

FLEXSTEEL INDUSTRIES INC
Form 10-Q
April 25, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2007

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.)

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P. O. BOX 877

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 ☒ No ☐

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 Exchange 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 Exchange Act).

Yes ☐ No ☒

Common Stock - \$1.00 Par Value

Shares Outstanding as of March 31, 2007

6,569,295

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

FLEXSTEEL INDUSTRIES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

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	March 31, 2007 (UNAUDITED)	June 30, 2006
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$2,281,832	\$1,985,768
Investments	975,656	817,618
Trade receivables less allowance for doubtful accounts:		
March 31, 2007, \$2,400,000;		
June 30, 2006, \$2,820,000	50,001,632	51,179,791
Inventories	75,148,334	84,769,972
Deferred income taxes	4,190,000	4,620,000
Other	1,956,876	2,014,121
Total current assets	134,554,330	145,387,270
NON-CURRENT ASSETS:		
Property, plant and equipment, net	30,259,434	24,158,041
Deferred income taxes	2,790,000	2,210,000
Other assets	11,928,218	11,570,393
TOTAL	\$179,531,982	\$183,325,704
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable trade	\$13,851,456	\$15,768,435
Notes payable	5,393,147	9,466,643
Accrued liabilities:		
Payroll and related items	8,038,197	7,720,173
Insurance	7,959,804	7,651,109
Other	8,275,417	7,793,645
Total current liabilities	43,518,021	48,400,005
LONG-TERM LIABILITIES:		
Long-term debt	21,463,751	21,846,386
Deferred compensation	5,337,760	5,207,176
Other liabilities	369,812	369,812
Total liabilities	70,689,344	75,823,379
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 March 31, 2007, 6,569,295 shares;		
outstanding June 30, 2006, 6,563,750 shares	6,569,295	6,563,750
Additional paid-in capital	4,002,138	3,670,152
Retained earnings	97,434,614	96,502,311
Accumulated other comprehensive income	836,591	766,112
Total shareholders' equity	108,842,638	107,502,325
TOTAL	\$179,531,982	\$183,325,704

See accompanying Notes to Consolidated Financial Statements (Unaudited).

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FLEXSTEEL INDUSTRIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	Three Months Ended		Nine Months Ended	
	March 31,		March 31,	
	2007	2006	2007	2006
NET SALES	\$ 104,071,451	\$ 110,345,280	\$ 311,110,666	\$ 314,081,702
COST OF GOODS SOLD	(83,593,396)	(88,979,296)	(252,453,428)	(253,869,453)
GROSS MARGIN	20,478,055	21,365,984	58,657,238	60,212,249
SELLING, GENERAL AND ADMINISTRATIVE	(18,277,812)	(18,223,706)	(52,885,603)	(54,320,932)
GAIN ON SALE OF LAND	392,685		392,685	
OPERATING INCOME	2,592,928	3,142,278	6,164,320	5,891,317
OTHER INCOME (EXPENSE):				
Interest and other income	128,356	247,120	459,363	554,055
Interest expense	(329,682)	(487,530)	(1,110,298)	(1,118,934)
Total	(201,326)	(240,410)	(650,935)	(564,879)
INCOME BEFORE INCOME TAXES	2,391,602	2,901,868	5,513,385	5,326,438
BENEFIT FROM (PROVISION FOR) INCOME TAXES	(870,000)	(1,140,000)	(2,020,000)	(2,090,000)
NET INCOME	\$ 1,521,602	\$ 1,761,868	\$ 3,493,385	\$ 3,236,438
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING:				
Basic	6,568,251	6,562,456	6,566,396	6,556,669
Diluted	6,586,488	6,583,230	6,578,661	6,576,487
EARNINGS PER SHARE OF COMMON STOCK:				
Basic	\$0.23	\$0.27	\$0.53	\$0.49
Diluted	\$0.23	\$0.27	\$0.53	\$0.49
DIVIDENDS DECLARED PER COMMON SHARE	\$0.13	\$0.13	\$0.39	\$0.39

See accompanying Notes to Consolidated Financial Statements (Unaudited).

FLEXSTEEL INDUSTRIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

Nine Months Ended
March 31,

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	2007	2006
OPERATING ACTIVITIES:		
Net income	\$3,493,385	\$3,236,438
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	3,989,813	4,099,889
Stock-based compensation expense	274,000	427,000
Gain on disposition of capital assets	(473,060)	(41,647)
Deferred income taxes	(194,670)	(470,000)
Changes in operating assets and liabilities:		
Trade receivables	1,178,159	(2,187,567)
Inventories	9,621,638	(16,841,089)
Other current assets	57,245	(570,859)
Other assets	(306,803)	(511,971)
Accounts payable trade	(1,916,979)	4,222,023
Accrued liabilities	1,107,064	2,037,849
Deferred compensation	130,584	109,798
Net cash provided by (used in) operating activities	16,960,376	(6,490,136)
INVESTING ACTIVITIES:		
Purchases of investments	(508,817)	(700,245)
Proceeds from sales of investments	356,266	1,331,355
Proceeds from sale of capital assets	637,466	75,286
Capital expenditures	(10,196,972)	(609,388)
Net cash (used in) provided by investing activities	(9,712,057)	97,008
FINANCING ACTIVITIES:		
(Repayment of) proceeds from short-term borrowings, net	(4,101,446)	897,493
Repayment of long-term borrowings	(354,686)	(132,126)
Proceeds from long-term borrowings		7,200,000
Dividends paid	(2,560,361)	(2,555,874)
Proceeds from issuance of common stock	64,238	78,101
Net cash (used in) provided by financing activities	(6,952,255)	5,487,594
Increase (decrease) in cash and cash equivalents	296,064	(905,534)
Cash and cash equivalents at beginning of period	1,985,768	1,706,584
Cash and cash equivalents at end of period	\$2,281,832	\$801,050

SUPPLEMENTAL CASH FLOW INFORMATION Cash paid during the period for:

	Nine Months Ended	
	March 31,	
	2007	2006
Interest	\$1,110,000	\$1,160,000
Income taxes	\$2,014,000	\$1,972,000

See accompanying Notes to Consolidated Financial Statements (Unaudited).

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

FOR THE PERIOD ENDED MARCH 31, 2007

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 nine-month period ended March 31, 2007 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2007. 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. It is suggested that these consolidated financial statements be read in conjunction with the consolidated financial statements for the year ended June 30, 2006, and the notes thereto, included in Flexsteel 's most recent Annual Report on Form 10-K as filed with the SEC.

DESCRIPTION OF BUSINESS Flexsteel 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), 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.

2. **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. Inventories valued on the LIFO method would have been approximately \$3.5 million and \$3.3 million higher at March 31, 2007 and June 30, 2006, respectively, if they had been valued on the FIFO method. At March 31, 2007 and June 30, 2006 the total value of LIFO inventory was \$3.1 million and \$3.8 million, respectively. A comparison of inventories is as follows (in millions):

	March 31, 2007	June 30, 2006
Raw materials	\$ 14.1	\$ 19.7
Work in process and finished parts	8.2	8.7
Finished goods	52.8	56.4
Total	\$ 75.1	\$ 84.8

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3. BORROWINGS AND CREDIT ARRANGEMENTS At March 31, 2007, outstanding borrowings consisted of the following (in millions):

Current:	
Current maturities of long-term debt	\$0.5
Overnight borrowing interest rate at prime minus 1%; unsecured	0.9
\$20.0 million working capital line of credit through June 29, 2007; interest rate at LIBOR +0.625%; unsecured	4.0
Long-Term:	
\$20.0 million revolving note; expires October 31, 2010; interest rate at LIBOR +0.75%; unsecured	20.0
\$2.6 million fixed rate note; requiring payments through March 2010; interest rate at 4.99%; secured by certain delivery equipment; net of current portion	1.5
Total	\$26.9

The Company has lines of credit of \$45.0 million with banks, with borrowings at differing rates based on the date and type of financing utilized.

The credit facilities provide for \$41.0 million in unsecured credit 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 with interest selected at the option of the Company at prime (8.25% at March 31, 2007) or LIBOR (5.32% at March 31, 2007) plus .625%. The short-term portion also provides overnight credit at prime rate less 1% when required for operations. At March 31, 2007, \$0.1 million was outstanding at prime rate less 1% (7.25%). The short-term line of credit expires June 29, 2007. The long-term portion of the credit facility provides up to \$20.0 million, of which \$20.0 million was outstanding at March 31, 2007, and expires October 31, 2010. Variable interest is set monthly at the option of the Company at prime or LIBOR plus 0.75%. The credit facility also provides \$1.0 million to support letters of credit issued by the Company, of which \$0.1 million was outstanding at March 31, 2007. 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%. On March 31, 2007, the Company had effectively fixed the interest rates at 4.1% on approximately \$10.8 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 March 31, 2007, the Company was in compliance with all financial covenants contained in the credit agreement. During fiscal 2007, the Company has begun the process of obtaining an extension or refinancing their working capital line of credit that expires June 29, 2007. The Company believes that it will be able to successfully refinance or extend the terms of the current agreement prior to its expiration date; however, there can be no assurance that the Company will be successful in these endeavors or that completion of such extension or refinancing will be on terms acceptable to the Company.

The Company financed the purchase of delivery equipment through a five-year fixed rate note at 4.99%. The note requires payments through March 2010. The balance outstanding at March 31, 2007 was approximately \$2.0 million. 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. This line of credit is at a rate of prime minus 1.0%, is unsecured and expires November 28, 2007. The Company receives no special services or pricing on the services performed by the bank due to the directorship of this officer. A total of \$0.8 million was outstanding on this line of credit at March 31, 2007.

4. **DERIVATIVE INSTRUMENTS & HEDGING ACTIVITIES** Related to its variable debt, the Company has interest rate swaps utilized to hedge against adverse changes in interest rates. The notional principal amounts of the outstanding interest rate swaps totaled \$10.8 million with a weighted average fixed rate of 4.1% at March 31, 2007. The interest rate swaps are not utilized to take speculative positions. The Board of Directors established the Company's policies with regard 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 \$0.1 million and \$0.4 million as of March 31, 2007 and June 30, 2006, respectively, and are reflected as other assets on the accompanying consolidated balance sheet. The fair value of the Company's interest rate swap agreements are based on values provided by the issuer. 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.
5. **ACCRUED WARRANTY COSTS** 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. The following table presents the changes in the Company's product warranty liability for the nine months ended March 31, 2007 and 2006 (in millions):

	2007	2006
Accrued warranty costs at June 30	\$1.1	\$1.2
Payments made for warranty and related costs	(2.4)	(3.0)
Accrual for product warranty	2.3	2.9
Accrued warranty costs at March 31	\$1.0	\$1.1

6. **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, granted or vested during the nine-months ended March 31, 2007 and 2006. As of March 31, 2007, there were 4,745 unvested shares outstanding with a weighted average grant date fair value of \$0.1 million, which will vest in the first quarter of fiscal 2008. Compensation cost related to these awards was not material during the three and nine month periods ended March 31, 2007 and is not expected to be material over the weighted average remaining life of 0.25 years. The Company expects forfeitures under this plan to be nominal. A total of 50 shares and no shares were forfeited in the nine months ended March 31, 2007 and 2006, respectively. At March 31, 2007, 69,407 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.

In December 2006 and 2005, the Company issued options for 135,000 and 159,500 common shares at exercise prices of \$12.63 and \$14.40 (the fair market value on the date of grant), respectively. 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 \$0.3 and \$0.4 million during the quarter ended December 31, 2006 and 2005, respectively. The Company also recorded reductions in its income tax expense of \$0.1 million

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related to the issuance of the options in both quarters ended December 31, 2006 and 2005. The assumptions used in determining the compensation expense and related income tax impacts are discussed below.