratio is being determined, to (ii) net income, plus amortization, depreciation, interest expense, income taxes, and the aggregate amount of all expenses related to options, (employee stock option plans or employee stock purchase plans which reduce net income), all computed for the twelve month period then ending with such fiscal quarter end.

3. **RATIFICATION.** The Borrower ratifies and reaffirms the Credit Agreement and the Credit Agreement shall remain in full force and effect as modified herein.
4. **BORROWER REPRESENTATIONS AND WARRANTIES.** The Borrower represents and warrants that (a) the representations and warranties contained in the Credit Agreement are true and correct in all material respects as of the date of this agreement, (b) no condition, act or event which could constitute an event of default under the Credit Agreement or any promissory note or credit facility executed in reference to the Credit Agreement exists, and (c) no condition, event, act or omission has occurred, which, with the giving of notice or passage of time, would constitute an event of default under the Credit Agreement or any promissory note or credit facility executed in reference to the Credit Agreement.
5. **FEES AND EXPENSES.** The Borrower agrees to pay all fees and out-of-pocket disbursements incurred by the Bank in connection with this agreement, including legal fees incurred by the Bank in the preparation, consummation, administration and enforcement of this agreement.
6. **EXECUTION AND DELIVERY.** This agreement shall become effective only after it is fully executed by the Borrower and the Bank.
7. **ACKNOWLEDGEMENTS OF BORROWER.** The Borrower acknowledges that as of the date of this agreement it has no offsets with respect to all amounts owed by the Borrower to the Bank arising under or related to the Credit Agreement on or prior to the date of this agreement. The Borrower fully, finally and forever releases and discharges the Bank and its successors, assigns, directors, officers, employees, agents and representatives from any and all claims, causes of action, debts and liabilities, of whatever kind or nature, in law or in equity, of the Borrower, whether now known or unknown to the Borrower, which may have arisen in connection with the Credit Agreement or the actions or omissions of the Bank related to the Credit Agreement on or prior to the date hereof. The Borrower acknowledges and agrees that this agreement is limited to the terms outlined above, and shall not be construed as an agreement to change any other terms or provisions of the Credit Agreement. This agreement shall not establish a course of dealing or be construed as evidence of any willingness on the Bank’s part to grant other or future agreements, should any be requested.

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8. **NOT A NOVATION.** This agreement is a modification only and not a novation. Except for the above-quoted modification(s), the Credit Agreement, any loan agreements, credit agreements, reimbursement agreements, security agreements, mortgages, deeds of trust, pledge agreements, assignments, guaranties, instruments or documents executed in connection with the Credit Agreement, and all the terms and conditions thereof, shall be and remain in full force and effect with the changes herein deemed to be incorporated therein. This agreement is to be considered attached to the Credit Agreement and made a part thereof. This agreement shall not release or affect the liability of any guarantor of any promissory note or credit facility executed in reference to the Credit Agreement or release any owner of collateral granted as security for the Credit Agreement. The validity, priority and enforceability of the Credit Agreement shall not be impaired hereby. To the extent that any provision of this agreement conflicts with any term or condition set forth in the Credit Agreement, or any document executed in conjunction therewith, the provisions of this agreement shall supersede and control. The Bank expressly reserves all rights against all parties to the Credit Agreement.

Borrower:

Flexsteel Industries, Inc.

By: /s/ Timothy E. Hall

Timothy E. Hall,

CFO

Printed Name

Title

Bank:

JPMorgan Chase Bank, N.A.

By: /s/ Robert E. McElwain

Robert E. McElwain,

SVP

Printed Name

Title

Date Signed: December 30, 2005



Amendment to Credit Agreement

This agreement is dated as of August 19, 2005, by and between Flexsteel Industries, Inc. (the "Borrower") and JPMorgan Chase Bank, N.A., as successor by merger to Bank One, NA, (the "Bank"), and its successors and assigns. The provisions of this agreement are effective on the date that this agreement has been executed by all of the signers and delivered to the Bank (the "Effective Date").

WHEREAS, the Borrower and the Bank entered into a credit agreement dated June 30, 2004, as amended (if applicable) (the "Credit Agreement"); and.

WHEREAS, the Borrower has requested and the Bank has agreed to amend the Credit Agreement as set forth below;

NOW, THEREFORE, in mutual consideration of the agreements contained herein and for other good and valuable consideration, the parties agree as follows:

1. **DEFINED TERMS.** Capitalized terms not defined herein shall have the meaning ascribed in the Credit Agreement.
2. **MODIFICATION OF CREDIT AGREEMENT.** The Credit Agreement is hereby amended as follows:
 - 2.1 From and after the Effective Date, the provision in the Credit Agreement under Section 1.4 captioned "**Facility C. (Letters of Credit)**" is hereby amended as follows: The language now reading "The Bank has approved a credit facility for letters of credit to the Borrower and/or DMI in the principal sum not to exceed \$5,000,000.00 in the aggregate at any one time outstanding ("Facility C")." is replaced with the following:

The Bank has approved a credit facility for letters of credit to the Borrower and/or DMI in the principal sum not to exceed \$8,000,000.00 in the aggregate at any one time outstanding ("Facility C").
 - 2.2 From and after the Effective Date, the following provision in the Credit Agreement under Section 1.4 captioned "**Facility C (Letters of Credit)**" Subsection (a) is hereby amended and restated to read as follows:

(a) the aggregate maximum available amount which is drawn and unreimbursed or may be drawn under all letters of credit which are outstanding at any time, including without limitation all letters of credit issued for the account of the Borrower and/or DMI which are outstanding on the date of this agreement, shall not exceed \$8,000,000.00.
3. **RATIFICATION.** The Borrower ratifies and reaffirms the Credit Agreement and the Credit Agreement shall remain in full force and effect as modified herein.
4. **BORROWER REPRESENTATIONS AND WARRANTIES.** The Borrower represents and warrants that (a) the representations and warranties contained in the Credit Agreement are true and correct in all material respects as of the date of this agreement, (b) no condition, act or event which could constitute an event of default under the Credit Agreement or any promissory note or credit facility executed in reference to the Credit Agreement exists, and (c) no condition, event, act or omission has occurred, which, with the giving of notice or passage of time, would constitute an event of default under the Credit Agreement or any promissory note or credit facility executed in reference to the Credit Agreement.
5. **FEES AND EXPENSES.** The Borrower agrees to pay all fees and out-of-pocket disbursements incurred by the Bank in connection with this agreement, including legal fees incurred by the Bank in the preparation, consummation, administration and enforcement of this agreement.
6. **EXECUTION AND DELIVERY.** This agreement shall become effective only after it is fully executed by the Borrower and the Bank.
7. **ACKNOWLEDGEMENTS OF BORROWER.** The Borrower acknowledges that as of the date of this agreement it has no offsets with respect to all amounts owed by the Borrower to the Bank arising under or related to the Credit Agreement on or prior to the date of this agreement. The Borrower fully, finally and forever releases and discharges the Bank and its successors, assigns, directors, officers, employees, agents and representatives from any and all claims, causes of action, debts and liabilities, of whatever kind or nature, in law or in equity, of the Borrower, whether now known or unknown to the Borrower, which may have arisen in connection with the Credit Agreement or the actions or omissions of the Bank related to the Credit Agreement on or prior to the date hereof. The Borrower acknowledges and agrees that this agreement is limited to the terms outlined above, and shall not be construed as an agreement to change any other terms or provisions of the Credit

Agreement. This agreement shall not establish a course of dealing or be construed as evidence of any willingness on the Bank's part to grant other or future agreements, should any be requested.

8. **NOT A NOVATION.** This agreement is a modification only and not a novation. Except for the above-quoted modification(s), the Credit Agreement, any loan agreements, credit agreements, reimbursement agreements, security agreements, mortgages, deeds of trust, pledge agreements, assignments, guaranties, instruments or documents executed in connection with the Credit Agreement, and all the terms and conditions thereof, shall be and remain in full force and effect with the changes herein deemed to be incorporated therein. This agreement is to be considered attached to the Credit Agreement and made a part thereof. This agreement shall not release or affect the liability of any guarantor of any promissory note or credit facility executed in reference to the Credit Agreement or release any owner of collateral granted as security for the Credit Agreement. The validity, priority and enforceability of the Credit Agreement shall not be impaired hereby. To the extent that any provision of this agreement conflicts with any term or condition set forth in the Credit Agreement, or any document executed in conjunction therewith, the provisions of this agreement shall supersede and control. The Bank expressly reserves all rights against all parties to the Credit Agreement.

Borrower:

Flexsteel Industries, Inc.

By: /s/ Timothy E. Hall

Timothy E. Hall, Chief Financial Officer

Printed Name Title

Date Signed: August 23, 2005

Bank:

JPMorgan Chase Bank, N.A.

By: /s/ John C. Otteson

John C. Otteson, First Vice President

Printed Name Title

Date Signed: August 25, 2005



Line of Credit Note

Due: June 29, 2006

\$20,000,000.00

Date: June 10, 2005

Promise to Pay. On or before June 29, 2006, for value received, Flexsteel Industries, Inc. (the "Borrower") promises to pay to JPMorgan Chase Bank, N.A. as successor by merger to Bank One, NA whose address is 1 East Ohio Street, Indianapolis, IN 46277 (the "Bank") or order, in lawful money of the United States of America, the sum of Twenty Million and 00/100 Dollars (\$20,000,000.00) or such lesser sum as is indicated on Bank records, plus interest as provided below.

Definitions. As used in this Note, the following terms have the following respective meanings:

"Advance" means a Eurodollar Advance or a Prime Rate Advance and **"Advances"** means all Eurodollar Advances and all Prime Rate Advances under this Note.

"Applicable Margin" means with respect to any Prime Rate Advance or Eurodollar Advance, as the case may be, the rate per annum set forth below opposite the applicable Funded Debt to EBITDA Ratio. Funded Debt to EBITDA Ratio is defined in the Credit Agreement.

Funded Debt to EBITDA Ratio	Applicable Margin	
	Prime Rate Advance	Eurodollar Advance
Greater than or equal to 2.00 to 1.00	0.00%	1.00%
Less than 2.00 to 1.00 but greater than or equal to 1.00 to 1.00	0.00%	0.75%
Less than 1.00 to 1.00	0.00%	0.50%

The Applicable Margin shall, in each case, be determined and adjusted quarterly on the first day of the month after the date of delivery of the quarterly and annual financial statements required by the Credit Agreement, *provided, however*, that if such financial statements are not delivered within two Business Days after the required date (each, an "Interest Determination Date"), the Applicable Margin shall increase to the maximum percentage amount set forth in the table above from the date such financial statements were required to be delivered to the Bank until received by the Bank. The Applicable Margin shall be effective from an Interest Determination Date until the next Interest Determination Date. Such determinations by the Bank shall be conclusive absent manifest error. The initial Applicable Margin for Prime Rate Advances is 0.00% and for Eurodollar Advances is 0.50%.

"Credit Agreement" means a certain Credit Agreement, dated June 30, 2004, between the Borrower and the Bank.

"Business Day" means (i) with respect to any borrowing, payment or rate selection of Eurodollar Advances, a day (other than a Saturday or Sunday) on which banks generally are open in Indiana and/or New York for the conduct of substantially all of their commercial lending activities and on which dealings in United States dollars are carried on in the London interbank market and (ii) for all other purposes, a day other than a Saturday, Sunday or any other day on which national banking associations are authorized to be closed.

"Eurodollar Base Rate" means, with respect to the relevant Interest Period, the applicable British Bankers' Association LIBOR rate for deposits in U.S. dollars as reported by any generally recognized financial information service as of 11:00 a.m. (London time) two Business Days prior to the first day of such Interest Period, and having a maturity equal to such Interest Period, *provided* that, if no such British Bankers' Association LIBOR rate is available to the Bank, the applicable Eurodollar Base Rate for the relevant Interest Period shall instead be the rate determined by the Bank to be the rate at which JPMorgan Chase & Co. or one of its affiliate banks offers to place deposits in U.S. dollars with first-class banks in the London interbank market at approximately 11:00 a.m. (London time) two Business Days prior to the first day of such Interest Period, in the approximate amount of the principal amount outstanding on such date and having a maturity equal to such Interest Period.

"Eurodollar Advance" means any borrowing under this Note when and to the extent that its interest rate is determined by reference to the Eurodollar Rate.

"Eurodollar Rate" means, with respect to a Eurodollar Advance for the relevant Interest Period, the sum of (i) the Applicable Margin plus (ii) the quotient of (a) the Eurodollar Base Rate applicable to such Interest Period, divided by (b) one minus the Reserve Requirement (expressed as a decimal) applicable to such Interest Period.

"Interest Period" means, with respect to a Eurodollar Advance, a period of one (1), two (2), three (3) or six (6) month(s) commencing on a Business Day selected by the Borrower pursuant to this Note. Such Interest Period shall end on the day which corresponds numerically to such date one (1), two (2), three (3) or six (6) month(s) thereafter, as applicable, *provided, however*, that if there is no such numerically corresponding day in such first, second, third or sixth succeeding month(s), as applicable, such Interest Period shall end on the last Business Day of such first, second, third or sixth succeeding month(s), as applicable. If an Interest Period would otherwise end on a day which is not a Business Day, such Interest Period shall end on the next succeeding Business Day, *provided, however*, that if said next succeeding Business Day falls in a new calendar month, such Interest Period shall end on the immediately preceding Business Day.

"Prime Rate" means a rate per annum equal to the prime rate of interest announced from time to time by the Bank or its parent (which is not necessarily the lowest rate charged to any customer), changing when and as said prime rate changes.

"Prime Rate Advance" means any Advance under this Note when and to the extent that its interest rate is determined by reference to the Prime Rate.

"Principal Payment Date" is defined in the paragraph entitled "Principal Payments" below.

"Regulation D" means Regulation D of the Board of Governors of the Federal Reserve System as from time to time in effect and any successor thereto or other regulation or official interpretation of said Board of Governors relating to reserve requirements applicable to member banks of the Federal Reserve System.

"Reserve Requirement" means, with respect to an Interest Period, the maximum aggregate reserve requirement (including all basic, supplemental, marginal and other reserves) which is imposed under Regulation D.

Interest Rates. The Advance(s) evidenced by this Note may be drawn down and remain outstanding as up to five (5) Eurodollar Advances and/or a Prime Rate Advance. The Borrower shall pay interest to the Bank on the outstanding and unpaid principal amount of each Prime Rate Advance at the Prime Rate plus the Applicable Margin and each Eurodollar Advance at the Eurodollar Rate. Interest shall be calculated on the basis of the actual number of days elapsed in a year of 360 days. In no event shall the interest rate applicable to any Advance exceed the maximum rate allowed by law. Any interest payment which would for any reason be deemed unlawful under applicable law shall be applied to principal.

Bank Records. The Bank shall, in the ordinary course of business, make notations in its records of the date, amount, interest rate and Interest Period of each Advance hereunder, the amount of each payment on the Advances, and other information. Such records shall, in the absence of manifest error, be conclusive as to the outstanding principal balance of and interest rate or rates applicable to this Note.

Notice and Manner of Electing Interest Rates on Advances. The Borrower shall give the Bank written notice (effective upon receipt) of the Borrower's intent to draw down an Advance under this Note no later than 11:00 a.m. Eastern time, one (1) Business Day before disbursement, if the full amount of the drawn Advance is to be disbursed as a Prime Rate Advance and three (3) Business Days before disbursement, if any part of such Advance is to be disbursed as a Eurodollar Advance. The Borrower's notice must specify: (a) the disbursement date, (b) the amount of each Advance, (c) the type of each Advance (Prime Rate Advance or Eurodollar Advance), and (d) for each Eurodollar Advance, the duration of the applicable Interest Period; *provided, however*, that the Borrower may not elect an Interest Period ending after the maturity date of this Note. Each Eurodollar Advance shall be in a minimum amount of One Million and 00/100 Dollars (\$1,000,000.00). All notices under this paragraph are irrevocable. By the Bank's close of business on the disbursement date and upon fulfillment of the conditions set forth herein and in any other of the Related Documents, the Bank shall disburse the requested Advances in immediately available funds by crediting the amount of such Advances to the Borrower's account with the Bank.

Conversion and Renewals. The Borrower may elect from time to time to convert one type of Advance into another or to renew any Advance by giving the Bank written notice no later than 11:00 a.m. Eastern time, one (1) Business Day before conversion into a Prime Rate Advance and three (3) Business Days before conversion into or renewal of a Eurodollar Advance, specifying: (a) the renewal or conversion date, (b) the amount of the Advance to be converted or renewed, (c) in the case of conversion, the type of Advance to be converted into (Prime Rate Advance or Eurodollar Advance), and (d) in the case of renewals of or

conversion into a Eurodollar Advance, the applicable Interest Period, provided that (i) the minimum principal amount of each Eurodollar Advance outstanding after a renewal or conversion shall be One Million and 00/100 Dollars (\$1,000,000.00); (ii) a Eurodollar Advance can only be converted on the last day of the Interest Period for the Advance; and (iii) the Borrower may not elect an Interest Period ending after the maturity date of this Note. All notices given under this paragraph are irrevocable. If the Borrower fails to give the Bank the notice specified above for the renewal or conversion of a Eurodollar Advance by 11:00 a.m. Eastern time three (3) Business Days before the end of the Interest Period for that Advance, the Advance shall automatically be converted to a Prime Rate Advance on the last day of the Interest Period for the Advance.

Interest Payments. Interest on the Advances shall be paid as follows:

- A. For each Prime Rate Advance, on the twenty-ninth day of each month beginning with the first month following disbursement of the Advance or following conversion of an Advance into a Prime Rate Advance, and at the maturity or conversion of the Advance into a Eurodollar Advance;
- B. For each Eurodollar Advance, on the last day of the Interest Period for the Advance and, if the Interest Period is longer than three months, at three-month intervals beginning with the day three months from the date the Advance is disbursed.

Principal Payments. All outstanding principal and interest is due and payable in full on June 29, 2006, which is defined herein as the "Principal Payment Date".

Default Rate of Interest. After a default has occurred under this Note, whether or not the Bank elects to accelerate the maturity of this Note because of such default, all Advances outstanding under this Note, including all Eurodollar Advances, shall bear interest at a per annum rate equal to the Prime Rate, plus the Applicable Margin for a Prime Rate Advance, plus three percent (3.00%) from the date the Bank elects to impose such rate. Imposition of this rate shall not affect any limitations contained in this Note on the Borrower's right to repay principal on any Eurodollar Advance before the expiration of the Interest Period for that Advance.

Prepayment. The Borrower may prepay all or any part of any Prime Rate Advance at any time without premium or penalty. The Borrower may prepay any Eurodollar Advance only at the end of an Interest Period.

Funding Loss Indemnification. Upon the Bank's request, the Borrower shall pay the Bank amounts sufficient (in the Bank's reasonable opinion) to compensate it for any loss, cost, or expense incurred as a result of:

- A. Any payment of a Eurodollar Advance on a date other than the last day of the Interest Period for the Advance, including, without limitation, acceleration of the Advances by the Bank pursuant to this Note or the Related Documents; or
- B. Any failure by the Borrower to borrow or renew a Eurodollar Advance on the date specified in the relevant notice from the Borrower to the Bank.

Additional Costs. If any applicable domestic or foreign law; treaty, government rule or regulation now or later in effect (whether or not it now applies to the Bank) or the interpretation or administration thereof by a governmental authority charged with such interpretation or administration, or compliance by the Bank with any guideline, request or directive of such an authority (whether or not having the force of law), shall (a) affect the basis of taxation of payments to the Bank of any amounts payable by the Borrower under this Note or the Related Documents (other than taxes imposed on the overall net income of the Bank by the jurisdiction or by any political subdivision or taxing authority of the jurisdiction in which the Bank has its principal office), or (b) impose, modify or deem applicable any reserve, special deposit or similar requirement against assets of, deposits with or for the account of, or credit extended by the Bank, or (c) impose any other condition with respect to this Note or the Related Documents and the result of any of the foregoing is to increase the cost to the Bank of maintaining any Eurodollar Advance or to reduce the amount of any sum receivable by the Bank on such an Advance, or (d) affect the amount of capital required or expected to be maintained by the Bank (or any corporation controlling the Bank) and the Bank determines that the amount of such capital is increased by or based upon the existence of the Bank's obligations under this Note or the Related Documents and the increase has the effect of reducing the rate of return on the Bank's (or its controlling corporation's) capital as a consequence of the obligations under this Note or the Related Documents to a level below that which the Bank (or its controlling corporation) could have achieved but for such circumstances (taking into consideration its policies with respect to capital adequacy) by an amount deemed by the Bank to be material, then the Borrower shall pay to the Bank, from time to time, upon request by the Bank, additional amounts sufficient to compensate the Bank for the increased cost or reduced sum receivable. Whenever the Bank shall learn of circumstances described in this section which are likely to result in additional costs to the Borrower, the Bank shall give prompt written notice to the Borrower of the basis for and the estimated amount of any such anticipated additional costs. A statement as to the amount of the increased cost or reduced sum receivable, prepared in good faith and in reasonable detail by the Bank and submitted by the Bank to the Borrower, shall be conclusive and binding for all purposes absent manifest error in computation.

Illegality. If any applicable domestic or foreign law, treaty, rule or regulation now or later in effect (whether or not it now applies to the Bank) or the interpretation or administration thereof by a governmental authority charged with such interpretation or administration, or compliance by the Bank with any guideline, request or directive of such an authority (whether or not having the force of law), shall make it unlawful or impossible for the Bank to maintain or fund the Eurodollar Advances, then, upon notice to the Borrower by the Bank, the outstanding principal amount of the Eurodollar Advances, together with accrued interest and any other amounts payable to the Bank under this Note or the Related Documents on account of the Eurodollar Advances shall be repaid (a) immediately upon the Bank's demand if such change or compliance with such requests, in the Bank's judgment, requires immediate repayment, or (b) at the expiration of the last Interest Period to expire before the effective date of any such change or request provided, however, that subject to the terms and conditions of this Note and the Related Documents the Borrower shall be entitled to

simultaneously replace the entire outstanding balance of any Eurodollar Advance repaid in accordance with this section with a Prime Rate Advance in the same amount.

Inability to Determine Interest Rate. If the Bank determines that (a) quotations of interest rates for the relevant deposits referred to in the definition of Eurodollar Rate are not being provided in the relevant amounts or for the relevant maturities for purposes of determining the interest rate on a Eurodollar Advance as provided in this Note, or (b) the relevant interest rates referred to in the definition of Eurodollar Rate do not accurately cover the cost to the Bank of

making or maintaining Eurodollar Advances, then the Bank shall forthwith give notice of such circumstances to the Borrower, whereupon (i) the obligation of the Bank to make Eurodollar Advances shall be suspended until the Bank notifies the Borrower that the circumstances giving rise to the suspension no longer exists, and (ii) the Borrower shall repay in full the then outstanding principal amount of each Eurodollar Advance, together with accrued interest, on the last day of the then current Interest Period applicable to the Advance, provided, however, that, subject to the terms and conditions of this Note and the Related Documents, the Borrower shall be entitled to simultaneously replace the entire outstanding balance of any Eurodollar Advance repaid in accordance with this section with a Prime Rate Advance in the same amount.

Obligations Due on Non-Business Day. Whenever any payment under this Note becomes due and payable on a day that is not a Business Day, if no default then exists under this Note, the maturity of the payment shall be extended to the next succeeding Business Day, except, in the case of a Eurodollar Advance, if the result of the extension would be to extend the payment into another calendar month, the payment must be made on the immediately preceding Business Day.

Matters Regarding Payment. The Borrower will pay the Bank at the Bank's address shown above or at such other place as the Bank may designate. Payments shall be allocated among principal, interest and fees at the discretion of the Bank unless otherwise agreed or required by applicable law. Acceptance by the Bank of any payment which is less than the payment due at the time shall not constitute a waiver of the Bank's right to receive payment in full at that time or any other time.

Authorization for Direct Payments (ACH Debits). To effectuate any payment due under this Note, the Borrower hereby authorizes the Bank to initiate debit entries to Account Number _____ at the Bank and to debit the same to such account. This authorization to initiate debit entries shall remain in full force and effect until the Bank has received written notification of its termination in such time and in such manner as to afford the Bank a reasonable opportunity to act on it. The Borrower represents that the Borrower is and will be the owner of all funds in such account. The Borrower acknowledges (1) that such debit entries may cause an overdraft of such account which may result in the Bank's refusal to honor items drawn on such account until adequate deposits are made to such account; (2) that the Bank is under no duty or obligation to initiate any debit entry for any purpose; and (3) that if a debit is not made because the above-referenced account does not have a sufficient available balance, or otherwise, the payment may be late or past due.

Credit Facility. The Bank has approved a credit facility to the Borrower in a principal amount not to exceed the face amount of this Note. The credit facility is in the form of advances made from time to time by the Bank to the Borrower. This Note evidences the Borrower's obligation to repay those advances. The aggregate principal amount of debt evidenced by this Note is the amount reflected from time to time in the records of the Bank. Until the earliest of maturity, the occurrence of any default, or the occurrence of any event that would constitute a default but for the giving of notice or the lapse of time or both until the end of any grace or cure period, the Borrower may borrow, pay down and reborrow under this Note subject to the terms of the Related Documents.

Renewal and Extension. This Note is given in replacement, renewal and/or extension of, but not extinguishing the indebtedness evidenced by, that Line of Credit Note dated June 30, 2004 executed by the Borrower in the original principal amount of Twenty Million and 00/100 Dollars (\$20,000,000.00), including previous renewals or modifications thereof, if any (the "Prior Note"), and is not a novation thereof. All interest evidenced by the Prior Note shall continue to be due and payable until paid. If applicable, all Collateral continues to secure the payment of this Note and the Liabilities. The provisions of this Note are effective on the date that this Note has been executed by all of the signers and delivered to the Bank.

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Miscellaneous. This Note binds the Borrower and its successors, and benefits the Bank, its successors and assigns. Any reference to the Bank includes any holder of this Note. This Note is issued pursuant and entitled to the benefits of that certain Credit Agreement by and between the Borrower and the Bank, dated June 30, 2004, and all replacements thereof (the "Credit Agreement") to which reference is hereby made for a more complete statement of the terms and conditions under which the loan evidenced hereby is made and is to be repaid. The terms and provisions of the Credit Agreement are hereby incorporated and made a part hereof by this reference thereto with the same force and effect as if set forth at length herein. No reference to the Credit Agreement and no provisions of this Note or the Credit Agreement shall alter or impair the absolute and unconditional obligation of the Borrower to pay the principal and interest on this Note as herein prescribed. Capitalized terms not otherwise defined herein shall have the meanings assigned to such terms in the Credit Agreement.

Address: 3400 Jackson St.
Dubuque, IA 52001

Borrower:

Flexsteel Industries, Inc.

By: /s/ R. J. Klosterman

R. J. Klosterman, Exec. V.P., C.F.O., Secretary

Printed Name

Title

Date Signed: June 15, 2005



This agreement is dated as of June 10, 2005 (the "Agreement Date"), by and between Flexsteel Industries, Inc. (the "Borrower") and JPMorgan Chase Bank, N.A. as successor by merger to Bank One, NA (the "Bank"). The provisions of this agreement are effective on the date that this agreement has been executed by all of the signers and delivered to the Bank (the "Effective Date").

WHEREAS, the Borrower executed a Line of Credit Note as evidence of indebtedness in the original face amount of Twenty Million and 00/100 Dollars (\$20,000,000.00), dated June 30, 2004 owing by the Borrower to the Bank, as same may have been amended or modified from time to time (the "Note"), which Note has at all times been, and is now, continuously and without interruption outstanding in favor of the Bank; and,

WHEREAS, the Borrower has requested and the Bank has agreed that the Note be modified to the limited extent as hereinafter set forth;

NOW THEREFORE, in mutual consideration of the agreements contained herein and for other good and valuable consideration, the parties agree as follows:

1. **ACCURACY OF RECITALS.** The Borrower acknowledges the accuracy of the Recitals stated above.

2. **MODIFICATION OF NOTE.**

2.1 From and after the Effective Date, the amount of the Note, and the maximum principal amount that may at any time be outstanding thereunder, is hereby decreased to Thirteen Million and 00/100 Dollars (\$13,000,000.00).

2.2 Each of the Related Documents is modified to provide that it shall be a default or an event of default thereunder if the Borrower shall fail to comply with any of the covenants of the Borrower herein or if any representation or warranty by the Borrower or by any guarantor herein is materially incomplete, incorrect, or misleading as of the date hereof. As used in this agreement, the "Related Documents" shall include the Note and all loan agreements, credit agreements, reimbursement agreements, security agreements, mortgages, deeds of trust, pledge agreements, assignments, guaranties, or any other instrument or document executed in connection with the Note or in connection with any other obligations of the Borrower to the Bank.

2.3 Each reference in the Related Documents to any of the Related Documents shall be a reference to such document as modified herein.

3. **RATIFICATION OF RELATED DOCUMENTS AND COLLATERAL.** The Related Documents are ratified and reaffirmed by the Borrower and shall remain in full force and effect as they may be modified herein. All real or personal property described as security in the Related Documents shall remain as security for the Note and the obligations of the Borrower in the Related Documents.

4. **BORROWER REPRESENTATIONS AND WARRANTIES.** The Borrower represents and warrants to the Bank:

4.1 No default or event of default under any of the Related Documents as modified hereby, nor any event, that, with the giving of notice or the passage of time or both, would be a default or an event of default under the Related Documents as modified herein has occurred and is continuing.

4.2 There has been no material adverse change in the financial conditions of the Borrower or any other person whose financial statement has been delivered to the Bank in connection with the Note from the most recent financial statement received by the Bank.

4.3 Each and all representations and warranties of the Borrower in the Related Documents are accurate on the date hereof.

4.4 The Borrower has no claims, counterclaims, defenses, or setoffs with respect to the loan evidenced by the Note or with respect to the Related Documents as modified herein.

4.5 The Note and the Related Documents as modified herein are the legal, valid, and binding obligations of the Borrower, enforceable against the Borrower in accordance with their terms.

4.6 The Borrower, other than any Borrower who is a natural person, is validly existing under the laws of the State of its formation or organization. The Borrower has the requisite power and authority to execute and deliver this agreement and to perform the obligations described in the Related Documents as modified herein. The execution and delivery of this agreement and the

performance of the obligations described in the Related Documents as modified herein have been duly authorized by all requisite action by or on behalf of the Borrower. This agreement has been duly executed and delivered by or on behalf of the Borrower.

5. **BORROWER COVENANTS.** The Borrower covenants with the Bank:

5.1 The Borrower shall execute, deliver, and provide to the Bank such additional agreements, documents, and instruments as reasonably required by the Bank to effectuate the intent of this agreement.

5.2 The Borrower fully, finally, and forever releases and discharges the Bank and its successors, assigns, directors, officers, employees, agents, and representatives from any and all causes of action, claims, debts, demands, and liabilities, of whatever kind or nature, in law or equity, of the Borrower, whether now known or unknown to the Borrower, (i) in respect of the loan evidenced by the Note and the Related Documents, or of the actions or omissions of the Bank in any manner related to the loan evidenced by the Note or the Related Documents and (ii) arising from events occurring prior to the date of this agreement.

5.3 The Borrower shall pay to the Bank:

5.3.1 All the internal and external costs and expenses incurred by the Bank in connection with this agreement (including, without limitation, inside and outside attorneys, appraisal, appraisal review, processing, title, filing, and recording costs, expenses, and fees).

6. **EXECUTION AND DELIVERY OF AGREEMENT BY THE BANK.** The Bank shall not be bound by this agreement until (i) the Bank has executed this agreement and (ii) the Borrower performed all of the obligations of the Borrower under this agreement to be performed contemporaneously with the execution and delivery of this agreement.

7. **INTEGRATION, ENTIRE AGREEMENT, CHANGE, DISCHARGE, TERMINATION, OR WAIVER.** The Note and the Related Documents as modified herein contain the complete understanding and agreement of the Borrower and the Bank in respect of the loan and supersede all prior representations, warranties, agreements, arrangements, understandings, and negotiations. No provision of the Note or the Related Documents as modified herein may be changed, discharged, supplemented, terminated, or waived except in a writing signed by the party against whom it is being enforced.

8. **GOVERNING LAW AND VENUE.** This agreement is delivered in the State of Indiana and governed by Indiana law (without giving effect to its laws of conflicts). The Borrower agrees that any legal action or proceeding with respect to any of its obligations under the Note or this agreement may be brought by the Bank in any state or federal court located in the State of Indiana, as the Bank in its sole discretion may elect. By the execution and delivery of this agreement, the Borrower submits to and accepts, for itself and in respect of its property, generally and unconditionally, the non-exclusive jurisdiction of those courts. The Borrower waives any claim that the State of Indiana is not a convenient forum or the proper venue for any such suit, action or proceeding. This agreement binds the Borrower and its successors, and benefits the Bank, its successors and assigns. The Borrower shall not, however, have the right to assign the Borrower's rights under this agreement or any interest therein, without the prior written consent of the Bank.

9. **COUNTERPART EXECUTION.** This agreement may be executed in multiple counterparts, each of which, when so executed, shall be deemed an original, but all such counterparts, taken together, shall constitute one and the same agreement.

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10. **NOT A NOVATION.** This agreement is a modification only and not a novation. In addition to all amounts hereafter due under the Note and the Related Documents as they may be modified herein, all accrued interest evidenced by the Note being modified by this agreement and all accrued amounts due and payable under the Related Documents shall continue to be due and payable until paid. Except for the above-quoted modification(s), the Note, any Related Documents, and all the terms and conditions thereof, shall be and remain in full force and effect with the changes herein deemed to be incorporated therein. This agreement is to be considered attached to the Note and made a part thereof. This agreement shall not release or affect the liability of any guarantor, surety or endorser of the Note or release any owner of collateral securing the Note. The validity, priority and enforceability of the Note shall not be impaired hereby. References to the Related Documents and to other agreements shall not affect or impair the absolute and unconditional obligation of the Borrower to pay the principal and interest on the Note when due. The Bank reserves all rights against all parties to the Note.

Address: 3400 Jackson St.
Dubuque, IA 52001

Borrower:

Flexsteel Industries, Inc.

By: /s/ R.J. Klosterman

R.J. Klosterman, Exec. V.P., C.F.O., Secretary

Printed Name Title

Date Signed: June 15, 2005

BANK'S ACCEPTANCE

The foregoing agreement is hereby agreed to and acknowledged.

Bank:

JPMorgan Chase Bank, N.A.

By: /s/ John C. Otteson

John C. Otteson, First Vice President

Printed Name Title

Date Signed: June 20, 2005

This agreement is dated as of June 10, 2005, by and between Flexsteel Industries, Inc. (the "Borrower") and JPMorgan Chase Bank, N.A. as successor by merger to Bank One, NA (the "Bank"), and its successors and assigns. The provisions of this agreement are effective on the date that this agreement has been executed by all of the signers and delivered to the Bank (the "Effective Date").

WHEREAS, the Borrower and the Bank entered into a credit agreement dated June 30, 2004, as amended (if applicable) (the "Credit Agreement"); and

WHEREAS, the Borrower has requested and the Bank has agreed to amend the Credit Agreement as set forth below;

NOW, THEREFORE, in mutual consideration of the agreements contained herein and for other good and valuable consideration, the parties agree as follows:

1. **DEFINED TERMS.** Capitalized terms not defined herein shall have the meaning ascribed in the Credit Agreement.
2. **MODIFICATION OF CREDIT AGREEMENT.** The Credit Agreement is hereby amended as follows:
 - 2.1 From and after the Effective Date, the following provision in the Credit Agreement under Section 1.2 captioned "**Facility A. (Line Of Credit)**" is hereby amended as follows: The language now reading "The Bank has approved a credit facility to the Borrower in the principal sum not to exceed \$20,000,000.00 in the aggregate at any one time outstanding (Facility A)", is replaced with the following:

The Bank has approved a credit facility to the Borrower in the principal sum not to exceed \$13,000,000.00 in the aggregate at any one time outstanding ("Facility A").
 - 2.2 From and after the Effective Date, the following provision in the Credit Agreement under Section 1.4 subsection (a) captioned "**Facility C. (Letter of Credit)**" is hereby amended and restated as follows:

(a) the aggregate maximum available amount which is drawn and unreimbursed or may be drawn under all letters of credit which are outstanding at any time, including without limitation all letters of credit issued for the account of the Borrower and/or DMI which are outstanding on the date of this agreement, shall not exceed \$5,000,000.00.
3. **RATIFICATION.** The Borrower ratifies and reaffirms the Credit Agreement and the Credit Agreement shall remain in full force and effect as modified herein.
4. **BORROWER REPRESENTATIONS AND WARRANTIES.** The Borrower represents and warrants that (a) the representations and warranties contained in the Credit Agreement are true and correct in all material respects as of the date of this agreement, (b) no condition, act or event which could constitute an event of default under the Credit Agreement or any promissory note or credit facility executed in reference to the Credit Agreement exists, and (c) no condition, event, act or omission has occurred, which, with the giving of notice or passage of time, would constitute an event of default under the Credit Agreement or any promissory note or credit facility executed in reference to the Credit Agreement.
5. **FEES AND EXPENSES.** The Borrower agrees to pay all fees and out-of-pocket disbursements incurred by the Bank in connection with this agreement, including legal fees incurred by the Bank in the preparation, consummation, administration and enforcement of this agreement.
6. **EXECUTION AND DELIVERY.** This agreement shall become effective only after it is fully executed by the Borrower and the Bank, and the Bank shall have received from the Borrower the following documents: Line of Credit Notes for \$20,000,000.00 and \$13,000,000.00.
7. **ACKNOWLEDGEMENTS OF BORROWER.** The Borrower acknowledges that as of the date of this agreement it has no offsets with respect to all amounts owed by the Borrower to the Bank arising under or related to the Credit Agreement on or prior to the date of this agreement. The Borrower fully, finally and forever releases and discharges the Bank and its successors, assigns, directors, officers, employees, agents and representatives from any and all claims, causes of action, debts and liabilities, of whatever kind or nature, in law or in equity, of the Borrower, whether now known or unknown to the Borrower, which may have arisen in connection with the Credit Agreement or the actions or omissions of the Bank related to the Credit Agreement on or prior to the date hereof. The Borrower acknowledges and agrees that this agreement is limited to

the terms outlined above, and shall not be construed as an agreement to change any other terms or provisions of the Credit Agreement. This agreement shall not establish a course of dealing or be construed as evidence of any willingness on the Bank's part to grant other or future agreements, should any be requested.

8. **NOT A NOVATION.** This agreement is a modification only and not a novation. Except for the above-quoted modification(s), the Credit Agreement, any loan agreements, credit agreements, reimbursement agreements, security agreements, mortgages, deeds of trust, pledge agreements, assignments, guaranties, instruments or documents executed in connection with the Credit Agreement, and all the terms and conditions thereof, shall be and remain in full force and effect with the changes herein deemed to be incorporated therein. This agreement is to be considered attached to the Credit Agreement and made a part thereof. This agreement shall not release or affect the liability of any guarantor of any promissory note or credit facility executed in reference to the Credit Agreement or release any owner of collateral granted as security for the Credit Agreement. The validity, priority and enforceability of the Credit Agreement shall not be impaired hereby. To the extent that any provision of this agreement conflicts with any term or condition set forth in the Credit Agreement, or any document executed in conjunction therewith, the provisions of this agreement shall supersede and control. The Bank expressly reserves all rights against all parties to the Credit Agreement.

Borrower:

Flexsteel Industries, Inc.

By: /s/ R.J. Klosterman

R.J. Klosterman,

Exec. V.P., C.F.O., Secretary

Printed Name

Title

Date Signed: June 15, 2005

Bank:

JPMorgan Chase Bank, N.A.

By: /s/ John C. Otteson

John C. Otteson,

First Vice President

Printed Name

Title

Date Signed: June 20, 2005



Line of Credit Note

\$20,000,000.00

Date: June 30, 2004

Due: September 30, 2007

Promise to Pay. On or before September 30, 2007, for value received, Flexsteel Industries, Inc. (the "Borrower") promises to pay to Bank One, NA, with its main office in Chicago, IL, whose address is 111 Monument Circle, Indianapolis, IN 46277 (the "Bank") or order, in lawful money of the United States of America, the sum of Twenty Million and 00/100 Dollars (\$20,000,000.00) or such lesser sum as is indicated on Bank records, plus interest as provided below.

Definitions. As used in this Note, the following terms have the following respective meanings:

"Advance" means a Eurodollar Advance or a Prime Rate Advance and **"Advances"** means all Eurodollar Advances and all Prime Rate Advances under this Note.

"Applicable Margin" means with respect to any Prime Rate Advance or Eurodollar Advance, as the case may be, the rate per annum set forth below opposite the applicable Funded Debt to EBITDA Ratio. Funded Debt to EBITDA Ratio is defined in the Credit Agreement.

Funded Debt to EBITDA Ratio	Applicable Margin	
	Prime Rate Advance	Eurodollar Advance
Greater than or equal to 2.00 to 1.00	0.00%	1.25%
Less than 2.00 to 1.00 but greater than or equal to 1.00 to 1.00	0.00%	0.75%
Less than 1.00 to 1.00	0.00%	0.75%

The Applicable Margin shall, in each case, be determined and adjusted quarterly on the first day of the month after the date of delivery of the quarterly and annual financial statements required by the Credit Agreement, *provided, however*, that if such financial statements are not delivered within two Business Days after the required date (each, an "Interest Determination Date"), the Applicable Margin shall increase to the maximum percentage amount set forth in the table above from the date such financial statements were required to be delivered to the Bank until received by the Bank. The Applicable Margin shall be effective from an Interest Determination Date until the next Interest Determination Date. Such determinations by the Bank shall be conclusive absent manifest error. The initial Applicable Margin for Prime Rate Advances is 0.00% and for Eurodollar Advances is 0.75%.

"Credit Agreement" means a certain Credit Agreement, dated June 30, 2004, between the Borrower and the Bank.

"Business Day" means (i) with respect to any borrowing, payment or rate selection of Eurodollar Advances, a day (other than a Saturday or Sunday) on which banks generally are open in Indiana and/or New York for the conduct of substantially all of their commercial lending activities and on which dealings in United States dollars are carried on in the London interbank market and (ii) for all other purposes, a day other than a Saturday, Sunday or any other day on which national banking associations are authorized to be closed.

"Eurodollar Base Rate" means, with respect to the relevant Interest Period, the applicable British Bankers' Association LIBOR rate for deposits in U.S. dollars as reported by any generally recognized financial information service as of 11:00 a.m. (London time) two Business Days prior to the first day of such Interest Period, and having a maturity equal to such Interest Period, *provided that*, if no such British Bankers' Association LIBOR rate is available to the Bank, the applicable Eurodollar Base Rate for the relevant Interest Period shall instead be the rate determined by the Bank to be the rate at which BANK ONE CORPORATION or one of its affiliate banks offers to place deposits in U.S. dollars with first-class banks in the London interbank market at approximately 11:00 a.m. (London time) two Business Days prior to the first day of such Interest Period, in the approximate amount of the principal amount outstanding on such date and having a maturity equal to such Interest Period.

“Eurodollar Advance” means any borrowing under this Note when and to the extent that its interest rate is determined by reference to the Eurodollar Rate.

“Eurodollar Rate” means, with respect to a Eurodollar Advance for the relevant interest Period, the sum of (i) the Applicable Margin plus (ii) the quotient of (a) the Eurodollar Base Rate applicable to such Interest Period, divided by (b) one minus the Reserve Requirement (expressed as a decimal) applicable to such interest Period.

“Interest Period” means, with respect to a Eurodollar Advance, a period of one (1), two (2), three (3) or six (6) month(s) commencing on a Business Day selected by the Borrower pursuant to this Note. Such Interest Period shall end on the day which corresponds numerically to such date one (1), two (2), three (3) or six (6) month(s) thereafter, as applicable, *provided, however*, that if there is no such numerically corresponding day in such first, second, third or sixth succeeding month(s), as applicable, such Interest Period shall end on the last Business Day of such first, second, third or sixth succeeding month(s), as applicable. If an Interest Period would otherwise end on a day which is not a Business Day, such Interest Period shall end on the next succeeding Business Day, *provided, however*, that if said next succeeding Business Day falls in a new calendar month, such Interest Period shall end on the immediately preceding Business Day.

“Prime Rate” means a rate per annum equal to the prime rate of interest announced from time to time by the Bank or its parent (which is not necessarily the lowest rate charged to any customer), changing when and as said prime rate changes.

“Prime Rate Advance” means any Advance under this Note when and to the extent that its interest rate is determined by reference to the Prime Rate.

“Principal Payment Date” is defined in the paragraph entitled “Principal Payments” below.

“Regulation D” means Regulation D of the Board of Governors of the Federal Reserve System as from time to time in effect and any successor thereto or other regulation or official interpretation of said Board of Governors relating to reserve requirements applicable to member banks of the Federal Reserve System.

“Reserve Requirement” means, with respect to an Interest Period, the maximum aggregate reserve requirement (including all basic, supplemental, marginal and other reserves) which is imposed under Regulation D.

Interest Rates. The Advance(s) evidenced by this Note may be drawn down and remain outstanding as up to five (5) Eurodollar Advances and/or a Prime Rate Advance. The Borrower shall pay interest to the Bank on the outstanding and unpaid principal amount of each Prime Rate Advance at the Prime Rate plus the Applicable Margin and each Eurodollar Advance at the Eurodollar Rate. Interest shall be calculated on the basis of the actual number of days elapsed in a year of 360 days. In no event shall the interest rate applicable to any Advance exceed the maximum rate allowed by law. Any interest payment which would for any reason be deemed unlawful under applicable law shall be applied to principal.

Bank Records. The Bank shall, in the ordinary course of business, make notations in its records of the date, amount, interest rate and Interest Period of each Advance hereunder, the amount of each payment on the Advances, and other information. Such records shall, in the absence of manifest error, be conclusive as to the outstanding principal balance of and interest rate or rates applicable to this Note.

Notice and Manner of Electing Interest Rates on Advances. The Borrower shall give the Bank written notice (effective upon receipt) of the Borrower’s intent to draw down an Advance under this Note no later than 11:00 a.m. Eastern time, one (1) Business Day before disbursement, if the full amount of the drawn Advance is to be disbursed as a Prime Rate Advance and three (3) Business Days before disbursement, if any part of such Advance is to be disbursed as a Eurodollar Advance. The Borrower’s notice must specify: (a) the disbursement date, (b) the amount of each Advance, (c) the type of each Advance (Prime Rate Advance or Eurodollar Advance), and (d) for each Eurodollar Advance, the duration of the applicable Interest Period; *provided, however*, that the Borrower may not elect an Interest Period ending after the maturity date of this Note. Each Eurodollar Advance shall be in a minimum amount of One Million and 00/100 Dollars (\$1,000,000.00). All notices under this paragraph are irrevocable. By the Bank’s close of business on the disbursement date and upon fulfillment of the conditions set forth herein and in any other of the Related Documents, the Bank shall disburse the requested Advances in immediately available funds by crediting the amount of such Advances to the Borrower’s account with the Bank.

Conversion and Renewals. The Borrower may elect from time to time to convert one type of Advance into another or to renew any Advance by giving the Bank written notice no later than 11:00 a.m. Eastern time, one (1) Business Day before conversion into a Prime Rate Advance and three (3) Business Days before conversion into or renewal of a Eurodollar Advance, specifying: (a) the renewal or conversion date, (b) the amount of the Advance to be converted or renewed, (c) in the case of conversion, the type of Advance to be converted into (Prime Rate Advance or Eurodollar Advance), and (d) in the case of renewals or conversion into a Eurodollar Advance, the applicable Interest Period, provided that (i) the minimum principal amount of each Eurodollar Advance outstanding after a renewal or conversion shall be One Million and 00/100 Dollars (\$1,000,000.00); (ii) a Eurodollar Advance can only be converted on the last day of the Interest Period for the Advance; and (iii) the Borrower may not elect an Interest Period ending after the maturity date of this Note. All notices given under this paragraph are irrevocable. If the Borrower fails to give the Bank the notice specified above for the renewal or conversion of a Eurodollar Advance by 11:00 a.m. Eastern time three (3) Business Days before the end of the Interest Period for that Advance, the Advance shall automatically be converted to a Prime Rate Advance on the last day of the Interest Period for the Advance.

The Borrower may permanently reduce the Line of Credit commitment, in integral multiples of \$1,000,000.00, by providing at least five Business Days’ written notice to the Bank and shall be irrevocable, which notice shall specify the amount of any such reduction, provided, however, that the amount of the aggregate commitment may not be reduced below the aggregate outstanding principal balance outstanding under this Note.

Interest Payments. Interest on the Advances shall be paid as follows:

A. For each Prime Rate Advance, on the last day of each month beginning with the first month following disbursement of the Advance or following conversion of an Advance into a Prime Rate Advance, and at the maturity or conversion of the Advance into a Eurodollar Advance;

B. For each Eurodollar Advance, on the last day of the Interest Period for the Advance and, if the Interest Period is longer than three months, at three-month intervals beginning with the day three months from the date the Advance is disbursed.

Principal Payments. All outstanding principal and interest is due and payable in full on September 30, 2007, which is defined herein as the “Principal Payment Date”.

Default Rate of Interest. After a default has occurred under this Note, whether or not the Bank elects to accelerate the maturity of this Note because of such default, all Advances outstanding under this Note, including all Eurodollar Advances, shall bear interest at a per annum rate equal to the Prime Rate, plus the Applicable Margin for a Prime Rate Advance, plus three percent (3.00%) from the date the Bank elects to impose such rate. Imposition of this rate shall not affect any limitations contained in this Note on the Borrower’s right to repay principal on any Eurodollar Advance before the expiration of the Interest Period for that Advance.

Prepayment. The Borrower may prepay all or any part of any Prime Rate Advance at any time without premium or penalty. The Borrower may prepay any Eurodollar Advance only at the end of an Interest Period.

Funding Loss Indemnification. Upon the Bank’s request, the Borrower shall pay the Bank amounts sufficient in the Bank’s reasonable opinion) to compensate it for any loss, cost, or expense incurred as a result of:

A. Any payment of a Eurodollar Advance on a date other than the last day of the Interest Period for the Advance, including, without limitation, acceleration of the Advances by the Bank pursuant to this Note or the Related Documents; or

B. Any failure by the Borrower to borrow or renew a Eurodollar Advance on the date specified in the relevant notice from the Borrower to the Bank.

Additional Costs. If any applicable domestic or foreign law, treaty, government rule or regulation now or later in effect (whether or not it now applies to the Bank) or the interpretation or administration thereof by a governmental authority charged with such interpretation or administration, or compliance by the Bank with any guideline, request or directive of such an authority (whether or not having the force of law), shall (a) affect the basis of taxation of payments to the Bank of any amounts payable by the Borrower under this Note or the Related Documents (other than taxes imposed on the overall net income of the Bank by the jurisdiction or by any political subdivision or taxing authority of the jurisdiction in which the Bank has its principal office), or (b) impose, modify or deem applicable any reserve, special deposit or similar requirement against assets of, deposits with or for the account of, or credit extended by the Bank, or (c) impose any other condition with respect to this Note or the Related Documents and the result of any of the foregoing is to increase the cost to the Bank of maintaining any Eurodollar Advance or to reduce the amount of any sum receivable by the Bank on such an Advance, or (d) affect the amount of capital required or expected to be maintained by the Bank (or any corporation controlling the Bank) and the Bank determines that the amount of such capital is increased by or based upon the existence of the Bank’s obligations under this Note or the Related Documents and the increase has the effect of reducing the rate of return on the Bank’s (or its controlling corporation’s) capital as a consequence of the obligations under this Note or the Related Documents to a level below that which the Bank (or its controlling corporation) could have achieved but for such circumstances (taking into consideration its policies with respect to capital adequacy) by an amount deemed by the Bank to be material, then the Borrower shall pay to the Bank, from time to time, upon request by the Bank, additional amounts sufficient to compensate the Bank for the increased cost or reduced sum receivable. Whenever the Bank shall learn of circumstances described in this section which are likely to result in additional costs to the Borrower, the Bank shall give prompt written notice to the Borrower of the basis for and the estimated amount of any such anticipated additional costs. A statement as to the amount of the increased cost or reduced sum receivable, prepared in good faith and in reasonable detail by the Bank and submitted by the Bank to the Borrower, shall be conclusive and binding for all purposes absent manifest error in computation.

Illegality. If any applicable domestic or foreign law, treaty, rule or regulation now or later in effect (whether or not it now applies to the Bank) or the interpretation or administration thereof by a governmental authority charged with such interpretation or administration, or compliance by the Bank with any guideline, request or directive of such an authority (whether or not having the

force of law), shall make it unlawful or impossible for the Bank to maintain or fund the Eurodollar Advances, then, upon notice to the Borrower by the Bank, the outstanding principal amount of the Eurodollar Advances, together with accrued interest and any other amounts payable to the Bank under this Note or the Related Documents on account of the Eurodollar Advances shall be repaid (a) immediately upon the Bank’s demand if such change or compliance with such requests, in the Bank’s judgment, requires immediate repayment, or (b) at the expiration of the last Interest Period to expire before the effective date of any such change or request provided, however, that subject to the terms and conditions of this Note and the Related Documents the Borrower shall be entitled to simultaneously replace the entire outstanding balance of any Eurodollar Advance repaid in accordance with this section with a Prime Rate Advance in the same amount.

Inability to Determine Interest Rate. If the Bank determines that (a) quotations of interest rates for the relevant deposits referred to in the definition of Eurodollar Rate are not being provided in the relevant amounts or for the relevant maturities for purposes of determining the interest rate on a Eurodollar Advance as provided in this Note, or (b) the relevant interest rates referred to in the definition of Eurodollar Rate do not accurately cover the cost to the Bank of making or maintaining Eurodollar Advances, then the Bank shall forthwith give notice of such circumstances to the Borrower, whereupon (i) the obligation of the Bank to make Eurodollar Advances shall be suspended until the Bank notifies the Borrower that the circumstances giving rise to the suspension no longer exists, and (ii) the Borrower shall repay in full the then outstanding principal amount of each Eurodollar Advance, together with accrued interest, on the last day of the then current Interest Period applicable to the Advance, provided, however, that, subject to the terms and conditions of this Note and the Related Documents, the Borrower shall be entitled to simultaneously replace the entire outstanding balance of any Eurodollar Advance repaid in accordance with this section with a Prime Rate Advance in the same amount.

Obligations Due on Non-Business Day. Whenever any payment under this Note becomes due and payable on a day that is not a Business Day, if no default then exists under this Note, the maturity of the payment shall be extended to the next succeeding Business Day, except, in the case of a Eurodollar Advance, if the result of the extension would be to extend the payment into another calendar month, the payment must be made on the immediately preceding Business Day.

Matters Regarding Payment. The Borrower will pay the Bank at the Bank’s address shown above or at such other place as the Bank may designate. Payments shall be allocated among principal, interest and fees at the discretion of the Bank unless otherwise agreed or required by applicable law. Acceptance by the Bank of any payment which is less than the payment due at the time shall not constitute a waiver of the Bank’s right to receive payment in full at that time or any other time.

Authorization for Direct Payments (ACH Debits). To effectuate any payment due under this Note, the Borrower hereby authorizes the Bank to initiate debit entries to Account Number _____ at the Bank and to debit the same to such account. This authorization to initiate debit entries shall remain in full force and effect until the Bank has received written notification of its termination in such time and in such manner as to afford the Bank a reasonable opportunity to act on it. The Borrower represents that the Borrower is and will be the owner of all funds in such account. The Borrower acknowledges (1) that such debit entries may cause an overdraft of such account which may result in the Bank's refusal to honor items drawn on such account until adequate deposits are made to such account; (2) that the Bank is under no duty or obligation to initiate any debit entry for any purpose; and (3) that if a debit is not made because the above-referenced account does not have a sufficient available balance, or otherwise, the payment may be late or past due.

Credit Facility. The Bank has approved a credit facility to the Borrower in a principal amount not to exceed the face amount of this Note. The credit facility is in the form of advances made from time to time by the Bank to the Borrower. This Note evidences the Borrower's obligation to repay those advances. The aggregate principal amount of debt evidenced by this Note is the amount reflected from time to time in the records of the Bank. Until the earliest of maturity, the occurrence of any default, or the occurrence of any event that would constitute a default but for the giving of notice or the lapse of time or both until the end of any grace or cure period, the Borrower may borrow, pay down and reborrow under this Note subject to the terms of the Related Documents.

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Miscellaneous. This Note binds the Borrower and its successors, and benefits the Bank, its successors and assigns. Any reference to the Bank includes any holder of this Note. This Note is issued pursuant and entitled to the benefits of that certain Credit Agreement by and between the Borrower and the Bank, dated June 30, 2004, and all replacements thereof (the "Credit Agreement") to which reference is hereby made for a more complete statement of the terms and conditions under which the loan evidenced hereby is made and is to be repaid. The terms and provisions of the Credit Agreement are hereby incorporated and made a part hereof by this reference thereto with the same force and effect as if set forth at length herein. No reference to the Credit Agreement and no provisions of this Note or the Credit Agreement shall alter or impair the absolute and unconditional obligation of the Borrower to pay the principal and interest on this Note as herein prescribed. Capitalized terms not otherwise defined herein shall have the meanings assigned to such terms in the Credit Agreement.

Address: P. O. Box 877
Dubuque, IA 52004-0877

Borrower:

Flexsteel Industries, Inc.

By: /s/ R.J. Klosterman

R.J. Klosterman, Exec. V.P., C.F.O., Secretary

Printed Name Title

Date Signed: June 29, 2004



Credit Agreement

This agreement dated as of June 30, 2004 between Bank One, NA, with its main office in Chicago, IL, and its successors and assigns, (the "Bank"), whose address is 111 Monument Circle, Indianapolis, IN 46277, and Flexsteel Industries, Inc. (the "Borrower"), whose address is P. O. Box 877, Dubuque, IA 52004-0877.

1. Credit Facilities.

1.1 Scope. This agreement governs Facility A, Facility B, and Facility C, and, unless otherwise agreed to in writing by the Bank and the Borrower or prohibited by applicable law, governs the Credit Facilities.

1.2 Facility A (Line of Credit). The Bank has approved a credit facility to the Borrower in the principal sum not to exceed \$20,000,000.00 in the aggregate at any one time outstanding ("Facility A"). Credit under Facility A shall be repayable as set forth in a Line of Credit Note executed concurrently with this agreement to evidence Facility A, and any renewals, modifications or extensions thereof. The proceeds of Facility A shall be used to refinance existing debt with the Bank in the name of DMI and to provide funds to finance additional working capital. The Borrower may elect from time to time to permanently reduce the amount of the Bank's commitment with respect to facility A as provided in the Line of Credit Note evidencing Facility A.

Non Usage Fee. The Borrower shall pay to the Bank a non-usage fee on the average daily unused portion of Facility A at a rate per annum set

forth below opposite the applicable Funded Debt to EBITDA Ratio, payable in arrears for each calendar quarter within ten (10) days of billing by the Bank. Funded Debt to EBITDA Ratio is defined in Section 4.2 K of the Credit Agreement.

Funded Debt to EBITDA Ratio	Non-usage Fee
Greater than or equal to 2.00 to 1.00	20 bp
Less than 2.00 to 1.00 but greater than or equal to 1.00 to 1.00	10 bp
Less than 1.00 to 1.00	10 bp

The Bank's determination of the non-usage fee on Facility A shall be conclusive, absent manifest error.

- 1.3 Facility B (Line of Credit).** The Bank has approved a credit facility to the Borrower in the principal sum not to exceed \$20,000,000.00 in the aggregate at any one time outstanding ("Facility B"). Credit under Facility B shall be repayable as set forth in a Line of Credit Note executed concurrently with this agreement to evidence Facility B, and any renewals, modifications or extensions thereof. The proceeds of Facility B shall be to refinance existing debt with the Bank in the name of DMI, and to provide funds to finance additional working capital. The Borrower may elect from time to time to permanently reduce the amount of the Bank's commitment with respect to facility B as provided in the Line of Credit Note evidencing Facility B.
- 1.4 Facility C (Letters of Credit).** The Bank has approved a credit facility for letters of credit to the Borrower and/ or DMI in the principal sum not to exceed \$7,000,000.00 in the aggregate at any one time outstanding ("Facility C"). The proceeds of Facility C shall be used to support letters of credit issued for the account of Borrower and / or DMI.

Non Usage Fee. The Borrower shall pay to the Bank a non-usage fee on the average daily unused portion of Facility C at a rate per annum set forth below opposite the applicable Funded Debt to EBITDA Ratio, payable in arrears for each calendar quarter within ten (10) days of billing by the Bank.

Funded Debt to EBITDA Ratio	Non-usage Fee
Greater than or equal to 2.00 to 1.00	20 bp
Less than 2.00 to 1.00 but greater than or equal to 1.00 to 1.00	10 bp
Less than 1.00 to 1.00	10 bp

The Bank's determination of the non-usage fee on Facility C shall be conclusive, absent manifest error.

Letters of Credit. At any time that no default has occurred and is continuing or would result, and no event has occurred and is continuing or would result which, with the giving of notice or the lapse of time or both would be a default, the Bank agrees to issue letters of credit for the account of the Borrower and/ or DMI until September 30, 2007, provided that (a) the aggregate maximum available amount which is drawn and unreimbursed or may be drawn under all letters of credit which are outstanding at any time, including without limitation all letters of credit issued for the account of the Borrower and/ or DMI which are outstanding on the date of this agreement, shall not exceed \$7,000,000.00, (b) the issuance of any letter of credit with an expiration date beyond September 30, 2007, shall be entirely at the discretion of the Bank, (c) any letter of credit shall be a commercial letter of credit and the form of the requested letter of credit shall be satisfactory to the Bank, in the Bank's sole discretion, and (d) the Borrower and DMI shall have executed an application and reimbursement agreement for any letter of credit in the Bank's standard form. The Borrower shall pay the Bank a fee (the "L/C Fee") for each commercial letter of credit that is issued, at a rate per annum set forth below opposite the applicable Funded Debt to EBITDA Ratio, payable in arrears for each calendar quarter within ten (10) days of billing by the Bank. Funded Debt to EBITDA Ratio is defined in Section 4.2L of the Credit Agreement. No credit shall be given for fees paid due to early termination of any letter of credit. The Borrower shall also pay the Bank's standard transaction fees with respect to any transactions occurring on an account of any letter of credit. Each fee shall be payable when the related letter of credit is issued, and transaction fees shall be payable upon completion of the transaction as to which they are charged. All fees may be debited by the Bank to any deposit account of the Borrower carried with the Bank without further authority and, in any event, shall be paid by the Borrower within ten (10) days following billing.

Funded Debt to EBITDA Ratio	L/C Fee
Greater than or equal to 2.00 to 1.00	125 bp
Less than 2.00 to 1.00 but greater than or equal to 1.00 to 1.00	75 bp
Less than 1.00 to 1.00	75 bp

The Bank's determination of the L/C Fee shall be conclusive, absent manifest error.

2. Definitions. As used in this agreement, the following terms have the following respective meanings:

- 2.1** "Credit Facilities" means all extensions of credit from the Bank to the Borrower, whether now existing or hereafter arising, including but not limited to those described in Section 1.
- 2.2** "Capital Expenditures" means any expenditure or the incurrence of any obligation or liability by the Borrower for any asset which is classified as a capital asset.
- 2.3** "Distributions" means all dividends and other distributions made by the Borrower to its shareholders, partners, owners or members, as the case may be, other than salary, bonuses, and other compensation for services expended in the current accounting period.
- 2.4** "DMI" means DMI Furniture, Inc.
- 2.5** "Funded Debt to EBITDA Ratio" is used as that term is defined in Section 4.2 K.
- 2.6** "Liabilities" means all obligations, indebtedness and liabilities of the Borrower to any one or more of the Bank, BANK ONE CORPORATION,

and any of their subsidiaries, affiliates or successors, now existing or later arising, including, without limitation, all loans, advances, interest, costs, overdraft indebtedness, credit card indebtedness, lease obligations, or obligations relating to any Rate Management Transaction, all monetary obligations incurred or accrued during the pendency of any bankruptcy, insolvency, receivership or other similar proceedings, regardless of whether allowed or allowable in such proceeding, and all renewals, extensions, modifications, consolidations or substitutions of any of the foregoing, whether the Borrower may be liable jointly with others or individually liable as a debtor, maker, co-maker, drawer, endorser, guarantor, surety or otherwise, and whether voluntarily or involuntarily incurred, due or not due, absolute or contingent, direct or indirect, liquidated or unliquidated. The term "Rate Management Transaction" in this agreement means any transaction (including an agreement with respect thereto) now existing or hereafter entered into among the Borrower, the Bank or BANK ONE CORPORATION, or any of its subsidiaries or affiliates or their successors, which is a rate swap, basis swap, forward rate transaction, commodity swap, commodity option, equity or equity index swap, equity or equity index option, bond option, interest rate option, foreign exchange transaction, cap transaction, floor transaction, collar transaction, forward transaction, currency swap transaction, cross-currency rate swap transaction, currency option or any other similar transaction

(including any option with respect to any of these transactions) or any combination thereof, whether linked to one or more interest rates, foreign currencies, commodity prices, equity prices or other financial measures.

- 2.7 "Notes" means the Line of Credit Note(s) described in Section 1, and all promissory notes, instruments and/or contracts evidencing the terms and conditions of the Liabilities.
- 2.8 "Related Documents" means all loan agreements, credit agreements, reimbursement agreements, security agreements, mortgages, deeds of trust, pledge agreements, assignments, guaranties, or any other instrument or document executed in connection with this agreement or in connection with any of the Liabilities.
- 2.9 "Subordinated Debt" means debt subordinated to the Bank in manner and by agreement satisfactory to the Bank.
- 2.10 "Subsidiary" of a person or entity means (i) any corporation more than 50% of the outstanding securities having ordinary voting power of which shall at the time be owned or controlled, directly or indirectly, by such person or entity or by one or more of its Subsidiaries or by such person or entity and one or more of its Subsidiaries, or (ii) any partnership, limited liability company, association, joint venture or similar business organization more than 50% of the ownership interests having ordinary voting power of which shall at the time be so owned or controlled. Unless otherwise expressly provided, all references herein to a "Subsidiary" shall mean a Subsidiary of the Borrower, and include, without limitation, DMI.

3. **Affirmative Covenants.** The Borrower shall, and shall cause each Subsidiary to::

- 3.1 **Insurance.** Maintain insurance with financially sound and reputable insurers covering its properties and business against those casualties and contingencies and in the types and amounts as are in accordance with sound business and industry practices, and furnish to the Bank, upon request of the Bank, reports on each existing insurance policy showing such information as the Bank may reasonably request.
- 3.2 **Existence.** Maintain its existence and business operations as presently in effect in accordance with all applicable laws and regulations, pay its debts and obligations when due under normal terms, and pay on or before their due date, all taxes, assessments, fees and other governmental monetary obligations, except as they may be contested in good faith if they have been properly reflected on its books and, at the Bank's request, adequate funds or security has been pledged to insure payment.
- 3.3 **Financial Records.** Maintain proper books and records of account, in accordance with generally accepted accounting principles, and consistent with financial statements previously submitted to the Bank.
- 3.4 **Inspection.** Permit the Bank, its assigns or agents, at such times and at such intervals as the Bank may reasonably require: (1) to inspect, examine, audit and copy its business records, and to discuss the its business, operations, and financial condition with its officers and accountants; and (2) to inspect the its business operations and sites.
- 3.5 **Financial Reports.** Furnish to the Bank whatever information, books and records the Bank may from time to time reasonably request, including at a minimum:

A. Via either the EDGAR System or its Home Page, within ten (10) days after the filing of its Quarterly Report on Form 10-Q for the fiscal quarter then ended with the Securities and Exchange Commission, but no event later than forty-five (45) days after the end of such fiscal quarter, copies of the financial statements for such fiscal quarter as contained in such Quarterly Report on Form 10-Q, and, as soon as it shall become available, a quarterly report to shareholders of the Borrower for the fiscal quarter then ended.

Via either the EDGAR System or its Home Page, promptly after the same become publicly available, copies of all periodic and other reports, proxy statements and other materials filed by the Borrower or any subsidiary with the Securities and Exchange Commission or any governmental authority succeeding to any or all of the functions of said Commission.

If for any reason the EDGAR System and/or its Home Page are not available to the Borrower as is required for making available the financial statements or reports referred to above, the Borrower shall then furnish a copy of such financial statements or reports to the Bank.

For the purposes of this section, "EDGAR System" means the Electronic Data Gathering Analysis and Retrieval System owned and operated by the United States Securities and Exchange Commission or any replacement system,

and "Home Page" means the Borrower's corporate home page on the World Wide Web accessible through the Internet via the universal resource locator (URL) identified as "www.flexsteel.com" or such other universal resource locator that the Borrower shall designate in writing to the Bank as its corporate home page on the World Wide Web.

B. Within one hundred (100) days after and as of the end of each of its fiscal years, a detailed financial statement including a balance sheet and statements of income, cash flow and retained earnings, such financial statement, to be audited by an independent certified public accountant of recognized standing acceptable to the Bank in the Bank's sole discretion.

- 3.6 **Notices of Claims, Litigation, Defaults, etc.** Promptly inform the Bank in writing of (1) all existing and all threatened litigation, claims,

investigations, administrative proceedings and similar actions affecting the Borrower or any Subsidiary, which could materially affect the financial condition of the Borrower or any Subsidiary; (2) the occurrence of any event which gives rise to the Bank's option to terminate the Credit Facilities; (3) the institution of steps by the Borrower or any Subsidiary to withdraw from, or the institution of any steps to terminate, any employee benefit plan as to which the Borrower and any Subsidiary may have liability; (4) any additions to or changes in the locations of the Borrower's or any Subsidiary's businesses; and (5) any alleged breach of any provision of this agreement or of any other agreement related to the Credit Facilities by the Bank.

- 3.7 Other Agreements.** Comply with all terms and conditions of all other agreements, whether now or hereafter existing, between the Borrower and any Subsidiary and any other party.
- 3.8 Title to Assets and Property.** Maintain good and marketable title to all of the Borrower's and each Subsidiary's assets and properties, and defend such assets and properties against all claims and demands of all persons at any time claiming any interest in them.
- 3.9 Additional Assurances.** Make, execute and deliver to the Bank such other agreements as the Bank may reasonably request to evidence the Credit Facilities and to perfect any security interests.
- 3.10 Employee Benefit Plans.** Maintain each employee benefit plan as to which the Borrower may have any liability, in compliance with all applicable requirements of law and regulations.
- 3.11 Banking Relationship.** Cause DMI to maintain its primary banking depository and disbursement relationship with the Bank and establish such accounts and maintain balances therein with the Bank sufficient to cover the cost of all the Bank's services provided; provided, however, that nothing herein shall require DMI to keep and maintain a specific minimum balance in such accounts.

Compliance Certificates. Provide the Bank, within forty-five (45) days after the end of each fiscal quarter, (excluding the 4th fiscal quarter) and within one hundred (100) days after the end of each fiscal year, with a certificate executed by the Borrower's chief financial officer, or other officer or a person acceptable to the Bank, certifying that, as of the date of the certificate, no default exists under any provision of this agreement.

4. Negative Covenants.

- 4.1** Unless otherwise noted, the financial requirements set forth in this section will be computed in accordance with generally accepted accounting principles applied on a basis consistent with financial statements previously submitted by the Borrower to the Bank.
- 4.2** Without the written consent of the Bank, the Borrower will not, and will not allow or permit any Subsidiary to:
- A. **Debt.** Incur, contract for, assume, or permit to remain outstanding, indebtedness for borrowed money, installment obligations, or obligations under capital leases or operating leases, other than (1) unsecured trade debt incurred in the ordinary course of business, (2) indebtedness owing to the Bank, (3) indebtedness reflected in the latest financial statement of the Borrower and the Subsidiaries furnished to the Bank prior to execution of this agreement and that is not to be paid with proceeds of borrowings under the Credit Facilities, and (4) other unsecured indebtedness and purchase money indebtedness in an aggregate amount not to exceed \$10,000,000.00 at any time outstanding for the Borrower and the Subsidiaries.
- B. **Guaranties.** Guarantee or otherwise become or remain secondarily liable on the undertaking of another, except for endorsement of drafts for deposit and collection in the ordinary course of business, and unsecured guaranties by the Borrower and the Subsidiaries in an aggregate amount not at any time exceeding \$3,000,000.00 of guaranteed debt.
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- C. **Liens.** Create or permit to exist any lien on any of its property, real or personal, except: existing liens known to the Bank; liens to the Bank; liens incurred in the ordinary course of business securing current non-delinquent liabilities for taxes, worker's compensation, unemployment insurance, social security and pension liabilities, and purchase money security interests which secure any purchase money indebtedness permitted under this agreement.
- D. **Use of Proceeds.** Use, or permit any proceeds of the Credit Facilities to be used, directly or indirectly, for: (1) any personal, family or household purpose; or (2) the purpose of "purchasing or carrying any margin stock" within the meaning of Federal Reserve Board Regulation U. At the Bank's request, the Borrower will furnish a completed Federal Reserve Board Form U-1.
- E. **Continuity of Operations.** (1) Engage in any business activities substantially different from those in which it is presently engaged; (2) cease operations, liquidate, merge, transfer, acquire or consolidate with any other entity, change its name, dissolve, or sell any assets out of the ordinary course of business; (3) enter into any arrangement with any person providing for the leasing by the Borrower or any subsidiary of real or personal property which has been sold or transferred by the Borrower or subsidiary to such person; or (4) change its business organization, the jurisdiction, under which its business organization is formed or organized, or its chief executive office, or any places of its businesses.
- F. **Limitation on Negative Pledge Clauses.** Enter into any agreement with any person other than the Bank which prohibits or limits the ability of the Borrower or any of its Subsidiaries to create or permit to exist any lien on any of its property, assets or revenues, whether now owned or hereafter acquired.
- G. **Conflicting Agreements.** Enter into any agreement containing any provision which would be violated or breached by the performance of the Borrower's obligations under this agreement.
- H. **Investments, and Acquisitions.** Permit to exist any investments (including without limitation, loans and advances to, and other investments in, Subsidiaries), or commitments therefor, or to create any subsidiary or to become or remain a partner in any partnership or joint venture, or make any acquisition of any person, except:
- (i) Cash equivalent investments;
 - (ii) Extensions of credit or credit accommodations to customers or vendors made by Borrower or a Subsidiary-in the ordinary

- course of business;
- (iii) Reasonable salary advances to non-executive employees, and other advances to agents and employees for anticipated expenses to be incurred on behalf of Borrower or any Subsidiary in the course of discharging their assigned duties;
- (iv) Existing investments in Subsidiaries and other investments in existence prior to the agreement date; or
- (v) Acquisitions made after the Agreement date, provided that, (a) the aggregate purchase prices paid or payable in all such acquisitions consummated during any period of twelve consecutive calendar months is not in excess of \$25,000,000.00 for the Borrower and the Subsidiaries, and no default has occurred and is continuing or would result and no event has occurred and is continuing or would result that, with the giving of notice or the lapse of time or both, would be a default.

I. **Asset Sales.** Lease, sell or otherwise dispose of its property to any other person, except:

- (i) sale of inventory in the ordinary course of business; or
- (ii) leases, sales or other dispositions of property with persons and entities who are unaffiliated with the Borrower or any Subsidiary, provided that the fair market value of such property when aggregated with the fair market value of all other property of Borrower and its Subsidiaries previously leased, sold or disposed of (other than inventory in the ordinary course of business) as permitted by this Section during the twelve-month period ending with the month in which any such lease, sale or other disposition occurs, does not exceed \$5,000,000.00.

J. **EBITDA/ Interest Ratio.** Permit as of any fiscal quarter end, its ratio determined on a consolidated basis for Borrower and its Subsidiaries, of (i) net income, plus amortization, depreciation, interest expense and income taxes, all computed for the twelve month period then ending, to (ii) interest expense, computed for the same such period, to be less than 3.00 to 1.00.

K. **Funded Debt to EBITDA Ratio.** Permit as of any fiscal quarter end, its "Funded Debt to EBITDA Ratio" to be greater than 3.50 to 1.00. As used herein, "Funded Debt to EBITDA Ratio" means the ratio, determined on a consolidated basis for Borrower and its Subsidiaries, of (i) total liabilities excluding (a) accounts arising from the purchase of goods and services in the ordinary course of business, (b) accrued expenses or losses, and (c) deferred

revenues or gains, all computed as of the end of the fiscal quarter for which this ratio is being determined, to (ii) net income, plus amortization, depreciation, interest expense and income taxes, all computed for the twelve month period ending with such fiscal quarter end.

L. **Government Regulation.** (1) Be or become subject at any time to any law, regulation, or list of any government agency (including, without limitation, the U.S. Office of Foreign Asset Control list) that prohibits or limits Bank from making any advance or extension of credit to Borrower or any Subsidiary or from otherwise conducting business with Borrower or any Subsidiary, or (2) fail to provide documentary and other evidence of Borrower's or any Subsidiary's identity as may be requested by Bank at any time to enable Bank to verify Borrower's or any Subsidiary's identity or to comply with any applicable law or regulation, including, without limitation, Section 326 of the USA Patriot Act of 2001, 31 U.S.C. Section 5318.

5. Representations.

5.1 **Representations by the Borrower.** The Borrower represents and warrants to the Bank that: (a) its principal residence or chief executive office is at the address shown above, (b) its name as it appears in this agreement is its exact name as it appears in its organizational documents, as amended, including any trust documents, (c) the execution and delivery of this agreement and the Notes, and the performance of the obligations they impose, do not violate any law, conflict with any agreement by which it is bound, or require the consent or approval of any governmental authority or other third party, (d) this agreement and the Notes are valid and binding agreements, enforceable according to their terms, (e) all balance sheets, profit and loss statements, and other financial statements and other information furnished to the Bank in connection with the Liabilities are accurate and fairly reflect the financial condition of the organizations and persons to which they apply on their effective dates, including contingent liabilities of every type, which financial condition has not changed materially and adversely since those dates, (f) no litigation, claim, investigation, administrative proceeding or similar action (including those for unpaid taxes) against the Borrower or any Subsidiary is pending or threatened, and no other event has occurred which may, in any one case or in the aggregate materially adversely affect the Borrower's consolidated financial condition or any of the Borrower's or any Subsidiary's properties, other than litigation, claims, or other events, if any, that have been disclosed to and acknowledged by the Bank in writing, (g) all of the Borrower's tax returns and reports that are or were required to be filed, have been filed, and all taxes, assessments and other governmental charges have been paid in full, except those presently being contested by the Borrower in good faith and for which adequate reserves have been provided, (h) the Borrower is not an "investment company" or a company "controlled" by an "investment company", within the meaning of the Investment Company Act of 1940, as amended, (i) the Borrower is not a "holding company", or a "subsidiary company" of a "holding company" or an "affiliate" of a "holding company" or of a "subsidiary company" of a "holding company" within the meaning of the Public Utility Holding Company Act of 1935, as amended, (j) there are no defenses or counterclaims, offsets or adverse claims, demands or actions of any kind, personal or otherwise, that the Borrower could assert with respect to this agreement or the Credit Facilities, (k) the Borrower owns, or is licensed to use, all trademarks, trade names, copyrights, technology, know-how and processes necessary for the conduct of its business as currently conducted, and (l) the execution and delivery of this agreement and the Notes and the performance of the obligations they impose, if the Borrower is other than a natural person (i) are within its powers, (ii) have been duly authorized by all necessary action of its governing body, and (iii) do not contravene the terms of its articles of incorporation or organization, its by-laws, or any partnership, operating or other agreement governing its affairs.

5.2 **Continuing Representations.** Each request for an advance or conversion or continuation of an advance under any of the Credit Facilities shall constitute a representation and warranty by the Borrower that all of the representations and warranties set forth in this agreement shall be true and correct on and as of such date with the same effect as though such representations and warranties had been made on such date, except to the extent that such representations and warranties are stated to expressly relate solely to an earlier date.

6. Default/Remedies.

6.1 **Events of Default/Acceleration.** If any of the following events occurs the Notes shall become due immediately, without notice, at the Bank's option:

A. The Borrower, any Subsidiary, or any guarantor of the Notes (the "Guarantor") fails to pay when due any amount payable under the Notes, under any of the Liabilities, or under any agreement or instrument evidencing debt to any creditor.

B. The Borrower, any Subsidiary, or any Guarantor (1) fails to observe or perform any other term of the Notes; (2) makes any materially incorrect or misleading representation, warranty, or certificate to the Bank; (3)

makes any materially incorrect or misleading representation in any financial statement or other information delivered to the Bank; or (4) defaults under the terms of any agreement or instrument relating to any debt for borrowed money (other than the debt evidenced by the Notes) and the effect of such default will allow the creditor to declare the debt due before its maturity.

C. In the event (1) there is a default under the terms of any Related Document, (2) any guaranty of the loan evidenced by the Notes is terminated or becomes unenforceable in whole or in part, (3) any Guarantor fails to promptly perform under its guaranty, or (4) the Borrower, any Subsidiary, or any Guarantor fail to comply with, or pay, or perform under any agreement, now or hereafter in effect, with BANK ONE CORPORATION, or any of its subsidiaries or affiliates or their successors or assigns.

D. There is any loss, theft, damage, or destruction of any collateral securing the Credit Facilities not covered by insurance.

E. A "reportable event" (as defined in the Employee Retirement Income Security Act of 1974 as amended) occurs that would permit the Pension Benefit Guaranty Corporation to terminate any employee benefit plan of the Borrower, any Subsidiary, or any affiliate of the Borrower.

F. The Borrower, any Subsidiary, or any Guarantor becomes insolvent or unable to pay its debts as they become due.

G. The Borrower, any Subsidiary, or any Guarantor (1) makes an assignment for the benefit of creditors; (2) consents to the appointment of a custodian, receiver, or trustee for itself or for a substantial part of its assets; or (3) commences any proceeding under any bankruptcy, reorganization, liquidation, insolvency or similar laws of any jurisdiction.

H. A custodian, receiver, or trustee is appointed for the Borrower; any Subsidiary, or any Guarantor or for a substantial part of its assets without its consent.

I. Proceedings are commenced against the Borrower, any Subsidiary, or any Guarantor under any bankruptcy, reorganization, liquidation, or similar laws of any jurisdiction, and they remain undismissed. for thirty (30) days after commencement; or the Borrower, any Subsidiary, or the Guarantor consents to the commencement of those proceedings.

J. Any judgment is entered against the Borrower, any Subsidiary, or any Guarantor, or any attachment, levy, or garnishment is issued against any property of the Borrower, any Subsidiary, or any Guarantor.

K. The Borrower, any Subsidiary, or any Guarantor dies, or a guardian or conservator is appointed for the Borrower, any Subsidiary, or any Guarantor or all or any portion of the Borrower's assets, any Subsidiary's assets, any Guarantor's assets, or the Collateral.

L. The Borrower, any Subsidiary, or any Guarantor, without the Bank's written consent (1) is dissolved, (2) merges or consolidates with any third party, (3) leases, sells or otherwise conveys a material part of its assets or business outside the ordinary course of its business, (4) leases, purchases, or otherwise acquires a material part of the assets of any other business entity, except in the ordinary course of its business, or (5) agrees to do any of the foregoing (notwithstanding the foregoing, any subsidiary may merge or consolidate with any other subsidiary, or with the Borrower, so long as the Borrower is the survivor).

6.2 Remedies.

A. **Generally.** If any of the Liabilities are not paid at maturity, whether by acceleration or otherwise, or if a default by anyone occurs under the terms of any agreement related to any of the Liabilities, then the Bank shall have the rights and remedies provided by law or this agreement: The Borrower is liable to the Bank for all reasonable costs and expenses of every kind incurred in the collection of the Notes, or in connection with the enforcement or preservation of rights under this agreement, or any amendment, supplement, or modification thereto, including without limitation reasonable attorneys' fees (including the fees of in-house counsel) and court costs. These costs and expenses include without limitation any costs or expenses incurred by the Bank in any bankruptcy, reorganization, insolvency or other similar proceeding. All amounts payable under the terms of the Notes shall be paid without relief from valuation and appraisal laws.

B. **Bank's Right of Setoff.** The Borrower, for itself and as agent on behalf of each of its Subsidiaries, grants to the Bank a security interest in, and the Bank is authorized, if a default or an "unmatured default" (hereinafter defined) has occurred and is continuing or would result, to setoff and apply, all Deposits, Securities and Other Property, and Bank Debt against any and all Liabilities of the Borrower to the Bank and against any and all indebtedness, liabilities, and obligations or any Subsidiary to the Bank. This right of setoff may be exercised, if a default or an unmatured default has occurred and is continuing or would result, at any time and from time to time, and without prior notice to the Borrower or any Subsidiary. This security interest and right of setoff may be enforced or exercised by the Bank regardless of whether or not the Bank has made any demand under this paragraph or whether the Liabilities are contingent, matured, or unmatured. Any delay, neglect or conduct by the Bank in exercising its rights under this paragraph will not be a waiver of the right to exercise this right of setoff or enforce this security interest. The rights of the Bank under this paragraph are in addition to other rights the Bank may have in the Related Documents or by law. In this paragraph: (a) the term "Deposits" means any and all accounts and deposits of the Borrower or any Subsidiary (whether general, special, time, demand, provisional or final) at any time held by the Bank (including all Deposits held jointly with another, but excluding any IRA or Keogh Deposits, or any trust Deposits in which a security interest would be prohibited by law); (b) the term "Securities and Other Property" means any and all securities and other property of the Borrower or any Subsidiary in the custody, possession or control of the Bank (other than property held by the Bank in a fiduciary capacity); (c) the term "Bank Debt" means all indebtedness at any time owing by the Bank, to or for the credit or account of the Borrower or any Subsidiary; and (d) the term "unmatured default" means an event which, with the giving of notice or the lapse of time or both, would be a default under this agreement or any of the Related Documents.

7. Miscellaneous.

7.1 **Notice.** Any notices and demands under or related to this document shall be in writing and delivered to the intended party at its address stated herein, and if to the Bank, at its main office if no other address of the Bank is specified herein, by one of the following means: (a) by hand, (b) by

a nationally recognized overnight courier service, or (c) by certified mail, postage prepaid, with return receipt requested. Notice shall be deemed given: (a) upon receipt if delivered by hand, (b) on the Delivery Day after the day of deposit with a nationally recognized courier service, or (c) on the third Delivery Day after the notice is deposited in the mail. "Delivery Day" means a day other than a Saturday, a Sunday or any other day on which national banking associations are authorized to be closed. Any party may change its address for purposes of the receipt of notices and demands by giving notice of such change in the manner provided in this provision.

- 7.2 **No Waiver.** No delay on the part of the Bank in the exercise of any right or remedy waives that right or remedy. No single or partial exercise by the Bank of any right or remedy precludes any other future exercise of it or the exercise of any other right or remedy. No waiver or indulgence by the Bank of any default is effective unless it is in writing and signed by the Bank, nor shall a waiver on one occasion bar or waive that right on any future occasion.
- 7.3 **Integration.** This agreement, the Notes, and any agreement related to the Credit Facilities embody the entire agreement and understanding between the Borrower and the Bank and supersede all prior agreements and understandings relating to their subject matter. If any one or more of the obligations of the Borrower under this agreement or the Notes is invalid, illegal or unenforceable in any jurisdiction, the validity, legality and enforceability of the remaining obligations of the Borrower shall not in any way be affected or impaired, and the invalidity, illegality or unenforceability in one jurisdiction shall not affect the validity, legality or enforceability of the obligations of the Borrower under this agreement or the Notes in any other jurisdiction.
- 7.4 **Governing Law and Venue.** This agreement is delivered in the State of Indiana and governed by Indiana law (without giving effect to its laws of conflicts). The Borrower agrees that any legal action or proceeding with respect to any of its obligations under this agreement may be brought by the Bank in any state or federal court located in the State of Indiana, as the Bank in its sole discretion may elect. By the execution and delivery of this agreement, the Borrower submits to and accepts, for itself and in respect of its property, generally and unconditionally, the nonexclusive jurisdiction of those courts. The Borrower waives any claim that the State of Indiana is not a convenient forum or the proper venue for any such suit, action or proceeding.
- 7.5 **Captions.** Section headings are for convenience of reference only and do not affect the interpretation of this agreement.
- 7.6 **Survival of Representations and Warranties.** The Borrower understands and agrees that in extending the Credit Facilities, the Bank is relying on all representations, warranties, and covenants made by the Borrower in this agreement or in any certificate or other instrument delivered by the Borrower to the Bank under this agreement. The Borrower further agrees that regardless of any investigation made by the Bank, all such representations, warranties and covenants

will survive the making of the Credit Facilities and delivery to the Bank of this agreement, shall be continuing in nature, and shall remain in full force and effect until such time as the Borrower's indebtedness to the Bank shall be paid in full.

- 7.7 **Non-Liability of the Bank.** The relationship between the Borrower on one hand and the Bank on the other hand shall be solely that of borrower and lender. The Bank shall have no fiduciary responsibilities to the Borrower. The Bank undertakes no responsibility to the Borrower to review or inform the Borrower of any matter. in connection with any phase of the Borrower's business or operations.
- 7.8 **Indemnification of the Bank.** The Borrower agrees to indemnify, defend and hold the Bank and BANK ONE CORPORATION, or any of its subsidiaries or affiliates or their successors, and each of their respective shareholders, directors, officers, employees and agents (collectively, the "Indemnified Persons") harmless from any and all obligations, claims, liabilities, losses, damages, penalties, fines, forfeitures, actions, judgments, suits, costs, expenses and disbursements of any kind or nature (including, without limitation, any Indemnified Person's attorneys' fees) (collectively, the "Claims") which may be imposed upon, incurred by or assessed against any Indemnified Person (whether or not caused by any Indemnified Person's sole, concurrent, or contributory negligence) arising out of or relating to this agreement; the exercise of the rights and remedies granted under this agreement (including, without limitation, the enforcement of this agreement and the defense of any Indemnified Person's action or inaction in connection with this agreement); and in connection with the Borrower's failure to perform all of the Borrower's obligations under this agreement, except to the limited extent that the Claims against any such Indemnified Person are proximately caused by such Indemnified Person's gross negligence or willful misconduct. The indemnification provided for in this section shall survive the termination of this agreement and shall extend to and continue to benefit each individual or entity who is or has at any time been an Indemnified Person.
- The Borrower's indemnity obligations under this section shall not in any way be affected by the presence or absence of covering insurance, or by the amount of such insurance or by the failure or refusal of any insurance carrier to perform any obligation on its part under any insurance policy or policies affecting the Borrower's assets or the Borrower's business activities. Should any Claim be made or brought against any Indemnified Person by reason of any event as to which the Borrower's indemnification obligations apply, then, upon any Indemnified Person's demand, the Borrower, at its sole cost and expense, shall defend such Claim in the Borrower's name, if necessary, by the attorneys for the Borrower's insurance carrier (if such Claim is covered by insurance), or otherwise by such attorneys as any Indemnified Person shall approve. Any Indemnified Person may also engage its own attorneys at its reasonable discretion to defend the Indemnified Person and to assist in its defense and the Borrower agrees to pay the fees and disbursements of such attorneys.
- 7.9 **Counterparts.** This agreement may be executed in multiple counterparts, each of which, when so executed, shall be deemed an original, but all such counterparts, taken together, shall constitute one and the same agreement.
- 7.10 **Advice of Counsel.** The Borrower acknowledges that it has been advised by counsel, or had the opportunity to be advised by counsel, in the negotiation, execution and delivery of this agreement and any documents executed and delivered in connection with the Credit Facilities.
- 7.11 **Conflicting Terms.** If this agreement is inconsistent with any provision in any agreement related to the Credit Facilities, the Bank shall determine, in the Bank's sole and absolute discretion, which of the provisions shall control any such inconsistency.
- 7.12 **Expenses.** The Borrower agrees to pay or reimburse the Bank for all its out-of-pocket costs and expenses and reasonable attorneys' fees (including the fees of in-house counsel) incurred in connection with the preparation and execution of this agreement, any amendment, supplement, or modification thereto, and any other documents prepared in connection herewith or therewith.
- 7.13 **Reinstatement.** All parties liable on the Notes agree that to the extent any payment is received by the Bank in connection with the Liabilities, and all or any part of such payment is subsequently invalidated, declared to be fraudulent or preferential, set aside or required to be repaid by the Bank or paid over to a trustee, receiver or any other entity, whether under any bankruptcy act or otherwise (any such payment is hereinafter referred to as a "Preferential Payment"), then the Notes shall continue to be effective or shall be reinstated, as the case may be, and whether or not

the Bank is in possession of the Notes, and, to the extent of such payment or repayment by the Bank, the Liabilities or part thereof intended to be satisfied by such Preferential Payment shall be revived and continued in full force and effect as if said Preferential Payment had not been made.

7.14 Severability. If any provision of this agreement cannot be enforced, the remaining portions of this agreement shall continue in effect.

7.15 Assignments. The Borrower agrees that the Bank may provide any information or knowledge the Bank may have about the Borrower or about any matter relating to the Notes or the Related Documents to BANK ONE CORPORATION, or any of its subsidiaries or affiliates or their successors, or to any one or more purchasers or potential purchasers of the Notes or the Related Documents. The Borrower agrees that the Bank may at any time sell, assign or transfer one or more interests or participations in all or any part of its rights and obligations in the Notes to one or more purchasers whether or not related to the Bank.

7.16 Waivers. Any party liable on the Notes waives (a) any right to receive notice of the following matters before the Bank enforces any of its rights: (i) (i) any demand, diligence, presentment, dishonor and protest, or (ii) any action that the Bank takes regarding anyone else, any collateral, or any of the Liabilities, that it might be entitled to by law or under any other agreement; (b) any right to require the Bank to proceed against any other obligor or guarantor of the Liabilities, or any collateral, or pursue any remedy in the Bank's power to pursue; (c) any defense based on any claim that any endorser or other parties' obligations exceed or are more burdensome than those of the Borrower; (d) the benefit of any statute of limitations affecting liability of any endorser or other party liable hereunder or the enforcement hereof; (e) any defense arising by reason of any disability or other defense of the Borrower or by reason of the cessation from any cause whatsoever (other than payment in full) of the obligation of the Borrower for the Liabilities; and (f) any defense based on or arising out of any defense that the Borrower may have to the payment or performance of the Liabilities or any portion thereof. Any party liable on the Notes consents to any extension or postponement of time of its payment without limit as to the number or period, to any substitution, exchange or release of all or any part of any collateral, to the addition of any other party; and to the release or discharge of, or suspension of any rights and remedies against, any person who may be liable for the payment of the Notes. The Bank may waive or delay enforcing any of its rights without losing them. Any waiver affects only the specific terms and time period stated in the waiver. No modification or waiver of any provision of the Notes is effective unless it is in writing and signed by the party against whom it is being enforced.

8. USA PATRIOT ACT NOTIFICATION. The following notification is provided to Borrower pursuant to Section 326 of the USA Patriot Act of 2001, 31 U.S.C. Section 5318:

IMPORTANT INFORMATION ABOUT PROCEDURES FOR OPENING A NEW ACCOUNT. To help the government fight the funding of terrorism and money laundering activities, Federal law requires all financial institutions to obtain, verify, and record information that identifies each person or entity that opens an account, including any deposit account, treasury management account, loan, other extension of credit, or other financial services product. What this means for Borrower: When Borrower opens an account, if Borrower is an individual Bank will ask for Borrower's name, taxpayer identification number, residential address, date of birth, and other information that will allow Bank to identify Borrower, and if Borrower is not an individual Bank will ask for Borrower's name, taxpayer identification number, business address, and other information that will allow Bank to identify Borrower. Bank may also ask, if Borrower is an individual to see Borrower's driver's license or other identifying documents, and if Borrower is not an individual to see Borrower's legal organizational documents or other identifying documents.

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9. WAIVER OF SPECIAL DAMAGES. THE BORROWER WAIVES, TO THE MAXIMUM EXTENT NOT PROHIBITED BY LAW, ANY RIGHT THE UNDERSIGNED MAY HAVE TO CLAIM OR RECOVER FROM THE BANK IN ANY LEGAL ACTION OR PROCEEDING ANY SPECIAL, EXEMPLARY, PUNITIVE OR CONSEQUENTIAL DAMAGES.

10. JURY WAIVER. THE BORROWER AND THE BANK HEREBY VOLUNTARILY, KNOWINGLY, IRREVOCABLY AND UNCONDITIONALLY WAIVE ANY RIGHT TO HAVE A JURY PARTICIPATE IN RESOLVING ANY DISPUTE (WHETHER BASED ON CONTRACT, TORT, OR OTHERWISE) BETWEEN THE BORROWER AND THE BANK ARISING OUT OF OR IN ANY WAY RELATED TO THIS DOCUMENT. THIS PROVISION IS A MATERIAL INDUCEMENT TO THE BANK TO PROVIDE THE FINANCING DESCRIBED HEREIN.

Address(es) for Notices:

P.O. Box 877
Dubuque, IA 52004-0877

Attn: Chief Financial Officer

Borrower:

Flexsteel Industries, Inc.

By: /s/ R. J. Klosterman

R. J. Klosterman, Exec. V.P., C.F.O., Secretary

Printed Name Title

Date Signed: June 29, 2004

Address for Notices:

111 Monument Circle
Indianapolis, IN 46277

Bank:

Bank One, NA, with its main office in Chicago, IL

Attn: _____

By: /s/ Brian Smith _____

Brian Smith, Vice President

Printed Name Title

Date Signed: June 30, 2004



Line of Credit Note

\$20,000,000.00

Date: June 30, 2004

Due: June 29, 2005

Promise to Pay. On or before June 29, 2005, for value received, Flexsteel Industries, Inc. (the "Borrower") promises to pay to Bank One, NA, with its main office in Chicago, IL, whose address is 111 Monument Circle, Indianapolis, IN 46277 (the "Bank") or order, in lawful money of the United States of America, the sum of Twenty Million and 00/100 Dollars (\$20,000,000.00) or such lesser sum as is indicated on Bank records, plus interest as provided below.

Definitions. As used in this Note, the following terms have the following respective meanings:

"Advance" means a Eurodollar Advance or a Prime Rate Advance and **"Advances"** means all Eurodollar Advances and all Prime Rate Advances under this Note.

"Applicable Margin" means with respect to any Prime Rate Advance or Eurodollar Advance, as the case may be, the rate per annum set forth below opposite the applicable Funded Debt to EBITDA Ratio. Funded Debt to EBITDA Ratio is defined in the Credit Agreement.

Funded Debt to EBITDA Ratio	Applicable Margin	
	Prime Rate Advance	Eurodollar Advance
Greater than or equal to 2.00 to 1.00	0.00%	1.00%
Less than 2.00 to 1.00 but greater than or equal to 1.00 to 1.00	0.00%	0.75%
Less 1.00 to 1.00	0.00%	0.50%

The Applicable Margin shall, in each case, be determined and adjusted quarterly on the first day of the month after the date of delivery of the quarterly and annual financial statements required by the Credit Agreement, *provided, however*, that if such financial statements are not delivered within two Business Days after the required date (each, an "Interest Determination Date"), the Applicable Margin shall increase to the maximum percentage amount set forth in the table above from the date such financial statements were required to be delivered to the Bank until received by the Bank. The Applicable Margin shall be effective from an Interest Determination Date until the next Interest Determination Date. Such determinations by the Bank shall be conclusive absent manifest error. The initial Applicable Margin for Prime Rate Advances is 0.00% and for Eurodollar Advances is 0.50%.

"Credit Agreement" means a certain Credit Agreement, dated June 30, 2004, between the Borrower and the Bank.

"Business Day" means (i) with respect to any borrowing, payment or rate selection of Eurodollar Advances, a day (other than a Saturday or Sunday) on which banks generally are open in Indiana and/or New York for the conduct of substantially all of their commercial lending activities and on which dealings in United States dollars are carried on in the London interbank market and (ii) for all other purposes, a day other than a Saturday, Sunday or any other day on which national banking associations are authorized to be closed.

"Eurodollar Base Rate" means, with respect to the relevant Interest Period, the applicable British Bankers' Association LIBOR rate for deposits in U.S. dollars as reported by any generally recognized financial information service as of 11:00 a.m. (London time) two Business Days prior to the first day of such Interest Period, and having a maturity equal to such Interest Period, *provided that*, if no such British Bankers' Association LIBOR rate is available to the Bank, the applicable Eurodollar Base Rate for the relevant Interest Period shall instead be the rate determined by the Bank to be the rate at which BANK ONE CORPORATION or one of its affiliate banks offers to place deposits in U.S. dollars with first-class banks in the London interbank market at approximately 11:00 a.m. (London time) two Business Days prior to the first day of such Interest Period, in the approximate amount of the principal amount outstanding on such date and having a maturity equal to such Interest Period.

"Eurodollar Advance" means any borrowing under this Note when and to the extent that its interest rate is determined by reference to the Eurodollar Rate.

"Eurodollar Rate" means, with respect to a Eurodollar Advance for the relevant Interest Period, the sum of (i) the Applicable Margin plus (ii) the quotient of (a) the Eurodollar Base Rate applicable to such Interest Period, divided by (b) one minus the Reserve Requirement (expressed as a decimal) applicable to such Interest Period.

“Interest Period” means, with respect to a Eurodollar Advance, a period of one (1), two (2), three (3) or six (6) month(s) commencing on a Business Day selected by the Borrower pursuant to this Note. Such Interest Period shall end on the day which corresponds numerically to such date one (1), two (2), three (3) or six (6) month(s) thereafter, as applicable, *provided, however*, that if there is no such numerically corresponding day in such first, second, third or sixth succeeding month(s), as applicable, such Interest Period shall end on the last Business Day of such first, second, third or sixth succeeding month(s), as applicable. If an Interest Period would otherwise end on a day which is not a Business Day, such Interest Period shall end on the next succeeding Business Day, *provided, however*, that if said next succeeding Business Day falls in a new calendar month, such Interest Period shall end on the immediately preceding Business Day.

“Prime Rate” means a rate per annum equal to the prime rate of interest announced from time to time by the Bank or its parent (which is not necessarily the lowest rate charged to any customer), changing when and as said prime rate changes.

“Prime Rate Advance” means any Advance under this Note when and to the extent that its interest rate is determined by reference to the Prime Rate.

“Principal Payment Date” is defined in the paragraph entitled “Principal Payments” below.

“Regulation D” means Regulation D of the Board of Governors of the Federal Reserve System as from time to time in effect and any successor thereto or other regulation or official interpretation of said Board of Governors relating to reserve requirements applicable to member banks of the Federal Reserve System.

“Reserve Requirement” means, with respect to an Interest Period, the maximum aggregate reserve requirement (including all basic, supplemental, marginal and other reserves) which is imposed under Regulation D.

Interest Rates. The Advance(s) evidenced by this Note may be drawn down and remain outstanding as up to five (5) Eurodollar Advances and/or a Prime Rate Advance. The Borrower shall pay interest to the Bank on the outstanding and unpaid principal amount of each Prime Rate Advance at the Prime Rate plus the Applicable Margin and each Eurodollar Advance at the Eurodollar Rate. Interest shall be calculated on the basis of the actual number of days elapsed in a year of 360 days. In no event shall the interest rate applicable to any Advance exceed the maximum rate allowed by law. Any interest payment which would for any reason be deemed unlawful under applicable law shall be applied to principal.

Bank Records. The Bank shall, in the ordinary course of business, make notations in its records of the date, amount, interest rate and Interest Period of each Advance hereunder, the amount of each payment on the Advances, and other information. Such records shall, in the absence of manifest error, be conclusive as to the outstanding principal balance of and interest rate or rates applicable to this Note.

Notice and Manner of Electing Interest Rates on Advances. The Borrower shall give the Bank written notice (effective upon receipt) of the Borrower’s intent to draw down an Advance under this Note no later than 11:00 a.m. Eastern time, one (1) Business Day before disbursement, if the full amount of the drawn Advance is to be disbursed as a Prime Rate Advance and three (3) Business Days before disbursement, if any part of such Advance is to be disbursed as a Eurodollar Advance. The Borrower’s notice must specify: (a) the disbursement date, (b) the amount of each Advance, (c) the type of each Advance (Prime Rate Advance or Eurodollar Advance), and (d) for each Eurodollar Advance, the duration of the applicable Interest Period; *provided, however*, that the Borrower may not elect an Interest Period ending after the maturity date of this Note. Each Eurodollar Advance shall be in a minimum amount of One Million and 00/100 Dollars (\$1,000,000.00). All notices under this paragraph are irrevocable. By the Bank’s close of business on the disbursement date and upon fulfillment of the conditions set forth herein and in any other of the Related Documents, the Bank shall disburse the requested Advances in immediately available funds by crediting the amount of such Advances to the Borrower’s account with the Bank.

Conversion and Renewals. The Borrower may elect from time to time to convert one type of Advance into another or to renew any Advance by giving the Bank written notice no later than 11:00 a.m. Eastern time, one (1) Business Day before conversion into a Prime Rate Advance and three (3) Business Days before conversion into or renewal of a Eurodollar Advance, specifying: (a) the renewal or conversion date, (b) the amount of the Advance to be converted or renewed, (c) in the case of conversion, the type of Advance to be converted into (Prime Rate Advance or Eurodollar Advance), and (d) in the case of renewals or conversion into a Eurodollar Advance, the applicable Interest Period, provided that (i) the minimum principal amount of each Eurodollar Advance outstanding after a renewal or conversion shall be One Million and 00/100 Dollars (\$1,000,000.00); (ii) a Eurodollar Advance can only be converted on the last day of the Interest Period for the Advance; and (iii) the Borrower may not elect an Interest Period ending after the maturity date of this Note. All notices given under this paragraph are irrevocable. If the Borrower fails to give the Bank the notice specified above for the renewal or conversion of a Eurodollar Advance by 11:00 a.m. Eastern time three (3) Business Days before the end of the Interest Period for that Advance, the Advance shall automatically be converted to a Prime Rate Advance on the last day of the Interest Period for the Advance.

The Borrower may permanently reduce the Line of Credit commitment, in integral multiples of \$1,000,000.00, by providing at least five Business Days’ written notice to the Bank and shall be irrevocable, which notice shall specify the amount of any such reduction, provided, however, that the amount of the aggregate commitment may not be reduced below the aggregate outstanding principal balance outstanding under this Note.

Interest Payments. Interest on the Advances shall be paid as follows:

- A. For each Prime Rate Advance, on the last day of each month beginning with the first month following disbursement of the Advance or following conversion of an Advance into a Prime Rate Advance, and at the maturity or conversion of the Advance into a Eurodollar Advance;
- B. For each Eurodollar Advance, on the last day of the Interest Period for the Advance and, if the Interest Period is longer than three months, at three-month intervals beginning with the day three months from the date the Advance is disbursed.

Principal Payments. All outstanding principal and interest is due and payable in full on June 29, 2005, which is defined herein as the “Principal Payment Date”.

Default Rate of Interest. After a default has occurred under this Note, whether or not the Bank elects to accelerate the maturity of this Note because of such default, all Advances outstanding under this Note, including all Eurodollar Advances, shall bear interest at a per annum rate equal to the Prime Rate, plus the Applicable Margin for a Prime Rate Advance, plus three percent (3.00%) from the date the Bank elects to impose such rate. Imposition of this rate shall not affect any limitations contained in this Note on the Borrower’s right to repay principal on any Eurodollar Advance before the expiration of the Interest Period for that Advance.

Prepayment. The Borrower may prepay all or any part of any Prime Rate Advance at any time without premium or penalty. The Borrower may prepay any Eurodollar Advance only at the end of an Interest Period.

Funding Loss Indemnification. Upon the Bank's request, the Borrower shall pay the Bank amounts sufficient (in the Bank's reasonable opinion) to compensate it for any loss, cost, or expense incurred as a result of:

- A. Any payment of a Eurodollar Advance on a date other than the last day of the Interest Period for the Advance, including, without limitation, acceleration of the Advances by the Bank pursuant to this Note or the Related Documents; or
- B. Any failure by the Borrower to borrow or renew a Eurodollar Advance on the date specified in the relevant notice from the Borrower to the Bank.

Additional Costs. If any applicable domestic or foreign law, treaty, government rule or regulation now or later in effect (whether or not it now applies to the Bank) or the interpretation or administration thereof by a governmental authority charged with such interpretation or administration, or compliance by the Bank with any guideline, request or directive of such an authority (whether or not having the force of law), shall (a) affect the basis of taxation of payments to the Bank of any amounts payable by the Borrower under this Note or the Related Documents (other than taxes imposed on the overall net income of the Bank by the jurisdiction or by any political subdivision or taxing authority of the jurisdiction in which the Bank has its principal office), or (b) impose, modify or deem applicable any reserve, special deposit or similar requirement against assets of, deposits with or for the account of, or credit extended by the Bank, or (c) impose any other condition with respect to this Note or the Related Documents and the result of any of the foregoing is to increase the cost to the Bank of maintaining any Eurodollar Advance or to reduce the amount of any sum receivable by the Bank on such an Advance, or (d) affect the amount of capital required or expected to be maintained by the Bank (or any corporation controlling the Bank) and the Bank determines that the amount of such capital is increased by or based upon the existence of the Bank's obligations under this Note or the Related Documents and the increase has the effect of reducing the rate of return on the Bank's (or its controlling corporation's) capital as a consequence of the obligations under this Note or the Related Documents to a level below that which the Bank (or its controlling corporation) could have achieved but for such circumstances (taking into consideration its policies with respect to capital adequacy) by an amount deemed by the Bank to be material, then the Borrower shall pay to the Bank, from time to time, upon request by the Bank, additional amounts sufficient to compensate the Bank for the increased cost or reduced sum receivable. Whenever the Bank shall learn of circumstances described in this section which are likely to result in additional costs to the Borrower, the Bank shall give prompt written notice to the Borrower of the basis for and the estimated amount of any such anticipated additional costs. A statement as to the amount of the increased cost or reduced sum receivable, prepared in good faith and in reasonable detail by the Bank and submitted by the Bank to the Borrower, shall be conclusive and binding for all purposes absent manifest error in computation.

Illegality. If any applicable domestic or foreign law, treaty, rule or regulation now or later in effect (whether or not it now applies to the Bank) or the interpretation or administration thereof by a governmental authority charged with such interpretation or administration, or compliance by the Bank with any guideline, request or directive of such an authority (whether or not having the

force of law), shall make it unlawful or impossible for the Bank to maintain or fund the Eurodollar Advances, then, upon notice to the Borrower by the Bank, the outstanding principal amount of the Eurodollar Advances, together with accrued interest and any other amounts payable to the Bank under this Note or the Related Documents on account of the Eurodollar Advances shall be repaid (a) immediately upon the Bank's demand if such change or compliance with such requests, in the Bank's judgment, requires immediate repayment, or (b) at the expiration of the last Interest Period to expire before the effective date of any such change or request provided, however, that subject to the terms and conditions of this Note and the Related Documents the Borrower shall be entitled to simultaneously replace the entire outstanding balance of any Eurodollar Advance repaid in accordance with this section with a Prime Rate Advance in the same amount.

Inability to Determine Interest Rate. If the Bank determines that (a) quotations of interest rates for the relevant deposits referred to in the definition of Eurodollar Rate are not being provided in the relevant amounts or for the relevant maturities for purposes of determining the interest rate on a Eurodollar Advance as provided in this Note, or (b) the relevant interest rates referred to in the definition of Eurodollar Rate do not accurately cover the cost to the Bank of making or maintaining Eurodollar Advances, then the Bank shall forthwith give notice of such circumstances to the Borrower, whereupon (i) the obligation of the Bank to make Eurodollar Advances shall be suspended until the Bank notifies the Borrower that the circumstances giving rise to the suspension no longer exists, and (ii) the Borrower shall repay in full the then outstanding principal amount of each Eurodollar Advance, together with accrued interest, on the last day of the then current Interest Period applicable to the Advance, provided, however, that, subject to the terms and conditions of this Note and the Related Documents, the Borrower shall be entitled to simultaneously replace the entire outstanding balance of any Eurodollar Advance repaid in accordance with this section with a Prime Rate Advance in the same amount.

Obligations Due on Non-Business Day. Whenever any payment under this Note becomes due and payable on a day that is not a Business Day, if no default then exists under this Note, the maturity of the payment shall be extended to the next succeeding Business Day, except, in the case of a Eurodollar Advance, if the result of the extension would be to extend the payment into another calendar month, the payment must be made on the immediately preceding Business Day.

Matters Regarding Payment. The Borrower will pay the Bank at the Bank's address shown above or at such other place as the Bank may designate. Payments shall be allocated among principal, interest and fees at the discretion of the Bank unless otherwise agreed or required by applicable law. Acceptance by the Bank of any payment which is less than the payment due at the time shall not constitute a waiver of the Bank's right to receive payment in full at that time or any other time.

Authorization for Direct Payments (ACH Debits). To effectuate any payment due under this Note, the Borrower hereby authorizes the Bank to initiate debit entries to Account Number _____ at the Bank and to debit the same to such account. This authorization to initiate debit entries shall remain in full force and effect until the Bank has received written notification of its termination in such time and in such manner as to afford the Bank a reasonable opportunity to act on it. The Borrower represents that the Borrower is and will be the owner of all funds in such account. The Borrower acknowledges (1) that such debit entries may cause an overdraft of such account which may result in the Bank's refusal to honor items drawn on such account until adequate deposits are made to such account; (2) that the Bank is under no duty or obligation to initiate any debit entry for any purpose; and (3) that if a debit is not made because the above-referenced account does not have a sufficient available balance, or otherwise, the payment may be late or past due.

Credit Facility. The Bank has approved a credit facility to the Borrower in a principal amount not to exceed the face amount of this Note. The credit facility is in the form of advances made from time to time by the Bank to the Borrower. This Note evidences the Borrower's obligation to repay those advances. The aggregate principal amount of debt evidenced by this Note is the amount reflected from time to time in the records of the Bank. Until the earliest of maturity, the occurrence

of any default, or the occurrence of any event that would constitute a default but for the giving of notice or the lapse of time or both until the end of any grace or cure period, the Borrower may borrow, pay down and reborrow under this Note subject to the terms of the Related Documents.

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Miscellaneous. This Note binds the Borrower and its successors, and benefits the Bank, its successors and assigns. Any reference to the Bank includes any holder of this Note. This Note is issued pursuant and entitled to the benefits of that certain Credit Agreement by and between the Borrower and the Bank, dated June 30, 2004, and all replacements thereof (the "Credit Agreement") to which reference is hereby made for a more complete statement of the terms and conditions under which the loan evidenced hereby is made and is to be repaid. The terms and provisions of the Credit Agreement are hereby incorporated and made a part hereof by this reference thereto with the same force and effect as if set forth at length herein. No reference to the Credit Agreement and no provisions of this Note or the Credit Agreement shall alter or impair the absolute and unconditional obligation of the Borrower to pay the principal and interest on this Note as herein prescribed. Capitalized terms not otherwise defined herein shall have the meanings assigned to such terms in the Credit Agreement.

Address: P.O. Box 877
Dubuque, IA 52004-0877

Borrower:

Flexsteel Industries, Inc.

By: /s/ R.J. Klosterman

R.J. Klosterman, Exec. V.P., C.F.O., Secretary

Printed Name

Title

Date Signed: June 29, 2004



Master Agreement
For Irrevocable
Letters of Credit

This Agreement is between

Flexsteel Industries, Inc.
and

Bank One, NA and its subsidiaries and affiliates

MASTER AGREEMENT FOR IRREVOCABLE LETTERS OF CREDIT

The undersigned ("Applicant") will, from time to time, request that one or more of Bank One, NA (Main Office Chicago) and/or any domestic or foreign Bank One Affiliate (as defined below) (each of such entities the "Issuer" with respect to each Credit and all of such entities collectively the "Issuers") issue for its account or for the account of the account party named in the Application, irrevocable commercial and/or standby letters of credit or other independent undertakings within the scope of applicable law (each such letter of credit or undertaking a "Credit"). Such requests will be made by submitting to the Issuer a completed Application (the "Application") substantially in the form(s) attached to this Master Agreement for Irrevocable Letters of Credit (the "Agreement") or such other form(s) as approved by the Issuer. Applicant agrees with Issuer that each Credit which may be issued by Issuer in its sole discretion, at the request of Applicant, shall be governed by the following terms and conditions, unless they are expressly changed in any Credit or the Application for any Credit, as approved in writing by Issuer, and, with regard to the provisions of Section 6 and 7 herein, regardless of whether such Credit or the Application provide otherwise:

1. **REIMBURSEMENTS.** Applicant agrees to pay on demand, in U.S. dollars, to Issuer at such place as Issuer may specify, the amount of each draft drawn under or purporting to be drawn under a Credit. Demand may be made in advance of payment at the request of Issuer. If a Credit provides for presentation of drafts in a currency other than U.S. dollars, Applicant shall, at Issuer's sole option, make payments to Issuer with respect to such drafts either (a) in such other currency at such place as Issuer may direct, or (b) in U.S. dollars at the rate of exchange determined by the Issuer to be the rate in effect in Chicago, Illinois or in such other place where the Issuer is located, at the time of payment of the draft or, if the Issuer determines that there is no such rate of exchange, Applicant shall pay Issuer an amount which in the sole judgment of Issuer shall be sufficient to meet Issuer's obligations hereunder.
2. **FEES AND INTEREST.** Applicant agrees to pay Issuer:
 - (a) On demand, Issuer's customary commissions and fees in effect from time to time and all costs and expenses, including reasonable attorneys' fees, including fees of attorneys who may be Issuer's employees, paid or incurred by Issuer in connection with the administration or enforcement of this Agreement or any Credit, and any adviser, confirming institution or entity or other nominated person's fees and costs that are chargeable to or paid by Issuer;
 - (b) Interest on all sums advanced by Issuer without reimbursement by Applicant at the per annum rate equal to the lesser of:
 - (i) the rate customarily charged by Issuer; or
 - (ii) the Prime Rate on the date of advance by the Issuer, provided that such rate of interest shall not exceed the maximum rate of interest, which may be charged under applicable law. The "Prime Rate" shall mean the rate of interest announced by the Issuer or its parent from time to time as its prime rate for interest rate determinations (which may or may not be the lowest interest rate charged by such bank), to be computed for actual days unpaid on a 360-day year basis; and
 - (c) In the event any change in any law or regulation, or in any interpretation by a court or administrative or governmental authority charged with the administration thereof shall either:
 - (i) impose, modify or make applicable any reserve, special deposit, or similar requirement against letters of credit issued by the Issuer; or impose on Issuer any other condition regarding this Agreement or any Credit;
 - (ii) and the result of any event referred to above shall be to increase the cost to Issuer of issuing or maintaining a Credit, then upon demand by Issuer, Applicant shall immediately pay to Issuer, such additional amounts as shall, in the judgment of Issuer, be sufficient to compensate Issuer for such increased cost, together with interest on each such amount from the date demanded until payment in full at the rate provided in subsection (b) above.

Issuer may assess fees even if incurred after the Credit expires at such rate as may be reasonably determined by Issuer.

3. **PAYMENTS.**
 - (a) Payments due from Applicant hereunder shall be made without withholding, deduction or set-off and shall be made free and clear of any taxes other than taxes directly imposed on Issuer.
 - (b) To effect any payment due hereunder, Applicant authorizes Issuer to debit any account that Applicant may have with Issuer or any direct or indirect subsidiary and/or affiliate of Bank One Corporation, or any successor holding company (each such subsidiary and/or affiliate referred herein as a "Bank One Affiliate").
4. **REPRESENTATIONS AND WARRANTIES.** In order to induce Issuer to issue each Credit, Applicant:

- (a) Represents and warrants to Issuer that each financial statement of Applicant furnished to Issuer was correct and complete and truly presented the financial condition of Applicant as of the date thereof and, since the date of the last such financial statement, there has been no material adverse change in the financial condition of Applicant, and
- (b) Makes to Issuer the following representations and warranties:
 - (i) Applicant is a corporation organized under the laws of Minnesota.
 - (ii) Applicant has the power and is duly authorized to execute and deliver this Agreement and is and will be duly authorized to execute and deliver each Application for a Credit. This Agreement, and each Application for a Credit, when executed and delivered, will constitute the valid and binding obligations of Applicant, enforceable in accordance with their terms, except as limited by bankruptcy, insolvency or similar laws of general application affecting the enforcement of creditors' rights generally and except to the extent that general principles of equity might affect the specific enforcement of this Agreement.
 - (iii) There is no litigation or administrative proceeding pending or threatened against Applicant, which might, if adversely determined, materially affect Applicant's ability to perform its obligations under this Agreement.
 - (iv) No default exists, nor has any event, act or omission occurred which, with the giving of notice or the passage of time, would constitute a default under any instrument or agreement evidencing or securing any indebtedness or liability of Applicant to any person.
 - (v) Applicant has no indebtedness for borrowed money, nor any obligation contingent or otherwise, directly or indirectly guaranteeing or in any manner providing for the payment of the indebtedness of another, except those disclosed on the most recent financial statements of Applicant furnished to Issuer and except for endorsements for collection or deposit in the ordinary course of business.
 - (vi) This Agreement and the underlying transaction do not and shall not conflict with any law, regulation, order, or governmental consent requirement (including, without limitation, any that regulate exports or imports, foreign assets, foreign exchange investments, margin stock, investment companies, securities offering, infringement, boycotts, or money laundering) applicable to the Applicant or the Issuer.

5. **COVENANTS.** Applicant agrees that so long as any drawing is available under any Credit, and until Issuer has been reimbursed for all drafts honored by it under any Credit, Applicant will comply in a timely manner with:

Its Obligations (as defined in Section 12); and

- (a) The following covenants:
 - (i) Applicant shall furnish to Issuer such financial information regarding Applicant as Issuer may from time to time reasonably request and shall permit representatives of Issuer to visit and inspect the properties and books and records of Applicant at any reasonable time and as often as may reasonably be desired.
 - (ii) Applicant shall pay all lawful taxes, assessments and governmental charges upon it or against its properties prior to the date on which penalties attach, unless and to the extent only that the same shall be contested in good faith and by appropriate proceedings.
 - (iii) Applicant shall not sell, lease, transfer or otherwise dispose of all or substantially all of its assets (other than sales made in the ordinary course of business).
 - (iv) if Applicant is a corporation, Applicant shall maintain its corporate existence and not merge or consolidate with or into any other corporation.
 - (v) If Applicant is a limited liability company or partnership, Applicant shall maintain its existence as a limited liability company or partnership and not merge or consolidate with or into any other limited liability company, partnership or corporation.
 - (vi) If Applicant is a partnership, Applicant shall not liquidate, terminate or dissolve.

6. **RESPONSIBILITY OF ISSUER.**

- (a) Delivery to Issuer or any of its Correspondents ("Correspondents") shall mean a bank or other financial institution or entity with which the Issuer usually maintains an account relationship) of any documents purporting to comply with the requirements of a Credit shall be sufficient evidence of the validity, genuineness and sufficiency thereof and of the good faith and proper performance of drawers and users of a Credit; their agents and assignees, and Issuer and its Correspondents may rely thereon without liability or responsibility with respect thereto, even if such documents should in fact prove to be in any or all respects invalid, insufficient, fraudulent or forged.
- (b) Issuer is expressly authorized and directed to honor any request for payment which is made under and in compliance with the terms and conditions of a Credit without regard to, and without any duty on Issuer's part to inquire into, the existence of any disputes or controversies between Applicant, any beneficiary of a Credit or any other person, firm or corporation or the rights, duties or liabilities of any of them.
- (c) Neither Issuer nor any Bank One Affiliate shall be liable to Applicant or any third party for:
 - (i) The use which may be made of any Credit or for any act or omission of any beneficiary thereof,
 - (ii) Any delay in giving or failing to give any notice,
 - (iii) Any error, neglect or default of any of its Correspondents,
 - (iv) The validity, sufficiency or genuineness of any document assigning or purporting to assign a Credit or any benefits thereunder or any act in reliance thereon,
 - (v) Errors in translation or in the interpretation of any of the terms and conditions of a Credit, or

- (vi) Errors, delays, misdeliveries or losses in the transmission of notices and communications by means of SWIFT, electronic mail, telex, telecopy, telefax, courier, mail or computer generated telecommunications or documents or items forwarded in connection with a Credit or any relevant draft.
- (d) Any action taken or omitted by Issuer or its Correspondents or any Bank One Affiliate in connection with a Credit, any instructions of Applicant or any drafts, documents or merchandise relative thereto shall, if in good faith, be conclusively deemed authorized by Applicant, whether expressly so or not.
- (e) If Applicant shall have requested a Credit for the accommodation of a third party, any instruction, consent, approval and other action or inaction of such third party with respect to a Credit or transactions thereunder shall be deemed to be the act or omission of Applicant for all purposes hereof, and Issuer shall be entitled to rely thereon.

7. **LIMITATION ON LIABILITY.** Specifically, but without limitation, Issuer shall not be responsible to Applicant for, and Issuer's rights and remedies against Applicant shall not be impaired by:

- (a) Action or inaction required or permitted under:
 - (i) the Uniform Commercial Code, the Uniform Customs and Practices for Documentary Credits (UCP 500), the International Standby Practices (ISP98) or the United Nations Convention on Independent Guarantees and Standby Letters of Credit, as chosen in, as applicable and/or in effect where and when the Credit is issued, from time to time;
 - (ii) the law or published practice rules to which the Credit is subject;
 - (iii) an applicable standard practice of banks that regularly issue letters of credit;
 - (iv) an applicable order, ruling or regulation of any court, arbitrator or government agency;
 - (v) a published statement or interpretation on a matter of applicable standard bank practice;
 - (vi) the laws, customs or regulations in effect in countries other than the country of the Issuer; or
 - (vii) an opinion received from Issuer's legal counsel on a matter of law or from an expert engaged by Issuer on a matter of practice;
- (b) Honor of any presentation that substantially or reasonably complies with the terms and conditions of the Credit, even if the Credit requires strict or literal compliance by the beneficiary;
- (c) Honor of a non-negotiable or informal or unmarked demand or of a demand by the beneficiary presented electronically, even if the Credit requires that the beneficiary's demand be in the form of a draft and states that it is drawn under the Credit;
- (d) Honor of documents signed or presented by or on behalf of, or requesting payment to, the beneficiary's purported successor by operation of law;
- (e) Honor of a presentation without regard to any non-documentary condition(s) in the Credit;
- (f) Honor or other recognition of a presentation or other demand that later is determined to have included invalid, forged or fraudulent documents or that was otherwise affected by the fraudulent, bad faith or illegal conduct of the beneficiary or other person (excluding Issuer's employees), including payment to a person who later is determined to have forged the signature of a beneficiary, nominated bank or assignee of letter of credit proceeds;
- (g) Honor of a presentation up to the amount available under the Credit against a draft or other documents claiming amount(s) in excess of the amount available;
- (h) Reimbursement of a nominated bank that does not give value or that misrepresents the basis on which it claims reimbursement;
- (i) Dishonor of any presentation that does not strictly comply or that is fraudulent, forged or otherwise not entitled to honor;
- (j) The use which may be made of the Credit or any acts or omissions of the users of the Credit;
- (k) Honor of any presentation without regard to particular conditions stipulated in the documents or superimposed thereon;
- (l) Any breach of contract between the beneficiary and Applicant or any of the parties to any underlying transaction;
- (m) The failure of any instrument to bear any reference or adequate reference to the Credit, or the failure of any draft to be endorsed by the payee or accompanied by documents at negotiation, or the failure of any negotiating bank to endorse any draft or other instrument in connection with the Credit or the failure of any person to note the amount of any draft on the reverse of the Credit or to surrender or take up the Credit or to send forward documents apart from drafts as required by the terms and conditions of the Credit (each of which provisions, if contained in the Credit itself, it is agreed may be waived by Issuer);
- (n) Any error, omission, interruption or delay in transmission or delivery of any message or advice in connection with the Credit whether transmitted by courier, mail, telex, SWIFT, electronic mail or any other telecommunication or otherwise and despite any cipher or code which may be employed.

The happening of any one or more of the contingencies referred to in the preceding paragraph shall not affect, impair or prevent the vesting of any of Issuer's rights or powers hereunder or Applicant's obligation to make reimbursement. In furtherance and extension thereof and not in limitation of the specific provisions herein above set forth, Applicant agrees that any action, inaction or omission by issuer or any of issuer's branches, affiliates (which shall also include Bank One Affiliates for all purposes of this section) and/or Correspondents under or in connection with the Credit or the related drafts, documents or property, if taken in good faith, shall be binding on Applicant and shall not put issuer or any of Issuer's branches, affiliates or Correspondents under any resulting liability to Applicant. Issuer shall not be responsible for any act, error, neglect, default, omission, insolvency or failure in the business of any of Issuer's branches, affiliates or Correspondents or for any refusal by Issuer or any of issuer's branches, affiliates or Correspondents to pay or honor drafts drawn under the Credit because of any United States or foreign laws or regulations now or hereafter in force or for any other matter beyond Issuer's control.

Applicant shall indemnify issuer and hold Issuer harmless from any cost, loss or expense which may be incurred by issuer if, at Applicant's request, the

8. **SECURITY INTEREST.** This Section Intentionally Deleted.
9. **CASH COLLATERAL.** Applicant agrees that upon and during the continuance of any (i) Event of Default, (ii) material adverse change in the business or financial condition of the Applicant, (iii) Applicant injunction action, beneficiary wrongful dishonor action, or other event that threatens to extend or increase the Issuer's contingent liability beyond the time, amount, or other limit provided in the Credit or this Agreement, or (iv) other event or condition that causes the Issuer in good faith to deem itself insecure, the Applicant must deposit with the Issuer, on demand, cash amount(s) in the aggregate amount of the Obligations.
10. **COMPLIANCE WITH LAWS.** Applicant agrees to comply with and represents that the underlying transaction complies with all applicable foreign and domestic laws and regulations with respect to the transaction covered by a Credit.

USA PATRIOT ACT NOTIFICATION. The following notification is provided to Applicant pursuant to Section 326 of the USA Patriot Act of 2001, 31 U.S.C. Section 5318:

IMPORTANT INFORMATION ABOUT PROCEDURES FOR OPENING A NEW ACCOUNT. To help the government fight the funding of terrorism and money laundering activities, Federal law requires all financial institutions to obtain, verify, and record information that identifies each person or entity that opens an account, including any deposit account, treasury management account, loan, other extension of credit, or other financial services product. What this means for Applicant: When Applicant opens an account, Bank will ask for Applicant's name, employer identification number, business address, and other information that will allow Bank to identify Applicant. Bank may also ask to see Applicant's legal organizational documents or other identifying documents.

11. **POWER OF ATTORNEY.** Applicant irrevocably appoints Issuer its attorney in fact to execute, file, register or record in the name of Applicant, any document or instrument of any kind or description including, without limitation thereto, assignments and endorsements which come into the possession of Issuer under a Credit or upon instructions of Applicant, and to perform such acts as Applicant may be required to perform hereunder, upon failure of Applicant to so act.
12. **EVENTS OF DEFAULT.** If any one or more of the following Events of Default shall occur:
- (a) Applicant fails to comply with any of the provisions of this Agreement; or
 - (b) Applicant or any Guarantor dies, ceases to exist, becomes insolvent or is the subject of bankruptcy or insolvency proceedings; or
 - (c) Any representation by Applicant or any Guarantor in this Agreement or otherwise, made to induce Issuer to issue a Credit, is incorrect in any material respect when made; or
 - (d) Applicant or any Guarantor defaults in any other agreement governing indebtedness of such Applicant or Guarantor;

then, all of the obligations and liabilities of Applicant to Issuer and all Issuer's claims against Applicant, whether arising or incurred under this Agreement or otherwise, whether now existing or hereafter incurred, and whether now or hereafter owing to or acquired in any manner by Issuer ("Obligations") shall, at Issuer's option and without notice or demand, mature and become immediately due and payable, with interest at the per annum rate which is three percentage points in excess of the Prime Rate as herein defined (provided such interest rate does not exceed the maximum rate of interest which may be charged under applicable law), and Issuer shall have all rights and remedies for default provided under applicable law. In addition to the foregoing, and not by way of limitation, upon the occurrence of an Event of Default, Issuer may require Applicant to deposit funds in an account held at any Bank One Affiliate in an amount equal to the undrawn amount of a Credit, such funds to be held as cash collateral by Issuer against future draws under any Credit.

13. **INDEMNITY.** Applicant hereby agrees to indemnify Issuer and each Bank One Affiliate for any loss, cost, damage, expense (including any reasonable charges for legal services) and/or liability whatsoever which they, or any of them, may sustain or incur on account of issuance of a Credit, payment or acceptance of any draft relative thereto, refusal or failure to pay or accept any such draft, any action or inaction respecting a Credit, instructions of Applicant or an accommodated party, drafts, documents or merchandise relative to a Credit or any action or inaction in reliance on the provisions hereof, except that Applicant shall have a claim against Issuer, and Issuer shall be liable to Applicant, to the extent, but only to the extent of any direct, as opposed to consequential, damages suffered by Applicant which Applicant proves were caused by:
- (a) Issuer's willful misconduct or gross negligence in determining whether documents presented under a Credit comply with the terms of a Credit, or
 - (b) Issuer's willful and unlawful failure to pay under a Credit after the presentation to it by the beneficiary of a Credit of a draft and documentation strictly complying with the terms and conditions of a Credit.

Additionally, Applicant agrees to indemnify the Issuer against all claims, obligations, and responsibilities (including attorney's fees) arising out of:

- (i) The imposition of law or practice other than that chosen in the Credit or applicable at the place of issuance;
- (ii) The fraud, forgery or illegal action of others; or
- (iii) The Issuer's performance of the obligations of a confirming institution or entity that wrongfully dishonors a confirmation.

Further, if any award, judgment or order is given or made for the payment of any amount due under this Agreement and such award, judgment or order is expressed in a currency other than the currency required under this Agreement, Applicant shall indemnify Issuer against and hold Issuer harmless from all loss and damage incurred by Issuer as a result of any variation in rates of exchange between the date of such award, judgment or order and the date of payment (or, in the case of partial payments, the date of each partial payment thereof) in the required currency.

14. **WAIVER.** TO THE EXTENT THE PREVIOUS SECTION DOES NOT RESTRICT A PARTY'S ABILITY TO EMPLOY JUDICIAL REMEDIES, ISSUER, APPLICANT, CORRESPONDENT AND EACH GUARANTOR, IF ANY, VOLUNTARILY, IRREVOCABLY AND UNCONDITIONALLY

WAIVE ANY RIGHT TO HAVE A JURY PARTICIPATE IN RESOLVING ANY DISPUTE, WHETHER SOUNDING IN CONTRACT, TORT OR OTHERWISE, BETWEEN THE PARTIES ARISING OUT OF, IN CONNECTION WITH, RELATED TO, OR INCIDENTAL TO A CREDIT, THIS APPLICATION AND/OR ANY DOCUMENT EVIDENCING AND/OR SECURING A CREDIT OR THIS AGREEMENT. THIS PROVISION IS A MATERIAL INDUCEMENT TO ISSUER AGREEING TO ENTER INTO THIS AGREEMENT AND ISSUE CREDITS HEREUNDER.

15. **LIMITATION OF INTEREST AND OTHER CHARGES.** Applicant and Issuer intend to conform strictly to the applicable usury laws now or hereafter in force with respect to this Agreement. To such end:
- (a) the aggregate of all interest and other charges constituting interest under such applicable usury laws and contracted for, chargeable or receivable under this Agreement shall never exceed the maximum amount of interest, nor produce a rate in excess of the maximum contract rate of interest, that Issuer is authorized to charge Applicant under such applicable usury laws;
 - (b) if any excess interest is provided for, it shall be deemed a mistake, and the excess shall, at the option of Issuer, either be refunded to Applicant or credited on the unpaid principal balance of Issuer's reimbursement obligation, and this Agreement shall be automatically reformed to permit only the collection of the maximum legal contract rate and the maximum amount of interest; and
 - (c) in determining the maximum amount of interest that Issuer may charge to Applicant, all interest shall be amortized, prorated, allocated and spread over the entire term of Applicant's reimbursement obligation (as extended, if applicable) to the full extent permitted by applicable usury laws. Reference herein to usury laws shall also include any applicable federal or state usury statutes or laws from time to time in effect to the extent the same may govern and control transactions covered hereunder.
16. **GUARANTORS.** This Section Intentionally Deleted.
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17. **CORRESPONDENTS.** This Section Intentionally Deleted.
18. **NONWAIVER.** Issuer shall have no duty to exercise any rights hereunder or otherwise with respect to any documents or instruments relative to a Credit and shall not be liable for any failure or delay in doing so. Issuer shall not be deemed to have waived any of its rights hereunder unless issuer shall have signed such waiver in writing.
19. **NOTICES AND COMMUNICATIONS.** Any notice or demand to either party given by the other party shall be deemed to have been delivered when deposited in the mail or transmitted by a telegraph, telex or facsimile to the last address of such party, which has previously been furnished to such other party. Applicant acknowledges and agrees that, at the discretion of Issuer, Issuer may accept and/or transmit notices and communications under the Application and this Agreement (including issuance of a Credit) by means of SWIFT, electronic mail, telex, telecopy, telefax, courier, mail or computer generated telecommunications.
20. **MISCELLANEOUS.**
- (a) If this Agreement is signed by more than one party, "Applicant" shall be deemed to refer to all of the undersigned, all Obligations of Applicant hereunder shall be joint and several and the liabilities of each shall be absolute and unconditional, regardless of the liability of any other party hereto.
 - (b) Any direct or indirect subsidiary and/or affiliate of Bank One Corporation or any successor holding company shall be referred to herein as a "Bank One Affiliate".
 - (c) Any reference in this Agreement to drafts shall also mean and include deferred payment undertakings.
 - (d) THIS AGREEMENT SHALL BE GOVERNED BY, AND CONSTRUED IN ACCORDANCE WITH, THE LAWS OF THE STATE OF ILLINOIS. Except as otherwise expressly provided herein or in a Credit, Issuer may rely for interpretation of a Credit or instructions or documents related thereto or issued under or in purported compliance with the above, on the Uniform Customs and Practice for Documentary Credits, ICC Publication No. 500 or the International Standby Practices 1998, whichever is stated as the governing rules in the Credit.
 - (e) The invalidity or unenforceability of any provision or portion of this Agreement or any instrument, document or agreement executed or made pursuant to or by virtue of this Agreement, shall not affect the validity or enforceability of any other provision or portion.
 - (f) This Agreement may only be amended upon the written consent of all the parties hereto, except that it may be amended by any Issuer in the event of a change of such Issuer's name, credit number, place of notice, presentation or drawing or other similar change at such Issuer's reasonable discretion.
 - (g) Except as otherwise specifically set forth herein, this Agreement confers no right or benefit upon any person other than the parties to this Agreement and their respective successors and assigns.
 - (h) Applicant agrees that in the event of any extension of the maturity or time for presentation of drafts, acceptances or documents, or any other modification of the terms of a Credit, (including without limitation, by mutual agreement between Applicant and Issuer; or in accordance with the Credit; or in accordance with rules, law, or practice governing the Credit), or in the event of any increase in the amount of a Credit, this Agreement shall be binding upon Applicant with regard to a Credit so increased, extended or otherwise modified, to drafts, documents and property covered thereby, and to any action taken by Issuer or any of its Correspondents in accordance with such extension, increase or other modification.
 - (i) Any and all payments made to Issuer shall be made free and clear of and without deduction for any present or future taxes, levies, imposts, deductions, charges or withholdings, and all liabilities with respect thereto, excluding income or franchise taxes imposed by the United States and any subdivisions thereof (such non excluded taxes herein called "Taxes"). If Applicant shall be required by law to deduct any Taxes from or in respect of any sum payable hereunder, (i) the sum payable shall be increased so that after making all required deductions, Issuer shall receive an amount equal to the sum Issuer would have received had no such deductions been made, (ii) Applicant shall make such deductions, and (iii) Applicant shall pay the full amount deducted to the relevant authority in accordance with applicable law, (iv) Applicant shall furnish Issuer with an original or certified copy of receipt of payment and remittance from the appropriate tax authority within thirty days of such payment. Applicant will indemnify Issuer for the full amount of Taxes (including without limitation any Taxes imposed by any jurisdiction on any amounts payable under this Section 20 (i)) paid by Issuer and any liability (including penalties, interest and expenses) arising therefrom or with respect

thereto, whether or not such Taxes were correctly or legally asserted. This indemnification shall be made within 30 days from the date Issuer makes written demand therefore.

21. **SURETYSHIP WAIVERS.** In the event this Agreement is signed by more than one party, each of the undersigned waives (a) to the extent permitted by law, all rights and benefits under any laws or statutes regarding sureties, as maybe amended; (b) any right to receive notice of the following matters before the Issuer enforces any of its rights: (i) the Issuer's acceptance of this Agreement; (ii) any credit that the Issuer extends to the Applicant; (iii) Applicant's default; (iv) any demand, diligence, presentment, dishonor and protest; (v) any action that the Issuer takes regarding the Applicant, beneficiary, anyone else, any Collateral, or any of the Obligations, that it might be entitled to by law or under any other agreement; (c) any right to require the Issuer to proceed against the Applicant, any other obligor or guarantor of the Obligations, or any Collateral, or pursue any remedy in the Issuer's power to pursue; (d) any defense based on any claim that any endorser or other parties' obligations exceed or are more burdensome than those of the Applicant; (e) the benefit of any statute of limitations affecting liability of any endorser or other party liable hereunder or the enforcement hereof; (f) any defense arising by reason of any disability or other. defense of the Applicant or by reason of the cessation from any cause whatsoever (other than payment in full) of the obligation of the Applicant for the Obligations; (g) any defense based on or arising out of any defense that the Applicant may have to the payment or performance of the Obligations or any portion thereof, (h) all rights, remedies, defenses and claims and/or rights of counterclaim, recoupment, offset or setoff, including, but not limited to, all offsets, setoffs, rights, remedies or defenses that may be afforded the endorser and any other party liable on this Agreement as any of such statutes may be amended from time to time; and (i) any defenses given to such endorser by any failure, neglect or omission by the Issuer to perfect in any manner the collection of the Obligations or the security given therefor, including the failure or omission to seek a deficiency judgment against the Applicant. Any party liable on this Agreement consents to any extension or postponement of time of its payment without limit as to the number or period, to any substitution, exchange or release of all or any part of the Collateral, to the addition of any other party, and to the release or discharge of, or suspension of any rights and remedies against, any person who may be liable for the payment of this Agreement. The Issuer may waive or delay enforcing any of its rights without losing them. Any waiver affects only the specific terms and time period stated in the waiver. No modification or waiver of any provision of this Agreement is effective unless it is in writing and signed by the party against whom it is being enforced.
22. **DURATION AND EFFECT OF AGREEMENT.** This Agreement shall remain in full force and effect until such time as Applicant has discharged in full its Obligations hereunder. Notwithstanding the foregoing sentence, if a Credit is issued in favor of a sovereign or commercial entity, which is to issue a guarantee or undertaking on Applicant's behalf in connection therewith, or is issued as support for such a guarantee, the Applicant shall remain liable on a Credit until Issuer is fully released in writing by such entity. This Agreement shall be binding upon Applicant, its personal representatives, successors and assigns and shall inure to the benefit of each Issuer, its successors and assigns. Issuer may grant participations in this Agreement and a Credit issued hereunder to one or more financial institutions. Applicant and/or Guarantor information may be transmitted to the participant.
23. **APPLICATIONS.** Applicant is authorized to present Applications for individual credits under this Agreement in writing or by means of SWIFT, electronic mail, telex, telecopy; telefax, courier, mail or computer generated telecommunications. If the Application is transmitted electronically, the terms and conditions of such Application shall be presented to the issuer in a format acceptable to the issuer, and Applicant shall follow such authentication procedures as reasonably established by Issuer, which may include the use of an encoded digital signature to be agreed upon in

advance with Issuer. Any Application presented to the Issuer by electronic means (which may or may not include a digital signature) will have the same legal effect as an Application in writing and will be binding upon and enforceable against the Applicant.

24. **EFFECT OF OTHER AGREEMENT.** Applicant is a party to a Credit Agreement dated as of June 30, 2004 between Flexsteel Industries, Inc. and Bank One, NA in the amount of \$47,000,000.00 (the "Credit Agreement"), and such credit agreement provides for the issuance of commercial and/or standby letters of credit on behalf of Applicant. The provisions of that credit agreement as they relate to letters of credit shall prevail over any inconsistent provisions of this Agreement.
25. **ELECTRONIC TRANSMISSIONS.** In the absence of written instructions to the contrary, Issuer is authorized to accept and process the Application and any amendments, transfers, assignments of proceeds and all documents relating to the Credit or the Application which are sent to Issuer by electronic transmission. Issuer may, but shall not be obligated to, require authentication of such electronic transmission or that Issuer receives original documents prior to acting on such electronic transmission. If it is a condition of the Credit that payment may be made upon receipt by Issuer of an electronic transmission advising negotiation, Applicant hereby agrees to reimburse Issuer on demand for the amount indicated in such electronic transmission advice, and further agrees to hold Issuer harmless if the documents fail to arrive, or if, upon the arrival of the documents, Issuer should determine that the documents do not comply with the terms and conditions of the Credit.
26. **TRANSFERS.** If, at Applicant's special request, the Credit is issued in transferable form, it is understood and agreed that issuer is under no duty to determine the proper identity of anyone appearing in the transfer request or in the draft or documents as transferee, nor shall Issuer be charged with responsibility of any nature or character for the validity or correctness of any transfer or successive transfers; and payment by Issuer to any purported transferee(s) as determined by Issuer is hereby authorized and approved. Applicant further agrees to hold Issuer harmless and indemnified against any liability or claim in connection with or arising out of the foregoing.
27. **WAIVER OF DISCREPANCIES AND BINDING TERMS ON ISSUER'S DECISIONS.** Applicant agrees that Issuer's decision, in accordance with standard banking practice, whether the documents presented appear on their face to comply with the terms and conditions of the Credit shall be conclusive and binding on Applicant. If Issuer determines that any draft or document does not appear to comply with the terms and conditions of the Credit, Issuer using its sole judgement may approach Applicant for a waiver of the discrepancy(ies), but shall not be obligated to do so. If Issuer determines that a presentation appears to comply with the terms and conditions of the Credit, Issuer is authorized to pay the amount thereof regardless of receipt of notice from Applicant or another person that any required document is forged or materially fraudulent.
28. **AGREEMENT.** EXCEPT AS PROVIDED FOR HEREIN, THIS WRITTEN AGREEMENT REPRESENTS THE FINAL AGREEMENT BETWEEN THE PARTIES WITH RESPECT TO ITS SUBJECT MATTER AND MAY NOT BE CONTRADICTED BY EVIDENCE OF PRIOR, CONTEMPORANEOUS, OR SUBSEQUENT ORAL AGREEMENTS OF THE PARTIES.

THERE ARE NO UNWRITTEN ORAL AGREEMENTS BETWEEN THE PARTIES.

IF THIS AGREEMENT IS SIGNED BY TWO OR MORE PARTIES, IT SHALL CONSTITUTE THE JOINT AND SEVERAL AGREEMENT OF SUCH PARTIES.

29. **IN THE EVENT COMMERCIAL CREDIT(S) ARE ISSUED UNDER THIS AGREEMENT, THE FOLLOWING TERMS AND PROVISIONS**

SHALL APPLY:

REIMBURSEMENT. In the event that any drafts are drawn by Applicant on Issuer in order to refinance any obligation set forth herein, and such drafts, at Issuer's option, are accepted by Issuer, Applicant agrees to pay Issuer on demand, but in any event not later than the maturity date, the amount of each such acceptance.

ABSENCE OF WRITTEN INSTRUCTIONS. In the absence of written instructions to the contrary, the Applicant agrees that (a) if the Credit authorizes drawings and/or shipments in installments and any installment is not drawn and/or shipped within the period allowed for that installment but the Applicant waives such discrepancy, the Issuer is authorized to honor any subsequent installments so long as documents for such installments are presented within the period allowed for such installments; and (b) each negotiation Credit shall expire at the counters of the nominated person even if notice of the presentation or any documents contained in the presentation is not received by the Issuer until after the expiry date of the Credit or any installment thereof.

RELEASE OF DOCUMENTS. In the event that the Issuer delivers to the Applicant or to a customs broker or any other person designated by the Applicant at the Applicant's request any of the documents of title pledged hereunder prior to having received payment in full of all the Applicant's liabilities to the Issuer, the Applicant agrees to obtain possession of any goods represented by such documents within twenty-one days after the date of delivery of such documents, and if the Applicant should fail to do so, the Applicant agrees to return such documents or to have them returned by the customs broker or such other person to the Issuer prior to the expiration of the twenty-one day period. The Applicant further agrees to execute and deliver to the Issuer receipts for such documents and the goods represented thereby identifying and describing such documents and goods, which receipts shall constitute a part of this Agreement. The Applicant hereby authorizes the Issuer, in the event that the Issuer becomes aware that the Applicant has claimed from the carrier any goods identified in the shipping documents required under the Credit and that such goods have been released to the Applicant or to a customs broker or agent acting on the Applicant's behalf, to immediately, and without further inquiry and consideration, charge the amount of the Credit represented by such goods to any available funds then held by the Issuer.

MISCELLANEOUS - OTHER. The Applicant agrees to procure promptly any necessary import, export or other licenses for the import, export or shipping of the property, and to comply with all United States and foreign governmental regulations in regard to the shipment of the property or the financing thereof, and to furnish such certificates in that respect as the Issuer may at any time require. The Applicant also agrees to keep the property adequately covered by insurance acceptable to the Issuer, to assign the policies or certificates of insurance to the Issuer or, at the Issuer's option, to make any loss or adjustment payable to the Issuer, and upon the Issuer's request, to furnish the Issuer with evidence of acceptance of any such assignment by the insurers.

30. **IN THE EVENT STANDBY CREDIT(S) ARE ISSUED UNDER THIS AGREEMENT, THE FOLLOWING TERMS AND PROVISIONS SHALL APPLY:**

IF THE CREDIT IS ISSUED SUBJECT TO UCP 500, UNLESS OTHERWISE AGREED: (A) IN THE EVENT THAT ANY INSTALLMENT OF THE CREDIT IS NOT DRAWN WITHIN THE PERIOD ALLOWED FOR THAT INSTALLMENT, THE CREDIT WILL CONTINUE TO BE AVAILABLE FOR ANY SUBSEQUENT INSTALLMENTS NOTWITHSTANDING UCP ARTICLE 41; AND (B) ISSUER MAY PROCESS AND ACCEPT ANY TRANSPORT DOCUMENT NOTWITHSTANDING THE REQUIREMENTS OF UCP ARTICLE 43.

IF THE CREDIT PROVIDES FOR AUTOMATIC EXTENSION WITHOUT AMENDMENT, APPLICANT AGREES THAT IT WILL NOTIFY ISSUER IN WRITING AT LEAST SIXTY (60) DAYS PRIOR TO THE LAST DAY SPECIFIED IN THE CREDIT BY WHICH ISSUER MUST GIVE NOTICE OF NON EXTENSION AS TO WHETHER OR NOT IT WISHES THE CREDIT TO BE EXTENDED. ANY DECISION TO EXTEND OR NOT EXTEND THE CREDIT SHALL BE IN ISSUER'S SOLE DISCRETION AND JUDGMENT. APPLICANT HEREBY ACKNOWLEDGES THAT IN THE EVENT ISSUER NOTIFIES THE BENEFICIARY OF THE CREDIT THAT IT HAS ELECTED NOT TO EXTEND THE CREDIT AND THE BENEFICIARY DRAWS ON THE CREDIT AFTER RECEIVING THE NOTICE OF NON-EXTENSION; THE APPLICANT ACKNOWLEDGES AND AGREES THAT APPLICANT SHALL HAVE NO CLAIM OR CAUSE OF ACTION AGAINST ISSUER OR DEFENSE AGAINST PAYMENT UNDER THE AGREEMENT FOR ISSUER'S DISCRETIONARY DECISION TO EXTEND OR NOT EXTEND THE CREDIT.

IF A CREDIT'S TERMS AND CONDITIONS PROVIDES THAT ISSUER GIVE BENEFICIARY A NOTICE OF PENDING EXPIRATION, APPLICANT AGREES THAT IT WILL NOTIFY ISSUER IN WRITING AT LEAST SIXTY (60) DAYS PRIOR TO THE LAST DAY SPECIFIED IN THE CREDIT BY WHICH ISSUER MUST GIVE SUCH NOTICE OF THE PENDING EXPIRATION DATE. IN THE EVENT APPLICANT FAILS TO SO NOTIFY ISSUER AND THE CREDIT IS EXTENDED, APPLICANTS OBLIGATIONS UNDER THIS AGREEMENT SHALL CONTINUE IN EFFECT AND BE BINDING ON APPLICANT WITH REGARD TO THE CREDIT AS SO EXTENDED.

APPLICANT:

FLEXSTEEL INDUSTRIES, INC.

By: /s/ R. J. Klosterman
Name: R. J. Klosterman
Its: Exec. V.P., C.F.O., Secretary
Dated: June 29, 2004

By: _____
 Name: _____
 Its: _____
 Dated: _____

Appendix A to the Master Agreement For Irrevocable Letters of Credit

(To be completed by Account Party/Applicant/Correspondent Bank)

A) In the event you issue or amend a commercial or a standby letter of credit ("Credit"), any One of the following individual(s) shall be authorized to sign behalf of

Flexsteel Industries, Inc.

Applicant Name/Correspondent Bank

K. B. Lauritsen	President, C.E.O.	/s/ <i>K. B. Lauritsen</i>	June 29, 2004
_____	_____	_____	_____
Printed Name	Title	Signature	Date
R. J. Klosterman	Exec. V.P., C.F.O.	/s/ <i>R. J. Klosterman</i>	June 29, 2004
_____	_____	_____	_____
Printed Name	Title	Signature	Date
Timothy E. Hall	Treasurer	/s/ <i>Timothy E. Hall</i>	June 29, 2004
_____	_____	_____	_____
Printed Name	Title	Signature	Date

B) In regards to commercial Letters of Credit ("Credit"), Bank One N.A. may accept and rely on instructions including without limitation, (a) waiving of discrepancies, (b) mailings/returning shipping documents, (c) changing Credit terms and conditions prior to issuance, and amendments to Credits which do not extend, increase or change the tenor of the draft(s) transmitted by the following authorized representatives of:

Flexsteel Industries, Inc.

Applicant Name/Correspondent Bank

K. B. Lauritsen	President, C.E.O.	/s/ <i>K. B. Lauritsen</i>	June 29, 2004
_____	_____	_____	_____
Printed Name	Title	Signature	Date
R. J. Klosterman	Exec. V.P., C.F.O.	/s/ <i>R. J. Klosterman</i>	June 29, 2004
_____	_____	_____	_____
Printed Name	Title	Signature	Date
Timothy E. Hall	Treasurer	/s/ <i>Timothy E. Hall</i>	June 29, 2004
_____	_____	_____	_____
Printed Name	Title	Signature	Date
Phillip J. Keller	C.F.O. DMI Furniture, Inc.	/s/ <i>Phillip J. Keller</i>	June 29, 2004
_____	_____	_____	_____
Printed Name	Title	Signature	Date

C) Signature Verification (Banker to complete this portion):

The above individual(s) is/are authorized to execute and sign applications, amendments and instructions on behalf of the Applicant.

Printed Name

Title

Signature

Date

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in Registration Statement Nos. 33-1836, 33-26267, 333-1413, 333-45768, and 333-105951 on Form S-8 of our reports dated August 28, 2006 appearing in this Annual Report on Form 10-K of Flexsteel Industries, Inc. and Subsidiaries for the year ended June 30, 2006.

DELOITTE & TOUCHE LLP

Minneapolis, Minnesota
August 28, 2006

CERTIFICATION BY CHIEF EXECUTIVE OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 302
OF THE SARBANES-OXLEY ACT OF 2002

I, K. Bruce Lauritsen, Chief Executive Officer of Flexsteel Industries, Inc. and Subsidiaries (the "Registrant"), certify that:

1. I have reviewed this annual report on Form 10-K of the Registrant;
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 we 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: September 7, 2006

By: /s/ K. Bruce Lauritsen

K. Bruce Lauritsen
Chief Executive Officer

CERTIFICATION BY CHIEF FINANCIAL OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 302
OF THE SARBANES-OXLEY ACT OF 2002

I, Timothy E. Hall, Chief Financial Officer of Flexsteel Industries, Inc. and Subsidiaries (the "Registrant"), certify that:

1. I have reviewed this annual report on Form 10-K of the Registrant;
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 we 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 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: September 7, 2006

By: /S/ Timothy E. Hall

Timothy E. Hall
Chief Financial Officer

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders of Flexsteel Industries, Inc.

We have audited the consolidated financial statements of Flexsteel Industries, Inc. and Subsidiaries (“the Company”) as of June 30, 2006 and 2005, and for each of the three years in the period ended June 30, 2006, and have issued our report thereon dated August 28, 2006; such report is included elsewhere in this Form 10-K. Our audits also included the financial statement schedule of the Company listed in Item 15. This financial statement schedule is the responsibility of the Company’s management. Our responsibility is to express an opinion based on our audits. In our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

DELOITTE & TOUCHE LLP

Minneapolis, Minnesota
August 28, 2006
