

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

FORM 10-Q

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

For the quarterly period ended September 30, 2018

or

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

For the transition period from _____ to _____

Commission file number **0-5151**

FLEXSTEEL INDUSTRIES, INC.

(Exact Name of Registrant as Specified in Its Charter)

Incorporated in State of Minnesota
(State or other Jurisdiction of
Incorporation or Organization)

42-0442319
(I.R.S. Identification No.)

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

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

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

Common Stock - \$1.00 Par Value
Shares Outstanding as of October 18, 2018

7,883,777

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

FLEXSTEEL INDUSTRIES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS (UNAUDITED)
(Amounts in thousands, except share and per share data)

| | September 30, 2018 | June 30, 2018 |
|--|-----------------------|-------------------|
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$ 23,349 | \$ 27,750 |
| Investments | 17,950 | 15,951 |
| Trade receivables – less allowances: | | |
| September 30, 2018, \$145; June 30, 2018, \$1,100 | 43,578 | 41,253 |
| Inventories | 90,284 | 96,204 |
| Other | 8,478 | 8,476 |
| Total current assets | <u>183,639</u> | <u>189,634</u> |
| NON-CURRENT ASSETS: | | |
| Property, plant and equipment, net | 99,178 | 90,725 |
| Deferred income taxes | 1,825 | 1,455 |
| Other assets | 2,506 | 2,479 |
| TOTAL | <u>\$ 287,148</u> | <u>\$ 284,293</u> |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Accounts payable – trade | \$ 19,510 | \$ 17,228 |
| Accrued liabilities: | | |
| Payroll and related items | 5,325 | 5,459 |
| Insurance | 4,293 | 4,439 |
| Advertising | 4,306 | 4,192 |
| Environmental remediation | 3,600 | 3,600 |
| Other | 6,755 | 6,011 |
| Total current liabilities | <u>43,789</u> | <u>40,929</u> |
| LONG-TERM LIABILITIES: | | |
| Other liabilities | 1,701 | 1,666 |
| Total liabilities | <u>45,490</u> | <u>42,595</u> |
| SHAREHOLDERS' EQUITY: | | |
| Common stock – \$1 par value; authorized 15,000,000 shares; outstanding September 30, 2018, 7,883,777 shares; outstanding June 30, 2018, 7,868,298 shares | 7,884 | 7,868 |
| Additional paid-in capital | 26,687 | 26,321 |
| Retained earnings | 209,115 | 209,553 |
| Accumulated other comprehensive loss | (2,028) | (2,044) |
| Total shareholders' equity | <u>241,658</u> | <u>241,698</u> |
| TOTAL | <u>\$ 287,148</u> | <u>\$ 284,293</u> |

See accompanying Notes to Consolidated Financial Statements (Unaudited).

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

| | Three Months Ended September 30, | |
|---|-------------------------------------|-----------------|
| | 2018 | 2017 |
| Net sales | \$ 113,487 | \$ 119,834 |
| Cost of goods sold | (91,696) | (93,694) |
| Gross margin | 21,791 | 26,140 |
| Selling, general and administrative | (20,196) | (18,236) |
| Gain on sale of facility | — | 1,835 |
| Operating income | 1,595 | 9,739 |
| Other income | 181 | 141 |
| Income before income taxes | 1,776 | 9,880 |
| Income tax provision | (480) | (3,700) |
| Net income | <u>\$ 1,296</u> | <u>\$ 6,180</u> |
| Weighted average number of common shares outstanding: | | |
| Basic | <u>7,875</u> | <u>7,830</u> |
| Diluted | <u>7,921</u> | <u>7,937</u> |
| Earnings per share of common stock: | | |
| Basic | <u>\$ 0.16</u> | <u>\$ 0.79</u> |
| Diluted | <u>\$ 0.16</u> | <u>\$ 0.78</u> |

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Amounts in thousands)

| | Three Months Ended September 30, | |
|--|-------------------------------------|-----------------|
| | 2018 | 2017 |
| Net income | \$ 1,296 | \$ 6,180 |
| Other comprehensive income: | | |
| Unrealized gain (loss) on securities | 18 | (25) |
| Reclassification of realized gains on securities to other income | 5 | 35 |
| Other comprehensive income before taxes | 23 | 10 |
| Income tax expense related to securities gain | (6) | (4) |
| Other comprehensive gain, net of tax | <u>17</u> | <u>6</u> |
| Comprehensive income | <u>\$ 1,313</u> | <u>\$ 6,186</u> |

See accompanying Notes to Consolidated Financial Statements (Unaudited).

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

| | Three Months Ended September 30, | |
|---|-------------------------------------|------------------|
| | 2018 | 2017 |
| OPERATING ACTIVITIES: | | |
| Net income | \$ 1,296 | \$ 6,180 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | |
| Depreciation | 1,903 | 1,847 |
| Deferred income taxes | (376) | 896 |
| Stock-based compensation expense | 549 | 353 |
| Change in provision for losses on accounts receivable | — | (75) |
| Gain on disposition of capital assets | (33) | (1,842) |
| Changes in operating assets and liabilities: | | |
| Trade receivables | (2,325) | (3,377) |
| Inventories | 5,919 | (4,826) |
| Other current assets | (2) | (436) |
| Other assets | — | — |
| Accounts payable – trade | 2,361 | 1,576 |
| Accrued liabilities | (563) | 1,089 |
| Other long-term liabilities | 43 | 147 |
| Net cash provided by operating activities | <u>9,898</u> | <u>1,532</u> |
| INVESTING ACTIVITIES: | | |
| Purchases of investments | (10,016) | (8,022) |
| Proceeds from sales of investments | 8,015 | 12,020 |
| Proceeds from sale of capital assets | 33 | 6,152 |
| Capital expenditures | (10,434) | (5,075) |
| Net cash (used in) provided by investing activities | <u>(12,402)</u> | <u>5,075</u> |
| FINANCING ACTIVITIES: | | |
| Dividends paid | (1,729) | (1,565) |
| Proceeds from issuance of common stock | 43 | 3 |
| Shares issued to employees, withheld for tax | (211) | (473) |
| Net cash used in financing activities | <u>(1,897)</u> | <u>(2,035)</u> |
| (Decrease) increase in cash and cash equivalents | (4,401) | 4,572 |
| Cash and cash equivalents at beginning of period | 27,750 | 28,874 |
| Cash and cash equivalents at end of period | <u>\$ 23,349</u> | <u>\$ 33,446</u> |

SUPPLEMENTAL INFORMATION
(Amounts in thousands)

| | Three Months Ended September 30, | |
|--|-------------------------------------|--------|
| | 2018 | 2017 |
| Income taxes paid, net | \$ — | \$ 115 |
| Capital expenditures in accounts payable | 4,006 | 2,080 |

See accompanying Notes to Consolidated Financial Statements (Unaudited).

FLEXSTEEL INDUSTRIES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE PERIOD ENDED SEPTEMBER 30, 2018

1. The consolidated financial statements included herein have been prepared by Flexsteel Industries, Inc. and Subsidiaries (the “Company” or “Flexsteel”), without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). The information furnished in the consolidated financial statements includes normal recurring adjustments and reflects all adjustments, which are, in the opinion of management, necessary for a fair presentation of such consolidated financial statements. Operating results for the quarter ended September 30, 2018, are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2019. Certain information and footnote disclosures normally included in the consolidated financial statements prepared in accordance with generally accepted accounting principles (“GAAP”) in the United States of America have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to make the information presented not misleading. Except to the extent updated or described below, the significant accounting policies set forth in Note 1 to the consolidated financial statements in the Company’s Annual Report on Form 10-K for the year ended June 30, 2018, appropriately represent, in all material respects, the current status of accounting policies and are incorporated by reference.

DESCRIPTION OF BUSINESS – Flexsteel Industries, Inc. and Subsidiaries (the “Company”) incorporated in 1929 is celebrating its 125th anniversary of the Company’s founding in 1893. Flexsteel Industries, Inc. is one of the oldest and largest manufacturers, importers and marketers of residential and contract upholstered and wooden furniture products in the United States. Over the generations the Company has built a committed retail and consumer following based on its patented, guaranteed-for-life Blue Steel SpringTM – the all-riveted, high-carbon, steel-banded seating platform that gives upholstered and leather furniture the strength and comfort to last a lifetime. With offerings for use in home, hotel, healthcare, recreational vehicle, marine and office, the Company distributes its furniture throughout the United States & Canada through the Company’s sales force and various independent representatives.

ACCOUNTING PRONOUNCEMENTS - In May 2014, the FASB issued *Revenue from Contracts with Customers, Topic 606 (ASU 2014-09)*, which provides a framework for the recognition of revenue, with the objective that recognized revenues properly reflect amounts an entity is entitled to receive in exchange for goods and services. The guidance is effective for annual reporting periods beginning after December 15, 2017, the Company’s fiscal year 2019. The guidance permits two methods of adoption: retrospectively to each prior reporting period presented (full retrospective method), or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application (modified retrospective method). The Company previously disclosed the intent to adopt the full retrospective method on July 1, 2018. As the adoption in the first quarter of fiscal 2019 was finalized, the new standard provided an immaterial balance sheet adjustment and had no impact on the income statement. Therefore, the Company has changed its adoption to the modified retrospective method. The adoption of this standard did not have a material impact on the Company’s consolidated financial statements as revenue is recognized when product ownership and risk of loss is transferred to the customer, collectability is probable and the Company has no remaining performance obligations. Thus, the timing of revenue recognition is not impacted by the new standard.

The Company’s revenues result from the sale of goods and reflect the consideration to which the Company expects to be entitled. The Company records revenue based on a five-step model in accordance with Accounting Standards Codification (“ASC”) 606, Revenue from Contracts with Customers (“ASC 606”). For its customer contracts, typically purchase orders, the Company identifies the performance obligations (goods), determines the transaction price, allocates the contract transaction price to the performance obligations, and recognizes the revenue when the performance obligation is transferred to the customer. A good is transferred when the customer obtains control of that good and risk of loss transfers at that point in time.

Provisions for customer volume rebates, product returns, discounts and allowances are variable consideration and are recorded as a reduction of revenue in the same period the related sales are recorded. Such provisions are calculated base upon agreed percentages. Consideration given to customers for cooperative advertising is recognized as a reduction of revenue except to the extent there is a distinct good or service and evidence of the fair value of the advertising, in which case the expense is classified as selling, general and administrative expense (SG&A).

The Company has a limited lifetime warranty on all products. The Company does not offer the option to purchase warranties. The Company accounts for warranties under ASC Subtopic 460, *Guarantees*, and not as variable consideration related to revenue.

Occasionally the Company receives deposits from customers before it has transferred control of the product to customers, resulting in contract liabilities. These contract liabilities are reported within “Accounts payable - trade” in the consolidated balance sheets. As of June 30, 2018, the Company had \$2.2 million of customer deposits. As of September 30, 2018, the Company had \$2.5 million of customer deposits.

Upon adoption of ASC 606, the Company elected the following practical expedients and policy elections:

- Costs for shipping and handling activities that occur before the customer obtains control of the product are accounted for as fulfillment activities. Accordingly, these expenses are recorded at the same time the Company recognizes revenue.
- Incremental costs of obtaining a contract, specifically commissions, are recorded as an SG&A expense when incurred.
- All taxes imposed on and concurrent with revenue-producing transactions and collected by the Company from a customer, including sales, use, excise, and franchise taxes are excluded from the measurement of the transaction price.

These accounting treatments are consistent with the Company’s policies prior to adoption of ASC 606. Therefore, there will be no impact to the consolidated financial statements.

Adoption of this standard did not result in significant changes to the Company’s accounting policies, business processes, systems or controls, or have a material impact on financial position, results from operations and cash flows or related disclosures. As such, prior period financial statements were not adjusted.

The following table disaggregates our net sales by product category for the quarter ended September 30, (in millions):

| | 2018 | 2017 |
|-------------|-----------------|-----------------|
| Residential | \$ 96.1 | \$ 101.8 |
| Contract | 17.4 | 18.0 |
| Total | <u>\$ 113.5</u> | <u>\$ 119.8</u> |

2. INVENTORIES

A comparison of inventories is as follows:

| (in thousands) | September 30, 2018 | June 30, 2018 |
|------------------------------------|-----------------------|------------------|
| Raw materials | \$ 12,931 | \$ 13,335 |
| Work in process and finished parts | 8,169 | 7,195 |
| Finished goods | 69,184 | 75,674 |
| Total | <u>\$ 90,284</u> | <u>\$ 96,204</u> |

3. FAIR VALUE MEASUREMENTS

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

During the quarter ended September 30, 2018, the Company purchased available-for-sale securities, U.S. Treasury bills and U.S. Agencies, which are recorded at fair market value. These securities are classified as "Investments" in the consolidated balance sheets. Unrealized gains or losses are recorded in "Accumulated other comprehensive loss" in the consolidated balance sheets. As of September 30, 2018, the fair market value and book value of the investments are \$18.0 million. As of June 30, 2018, the fair market value and book value of the investments were \$16.0 million. These assets are classified as Level 1 in accordance with fair value measurements described above.

4. CREDIT ARRANGEMENTS

The Company maintains an unsecured credit agreement that provides short-term working capital financing up to \$10.0 million with interest of LIBOR plus 1% (3.26% at September 30, 2018), including up to \$4.0 million of letters of credit. Letters of credit outstanding at September 30, 2018, totaled \$1.3 million. Other than the outstanding letters of credit, the Company did not utilize borrowing availability under the credit facility, leaving borrowing availability of \$8.7 million as of September 30, 2018. The credit agreement expires June 30, 2019. At September 30, 2018, the Company was in compliance with all of the financial covenants contained in the credit agreement.

The Company maintains an additional unsecured \$10.0 million line of credit, with interest at prime minus 2% (3.25% at September 30, 2018). No amount was outstanding on the line of credit at September 30, 2018. This line of credit matures December 31, 2018.

5. INCOME TAXES

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

During the three months ended September 30, 2018, the Company realized an income tax provision reduction of approximately \$0.2 million as a result of the Tax Reform federal statutory corporate tax rate change. The effective tax rate for the periods ended September 30, 2018 and 2017 were 27.0% and 37.5%, respectively.

6. STOCK BASED COMPENSATION

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

(1) Long-Term Incentive Compensation Plan

The long-term incentive compensation plan provides for shares of common stock to be awarded to officers and key employees based on performance targets set by the Compensation Committee of the Board of Directors (the "Committee"). The Company's shareholders previously approved 700,000 shares to be issued under the plan. As of September 30, 2018, 102,183 shares have been issued. The Committee selected fully-diluted earnings per share as the performance goal for the three-year performance periods July 1, 2016 – June 30, 2019 (2017-2019), July 1, 2017 – June 30, 2020 (2018-2020) and July 1, 2018 – June 30, 2021 (2019-2021). The Committee also selected total shareholder return as a performance goal for the executive officers for the three-year performance periods 2017-2019, 2018-2020 and 2019-2021. Stock awards will be issued to participants as soon as practicable following the end of the performance periods subject to verification of results and Committee approval. The compensation cost related to the number of shares to be granted under each performance period is fixed on the grant date, which is the date the performance period begins.

During the quarters ended September 30, 2018 and September 30, 2017, the Company recorded no plan expense. If the target performance goals for 2017-2019, 2018-2020 and 2019-2021 plans would be achieved, the total amount of compensation cost recognized over the requisite performance periods would be \$0.9 million, \$0.6 million and \$0.4 million, respectively.

(2) Stock Plans

Omnibus Stock Plan

The Omnibus Stock Plan is for key employees, officers and directors and provides for the granting of incentive and nonqualified stock options, restricted stock, restricted stock units, stock appreciation rights and performance units. The Company's shareholders previously approved 700,000 shares to be issued under the plan.

Under the plan, options were granted at an exercise price equal to the fair market value of the underlying common stock at the date of grant and exercisable for up to 10 years. All options were exercisable when granted. It is the Company's policy to issue new shares upon exercise of stock options. The Company accepts shares of the Company's common stock as payment for the exercise price of options. Shares received as payment are retired upon receipt. During the quarters ended September 30, 2018 and 2017, the Company issued options for 36,095 and 21,439 common shares and recorded expense of \$0.3 million and \$0.2 million related to stock option grants, respectively.

Under the plan, the Company issued 2,590 and 1,863 shares to non-executive directors as compensation and recorded expense of \$0.1 million during the quarters ended September 30, 2018 and 2017, respectively.

During the quarter ended September 30, 2018, the Company recorded \$0.2 million compensation expense for grants of an aggregate 39,666 restricted stock units under the plan to four executive officers as per their notification of award letters dated July 1, 2018. During the quarter ended September 30, 2017, the Company recorded \$0.1 million compensation expense for grants of an aggregate 6,280 restricted stock units under the plan to two executive officers as per their notification of award letters dated July 1, 2017.

During the quarter ended September 30, 2017, the Company issued 2,000 restricted stock units outside of the plan to its Chief Executive Officer as compensation expense related to a Letter Agreement signed June 29, 2012. This was the final restricted stock unit issuance related to the Letter Agreement.

At September 30, 2018, 437,117 shares were available for future grants under the plan.

2006 and 2009 Stock Option Plans

The stock option plans were for key employees, officers and directors and provided for granting incentive and nonqualified stock options. Under the plans, options were granted at an exercise price equal to the fair market value of the underlying common stock at the date of grant and exercisable for up to 10 years. All options were exercisable when granted. No additional options can be granted under the 2006 and 2009 stock option plans. A summary of the status of the Company's stock plans as of September 30, 2018, June 30, 2018 and 2017 and the changes during the periods then ended is presented below:

| | Shares (in thousands) | Weighted Average Exercise Price | Aggregate Intrinsic Value (in thousands) |
|---|--------------------------|---------------------------------------|--|
| Outstanding and exercisable at June 30, 2017 | 187 | \$ 27.21 | \$ 5,039 |
| Granted | 21 | 45.21 | |
| Exercised | (21) | 18.89 | |
| Canceled | (21) | 26.77 | |
| Outstanding and exercisable at June 30, 2018 | 166 | 30.65 | 1,841 |
| Granted | 36 | 32.80 | |
| Exercised | (3) | 17.23 | |
| Canceled | (3) | 45.46 | |
| Outstanding and exercisable at September 30, 2018 | 196 | \$ 30.97 | \$ 744 |

The following table summarizes information for options outstanding and exercisable at September 30, 2018:

| Range of Prices | Options Outstanding and Exercisable (in thousands) | Weighted Average | |
|--------------------|--|---------------------------|-------------------|
| | | Remaining Life (years) | Exercise Price |
| \$ 6.96 – 13.90 | 17 | 2.1 | \$ 11.16 |
| 17.23 – 19.77 | 26 | 3.5 | 18.88 |
| 20.50 – 27.57 | 36 | 4.8 | 25.54 |
| 31.06 – 32.80 | 65 | 8.3 | 32.30 |
| 43.09 – 47.45 | 52 | 8.0 | 45.36 |
| \$ 6.96 – 47.45 | 196 | 6.4 | \$ 30.97 |

7. EARNINGS PER SHARE

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

In computing EPS for the quarters ended September 30, 2018 and 2017, net income as reported for each respective period is divided by the fully diluted weighted-average number of shares outstanding:

| (in thousands) | Three Months Ended September 30, | |
|--------------------------|-------------------------------------|-------|
| | 2018 | 2017 |
| Basic shares | 7,875 | 7,830 |
| Potential common shares: | | |
| Stock options | 40 | 89 |
| Long-term incentive plan | — | 16 |
| Non-vested shares | 6 | 2 |
| | 46 | 107 |
| Diluted shares | 7,921 | 7,937 |
| Anti-dilutive shares | 52 | — |

Cash dividends declared per common share were \$0.22 for the quarters ended September 30, 2018 and 2017.

8. LITIGATION

Environmental Matters – In March 2016, the Company received a General Notice Letter for the Lane Street Groundwater Superfund Site (the “Lane Street Site”) located in Elkhart, Indiana from the U.S. Environmental Protection Agency (EPA). In April 2016, the EPA issued their proposed clean-up plan for groundwater pollution and request for public comment. The Company responded to the request for public comment in May 2016. The EPA issued a Record Decision selecting a remedy in August 2016 and estimated total costs to remediate of \$3.6 million. In July 2017, the EPA issued a Special Notice Letter to the Company demanding that the Company perform the remedy selected and pay for the remediation cost and past response costs of \$5.5 million. On October 12, 2017, the Company, after consultation with its insurance carriers, offered an amount, fully reimbursable by insurance coverage, to the EPA to resolve this matter. On November 6, 2017, the settlement offer extended on October 12, 2017 was rejected.

In April 2018, the EPA issued a Unilateral Administrative Order for Remedial Design and Remedial Action (the “Order”) against the Company. The Order was issued under Section 106(a) of the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), 42 U.S.C. §9606(a). The Order directs the Company to perform remedial design and remedial action for the Lane Street Site. The Order was to be effective May 29, 2018. To ensure completion of the remediation work, the EPA required the Company to secure financial assurance in the initial amount of \$3.6 million, which as noted above, is the estimated cost of remedial work. The Company believes that financial assurance is not required because it meets the relevant financial test criteria as provided in the Order. In May 2018, the EPA agreed to suspend enforcement of the Order so that the Company could conduct environmental testing upgradient to its former manufacturing location pursuant to an Administrative Order on Consent (AOC). On July 5, 2018, the EPA proposed a draft AOC, to which the Company provided revisions. As of October 19, 2018, the Company has not finalized the AOC with the EPA. The Company maintains its position that it did not cause nor contribute to the contamination. However, in accordance with FASB issued *Asset Retirement and Environmental Obligations (ASC 410-30)*, the Company accrued and reflected \$3.6 million in the financial results for the quarter ended September 30, 2018. The Company continues to evaluate the Order, its legal options and insurance coverages to assert its defense and recovery of current and future expenses related to this matter.

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

9. SUBSEQUENT EVENTS

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

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

GENERAL:

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

CRITICAL ACCOUNTING POLICIES:

There have been no material changes to our critical accounting policies and estimates from the information provided in Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations”, included in our 2018 annual report on Form 10-K.

Overview

The following table has been prepared as an aid in understanding the Company’s results of operations on a comparative basis for the quarters ended September 30, 2018 and 2017. Amounts presented are percentages of the Company’s net sales.

| | Three Months Ended September 30, | |
|-------------------------------------|-------------------------------------|--------|
| | 2018 | 2017 |
| Net sales | 100.0% | 100.0% |
| Cost of goods sold | (80.8) | (78.2) |
| Gross margin | 19.2 | 21.8 |
| Selling, general and administrative | (17.8) | (15.2) |
| Gain on sale of facility | — | 1.6 |
| Operating income | 1.4 | 8.2 |
| Other income, net | 0.1 | 0.1 |
| Income before income taxes | 1.5 | 8.3 |
| Income tax provision | (0.4) | (3.1) |
| Net income | 1.1% | 5.2% |

Results of Operations for the Quarter Ended September 30, 2018 vs. 2017

The following table compares net sales for the quarter ended September 30, (in millions):

| | 2018 | 2017 | \$ Change | % Change |
|-------------|----------|----------|-----------|----------|
| Residential | \$ 96.1 | \$ 101.8 | \$ (5.7) | -5.6% |
| Contract | 17.4 | 18.0 | (0.6) | -3.3% |
| Total | \$ 113.5 | \$ 119.8 | \$ (6.3) | -5.3% |

For the first quarter, net sales were \$113.5 million, down 5.3% to prior year quarter. Residential decreased 5.6% within the quarter primarily driven by products sold through ecommerce. The Company experienced higher returns, allowances and promotional costs related to the sales of its ecommerce products as these sales continue to stabilize after the partial implementation of the business information system in the fourth quarter. On a sequential quarter basis, ecommerce product volume improved mid-single digits. Contract net sales decreased 3.3% due to volume declines in commercial office products as we intentionally scaled back our offering in this category to improve profitability offset by strong double-digit growth in our recreational vehicle products.

Gross margin as a percent of net sales for the quarter ended September 30, 2018 was 19.2% compared to 21.8% for the prior year quarter. Higher labor costs drove approximately 200 basis points of deterioration in the fiscal first quarter in comparison to the prior year quarter. Pricing initiatives fully offset inflation in steel, plywood and poly foam in the first quarter. The classification of certain rebates as a reduction of revenue in the current year quarter, which in the prior year quarter had been considered selling, general and administrative expense, also impacted the quarter results compared to prior year quarter.

Selling, general and administrative (SG&A) expenses were 17.8% of net sales in the quarter ended September 9, 2018 compared to 15.2% of net sales in the prior year quarter. The first quarter SG&A expenses includes \$1.3 million pre-tax expense for one-time severance and ancillary costs related to the September 30, 2018 retirement of Karel Czanderna, former President and Chief Executive Officer. On an after-tax basis, the expense represents \$1.0 million or \$0.13 per share. The Company's SG&A expenses increased 40 basis points to support its strategic digital marketing investment aimed at directly influencing consumers as they dream and plan on-line for future furniture purchases. Quarter results were also impacted by higher costs associated with the new business information system, initial phases of relocating the Dubuque operation to its new facility and lost volume leverage, partially offset by the classification of certain rebates as a reduction of sales to be consistent with ASC Topic 606.

During the prior year quarter, the Company completed a \$6.5 million sale of a facility and recognized a pre-tax gain of \$1.8 million. On an after-tax basis, the gain represents \$1.1 million or \$0.14 per share.

The effective tax rate for the current year quarter was 27.0% compared to 37.5% in the prior year quarter. The current fiscal year results were positively impacted by the passage of the Tax Cuts and Jobs Act. For the fiscal year 2019, the Company expects an effective tax rate range of 25% to 27%.

The above factors resulted in net income of \$1.3 million or \$0.16 per share for the quarter ended September 30, 2018, compared to \$6.2 million or \$0.78 per share in the prior year quarter.

All earnings per share amounts are on a diluted basis.

Liquidity and Capital Resources

Working capital (current assets less current liabilities) at September 30, 2018 was \$139.8 million compared to \$148.7 million at June 30, 2018. Primary changes in working capital include decreases in inventory of \$5.9 million and cash and cash equivalents of \$4.4 million, and increases in accounts receivable of \$2.3 million, accounts payable of \$2.3 million and investments of \$2.0 million.

For the quarter ended September 30, 2018, capital expenditures were \$10.4 million including \$8.1 million for the Company's new manufacturing facility and \$1.8 million invested to upgrade the business information system. During the quarter ended September 30, 2018, dividend payments increased to \$1.7 million from \$1.6 million during the prior year period.

The Company maintains a credit agreement which provides unsecured short-term working capital financing up to \$10.0 million with interest of LIBOR plus 1% (3.26% at September 30, 2018), including up to \$4.0 million of letters of credit. Letters of credit outstanding at September 30, 2018 totaled \$1.3 million, leaving borrowing availability of \$8.7 million. The credit agreement expires June 30, 2019.

The Company maintains an additional unsecured \$10.0 million line of credit, with interest at prime minus 2% (3.25% at September 30, 2018). No amount was outstanding on the line of credit at September 30, 2018. This line of credit matures December 31, 2018.

Net cash provided by operating activities of \$9.9 million for the quarter ended September 30, 2018 was comprised primarily of net income of \$1.3 million, depreciation of \$1.9 million, a decrease in inventory of \$5.9 million, and increases in accounts receivable of \$2.3 million and accounts payable of \$2.4 million. Net cash provided by operating activities for the quarter ended September 30, 2017 was \$1.5 million.

Net cash used in investing activities was \$12.4 million for the quarter ended September 30, 2018 compared to net cash provided by investing activities of \$5.1 million for the quarter ended September 30, 2017. Capital expenditures were \$10.4 million and \$5.1 million during the quarters ended September 30, 2018 and 2017, respectively. Proceeds from the sale of capital assets was \$6.2 million during the quarter ended September 30, 2017.

Net cash used in financing activities was \$1.9 million in the quarter ended September 30, 2018 primarily due to dividends paid of \$1.7 million. Net cash used in financing activities was \$2.0 million for the quarter ended September 30, 2017 primarily due to dividends paid of \$1.6 million.

Capital expenditures are estimated to be \$14 million for the remainder of fiscal 2019. Management believes that the Company has adequate cash and cash equivalents, investments, cash flows from operations and credit arrangements to meet its operating and capital requirements for fiscal year 2019. In the opinion of management, the Company's liquidity and credit resources provide it with the ability to react to opportunities as they arise, to pay quarterly dividends to its shareholders, and to purchase productive capital assets that enhance safety and improve operations.

Contractual Obligations

As of September 30, 2018, there have been no material changes to our contractual obligations presented in our Annual Report on Form 10-K for the year ended June 30, 2018.

Outlook

The Company expects sequential near-term revenue and earnings growth, subject to the impact of current and impending tariffs. The Company remains committed to its core strategies, which include providing a wide range of quality product offerings and price points to the residential and contract markets, combined with a conservative approach to business. We strive for an agile business model and supply chain to adapt to changing customer requirements in all the markets we serve with the expectations that the Company grows faster than the market. The Company will maintain its focus on a strong balance sheet through emphasis on cash flow and increasing profitability. The Company believes these core strategies are in the best interest of its shareholders.

The management team is focused on making progress in three key areas to improve business results. With the implementation of the new business information system in the fourth quarter, the Company experienced higher than expected disruption to customers which resulted in service level penalties and volume impacts. The management team made progress on stabilizing the system and expects to see improvement in service level during the remainder of fiscal 2019. However, given the disruption, especially in ecommerce products, the Company expects volume to recover at a slower rate over the coming quarters.

Labor in the first quarter improved in comparison to the fourth quarter results as the Company reduced excess labor capacity and annualized the government mandated labor wage increase in our Mexican facility. Labor efficiency and utilization continued to be a challenge in the quarter. The management team is identifying and implementing additional initiatives to further mitigate increased labor costs.

Last, import tariffs were implemented late in the first fiscal quarter. The Company participated in the October High Point Market and is anticipating potential for volume declines if the tariff is escalated to 25%. The Company has reduced acquisition costs and increased prices to mitigate but not eliminate the tariff impact. If new tariffs are levied, additional cost reductions and price increases would be required to mitigate negative impacts on the business. Current and future price increases may have an adverse impact on volume. Inability to reduce acquisition costs or pass through pricing to mitigate the tariffs poses significant risk to current and future earnings.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

Foreign Currency Risk – During the quarters ended September 30, 2018 and 2017, the Company did not have sales, but has purchases and other expenses denominated in foreign currencies. The market risk associated with currency exchange rates and prices is not considered significant.

Interest Rate Risk – The Company's primary market risk exposure with regard to financial instruments is changes in interest rates. At September 30, 2018, the Company did not have any debt outstanding.

Item 4. Controls and Procedures

(a) *Evaluation of disclosure controls and procedures.* Based on their evaluation as of the end of the period covered by this Quarterly Report on Form 10-Q, our interim president and chief financial officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) were effective as of September 30, 2018.

(b) *Changes in internal control over financial reporting.* During the quarter ended September 30, 2018, there were no significant changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934, as amended) that have materially affected, or are reasonably likely to materially affect the Company's internal control over financial reporting.

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

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

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

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

PART II OTHER INFORMATION

Item 1A. Risk Factors

Other than the item mentioned below, there has been no material change in the risk factors set forth under Part 1, Item 1A "Risk Factors" in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2018.

Effective September 24, 2018, the current U.S. administration imposed a 10% tariff on goods imported into the United States from China, including all furniture and furniture components manufactured in China, with the potential for the tariffs to increase to 25% on January 1, 2019. In fiscal 2018, approximately 44% of the Company's sales were imported from China. Inability to reduce acquisition costs or pass through price increases may have an adverse impact on sales volume, earnings and liquidity.

Item 5. Other Information

The Company filed a Current Report on Form 8-K on September 26, 2018 to disclose that Karel K. Czanderna, the Company's former President, Chief Executive Officer and Director, and the Company had entered into a Retirement Agreement and Release ("Agreement"). The Company and Ms. Czanderna have entered into an amendment to the Agreement dated October 25, 2018 clarifying that Ms. Czanderna will have three years from her September 9, 2018 retirement date to exercise her outstanding options.

The foregoing description of the Amendment to Retirement Agreement and Release is qualified in its entirety by reference to such amendment filed with this Form 10-Q as Exhibit 10.1.

Item 6. Exhibits

[10.1](#) [Amendment to Retirement Agreement and Release, dated October 25, 2018.](#)

[31.1](#) [Certification](#)

[31.2](#) [Certification](#)

[32](#) [Certification by Interim President and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.](#)

101.INS XBRL Instance Document

101.SCH XBRL Taxonomy Extension Schema Document

101.CAL XBRL Taxonomy Extension Calculation Linkbase Document

101.LAB XBRL Taxonomy Extension Labels Linkbase Document

101.DEF XBRL Taxonomy Extension Definition Linkbase Document

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

SIGNATURES

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

FLEXSTEEL INDUSTRIES, INC.

Date: October 30, 2018

By: /s/ Marcus D. Hamilton

Marcus D. Hamilton

Chief Financial Officer

(Principal Financial & Accounting Officer)

AMENDMENT TO RETIREMENT AGREEMENT AND RELEASE

This AMENDMENT TO RETIREMENT AGREEMENT AND RELEASE (“**Amendment**”) by and between Flexsteel Industries, Inc. (the “**Company**”) and Karel Czanderna (“**Executive**”) is effective as of the date set forth below.

RECITALS

A. Executive and the Company are parties to a Retirement Agreement and Release executed on September 21, 2018 (the “**Retirement Agreement**”). All capitalized terms used and not otherwise defined in this Amendment shall have the meanings assigned to them in the Retirement Agreement.

B. Executive and the Company desire to clarify through this Amendment certain issues related to options to purchase the Company’s stock that were granted to Executive by the Company before the Retirement Date.

AGREEMENT

In consideration of the above recitals, which are hereby incorporated, and the promises set forth in this Amendment, the parties agree as follows:

1. Amendment to Retirement Agreement. Executive and the Company agree to amend the Retirement Agreement to clarify that no provision of the Retirement Agreement waived Executive’s right to exercise any and all options to purchase shares of the Company’s stock that were granted to Executive by the Company, and that remain outstanding on the Retirement Date (such options, herein, the “**Options**”). Further, notwithstanding any other provision of the Retirement Agreement or any other agreement related to the Options, Executive and the Company agree that Executive shall have until the date that is three (3) years after the Retirement Date to exercise the Options, and that after the date that is three (3) years after the Retirement Date, Executive shall have no right to exercise the Options.

2. Retirement Agreement Not Otherwise Modified; Miscellaneous. This Amendment does not change or modify the Retirement Agreement or any other agreement between Executive and the Company except as set forth in Section 1 above. All other terms of the Retirement Agreement are unmodified and apply to this Amendment as well as the Retirement Agreement. No representations as to tax consequences of this Agreement have been made to Executive by the Company or any of its representatives. The Company has not made any representations or oral or written statements on which Executive has relied in executing this Amendment.

This Amendment is effective on the 25th day of October 2018.

/s/ Karel Czanderna

Karel Czanderna

Flexsteel Industries, Inc.

/s/ Eric Rangen

By Eric Rangen

Its Chair, Board of Directors

CERTIFICATION

I, Jeffrey T. Bertsch, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Flexsteel Industries, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) disclosed in this report any changes in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and
5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the Audit and Ethics Committee of the Registrant's Board of Directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Date: October 30, 2018

By: /s/ Jeffrey T. Bertsch
 Jeffrey T. Bertsch
 Interim President

CERTIFICATION

I, Marcus D. Hamilton, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Flexsteel Industries, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) disclosed in this report any changes in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and
5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the Audit and Ethics Committee of the Registrant's Board of Directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Date: October 30, 2018

By: /s/ Marcus D. Hamilton
 Marcus D. Hamilton
 Chief Financial Officer

CERTIFICATION BY
INTERIM PRESIDENT AND CHIEF FINANCIAL OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Flexsteel Industries, Inc. (the "Company") on Form 10-Q for the quarter ended September 30, 2018 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), we, Jeffrey T. Bertsch, Interim President, and Marcus D. Hamilton, Chief Financial Officer, of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and;
- (2) The information contained in the Report fairly presents, in all material respects, the consolidated financial condition and results of operations of the Company.

Date: October 30, 2018

By: /S/ Jeffrey T. Bertsch
Jeffrey T. Bertsch
Interim President

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