

Flexsteel Industries, Inc.

# Annual Report

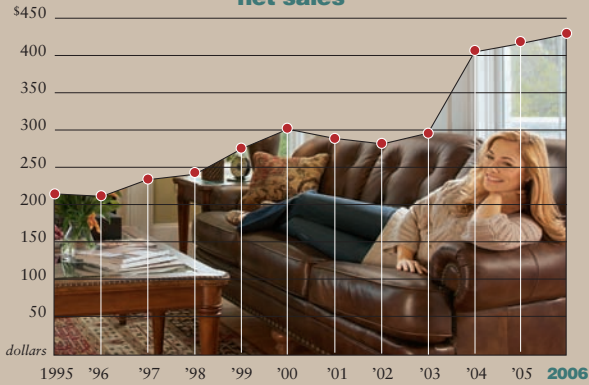
*fiscal year ended June 30, 2006*



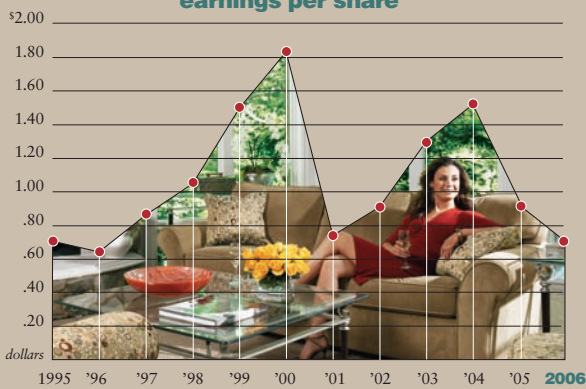
*excellence plus...*

# financial highlights

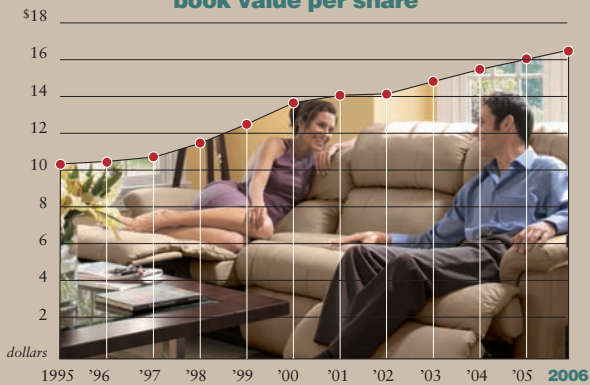
net sales



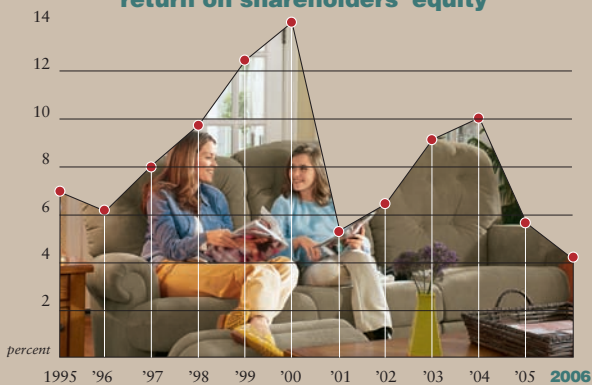
earnings per share



book value per share



return on shareholders' equity



**Flexsteel**<sup>®</sup>  
America's Seating Specialist

(Amounts in thousands, except per share data)

	For the years ended June 30,		
	2006	2005	2004
Net sales	<b>\$ 426,408</b>	\$ 410,023	\$ 401,222
Operating income	<b>8,561</b>	9,066	16,602
Income before income taxes	<b>7,778</b>	8,704	16,740
Net income	<b>4,718</b>	6,044	10,130
Average common shares outstanding:			
Basic	<b>6,558</b>	6,531	6,440
Diluted	<b>6,577</b>	6,601	6,530
Earnings per share:			
Basic	<b>\$ 0.72</b>	\$ 0.93	\$ 1.57
Diluted	<b>0.72</b>	0.92	1.55
Cash dividends per share	<b>\$ 0.52</b>	\$ 0.52	\$ 0.52
At June 30,			
Working capital	<b>\$ 96,987</b>	\$ 85,388	\$ 83,352
Property, plant & equipment (net)	<b>24,158</b>	26,141	30,327
Total assets	<b>183,326</b>	166,658	169,519
Long-term debt	<b>22,313</b>	12,800	17,583
Shareholders' equity	<b>107,502</b>	104,798	101,612



## To Our Shareholders:

Excellence *Plus*. The fiscal year just concluded saw strong, double-digit growth in our commercial office and hospitality furniture sales. Our demonstrated strength in these areas is an outgrowth of a record of excellence in product development, quality and value that goes back over a century.



*Ronald J. Klosterman*  
President and Chief Operating Officer



*K. Bruce Lauritsen*  
Vice Chairman and Chief Executive Officer



*L. Bruce Boylen*  
Chairman of the Board

Our residential furniture sales showed a net increase: a decrease in domestic production was more than offset by growth in foreign-sourced products.

We are still a leader in RV/marine seating sales, though our sales declined due to weakness in the wholesale market. We are confident that the demographics for these products remain favorable.

The domestic furniture market is undergoing far-reaching changes. The availability, the value, and the quality of imported furniture and furniture components present us with both challenge and opportunity. We are responding with a blended marketing strategy that combines the best of our domestically-manufactured products with matching quality in imports. Integral to that strategy is our ability to offer a much wider product selection through domestic production, using smaller, more frequent, and more varied product runs in our nine strategically-located

manufacturing facilities. Well-established relationships with key suppliers ensure prompt delivery of component parts from both domestic and offshore suppliers.

Those offshore suppliers must meet our standards of quality and value. With an experienced overseas staff of one-hundred-plus constantly monitoring the scheduling, production, and quality of those products being made for us, we are able to avoid the vagaries in the market that plague many companies.

This blended strategy means we can maintain the Flexsteel quality standards and offer a wider selection than ever of home furnishings, including the Wynwood lines of bedroom, dining room, and home office furniture and our fully-upholstered Latitudes leather furniture collection. Imports also include our beautiful occasional pieces, such as chairs framed in carved wood and a wide array of occasional tables that highlight both our upholstered

*Cover: The casual sophistication of the Wrangler Home Collection™ has wide appeal, as does the practicality of the handsome genuine leather upholstery of this Jamestown group.*

*Opposite, lower right: Handsome executive office furniture and a reputation for quality are just two reasons for the outstanding performance of our DMI Office Division.*

*Lower left: More Wrangler visual appeal: a slate-topped chest with a shaped front and antique crackle finish.*

*Lower right: This Knob Creek bedroom group is typical of the “must-have” styling and visible quality of Wynwood bedroom and dining room furniture.*





and Wynwood furniture. Other important offshore sources include cut-and-sew operations that prepare leather and fabric covers for our upholstered furniture.

Domestic production is essential for supporting our custom-order business, which remains an important strategy. Certain commercial seating items and RV/marine seating are also most effectively produced domestically. In all these areas, an increasing number of component parts can often be more economical to import. This is especially true of wood trim and leather and fabric upholstery for our domestically-produced furniture.

For proper balance of domestic and overseas production, we are optimizing our production facilities. By making the most cost-effective use of our nation-wide factory network, we reduce both direct costs and overhead. We've consolidated manufacturing square footage to more efficiently meet production demands, utilizing the space thus made available for warehousing and distribution of finished products.

We continue to develop and explore potential new marketing methods and profitable market niches. One with

considerable promise is the RV/marine aftermarket: owners updating the interiors of their boats and motor homes, the latter frequently becoming second homes. The experience we have gained in manufacturing to critical tolerances for the RV industry carries over into our seating for the marine market.

DMI Office, which turned in a stellar performance this fiscal year, designs, manufactures, and markets executive office furniture. Our newest styles were a hit at the recent Neocon trade show in Chicago. Sales trends are excellent, and we are working to strengthen existing distribution channels and open new ones.

Home Styles is a specialty division created to sell to non-traditional furniture markets, such as Big Box stores and Internet retailers. The Wynwood and Flexsteel names combine to offer whole-house furnishings—from home theaters and great rooms to bedrooms, formal dining and living rooms.

Of course, we continue to take full advantage of technological improvements, with cutting-edge cutting machines. Our commercial seating division now has over two hundred designs in its computerized

three-dimensional library. These customizable designs reduce lead-time and costs; they also give the client a much-appreciated, accurate 3-D image of the piece of furniture being offered.

### **Excellence Plus in Taste & Style...**

Imports and changing demographics are working hand-in-hand to give a new complexion to the market. While consumers still value the quality that is a Flexsteel hallmark, they also value freshness, diversity, and life-style expressions.

And we give it to them. Flexsteel grows more beautiful every year. Some of our most outstanding style introductions this year are imported, particularly in leather, which remains enormously popular. To our successful Latitudes leather sofa collection, we have added the Destination chair collection. Both are eminently affordable, include the Flexsteel seat spring and, thanks to our capable overseas staff, beautifully detailed.

But taste is highly subjective, and astute guesses are not enough. Market research has shown us that in the matter

Opposite main: *As befitting a world-class motor yacht, the interior appointments of the Marquis 65 are meant to invite and impress. Here, the artistry of the craftsman's touch becomes most evident. Premium materials and fabrics combine with hand-crafting skills and soothing dimensions to create an environment that appeals equally to your physical and aesthetic senses. Photography courtesy Carver Industries, LLC*

Opposite below left: *Flexsteel comfort on the road: our handsome sofa-sleepers are features in today's finest motor homes, such as the Fleetwood American Eagle. We also provide swivel lounge chairs and bucket seats. Photography courtesy Fleetwood Enterprises, Inc.*

Opposite below right: *Chamberlain is an outstanding group with beautiful crossover styling. The sofa and chairs, shown in a fabric from our Coastal Retreat collection, are accented with basket-weave rattan. A complete selection of matching tables, bookcases, and entertainment furniture.*

Below left: *A striking choice from our Lodge Retreat Collection of over 50 fabrics enhances the upscale styling and generous proportions of this sofa. Handsomely accented by a Destinations leather chair and ottoman.*

Below right: *Beautifully carved wood frames are produced overseas, but custom upholstered in America in any of our hundreds of beautiful fabrics.*





of upholstery fabrics, or covers, there are significant differences in preferences from one area of the country to another. Now we offer our dealers fabric selections customized for their areas.

The Lodge Collection of fabrics appeals to the Southwest with a selection of earth tones and rustic looks, while the Coastal Collection, with looks popular on the Atlantic Coast and the Southeast, includes more pastels and delicate looks. These two collections have been so successfully received that we plan to introduce a third collection at the Fall Market.

While we continue to offer the traditional handle-operated recliner, we also offer high-leg designs whose classic lines make them suitable as suite chairs in leather or fabric. In all our reclining furniture, softness, comfort and styling are important buying considerations. Probably nothing tells this story more than the look on customers' faces when they sink into the comfort we provide. Though it is produced domestically, cut-and-sew fabric or leather upholstery help make our reclining furniture price-competitive.

There are many ways to furnish the whole home with Flexsteel. For example, the Wrangler Home Collection continues

to earn a leading place in our repertoire, with popular looks for the living room, bedroom, and dining rooms, including appropriate accessories. The Wynwood line of beautiful wood furniture offers top quality in traditional dining and bedroom furniture. For the richly-appointed commercial office to the small or home office, DMI Office creates handsome desks, wall units, bookcases, credenzas, and file storage.

In seating for recreational vehicles and in boats, consumers still prefer rounded forms, simple lines, increased functionality, and fine detailing. Flexsteel, long the standard in motor home seating, is a growing success story in the marine market for stylish seating both above and below deck.

Senior and assisted-living facilities value a residential look, and Flexsteel expertise allows us to produce chairs with home-like styling that withstand heavy use.

Second homes are often downsized retirement homes, and scale becomes important. Our line always includes pieces with the appropriate proportions.

### ...and in Marketing

As the want-it-now syndrome still rules in the shopping of many boomer-echoers and Gen-Xer's, the successful marketer

will have his product where the consumer is—whether that is on the Internet, in a Big Box store, wholesale clubs, at a gallery, in a mail-order catalog, or at an independent dealer. All of these are Flexsteel opportunities. The marketer will also differentiate his product from that of the competitor, providing quality, choice and availability.

We constantly work with our dealer Galleries to help them stand out, providing design, layout and lighting consulting, up-to-the-minute fabrics, and numerous sales aids including customizable advertising. These galleries are highly successful, providing a wealth of design possibilities in custom orders, a key component of our residential furniture business. We are also introducing the gallery concept to the office furniture dealers carrying DMI Office furniture.

For the retailer who wants to add greater depth of choice in bedroom and dining room furniture at selected price points, Wynwood has developed a package concept which allows the retailer to “mix and match” popular styles at container prices.

The Home Styles Division meets a special market niche. It offers such casual, practical ready-to-assemble furniture as kitchen carts and armoires, in such

Opposite: An important demand in the growing markets for hospitality and health care seating is the creation of a welcoming environment. This dining room at one of the newest Angelus Retirement Communities is a splendid example of beauty and practicality, accomplished with Flexsteel chairs.

Below left: Petrona, a trend-setting Wynwood dining room collection, was inspired by the world's tallest buildings, the twin towers at Kuala Lumpur in Malaysia.

Below right: Our Home Styles Create-A-Cart program, offering a variety of finishes, sizes, and tops in kitchen carts, is selling well both on the Internet and through major retailers.



non-traditional channels as nationwide chains, catalogs and the Internet. Non-traditional avenues also offer sales opportunities for our recliners.

Both Flexsteel and Wynwood enjoy excellent name recognition making them easier to place in stores. We recognize that our offerings must also keep pace with the emerging young, well-educated and affluent consumer. Our designer/consumer focus groups help us to define their needs.

We continue to develop numerous cross-marketing possibilities by blending the previously-established markets of Flexsteel and DMI Furniture.

An eco-friendly trend in the furniture industry has an extremely promising future. Foam cushioning made from organic materials, now being evaluated, could reduce the use of petrochemicals. Already we are using exotic woods cut from tree farms, rather than from old forests.

### **Excellence Plus in Outlook**

As we look out over the world today, it is clear that we can expect cost increases in every raw material category, along with higher transportation and factory energy expenses, meaning continued pressure on our profits. Nevertheless, our history, our

market research, and our strong financial condition combine to give us excellent cause for optimism.

The macroeconomics for hospitality seating are excellent: the industry pipeline is robust for the foreseeable future and we have excellent relationships with most major hotel/motel chains. Our DMI executive office furniture is expected to continue its excellent performance.

Demographics also favor us in the recreational vehicle market, where Flexsteel is synonymous with safe, reliable seating. Though sales of large motor homes have been sluggish, retiring boomers remain excellent candidates for them, while many of the younger generations are discovering the pleasures of RV living in towable trailers and fifth wheels. The RV aftermarket is also thriving, as many older vehicles are being refurbished.

And, of course, the aging boomers are a huge market. They know Flexsteel and, as they retire, they are buying furniture for second homes, or new downsized homes, while some are beginning to move into newly-built senior living facilities where they often find the comfort of home in Flexsteel furniture.

Though consumer confidence may remain fragile in uncertain times, in all branches of our business we continue to offer assurance to the consumer with quality, style, availability and functionality, backed by the finest warranties in the industry.

We are also blessed with strong dealer networks, a cadre of experienced and dedicated associates including a seasoned management team, and the resources of quality vendors. With their help, Flexsteel looks forward to a future of excellence—*plus*.

Ronald J. Klosterman  
*President and Chief Operating Officer*

K. Bruce Lauritsen  
*Vice Chairman and Chief Executive Officer*

L. Bruce Boylen  
*Chairman of the Board*

Below left: *Brisbane*, one of our high-leg recliners offers graceful, living-room styling with all the comfort of a traditional recliner.

Below right: *At the Spring Market*, we introduced nine superbly tailored *Destinations* leather chairs with matching ottomans. An instant hit, these chairs feature a unique finishing technique: dyes are hand-applied after the furniture is tailored, adding depth and incomparable character to the leather.





## Locations

Flexsteel Industries, Inc.\*  
**Dubuque, Iowa 52001**  
(563) 556-7730  
J. E. Gilbertson, General Manager

Flexsteel Industries, Inc.  
**Dublin, Georgia 31040**  
(478) 272-6911  
M.C. Dixon, General Manager

Flexsteel Industries, Inc.  
**Lancaster, Pennsylvania 17604**  
(717) 392-4161  
R. C. Adams, General Manager

\* Executive Offices

Flexsteel Industries, Inc.  
**Riverside, California 92504**  
(951) 354-2440  
D.J. Bashor, General Manager

Flexsteel Industries, Inc.  
**New Paris, Indiana 46553**  
(574) 831-4050  
G. A. Ummel, General Manager

Flexsteel Industries, Inc.  
**Harrison, Arkansas 72601**  
(870) 743-1101  
M.J. Feldman, General Manager

Flexsteel Industries, Inc.  
**Commercial Seating Division**  
**Starkville, Mississippi 39760**  
(662) 323-5481  
R. W. McLeod, Director of Operations

Vancouver Distribution Center  
**Vancouver, Washington 98668**  
(206) 696-9955  
D.J. Bashor, General Manager

DMI Furniture, Inc.  
**Louisville, Kentucky 40059**  
(502) 426-4351  
D. D. Dreher, President & C.E.O.

## Directors & Officers

**L. Bruce Boylen**  
Chairman of the Board of Directors  
Retired Vice President  
Fleetwood Enterprises, Inc.

**K. Bruce Lauritsen**  
Vice Chairman of the Board of Directors  
Chief Executive Officer

**Ronald J. Klosterman**  
President & Chief Operating Officer  
Director

**Jeffrey T. Bertsch**  
Senior Vice President, Corporate Services  
Director

**Mary C. Bottie**  
Director  
Retired Vice President  
Marketing and Operations  
Motorola, Inc.

**Patrick M. Crahan**  
Senior Vice President, Commercial Seating  
Director

**Lynn J. Davis**  
Director  
President and Chief Operating Officer  
August Technology

**Robert E. Deignan**  
Director  
Attorney at Law  
Baker & McKenzie LLP

**Thomas E. Holloran**  
Director  
Professor Emeritus  
College of Business  
Senior Distinguished Fellow  
School of Law  
University of St. Thomas  
St. Paul, Minnesota

**Eric S. Rangen**  
Director  
Consultant

**James R. Richardson**  
Senior Vice President, Sales and Marketing  
Director

**Carolyn T. B. Bleile**  
Vice President, Merchandising

**Thomas D. Burkart**  
Senior Vice President, Vehicle Seating

**Kevin F. Crahan**  
Vice President, Commercial Seating Sales

**Donald D. Dreher**  
Senior Vice President  
President & CEO, DMI Furniture, Inc.

**Lee D. Fautsch**  
Vice President, Residential Sales

**James E. Gilbertson**  
Vice President, Vehicle Seating

**Timothy E. Hall**  
Vice President—Finance  
Chief Financial Officer  
Secretary

**Michael A. Santillo**  
Vice President, Vehicle Seating Marketing

## Audit and Ethics Committee

Thomas E. Holloran, Chairman  
Mary C. Bottie  
Lynn J. Davis  
Robert E. Deignan  
Eric S. Rangen

## Nominating and Compensation Committee

Robert E. Deignan, Chairman  
Lynn J. Davis  
Thomas E. Holloran

## Transfer Agent and Registrar

Wells Fargo Shareowner Services  
P. O. Box 64854  
South St. Paul, Minnesota 55164-0854

## General Counsels

Irving C. MacDonald  
Minneapolis, Minnesota  
O'Connor and Thomas, P.C.  
Dubuque, Iowa  
Gray, Plant, Mooty, Mooty & Bennett, P.A.  
Minneapolis, Minnesota

## NASDAQ Global Market NASDAQ Symbol—FLXS

## Annual Meeting

December 11, 2006, 2:00 p.m.  
Hilton Minneapolis  
1001 Marquette Avenue  
Minneapolis, Minnesota 55403

## Permanent Showrooms

High Point, North Carolina  
Las Vegas, Nevada

## Internet

[www.flexsteel.com](http://www.flexsteel.com)  
[www.flexsteelcommercialfurniture.com](http://www.flexsteelcommercialfurniture.com)  
[www.dmfurniture.com](http://www.dmfurniture.com)

## AFFIRMATIVE ACTION POLICY

It is the policy of Flexsteel Industries, Inc. that all employees and potential employees shall be judged on the basis of qualifications and ability, without regard to age, sex, race, creed, color or national origin in all personnel actions. No employee or applicant for employment shall receive discriminatory treatment because of physical or mental disability in regard to any position for which the employee or applicant for employment is qualified. Employment opportunities, and job advancement opportunities will be provided for qualified disabled veterans and veterans of the Vietnam era. This policy is consistent with the Company's plan for "Affirmative Action" in implementing the intent and provisions of the various laws relating to employment and non-discrimination.

## ANNUAL REPORT ON FORM 10-K AVAILABLE

A copy of the Company's annual report on Form 10-K, as filed with the Securities and Exchange Commission, can be obtained without charge by writing to:

Office of the Secretary  
Flexsteel Industries, Inc.  
P. O. Box 877  
Dubuque, Iowa 52004-0877

Public spaces, such as this lobby of the Hilton Garden Inn in Dubuque, Iowa, demand aesthetically pleasing seating that will stand up to constant use. Our Commercial Seating Division provided these handsome exposed-wood chairs and fully upholstered sofas.



 ***Flexsteel***<sup>®</sup>  
America's Seating Specialist

P.O. Box 877 • Dubuque IA 52004-0877

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