FLEXSTEEL INDUSTRIES INC
Form 10-Q
February 09, 2010

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

FORM 10-Q

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

For the quarterly period ended December 31, 2009

or

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

For the transition period from to

Commission file number **0-5151**

FLEXSTEEL INDUSTRIES, INC.

(Exact Name of Registrant as Specified in Its Charter)

Incorporated in State of Minnesota	42-0442319
(State or other Jurisdiction of Incorporation or Organization)	(I.R.S. Identification No.)

3400 JACKSON STREET
DUBUQUE, IOWA 52004-0877
(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 x. No o.

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 o. No o.

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

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

Common Stock - $1.00 Par Value	
Shares Outstanding as of December 31, 2009	6,611,693

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

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

	December 31, 2009 (UNAUDITED)	June 30, 2009
ASSETS		
CURRENT ASSETS:		
Cash	$ 12,875	$ 1,714
Trade receivables less allowance for doubtful accounts: December 31, 2009, $1,980; June 30, 2009, $1,760	32,963	31,282
Inventories	66,834	73,844
Deferred income taxes	4,340	3,960
Other	1,731	3,913
Total current assets	118,743	114,713
NON-CURRENT ASSETS:		
Property, plant and equipment, net	22,742	23,298
Deferred income taxes	2,555	2,145
Other	11,347	10,815
TOTAL	$ 155,387	$ 150,971
LIABILITIES AND SHAREHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable trade	$ 9,665	$ 9,745
Notes payable	5,000	10,000
Accrued liabilities:		
Payroll and related items	6,220	4,938
Insurance	6,599	6,519
Other	8,140	5,095
Total current liabilities	35,624	36,297
LONG-TERM LIABILITIES:		
Deferred compensation	4,930	4,991
Other	3,264	2,685
Total liabilities	43,818	43,973
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 December 31, 2009, 6,611,693 shares; outstanding June 30, 2009, 6,576,373 shares	6,612	6,576
Additional paid-in capital	5,005	4,370
Retained earnings	101,500	97,816
Accumulated other comprehensive loss	(1,548)	(1,764)
Total shareholders equity	111,569	106,998
TOTAL	$ 155,387	$ 150,971

See accompanying Notes to Consolidated Financial Statements (Unaudited).

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2009	2008	2009	2008
NET SALES	$ 83,524	$ 84,550	$ 159,465	$ 175,966
COST OF GOODS SOLD	(63,483)	(68,419)	(122,868)	(142,699)
GROSS MARGIN	20,041	16,131	36,597	33,267
SELLING, GENERAL AND ADMINISTRATIVE	(15,263)	(15,393)	(29,404)	(32,163)
FACILITY CONSOLIDATION AND OTHER CHARGES		(504)		(1,852)
OPERATING INCOME (LOSS)	4,778	234	7,193	(748)
OTHER INCOME (EXPENSE):				
Interest and other income	91	503	123	613
Interest expense	(95)	(271)	(233)	(558)
Total	(4)	232	(110)	55
INCOME (LOSS) BEFORE INCOME TAXES	4,774	466	7,083	(693)
(PROVISION FOR) BENEFIT FROM INCOME TAXES	(1,810)	(170)	(2,740)	240
NET INCOME (LOSS)	$ 2,964	$ 296	$ 4,343	$ (453)
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING:				
Basic	6,588	6,576	6,582	6,576
Diluted	6,627	6,652	6,621	6,576
EARNINGS (LOSS) PER SHARE OF COMMON STOCK:				
Basic	$ 0.45	$ 0.04	$ 0.66	$ (0.07)
Diluted	$ 0.45	$ 0.04	$ 0.66	$ (0.07)
DIVIDENDS DECLARED PER COMMON SHARE	$ 0.05	$ 0.13	$ 0.10	$ 0.26

See accompanying Notes to Consolidated Financial Statements (Unaudited).

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

	Six Months Ended December 31, 2009	Six Months Ended December 31, 2008
OPERATING ACTIVITIES:		
Net income (loss)	$ 4,343	$ (453)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation	1,545	1,986
Deferred income taxes	(922)	(241)
Stock-based compensation expense	431	114
Gain on disposition of capital assets	(6)	(186)
Gain on sale of investments		(462)
Impairment of long-lived assets		137
Changes in operating assets and liabilities:		
Trade receivables	(1,681)	6,027
Inventories	7,010	1,749
Other current assets	2,182	591
Other assets	4	11
Accounts payable trade	(151)	3,576
Accrued liabilities	4,405	(3,298)
Other long-term liabilities	683	27
Deferred compensation	(61)	(315)
Net cash provided by operating activities	17,782	9,263
INVESTING ACTIVITIES:		
Proceeds from sales of investments	245	1,220
Purchases of investments	(537)	(130)
Proceeds from sale of capital assets	11	554
Capital expenditures	(923)	(772)
Net cash (used in) provided by investing activities	(1,204)	872
FINANCING ACTIVITIES:		
Repayment of short-term borrowings, net	(5,000)	(3,217)
Repayment of long-term borrowings		(7,247)
Dividends paid	(658)	(1,710)
Proceeds from issuance of common stock	241	
Net cash used in financing activities	(5,417)	(12,174)
Increase (decrease) in cash	11,161	(2,039)
Cash at beginning of period	1,714	2,841
Cash at end of period	$ 12,875	$ 802

SUPPLEMENTAL CASH FLOW INFORMATION Cash paid during the period for:
(Amounts in thousands)

	Six Months Ended December 31, 2009	Six Months Ended December 31, 2008
Interest	$ 233	$ 568
Income taxes refunded, net	$ (1,290)	$ (62)

See accompanying Notes to Consolidated Financial Statements (Unaudited).

FLEXSTEEL INDUSTRIES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
FOR THE PERIOD ENDED DECEMBER 31, 2009

1. The consolidated financial statements included herein have been prepared by Flexsteel Industries, Inc. and Subsidiaries (the Company or Flexsteel), without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). The information furnished in the consolidated financial statements includes normal recurring adjustments and reflects all adjustments, which are, in the opinion of management, necessary for a fair presentation of such consolidated financial statements. Operating results for the three and six-month periods ended December 31, 2009 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2010. Certain information and footnote disclosures normally included in the consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to make the information presented not misleading. Except to the extent updated or described below, the significant accounting policies set forth in Note 1 to the consolidated financial statements in the Company s Annual Report on Form 10-K for the year ended June 30, 2009, appropriately represent, in all material respects, the current status of accounting policies and are incorporated by reference.

DESCRIPTION OF BUSINESS Flexsteel was incorporated in 1929 and is one of the oldest and largest manufacturers, importers and marketers of 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, hospitality, health care and motor vehicle applications. Featured as a basic component in most of the upholstered furniture is a unique steel drop-in seat spring from which our name Flexsteel is derived. The Company distributes its products throughout the United States through the Company s sales force and various independent representatives to furniture dealers, department stores, recreational vehicle manufacturers, catalogs, 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 one active wholly-owned subsidiary, DMI Furniture, Inc. (DMI), which is a Louisville, Kentucky-based, manufacturer, importer and marketer of residential and commercial office furniture with manufacturing and warehouses in Indiana and manufacturing sources in Asia. DMI s divisions are WYNWOOD, Homestyles and DMI Commercial Office Furniture.

FAIR VALUE New accounting guidance on fair value measurements for certain financial assets and liabilities requires that assets and liabilities carried at fair value be classified and disclosed in one of three categories: Level 1: Quoted market prices in active markets for identical assets or liabilities, Level 2: Observable market-based inputs or unobservable inputs that are corroborated by market data or Level 3: Unobservable inputs reflecting the reporting entity s own assumptions or external inputs from inactive markets. In valuing assets and liabilities, the Company is required to maximize the use of quoted market prices and minimize the use of unobservable inputs. The Company calculates the fair value of Level 1 and Level 2 instruments based on the exchange traded price of similar or identical instruments where available or based on other observable instruments. The Company has not changed its valuation techniques in measuring the fair value of any financial assets and liabilities during the period.

2. INVENTORIES

The Company values inventory at the lower of cost or market. Raw steel is valued on the last-in, first-out (LIFO) method. Other inventories are valued on the first-in, first-out (FIFO) method. Inventories valued on the LIFO method would have been approximately $2.0 million higher at December 31, 2009 and $2.2 million higher at June 30, 2009, if they had been valued on the FIFO method. At December 31, 2009 and June 30, 2009 the total value of LIFO inventory was $1.6 million and $1.8 million, respectively. A comparison of inventories is as follows (in thousands):

	December 31, 2009	June 30, 2009
Raw materials	$ 9,063	$ 9,832
Work in process and finished parts	5,049	5,124
Finished goods	52,722	58,888
Total	$ 66,834	$ 73,844

3. BORROWINGS AND CREDIT ARRANGEMENTS

The Company has lines of credit of $30.0 million with banks, with borrowings at differing rates based on the date and type of financing utilized.

The Company s credit facility agreements with its primary bank provide long-term borrowing availability of $10.0 million, which matures on September 30, 2011, and short-term borrowing availability of $15.0 million, which matures on June 30, 2010. The Company pledged accounts receivable and inventory as security under the credit facility agreements. The amount of credit available to the Company is based on eligible accounts receivable and inventory as defined in the agreements. At December 31, 2009, the Company had available collateral, as defined by the bank, of $51 million with borrowing availability of $25 million of which $5 million was outstanding.

The agreements provide short-term working capital financing up to $15.0 million with interest selected at the option of the Company at a Commercial Bank Floating Rate (CBFR) which is the prime rate subject to a floor calculation of adjusted one month LIBOR rate (3.25% at December 31, 2009) or LIBOR (0.23% at December 31, 2009) plus 2.25%. The Company had $5 million and $10 million outstanding at December 31, 2009 and June 30, 2009, respectively (see Note 11). The short-term portion also provides overnight credit when required for operations at prime. No amounts were outstanding at December 31, 2009 and June 30, 2009 related to overnight credit. As prescribed by GAAP, which is previously discussed in Note 1, the Company recognizes the fair value of the borrowings as a Level 2 valuation.

The long-term portion of the credit facility provides up to $10.0 million and expires September 30, 2011. No amount was outstanding at December 31, 2009 and June 30, 2009. Variable interest is set monthly at the option of the Company at a CBFR or LIBOR plus 3.0%. 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.

As of December 31, 2009, the Company has effectively fixed the interest rates at 4.9% on $5.0 million of its short-term debt through the use of interest rate swaps. Subsequent to the end of the quarter, the Company paid off its short-term debt of $5.0 million and terminated the interest rate swap for $0.2 million using available cash.

The credit agreement contains financial covenants. The primary covenant is an interest coverage ratio. The ratio is computed as net (loss) income plus amortization, depreciation, interest expense, income taxes and the aggregate of all expenses related to stock options (EBITDA) divided by interest expense, which will vary by quarter over the term of the agreement. At December 31, 2009, the Company was in compliance with all of the financial covenants contained in the credit agreement.

An officer of the Company is a director at a bank where the Company maintains an unsecured $5.0 million line of credit, cumulative letter of credit facilities and where its routine daily banking transactions are processed. In addition, the Rabbi Trust assets related to executive officer deferred compensation are administered by this bank s trust department. The Company is contingently liable to insurance carriers under its comprehensive general, product, and vehicle liability policies, as well as some workers compensation, and has provided letters of credit in the amount of $3.4 million. The Company receives no special services or pricing on the services performed by the bank due to the directorship of this officer. No amount was outstanding on the line of credit at prime minus 1.0% at December 31, 2009 and June 30, 2009.

4. DERIVATIVE INSTRUMENTS & 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 amount of the outstanding interest rate swap totaled $5.0 million with a fixed rate of 4.9% at December 31, 2009. 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 (loss) income. The cumulative fair value of the swaps was a liability of approximately $0.2 million and $0.3 million as of December 31, 2009 and June 30, 2009, respectively, and is reflected as other liabilities on the accompanying consolidated balance sheets. At each reporting period, the Company performs an assessment of hedge effectiveness by verifying and documenting whether the critical terms of the derivative instruments and the hedged items have changed during the period in review. 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. The Company does not hold these derivative instruments for trade and does not plan to sell the instruments. The Company recognizes the fair value of the swap liability as a Level 2 valuation. Subsequent to the end of the quarter, the Company terminated the interest rate swap for $0.2 million.

5. STOCK-BASED COMPENSATION

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

(1) 2007 Long-Term Management Incentive Compensation Plan The plan provides for shares of common stock and cash to be awarded to officers and key employees based on performance targets set by the Nominating and Compensation Committee of the Board of Directors (the Committee). The Committee selected consolidated operating results for organic net sales growth and fully-diluted earnings per share for the three-year performance periods beginning July 1, 2007 and ending on June 30, 2010, beginning July 1, 2008 and ending on June 30, 2011, and beginning July 1, 2009 and ending on June 30, 2012. The Committee has also specified that payouts, if any, for awards earned under the fiscal years 2008-2010, 2009-2011 and 2010-2012 performance periods will be 60% stock and 40% cash. Awards will be paid to participants as soon as practicable following the end of the performance periods, verification of results, and subject to the negative discretion of the Committee. As the payouts of these awards are subject to the negative discretion of the Committee the grant date is not established until the awards are paid. Accordingly, compensation cost is re-measured based on the award s estimated fair value at the end of each reporting period prior to the grant date to the extent service has been rendered in comparison to the total requisite service period. Further, the accrual of compensation cost is based on the probable outcomes of the performance conditions. The portion of the accrued award payable in stock is classified within equity and the portion of the accrued award payable in cash is classified within liabilities. As of December 31, 2009, the Company has accrued $0.3 million for estimated awards of stock and cash under the long-term incentive plan. No compensation costs were accrued at June 30, 2009.

The fair value of the equity portion of the award is estimated each period based on the market value of the Company s common shares reduced by the present value of expected dividends to be paid prior to the service period, discounted using a risk-free interest rate. In the period the grant date occurs, cumulative compensation cost will be adjusted to reflect the cumulative effect of measuring compensation cost based on the fair value at the grant date. Under the plan the aggregate number of shares and cash that could be awarded to key executives if the target and maximum performance goals are met are as follows (in thousands):

	At Target		At Maximum	
Performance Period	Stock	Cash	Stock	Cash
Fiscal Year 2008 2010	33	$ 227	53	$ 364
Fiscal Year 2009 2011	45	$ 304	71	$ 487
Fiscal Year 2010 2012	58	$ 397	93	$ 635

If the target performance goals would be achieved the total amount of stock compensation cost recognized over the requisite service periods would be $0.6 million (2008-2010), $0.8 million (2009-2011) and $1.0 million (2010-2012) based on the estimated fair values