



# building on tradition



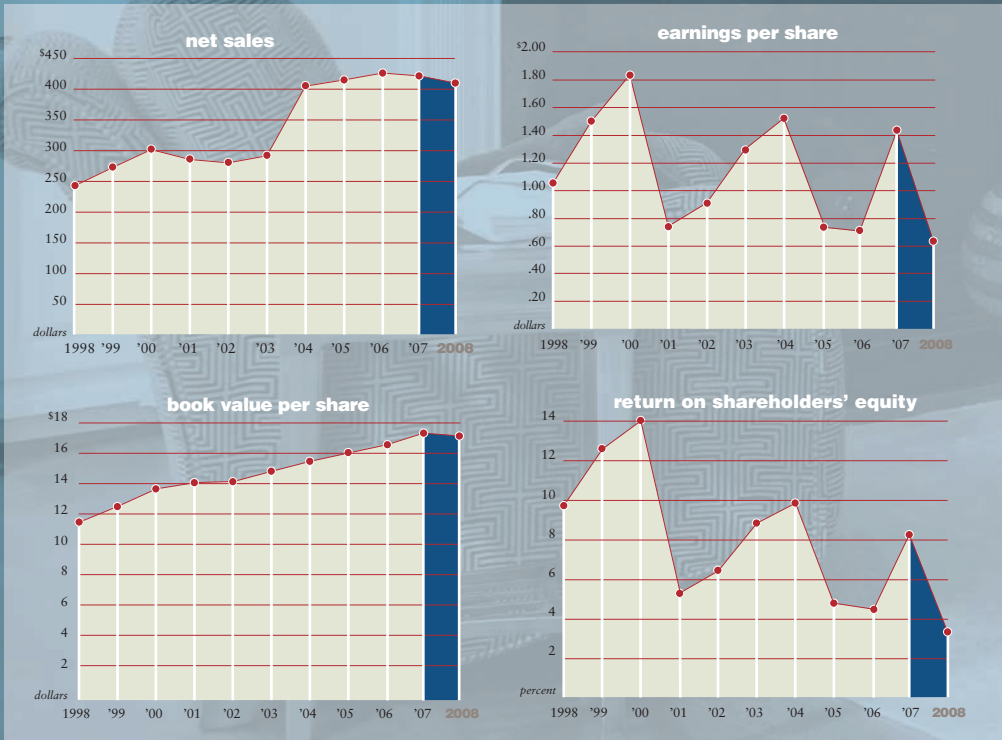
Flexsteel Industries, Inc.

Annual Report

fiscal year ended June 30, 2008

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

# Financial Highlights



(Amounts in thousands, except per share data)

	For the years ended June 30,		
	2008	2007	2006
Net sales	\$ 405,655	\$ 425,400	\$ 426,408
Operating income	7,596	14,699	8,561
Income before income taxes	6,596	14,484	7,778
Net income	4,236	9,334	4,718
Average common shares outstanding:			
Basic	6,574	6,568	6,558
Diluted	6,611	6,583	6,577
Earnings per share:			
Basic	\$ 0.64	\$ 1.42	\$ 0.72
Diluted	0.64	1.42	0.72
Cash dividends per share	\$ 0.52	\$ 0.52	\$ 0.52
At June 30,			
Working capital	\$ 100,920	\$ 97,902	\$ 95,551
Property, plant & equipment (net)	26,372	28,168	24,158
Total assets	179,906	185,014	184,176
Long-term debt	20,811	21,336	21,846
Shareholders' equity	112,752	112,678	106,066



Cover: Building on our tradition of excellence, Flexsteel is diversified into a wide range of seating products, specialized for the residential, commercial hospitality and recreational vehicle seating markets.

Ronald J. Klosterman  
President and Chief Executive Officer

L. Bruce Boylen  
Chairman of the Board



# beautiful homes



*Flexsteel's Latitudes Collection of fine seating and DMI's Wynwood brand of dining and bedroom furniture are globally sourced to provide high-quality craftsmanship and exceptional value.*

## carved detail

*Charisma accent chairs, and many other wood products benefit from our global sourcing capabilities. Expert carving and beautiful finishes create the heirloom-quality and fashion-forward furniture that will capture future consumer interest.*



### To Our Shareholders:

In the midst of some of the worst economic and financial news in decades, Flexsteel remains confident.

During our 115-year history, we've lived through many economic downturns, from mild recessions to outright panics. In that time we've grown from a regional company into a national maker and marketer of fine furniture products serving many markets.

Over those 115 years we have developed abiding traditions and a corporate culture of success. You will see in this report how we protect your investment by responding to this challenging market with our traditional vitality, quality, flexibility, innovation, responsibility, and stability.

Fiscal year 2008 began with slowing general economic conditions that deteriorated as the year progressed. We have weathered declines in the housing market, the mortgage crisis, double-digit stock market valuation decreases, \$4.00 per gallon gasoline and \$5.00 per gallon diesel fuel. Consumer confidence hit its lowest level since 1981.

In spite of this economic scenario, our net revenue during the first two quarters was flat with the prior year, while our net income increased to \$3.1 million from \$2.0 million in the year earlier period. During the last six months, both our revenue and net income were negatively impacted by the economic factors noted above along with significant cost increases for materials, especially components with steel or petrochemical content. For the full fiscal year, net sales were \$406 million, down from \$425 million in the prior year. Residential net sales were \$258 million compared to \$260 million last year. Commercial net sales were \$92 million, a decrease of 8% from the prior year. Vehicle Seating net sales declined 15% to \$56 million in FY2008. Net income for the fiscal year ended June 30, 2008 was \$4.2 million or \$0.64 per share compared to \$9.3 million or \$1.42 per share in the prior fiscal year. Results for the prior fiscal year include three non-recurring items which resulted in gains of approximately \$3.2 million, or \$0.49 per share after tax. Excluding these three items, net income for the year ended June 30, 2007 was \$6.1 million or \$0.93 per share.



excellence in

Photography used by permission of Carver Yacht



marine

Whether you drive on land, water, or both Flexsteel vehicle seating will enhance your comfort, as shown in Carver Yacht's 56 Voyager SE.



Photography used by permission of Polaris Industries

Photography used by permission of Global Electric Motorcars



new markets

Emerging vehicle seating markets present new opportunities for Flexsteel. We designed dependable, safe seating for the GEM® (Global Electric Motorcars), a Neighborhood Electric Vehicle (NEV) marketed by a Chrysler company and rugged sports vehicles for Polaris. For those with limited mobility, cars seats that turn out are offered by Bruno Independent Living Aids.

Photography used by permission of Bruno Independent Living Aids



The new fiscal year is beginning with a carryover of the difficult economic conditions that faced us at the end of fiscal year 2008. While we expect that these conditions will likely persist for much or all of FY2009, we remain confident in our strategies. During this coming year we will focus on cost control and work to maintain and increase share in each of our markets. This strategy, along with our strong financial position, will allow us to experience growth and success when the economy improves.

### Traditional Vitality

A visitor to the International Home Furnishings Market at High Point, N.C., asked what he liked best at the spring market and singled out our Flexsteel Gallery program. He called it "exciting," adding, "they (Flexsteel) are doing what they do best."

It was exciting. We project a vivacious lifestyle image through inspired gallery collections and sleek national advertising. Some of our newest designs reflect uptown urban chic, while in all our divisions we are seeing a

national trend toward transitional styling. Both in residential and office furniture, the trend is toward cleaner lines and softer silhouettes. In bedroom and dining room furniture, darker wood finishes are now preferred over lighter finishes. Transitional designs are clearly a favorite, but we have something for everyone, offering silhouettes appropriate for a large suburban home, an urban loft, a western lodge, or a simple coastal cottage. In marine, automotive, or motor home seating, we can offer the sophisticated high-end styling that spells luxury.

The Latitudes® collection of home seating continues to be an outstanding success. Mostly leather and highly popular, it is made in Asia with all of our traditional quality, including the Flexsteel seat spring. An even newer collection is the South Haven sofa line, an entry-level line with defined sofas and fabrics. Attractively designed and priced, it has drawn much support from Flexsteel Gallery dealers and dominant regional retailers. These collections are popular with retailers because they offer the consumer traditional Flexsteel quality at a competitive price.



# vehicle seating

motor home, travel trailer & fifth wheel



Take your ATV or motorcycles with you. The Jayco Seneca ZX Toy Hauler has luxurious full-featured motor home comfort and a 90 by 96 inch power lift tailgate.



The standard of comfort and safety in motor coach seating is Flexsteel, a feature of the American Allegiance, Fleetwood Enterprises' first new product in its American Coach line in a decade.

Flexsteel vehicle seating products successfully combine furniture fashion with weight, safety and storage requirements.



Many consumers describe their style preferences as *eclectic*; these smart buyers choose to put their own stamp on their homes. Many of them shop on-line to find the perfect selection or roomful of furniture, using the Sneak Preview program on the web. They can preview frame and fabric selections on our Web site, and then be referred to the nearest dealer where they can finalize their custom-selected furniture for their home.

## Traditional Quality

Over the years we have continued to improve the blue steel seat spring that made our upholstered furniture famous for its durability in the home seating market. It is guaranteed for life, as are many other components, providing comfortable assurance for the furniture buyer. Our retailers know how to show their customers the details that are typical Flexsteel quality. More and more consumers now know the Flexsteel name, and believe it's worth spending a few extra dollars to get this demonstrable quality in their homes.

We're also known to the RVing public. In their advertising materials, the makers of motor homes highlight the name

Flexsteel on their captain's chairs. They have found that their buyers recognize the name as promising quality, safety, and comfort.

## Traditional Flexibility

Because consumer tastes in design typically change over a period of time, designers, manufacturers and retailers usually have time to tailor their responses. On the other hand, as the current conditions illustrate, the economy can sometimes change with dramatic suddenness requiring the fast response that only a versatile team, with solid financial backing, can do. The current housing crisis and the credit crunch pose real problems for some retailers, made worse by declining consumer confidence. Our long experience in serving retailers means we understand their economics and needs. We can often ease their cash-flow problems through our ability to time our production and shipments to fit their inventory requirements.

Another competitive advantage derived from our unique history is our crossover capability. Years of making our seat spring gave us metal-working experience that,



# commercial hospitality

*The luxurious Jumeirah Essex House, overlooking Central Park in New York City, selected Flexsteel Hospitality sofas, chairs, sleepers and task chairs for its \$90 million refurbishing project.*

## custom built



*Photography used by permission of Jumeirah Essex House*

## senior living

*As America ages, Flexsteel Senior Living products combine the look and feel of home with the durability and safety requirements of Assisted Living and other institutional care facilities.*



combined with our furniture experience, led us into the recreational vehicle seating market, which in turn has led to making marine seating. Our engineering and design experience give us a competitive advantage also in the commercial or contract seating business, which has developed into a strong part of our business.

By being flexible in marketing, we have developed our current blended strategy, which means we buy overseas when we can achieve Flexsteel quality there. Production quality is assured through the oversight of knowledgeable associates, while technology allows real-time control.

### Traditional Innovation

Maintaining our traditions means keeping up with the times, which means taking full advantage of technology. Technology lets us stay in touch with our customers: this past year, more than 50,000 orders came in electronically. We keep tabs by video on our overseas production, so we can address, in real time, problems that may arise thousands of miles away. Technology also smoothes the shipments from abroad by keeping track of containers, port arrival,

and transport status as well as handling brokerage invoices and customs. This system is of tremendous help in bringing in finished goods and those materials we import, such as wooden legs and other parts, and frames for our extensive line of exposed-wood chairs. This year, as a corporation, we have imported 8,000 containers of finished goods and 75 containers of materials. Our information systems staff of programmers and support specialists keeps the corporate network humming.

We are innovative, too, in our approaches to markets. People are not buying recreational vehicles and that seating market has plunged. However, several years ago our Recreational Vehicle Seating division began making strides in the marine market for both above- and below-deck seating for recreational watercraft. We have developed for these markets a longer sleep sofa and a new, all-in-one U-shaped multi-purpose lounge for eating and sleeping. We are also exploring possibilities in ATVs, buses, vans, electric cars, and after-market products for all these segments.

# furniture



Photography used by permission of Ken Smith / Design Photography

## office & reception

*Our depth in commercial furniture is illustrated in the seating for this children's entertainment center in the American Bank & Trust, Dubuque, Iowa, and in DMI executive office furniture.*



## restaurant & lounge

*Restaurant and lounge seating is an important component of the commercial hospitality package. Expertise in finishing wood complements our tradition of fine upholstery craftsmanship.*



The DMI division has introduced media chests for flat-panel TVs. Every Wynwood bedroom collection now features such a chest, which is replacing the once-popular bedroom armoire. Our DMI office furniture now includes office groups, flat-packed for ease in shipping, that can be easily and quickly assembled by the dealer or end user. The Home Styles group will add, to its line of KD home office and entertainment line, a Cabana Banana line of woven banana-leaf chairs and sofas that can be shipped via UPS.

The Commercial Seating division, serving the hospitality markets and commercial interior designers, offers an advanced Quick Ship program that lets the designer see her fabric selections on Flexsteel frames. We also have software that can not only give the buyer a complete, three-dimensional view of the product, but also allow real-time changes electronically. This is a competitive advantage, one that can speed the approval process of custom-built hospitality items.

### Traditional Responsibility

Recognizing that natural resources are not infinite, Flexsteel's corporate philosophy emphasizes sustainability. Already,

we recycle our foam and cardboard from production. We use low-VOC finishes on our furniture. Low-VOC (volatile organic compounds) provide easy cleanup, reduce allergenic toxins and, especially important for our planet, reduce contaminant concentrations in landfill, groundwater, and the ozone layer.

Our metalworking plant in Dubuque has invested in a new degreasing/phosphatizing system, which gives us the same quality painted steel for our springs and frames in a cleaner environment.

We recently started an effort towards attaining American Home Furnishings Association's *Enhancing Furniture's Environmental Culture* (EFEC) and *Sustainable by Design* (SBD) standards. A company-wide initiative, it will gain us recognition for our efforts in sustainability practices. These programs, created by the AHFA, will certify our commitment to be environmentally and socially responsible. As we go forward, we will continue to examine, explore and invest into becoming a more environmentally conscious organization.



executive office



home entertainment

*Completing our furnishings for the home is the extensive line of DMI. It includes beautifully finished dining and bedroom furniture, notably the handsome new entertainment centers designed for LCD and plasma screens. DMI also designs and sells fine furniture for home and commercial offices.*

## Traditional Stability

One of Flexsteel's greatest assets continues to be our strong financial condition, one that has helped us weather many economic storms over the past century. Our financial strength and reliability are greatly reassuring both to our independent retailers and to the major chains who have had problems with weaker companies, whose ability to meet their commitments may be unpredictable.

We have the resources to develop and market new products to meet the demands of the markets we serve. We will be well positioned and prepared for the changes that will take place as the economy recovers.

## Building on Tradition

Due to current economic conditions and consumer confidence levels, we are faced with many challenges during the remaining calendar year. The recreational vehicle market has changed substantially and perhaps permanently, but we are expanding our presence into more areas.

The residential furniture market is off markedly overall, but we continue to enjoy substantial sales by tailoring our offerings

to the market's needs. The close, long-term relationships we have built with many of our customers will be beneficial both to us and to them.

Our commercial seating market is largely driven by the hospitality market, which itself is affected by the downturn in travel, but here, too, we are exploring such new opportunities as higher-education seating, a natural fit for us as seating specialists. There are also opportunities in the extended-stay segment of the hospitality market and mid-scale hotels, both of which tend to be more recession-proof. We also expect accelerated growth in the market for senior living facilities.

Our Flexsteel traditions are based on time-honored American principles: quality in our products, sound fiscal policies, and dependability in our relationships. These traditions have helped Flexsteel grow steadily for over a century. With the help of dedicated associates, skilled artisans and our dependable vendors, we fully expect this growth to continue.

*R. J. Klosterman*

Ronald J. Klosterman  
President and Chief Executive Officer

*L. Bruce Boyle*

L. Bruce Boyle  
Chairman of the Board



**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**Form 10-K**

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the fiscal year ended **June 30, 2008**

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)

<b>Minnesota</b> (State or other jurisdiction of incorporation or organization)	<b>42-0442319</b> (I.R.S. Employer Identification No.)
<b>3400 Jackson Street, Dubuque, Iowa</b> (Address of principal executive offices)	<b>52004-0877</b> (Zip Code)
Registrant's telephone number, including area code:	<b>(563) 556-7730</b>

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

Title of each class Common Stock, \$1.00 Par Value	Name of each exchange on which registered The NASDAQ Stock Market LLC
---	--

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

None  
(Title of Class)

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

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

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

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

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

Large accelerated filer \_\_\_\_\_ Accelerated filer  Non-accelerated filer \_\_\_\_\_ Smaller reporting company \_\_\_\_\_

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

The aggregate market value of the voting stock held by non-affiliates, computed by reference to the last sales price on December 29, 2007 (which was the last business day of the registrant's most recently completed second quarter) was \$49,984,743.

Indicate the number of shares outstanding of each of the registrant's classes of Common Stock, as of the latest practicable date.  
6,575,633 Common Shares (\$1 par value) as of September 9, 2008.

**DOCUMENTS INCORPORATED BY REFERENCE**

In Part III, portions of the registrant's 2008 Proxy Statement to be filed with the Securities and Exchange Commission within 120 days of the Registrant's fiscal year end.

## **EXPLANATORY NOTE**

As discussed in Note 19 to the accompanying Consolidated Financial Statements in this Annual Report on Form 10-K, Flexsteel Industries, Inc. and Subsidiaries, (the "Company") has restated the consolidated financial statements for the fiscal years ended June 30, 2007 and 2006 and the condensed consolidated financial statements for the quarters in the previously mentioned fiscal years and for the quarters ended March 31, 2008, December 31, 2007 and September 30, 2007. This Form 10-K also reflects the effects of the restatements within "Selected Financial Data" in Item 6, "Management's Discussion and Analysis of Financial Condition and Results of Operations," in Item 7 and "Controls and Procedures" in Item 9A.

### **Background of Restatement**

During the 2008 fiscal year-end closing process the Company identified unsupported reconciling amounts that reduced the accounts payable balances at a material consolidated subsidiary. After completing analysis of these unsupported reconciling amounts, it was determined that they principally related to the historical accounting at the subsidiary for the capitalization of inventory costs and the clearing of accruals from accounts payable relating to transactions occurring in fiscal years 2004 and 2005. The historical subsidiary inventory standard costing system, established prior to the warehousing of inventory in China, did not appropriately differentiate the costing of inventory balances warehoused in China versus the United States. The warehoused inventories in China inappropriately included freight-in costs for shipments to the United States that had not been incurred. During fiscal year 2006, the Company modified the subsidiary's inventory costing process which rectified the costing error in inventory on a prospective basis but resulted in the reclassification of the historical error in inventory freight costs as a reduction to accounts payable with the erroneous belief that the reduction to accounts payable would offset future freight invoices. As a result of this error, the \$2.287 million reduction within accounts payable remained until identified during the fiscal year 2008 closing process.



## PART I

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

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

#### **Item 1. Business**

##### General

Flexsteel Industries, Inc. and Subsidiaries (the “Company”) was incorporated in 1929 and is one of the oldest and largest manufacturers, importers and marketers of residential, recreational vehicle and commercial upholstered and wooden furniture products in the country. Product offerings include a wide variety of upholstered and wood furniture such as sofas, loveseats, chairs, reclining and rocker-reclining chairs, swivel rockers, sofa beds, convertible bedding units, occasional tables, desks, dining tables and chairs and bedroom furniture. The Company’s products are intended for use in home, office, motor home, travel trailer, yacht, pontoon, health care and hotel 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 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 one active wholly-owned subsidiary: DMI Furniture, Inc. (“DMI”), acquired effective September 17, 2003, which is a Louisville, Kentucky-based, 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. The Company has two inactive wholly-owned subsidiaries: (1) Desert Dreams, Inc., which owned and leased a commercial building to an unrelated entity until it was sold in June, 2007 and (2) Four Seasons, Inc.

The Company operates in one reportable operating segment, furniture products. Our furniture products business involves the distribution of manufactured and imported products consisting of a broad line of upholstered and wooden furniture for residential, recreational vehicle, and commercial markets. The Company makes minimal export sales. No single customer accounted for more than 10% of net sales.

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

	<b>FOR THE YEARS ENDED JUNE 30,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
Residential .....	\$ 258,084	\$ 259,710	\$ 267,714
Recreational Vehicle .....	56,090	66,165	71,981
Commercial .....	91,481	99,525	86,713
	<u>\$ 405,655</u>	<u>\$ 425,400</u>	<u>\$ 426,408</u>

#### *Manufacturing and Offshore Sourcing*

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

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

We integrate our manufactured products with finished products acquired from offshore suppliers who can meet our quality specification and scheduling requirements. We will continue to pursue and refine this blended strategy, offering customers manufactured goods, products manufactured utilizing imported component parts, and ready-to-deliver imported products. The Company believes that it best serves customers by offering products from each of these categories to assist customers in reaching specific consumers with varied price points, styles and product categories. This blended focus on products allows the Company to provide a wide range of options to satisfy customer requirements.

#### *Competition*

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

#### *Seasonality*

The Company's business is not considered seasonal.

#### *Foreign Operations*

The Company makes minimal export sales. At June 30, 2008, the Company had approximately 100 employees located in Asia to inspect and coordinate the delivery of purchased products.

#### *Customer Backlog*

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

<u>June 30, 2008</u>	<u>June 30, 2007</u>	<u>June 30, 2006</u>
\$ 45,700	\$ 50,900	\$ 50,600



### *Raw Materials*

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

### *Industry Factors*

The Company has exposure to actions by governments, including tariffs. Tariffs are a possibility on any imported or exported products.

### *Government Regulations*

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

### *Environmental Matters*

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

### *Trademarks, Patents and Licenses*

The Company owns the American and Canadian improvement patents to its Flexsteel seat spring, as well as patents on convertible beds and various other recreational vehicle seating products. The Company owns certain trademarks in connection with its furniture products, which trademarks are due to expire on dates ranging from 2008 to 2023. The Company does not consider its trademarks, patents and licenses material to its business.

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

<u>Fiscal Year Ended June 30,</u>	<u>Expenditures</u>
2008	\$3,130
2007	\$3,270
2006	\$2,990

### *Employees*

The Company had approximately 2,000 employees as of June 30, 2008 including approximately 600 employees that are covered by collective bargaining agreements. Management believes it has good relations with employees.

### *Website and Available Information*

Our website is located at [www.flexsteel.com](http://www.flexsteel.com). Information on the website does not constitute part of this Annual Report on Form 10-K.

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

## **Item 1A – Risk Factors**

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

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

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

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

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

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

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

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

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

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



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

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

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

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

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

Although we have no customers that individually represent 10% or more of our net sales, the possibility of business failures by, or the loss of, large customers could decrease our future sales and earnings. Lost sales may be difficult to replace and any amounts owed to us may become uncollectible. Our inability to fill customer orders during an extended business interruption could negatively impact existing customer relationships resulting in market share decreases.

Upholstered furniture is highly fashion oriented, and if we are not able to acquire sufficient fabric variety, or if we are unable to predict or respond to changes in fashion trends, we may lose sales and have to sell excess inventory at reduced prices.

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

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

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

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

**We may become subject to litigation or other contingent liabilities, downgrades in our credit ratings, or potential additional cash and noncash charges because of our error corrections in our Consolidated Financial Statements which could have a material adverse effect on the Company.**

As described in the Explanatory Note immediately preceding Part I, Item 1, and in Note 19 "Error Corrections" of the Notes to Consolidated Financial Statements in this Annual Report on Form 10-K, we identified certain errors in the

reconciliation of accounts payable at June 30, 2008. As a result of these errors, we restated, in this Annual Report on Form 10-K, certain of our previously filed financial statements. We could be subject to litigation or other contingent liabilities, credit rating downgrades, or cash or non-cash charges due to these errors, any or all of which could have a material adverse effect on us.

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

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

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

Accounting rules require that long-lived assets be tested for impairment whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. We have substantial long-lived assets, consisting primarily of property, plant and equipment, which based upon such events or changes in circumstances there could be a write-down of all or a portion of these assets negatively impacting earnings.

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

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

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

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

**Terms of collective bargaining agreements and labor disruptions could adversely impact our results of operations.**

We employ approximately 2,000 people, 30% of whom are covered by union contracts. Where a significant portion of our workers are unionized, our ability to implement productivity improvements and effect savings with respect to health care, pension and other retirement costs is more restricted than in many nonunion operations as a result of various restrictions specified in our collective bargaining agreements. Terms of collective bargaining agreements that prevent us from competing effectively could adversely affect our financial condition, results of operations and cash flows. We are committed to working with those groups to resolve conflicts as they arise. However, there can be no assurance that these efforts will be successful.

**We may have material weaknesses in our internal control over financial reporting and the existence of material weaknesses, if any, may have an adverse impact on our stock price.**

Our management, including our Chief Executive Officer and our Chief Financial Officer, does not expect that our internal control over financial reporting will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the



benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluations of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. Our internal control over financial reporting, however, is designed to provide reasonable assurance that the objectives of internal control over financial reporting are met. The existence of material weaknesses in our internal control over financial reporting may have an adverse impact on our stock price.

**Item 1B. Unresolved Staff Comments**

None.

**Item 2. Properties**

The Company owns the following facilities as of June 30, 2008:

<u>Location</u>	<u>Approximate Size (square feet)</u>	<u>Principal Operations</u>
Dubuque, Iowa	853,000	Warehouse – Recreational Vehicle – Metal Working and Corporate Offices
Lancaster, Pennsylvania *	216,000	Upholstered Furniture
Riverside, California	305,000	Upholstered Furniture – Recreational Vehicle – Warehouse and Distribution
Dublin, Georgia	300,000	Upholstered Furniture
Harrison, Arkansas	221,000	Upholstered Furniture – Woodworking
Starkville, Mississippi	349,000	Upholstered Furniture – Woodworking
New Paris, Indiana *	168,000	Recreational Vehicle – Metal Working
Huntingburg, Indiana	691,000	Case Goods Production and Assembly – Woodworking – Warehouse
Ferdinand, Indiana	32,000	Woodworking

\* See Note 18 to the Consolidated Financial Statements included in this Annual Report on Form 10-K.

The Company leases the following facilities as of June 30, 2008:

<u>Location</u>	<u>Approximate Size (square feet)</u>	<u>Principal Operations</u>
Vancouver, Washington	16,000	Warehouse and Distribution
Louisville, Kentucky	15,000	Administrative Offices
Ferdinand, Indiana	158,000	Warehouse and Distribution
Jasper, Indiana	27,000	Warehouse and Distribution
Shenzhen, China	2,000	Office
Bangkok, Thailand	1,900	Office

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

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

**Item 3. Legal Proceedings**

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

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

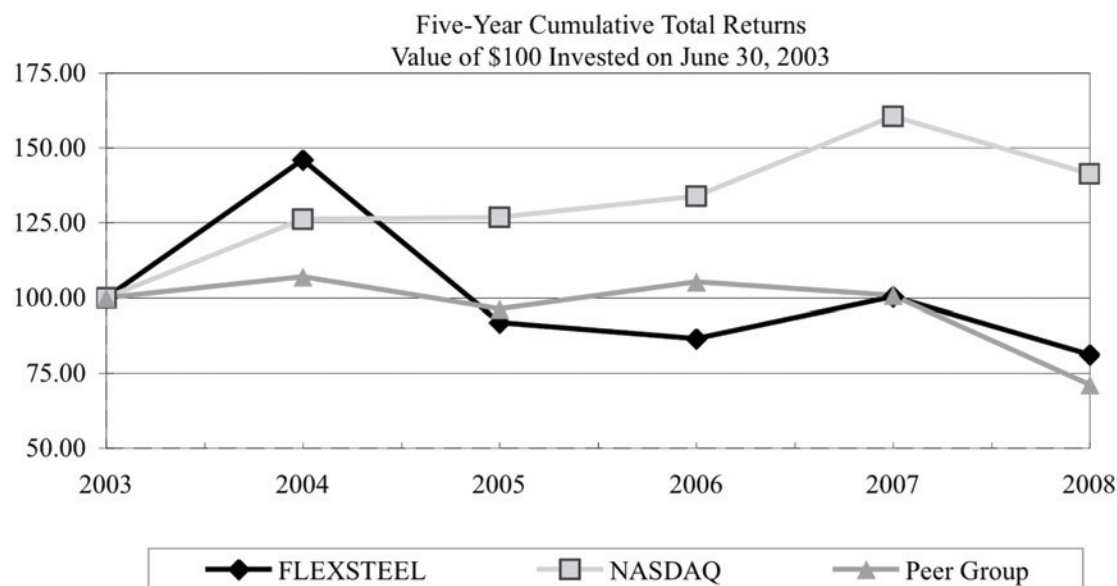
During the quarter ended June 30, 2008 no matter was submitted to a vote of security holders.

## PART II

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

##### Share Investment Performance

The following graph is based upon the SIC Code #251 Household Furniture Index as a peer group. It shows changes over the past five-year period in the value of \$100 invested in: (1) Flexsteel's common stock; (2) The NASDAQ Global Market; and (3) an industry peer group of the following: Bassett Furniture Ind., Chromcraft Revington Inc., Ethan Allen Interiors, Furniture Brands Intl., Hooker Furniture Corp., Interface Inc., Kimball International, Natuzzi S.P.A., La-Z-Boy Inc., and Stanley Furniture Inc.



	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>
Flexsteel	100.00	146.06	91.75	86.56	100.25	81.05
Peer Group	100.00	106.94	96.27	105.22	100.73	71.11
NASDAQ	100.00	126.19	126.75	133.85	160.42	141.30

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

	<u>Sale Price of Common Stock *</u>				<u>Cash Dividends</u>	
	<u>Fiscal 2008</u>		<u>Fiscal 2007</u>		<u>Per Share</u>	
	<u>High</u>	<u>Low</u>	<u>High</u>	<u>Low</u>	<u>Fiscal 2008</u>	<u>Fiscal 2007</u>
First Quarter .....	\$ 14.75	\$ 12.92	\$ 13.59	\$ 12.02	\$ 0.13	\$ 0.13
Second Quarter.....	14.86	11.60	13.26	11.55	0.13	0.13
Third Quarter .....	14.50	11.00	15.47	12.51	0.13	0.13
Fourth Quarter.....	13.98	11.01	15.94	12.71	0.13	0.13

\* Reflects the market price as reported on The NASDAQ Global Market.

The Company estimates there were approximately 1,900 holders of common stock of the Company as of June 30, 2008.

There were no repurchases of the Company's common stock during the quarter ended June 30, 2008.



## Item 6. Selected Financial Data

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

### Five-Year Review

(Amounts in thousands, except per share data)

	FOR THE YEARS ENDED JUNE 30,				
	2008	2007	2006	2005	2004 (6)
<b>SUMMARY OF OPERATIONS</b>					
Net sales .....	\$ 405,655	\$ 425,400	\$ 426,408	\$ 410,023	\$ 401,222
Cost of goods sold .....	327,165	344,177	345,068	334,978 (1)	318,526 (1)
Operating income.....	7,596	14,699	8,561	7,258 (1)	16,123 (1)
Interest and other income .....	469	1,277	775	628	977
Interest expense.....	1,468	1,491	1,557	990	839
Income before income taxes.....	6,596	14,484	7,778	6,896 (1)	16,261 (1)
Provision for income taxes (5)....	2,360	5,150	3,060	1,990 (1)	6,430 (1)
Net income (2) (3) (4) (5).....	4,236	9,334	4,718	4,906 (1)	9,831 (1)
Earnings per common share:					
(2) (3) (4) (5)					
Basic .....	0.64	1.42	0.72	0.75 (1)	1.53 (1)
Diluted .....	0.64	1.42	0.72	0.74 (1)	1.51 (1)
Cash dividends declared per common share .....	\$ 0.52	\$ 0.52	\$ 0.52	\$ 0.52	\$ 0.52
<b>SELECTED DATA AS OF JUNE 30</b>					
Average common shares outstanding:					
Basic .....	6,574	6,568	6,558	6,531	6,440
Diluted .....	6,611	6,583	6,577	6,601	6,530
<b>CONSOLIDATED BALANCE SHEET DATA</b>					
Total assets .....	\$ 179,906	\$ 185,014 (1)	\$ 184,176 (1)	\$ 165,221 (1)	\$ 169,220 (1)
Property, plant and equipment, net .....	26,372	28,168	24,158	26,141	30,327
Capital expenditures .....	1,228	10,839	3,411	3,347	6,030
Long-term debt.....	20,811	21,336	21,846	12,800	17,583
Working capital (current assets less current liabilities) .....	100,920	97,902 (1)	95,551 (1)	83,952 (1)	83,054 (1)
Shareholders' equity .....	\$ 112,752	\$ 112,679 (1)	\$ 106,066 (1)	\$ 103,361 (1)	\$ 101,313 (1)
<b>SELECTED RATIOS</b>					
Net income as percent of sales....	1.0%	2.2%	1.1%	1.2% (1)	2.5% (1)
Current ratio .....	3.5 to 1	3.2 to 1 (1)	2.9 to 1 (1)	3.0 to 1 (1)	2.9 to 1 (1)
Return on ending shareholders' equity .....	3.8%	8.3% (1)	4.5% (1)	4.8% (1)	9.7% (1)
Return on beginning shareholders' equity.....	3.8%	8.8% (1)	4.6% (1)	4.8% (1)	10.5% (1)
Average number of employees ...	2,140	2,290	2,400	2,460	2,610

(1) Indicates an item that has been restated as described in Note 19 to the Consolidated Financial Statements or recalculated to reflect the restatement based on information provided in Note 19 to the Consolidated Financial Statements included in this Annual Report on Form 10-K.

(2) Fiscal 2007 net income and per share amounts reflect the net gain (after tax) on sale of building of approximately \$2.5 million or \$0.37 per share, the gain on life insurance of \$0.6 million or \$0.08 per share and the net gain (after tax) on the sale of vacant land of approximately \$0.2 million or \$0.04 per share.

- (3) Fiscal 2008, 2007 and 2006 net income and per share amounts reflect the recording of stock-based compensation expense, as required by Statement of Financial Accounting Standard No. 123 (Revised), of \$0.1 million, \$0.2 million and \$0.4 million (after tax), respectively, or \$0.02 per share, \$0.04 per share and \$0.06 per share, respectively.
- (4) Fiscal 2005 net income and per share amounts reflect a net gain (after tax) on the sale of facilities of approximately \$0.5 million or \$0.08 per share.
- (5) During Fiscal 2005, an examination by the Internal Revenue Service of the Company's federal income tax returns for the fiscal years ended June 30, 2004 and 2005 was completed. Due to the favorable settlement results, the Company reduced its estimate of accrued tax liabilities by \$0.7 million. The decrease resulted in an income tax rate of 30.6% for the fiscal year ended June 30, 2005.
- (6) The Company acquired DMI Furniture, Inc. ("DMI") in a business combination accounted for as a purchase on September 17, 2003. The amounts herein include the operations of DMI since that date.

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

All of the financial information presented in this Item 7 has been revised to reflect the impact of the restatement of the Company's Consolidated Financial Statements, which is more fully described in Note 19, "Error Corrections" of the Notes to Consolidated Financial Statements in this Annual Report on Form 10-K. The cumulative impact of the unreconciled accounts payable was an increase to accounts payable of \$2.3 million, an increase to deferred income taxes-current of \$0.9 million and a reduction to Shareholder's Equity of \$1.4 million, as of July 1, 2005.

### **General**

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

### **Critical Accounting Policies**

The discussion and analysis of the Company's consolidated financial statements and results of operations are based on consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America. Preparation of these consolidated financial statements requires the use of estimates and judgments that affect the reported results. The Company uses estimates based on the best information available in recording transactions and balances resulting from business operations. Estimates are used for such items as collectibility of trade accounts receivable, inventory valuation, depreciable lives, self-insurance programs, warranty costs and income taxes. Ultimate results may differ from these estimates under different assumptions or conditions.

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

Inventories – the Company values inventory at the lower of cost or market. A large portion of our finished goods inventory is made to order and many of our raw material parts are interchangeable between products. Historically inventory write-downs to market have been in fabric, wood frame and trim, and sourced products purchased for inventory. Management assesses the inventory on hand versus estimated future usage and estimated selling prices and if necessary writes down the obsolete or excess inventory to market. Although, we believe that inventory valuations are reasonable, unexpected changes in sales volume due to economic or competitive conditions may impact inventory valuations. Raw steel, lumber and wood frame parts are valued on the last-in, first-out ("LIFO") method. Other inventories are valued on the first-in, first-out ("FIFO") method. Changes in the market conditions could require a write down of inventory.

Self-insurance programs – the Company is self-insured for health care and most workers' compensation up to predetermined amounts above which third party insurance applies. The Company purchases specific stop-loss insurance for individual health care claims in excess of \$150,000 per plan year, with a \$1.0 million individual lifetime maximum. For workers' compensation the Company retains the first \$350,000 per claim and purchases excess coverage up to the statutory limits for amounts in excess of the retention limit. The Company is contingently liable to insurance carriers under its comprehensive general, product, and vehicle liability policies, as well as some workers'



compensation. Losses are accrued based upon the Company's estimates of the aggregate liability of claims incurred using certain actuarial assumptions followed in the insurance industry and based on Company experience. The actual claims experience could differ from the estimates made by the Company based on actual experience.

Income taxes – the Company accounts for income taxes in accordance with the provisions of Statement of Financial Accounting Standards (SFAS) No. 109, Accounting for Income Taxes. In the preparation of the Company's consolidated financial statements, management calculates income taxes. This includes estimating the Company's current tax liability as well as assessing temporary differences resulting from different treatment of items for tax and book accounting purposes. These differences result in deferred tax assets and liabilities, which are recorded on the balance sheet. These assets and liabilities are analyzed regularly and management assesses the likelihood that deferred tax assets will be realized from future taxable income. We make judgments regarding the potential tax effects of various transactions including a liability for uncertain tax positions in accordance with FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 ("FIN 48").

Revenue recognition – is upon delivery of product to our customer and when collectibility is reasonably assured. Delivery of product to our customer is evidenced through the shipping terms indicating when title and risk of loss is transferred. Our ordering process creates persuasive evidence of the sale arrangement and the sales amount is determined. The delivery of the goods to our customer completes the earnings process. Net sales consist of product sales and related delivery charge revenue, net of adjustments for returns and allowances. Shipping and handling costs are included in cost of goods sold.

### Recently Issued Accounting Pronouncements

See Item 8. Note 1 to the Company's Consolidated Financial Statements.

### Results of Operations

The following table has been prepared as an aid in understanding the Company's results of operations on a comparative basis for the fiscal years ended June 30, 2008, 2007 and 2006. Amounts presented are percentages of the Company's net sales.

	<b>FOR THE YEARS ENDED JUNE 30,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
Net sales .....	100.0%	100.0%	100.0%
Cost of goods sold .....	(80.7)	(80.9)	(80.9)
Gross margin .....	19.3	19.1	19.1
Selling, general and administrative .....	(17.5)	(16.7)	(17.1)
Gain on sale of land and building .....	-	1.0	-
Operating income .....	1.8	3.4	2.0
Other expense, net .....	(0.2)	0.0	(0.2)
Income before income taxes .....	1.6	3.4	1.8
Provision for income taxes .....	(0.6)	(1.2)	(0.7)
Net income .....	1.0%	2.2%	1.1%

### Fiscal 2008 Compared to Fiscal 2007

Net sales for the fiscal year ended June 30, 2008 were \$405.7 million compared to \$425.4 million in the prior fiscal year, a decrease of 4.6%. Residential net sales were \$258.1 million compared to \$259.7 million in the fiscal year ended June 30, 2007, a decrease of 0.6%. Commercial net sales were \$91.5 million for the fiscal year ended June 30, 2008, a decrease of 8.1% from the fiscal year ended June 30, 2007. Recreational vehicle net sales were \$56.1 million for the fiscal year ended June 30, 2008, a decrease of 15.2% from the fiscal year ended June 30, 2007. The fiscal year decline in all net sales categories is due to a generally soft market environment.

Net income for the fiscal year ended June 30, 2008 was \$4.2 million or \$0.64 per share compared to \$9.3 million or \$1.42 per share in the fiscal year ended June 30, 2007. Results for the fiscal year ended June 30, 2007 were favorably impacted by three significant non-recurring events. The Company sold a commercial property, which resulted in a pre-tax gain of approximately \$4.0 million, or \$0.37 per share after tax. The Company recognized a pre-tax gain on the sale of vacant land of approximately \$0.4 million or \$0.04 per share after tax. These gains are reported as "Gain

on sale of capital assets” in the Consolidated Statements of Income. The Company also realized a non-taxable gain on life insurance of \$0.6 million, or \$0.08 per share. This gain is included in “Interest and other income” in the Consolidated Statements of Income.

Gross margin for the fiscal years ended June 30, 2008 and 2007 was 19.3% and 19.1%, respectively.

Selling, general and administrative expenses were 17.5 % and 16.7% of net sales for the fiscal years ended June 30, 2008 and 2007, respectively. The percentage increase in selling, general and administrative costs compared to the prior fiscal year is due primarily to higher marketing and sales support expenses and higher bad debt expense of \$1.1 million on reduced revenues on a year over year basis.

The effective income tax rate for the fiscal year ended June 30, 2008 was 35.8%, reflecting lower net income compared to the prior year. The effective income tax rate was 35.6% for the fiscal year ended June 30, 2007. The 2007 rate was reduced by approximately 1.4% due to the non-taxable life insurance gain.

The above factors resulted in net income for the fiscal year ended June 30, 2008 of \$4.2 million or \$0.64 per share compared to \$9.3 million or \$1.42 per share for the fiscal year ended June 30, 2007.

All earnings per share amounts are on a diluted basis.

### **Fiscal 2007 Compared to Fiscal 2006**

Net sales for the fiscal year ended June 30, 2007 were \$425.4 million compared to \$426.4 million in the prior fiscal year. Residential net sales were \$259.7 million, a decrease of 3% from the fiscal year ended June 30, 2006. Commercial net sales were \$99.5 million for the fiscal year ended June 30, 2007, an increase of 15% from the fiscal year ended June 30, 2006. This increase in commercial net sales for the fiscal year ended June 30, 2007 is primarily due to expanded commercial office product offerings and improved industry performance of hospitality products. Recreational vehicle net sales were \$66.2 million for the fiscal year ended June 30, 2007, a decrease of 8% from the fiscal year ended June 30, 2006. The fiscal year decline in recreational vehicle net sales is due to a generally soft wholesale market environment for recreational vehicles.

Net income for the fiscal year ended June 30, 2007 was \$9.3 million or \$1.42 per share. Results for the fiscal year ended June 30, 2007 were favorably impacted by three significant non-recurring events. The Company sold a commercial property, which resulted in a pre-tax gain of approximately \$4.0 million, or \$0.37 per share after tax. The Company recognized a pre-tax gain on the sale of vacant land of approximately \$0.4 million or \$0.04 per share after tax. These gains are reported as “Gain on sale of capital assets” in the Consolidated Statements of Income. The Company also realized a non-taxable gain on life insurance of \$0.6 million, or \$0.08 per share. This gain is included in “Interest and other income” in the Consolidated Statements of Income.

Gross margin for the fiscal years ended June 30, 2007 and 2006 was 19.1%.

Selling, general and administrative expenses were 16.7% and 17.1% of net sales for the fiscal year ended June 30, 2007 and 2006, respectively. The decrease in selling, general and administrative costs of approximately \$1.9 million compared to the prior fiscal year is due primarily to lower marketing and sales support expenses and lower bad debt expense of \$0.8 million.

The effective income tax rate for the fiscal year ended June 30, 2007 was 35.6%. The rate was reduced by approximately 1.4% due to the non-taxable life insurance gain. The effective income tax rate was 39.3% for the fiscal year ended June 30, 2006.

The above factors resulted in net income for the fiscal year ended June 30, 2007 of \$9.3 million or \$1.42 per share compared to \$4.7 million or \$0.72 per share for the fiscal year ended June 30, 2006.

All earnings per share amounts are on a diluted basis.

### **Liquidity and Capital Resources**

Net cash provided by operating activities was \$8.7 million in fiscal year 2008 compared to \$10.3 million in fiscal year 2007. Significant working capital changes from June 30, 2007 to June 30, 2008 included: decreased accounts

receivables of \$12.5 million, increased inventory levels of \$7.0 million and decreased accounts payable of \$1.3 million. The decrease in receivables is related to timing of shipments and related payment terms, collection efforts and lower net sales. The increase in inventory is due primarily to timing of inventory purchases to meet our forecasted customer demands especially sourced products where there are longer lead times for international shipments. The decrease in accounts payable is due to the timing of payments. The Company expects that due to the nature of our operations that there will continue to be significant fluctuations in inventory levels, the related accounts payable, and cash flows from operations due to the following: we purchase a significant amount of inventory in large orders from overseas suppliers with significant lead times and depending on the timing of those large orders inventory levels can be significantly impacted, we have various large customers that purchase significant quantities of inventory at a time and the timing of those purchases can significantly impact inventory levels, accounts receivable, accounts payable and short-term borrowings. As discussed below the Company believes it has adequate financing arrangements and access to capital to absorb these fluctuations in operating cash flow.

Net cash used in investing activities was \$1.0 million in fiscal year 2008 compared to \$5.1 million in fiscal year 2007. The significant change in investing activities is related to the large amount of capital expenditures made in 2007 somewhat offset by a sale of land and commercial property. Capital expenditures were \$1.2 million, \$10.8 million and \$3.4 million (of which \$2.6 million was a non-cash purchase of equipment by assumption of a note payable) in fiscal years 2008, 2007 and 2006, respectively. Fiscal 2008 expenditures were primarily for manufacturing equipment. Depreciation and amortization expense was \$4.4 million and \$5.3 million for the fiscal years ended June 30, 2008 and 2007, respectively. The Company expects that capital expenditures will be approximately \$3.0 million in fiscal year 2009. The significant fiscal year 2007 capital expenditure cash outflows were offset by a significant sale of commercial property resulting in total cash proceeds of \$5.5 million and a sale of vacant land of approximately \$0.4 million. The commercial property was previously leased to a non-related third party and used as retail space. Neither the sale of the commercial property or vacant land is expected to significantly impact future operations.

Net cash used in financing activities was \$5.8 million in fiscal year 2008 compared to \$6.3 million in fiscal year 2007. For fiscal years 2008 and 2007, repayment of debt and the payment of dividends were the primary financing activities utilizing cash. For fiscal year 2006, borrowings were used to pay for the expansion of inventory programs and accounts receivable and the payment of dividends. Cash dividends were \$3.4 million in 2008 and in 2007.

Management believes that the Company has adequate cash, cash equivalents, and credit arrangements to meet its operating and capital requirements for fiscal year 2009. In the opinion of management, the Company's liquidity and credit resources provide it with the ability to react to opportunities as they arise, the ability to pay quarterly dividends to its shareholders, and ensures that productive capital assets that enhance safety and improve operations are purchased as needed.

The following table summarizes the Company's contractual obligations at June 30, 2008 and the effect these obligations are expected to have on the Company's liquidity and cash flow in the future (in thousands):

	<b>Total</b>	<b>Less than 1 Year</b>	<b>1 - 3 Years</b>	<b>3 - 5 Years</b>	<b>More than 5 Years</b>
Long-term debt obligations.....	\$ 25,954	\$ 5,143	\$ 811	\$ 20,000	\$ -
Interest on long-term debt obligations.....	3,252	1,030	2,060	162	-
Operating lease obligations.....	6,244	2,601	3,359	284	-
Total contractual cash obligations .....	<u>\$ 35,450</u>	<u>\$ 8,774</u>	<u>\$ 6,230</u>	<u>\$ 20,446</u>	<u>\$ -</u>

Contractual obligations associated with the Company's deferred compensation plans were excluded from the table above as the Company cannot predict when the events that trigger payment will occur. Total accumulated deferred compensation liabilities were \$5.3 million at June 30, 2008. At June 30, 2008 the Company had no capital lease obligations, and no purchase obligations for raw materials or finished goods. The purchase price on all open purchase orders was fixed and denominated in U.S. dollars. Additionally, the Company has excluded the FIN 48 reserve from the above table as the timing of any payments cannot be reasonably estimated.

### **Financing Arrangements**

See Note 7 to the Consolidated Financial Statements on page 28 of this Annual Report on Form 10-K.



## Outlook

The fiscal year ended June 30, 2008 began well with the first two quarters showing improved earnings over fiscal year 2007 on only slightly lower net sales. Beginning in the third fiscal quarter net sales dropped more rapidly, and although net earnings were only about 55% of the prior year quarterly amount, our net income for the nine-months was still ahead of the prior year nine-month total. The fourth quarter 12% decrease in net sales hampered the ability to absorb fixed costs and that, combined with additional bad debt and selling expenses, contributed negatively to fiscal year 2008 results. Normally, at least one of the markets in which we sell products is doing well. However, residential net sales were off 1%, commercial net sales were down 8%, and recreational vehicle seating net sales were down 15%. We do not believe that we are losing market share in these categories.

The U.S. economy, where most of our products are sold, has been greatly impacted by the credit crisis in the home mortgage sector, a fall in the value of the U.S. dollar versus most other major currencies, volatile high-cost fuel, increasing food prices and a changing political landscape. These factors have contributed to the lowest consumer confidence levels since 1981.

We have been negatively impacted by price increases in the raw materials and component parts, such as steel, poly foam and fabrics, as well as increases in the cost to transport those materials to our manufacturing facilities and products to our customers. Our overseas manufacturers have also increased prices and the cost to transport those products to the U.S. has increased with the price of fuel. We see no near term improvement in macro-economic operating conditions.

This year Flexsteel Industries, Inc. will complete its 115th year doing business in the furniture industry. While we have seen challenging business conditions before, they are never comfortable or reassuring to our shareholders. In response to these challenges, we have:

- implemented price increases to offset cost increases where possible,
- commenced the closing of two manufacturing operations, Lancaster, PA and New Paris, IN, to more closely match our manufacturing capacity with our expected demand for residential and recreational vehicle seating products and we anticipate annual pre-tax savings in the range of \$3.5 million to \$4.0 million from this manufacturing consolidation,
- focused attention on our credit risk exposure,
- maintained a close relationship with our customers to offer products and services they need to operate effectively and profitability, and
- continued to focus on profitability and cash flow over top line growth to maintain a strong balance sheet.

While we expect that current business conditions will persist for most, if not all, of fiscal year 2009, we remain optimistic that our strategy of a wide range of quality product offerings and price points to the residential, recreational vehicle and commercial markets combined with our conservative approach to business will be rewarded over the longer-term.

## **Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

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

*Impairment of long-lived assets* – Accounting rules require that long-lived assets be evaluated for impairment whenever events or changes in circumstances indicate that its carrying value may not be recoverable. We have substantial long-lived assets, consisting mainly of property, plant and equipment, which based upon such events or changes in circumstances, there could be a write-down of all or a portion of these assets and a corresponding reduction in our earnings and net worth. At June 30, 2008, no impairment of long-lived assets has been identified.

*Foreign Currency Risk* – During fiscal years 2008, 2007 and 2006, the Company did not have sales, purchases, or other expenses denominated in foreign currencies. As such, the Company is not exposed to market risk associated with currency exchange rates and prices.

*Interest Rate Risk* – The Company's primary market risk exposure with regard to financial instruments is changes in interest rates. At June 30, 2008, a hypothetical 100 basis point increase in short-term interest rates would decrease annual pre-tax earnings by approximately \$150,000, assuming no change in the volume or composition of debt. As of June 30, 2008, the Company has effectively fixed the interest rates at 4.5% on approximately \$15.0 million of its long-term debt through the use of interest rate swaps, and the above estimated earnings reduction takes these swaps into account. On July 31, 2008, a \$5.0 million swap matured. As of the date of this Annual Report on Form 10-K, the Company has effectively fixed its interest rate at 5.0% on approximately \$10.0 million of its long-term debt through the use of interest rate swaps. As of June 30, 2008, the fair value of these swaps is a liability of approximately \$0.3 million and is included in other liabilities. As of June 30, 2007, the fair value of these swaps were an asset of approximately \$0.1 million and was included in other assets.

*Tariffs* – The Company has exposure to actions by governments, including tariffs. Tariffs are a possibility on any imported or exported products.

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

**Item 8. Financial Statements and Supplementary Data**

	<b>Page(s)</b>
Report of Independent Registered Public Accounting Firm .....	19
Consolidated Balance Sheets at June 30, 2008 and 2007 (As Restated).....	20
Consolidated Statements of Income for the Years Ended June 30, 2008, 2007, and 2006.....	21
Consolidated Statements of Changes in Shareholders' Equity for the Years Ended June 30, 2008, 2007 (As Restated), and 2006 (As Restated) .....	22
Consolidated Statements of Cash Flows for the Years Ended June 30, 2008, 2007, and 2006 (As Restated) .....	23
Notes to Consolidated Financial Statements .....	24



## **REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Shareholders of Flexsteel Industries, Inc.

We have audited the accompanying consolidated balance sheets of Flexsteel Industries, Inc. and subsidiaries (the "Company") as of June 30, 2008 and 2007, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for each of the three years in the period ended June 30, 2008. Our audits also included the financial statement schedule listed in the Index at Item 15. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Flexsteel Industries, Inc. and subsidiaries at June 30, 2008 and June 30, 2007, and the results of their operations and their cash flows for each of the three years in the period ended June 30, 2008, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

As discussed in Note 19 to the consolidated financial statements, the accompanying consolidated financial statements have been restated.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of June 30, 2008, based on the criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated September 10, 2008 expressed an adverse opinion on the Company's internal control over financial reporting because of a material weakness.

*DELOITTE & TOUCHE LLP*

Minneapolis, Minnesota  
September 10, 2008

**FLEXSTEEL INDUSTRIES, INC. AND SUBSIDIARIES**

**Consolidated Balance Sheets**

ASSETS	JUNE 30,	
	2008	2007 (As Restated)
CURRENT ASSETS:		
Cash and cash equivalents .....	\$ 2,841,323	\$ 900,326
Investments .....	1,160,066	976,180
Trade receivables – less allowance for doubtful accounts: 2008, \$2,110,000; 2007, \$2,090,000 .....	43,783,224	56,273,874
Inventories .....	85,791,400	78,756,985
Deferred income taxes .....	4,210,000	4,700,000
Other .....	2,853,634	1,759,045
Total current assets .....	<u>140,639,647</u>	<u>143,366,410</u>
NONCURRENT ASSETS:		
Property, plant and equipment, net .....	26,372,392	28,168,244
Deferred income taxes .....	1,392,187	1,270,000
Other assets .....	11,501,992	12,209,528
TOTAL .....	<u>\$ 179,906,218</u>	<u>\$ 185,014,182</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
CURRENT LIABILITIES:		
Accounts payable – trade .....	\$ 14,580,275	\$ 15,893,964
Notes payable and current maturities on long-term debt .....	5,142,945	7,030,059
Accrued liabilities:		
Payroll and related items .....	6,759,941	7,530,083
Insurance .....	7,176,799	7,615,532
Other .....	6,059,575	7,394,448
Total current liabilities .....	<u>39,719,535</u>	<u>45,464,086</u>
LONG-TERM LIABILITIES:		
Long-term debt .....	20,810,597	21,336,352
Deferred compensation .....	5,343,545	5,535,113
Other liabilities .....	1,280,154	–
Total liabilities .....	<u>67,153,831</u>	<u>72,335,551</u>
COMMITMENTS AND CONTINGENCIES (Note 14)		
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 2008, 6,575,633 shares; 2007, 6,570,467 shares...	6,575,633	6,570,467
Additional paid-in capital .....	4,255,996	4,013,456
Retained earnings .....	101,692,431	100,984,577
Accumulated other comprehensive income .....	228,327	1,110,131
Total shareholders' equity .....	<u>112,752,387</u>	<u>112,678,631</u>
TOTAL .....	<u>\$ 179,906,218</u>	<u>\$ 185,014,182</u>

*See accompanying Notes to Consolidated Financial Statements.*

**FLEXSTEEL INDUSTRIES, INC. AND SUBSIDIARIES****Consolidated Statements of Income**

	<b>FOR THE YEARS ENDED JUNE 30,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
NET SALES .....	\$ 405,654,829	\$ 425,399,951	\$ 426,407,585
COST OF GOODS SOLD .....	(327,165,396)	(344,176,763)	(345,068,305)
GROSS MARGIN .....	78,489,433	81,223,188	81,339,280
SELLING, GENERAL AND ADMINISTRATIVE .....	(70,893,485)	(70,895,260)	(72,778,577)
GAIN ON SALE OF CAPITAL ASSETS .....	-	4,370,712	-
OPERATING INCOME .....	7,595,948	14,698,640	8,560,703
OTHER INCOME (EXPENSE):			
Interest and other income .....	468,933	1,276,857	774,783
Interest expense .....	(1,468,476)	(1,491,510)	(1,557,303)
Total .....	(999,543)	(214,653)	(782,520)
INCOME BEFORE INCOME TAXES .....	6,596,405	14,483,987	7,778,183
PROVISION FOR INCOME TAXES .....	(2,360,000)	(5,150,000)	(3,060,000)
NET INCOME .....	\$ 4,236,405	\$ 9,333,987	\$ 4,718,183
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING:			
Basic .....	6,573,999	6,567,522	6,558,440
Diluted .....	6,611,136	6,582,558	6,577,278
EARNINGS PER SHARE OF COMMON STOCK:			
Basic .....	\$ 0.64	\$ 1.42	\$ 0.72
Diluted .....	\$ 0.64	\$ 1.42	\$ 0.72
CASH DIVIDENDS DECLARED PER COMMON SHARE .....	\$ 0.52	\$ 0.52	\$ 0.52

*See accompanying Notes to Consolidated Financial Statements.*



**FLEXSTEEL INDUSTRIES, INC. AND SUBSIDIARIES**  
**Consolidated Statements of Changes in Shareholders' Equity**

	<u>Total Par Value of Common Shares (\$1 Par)</u>	<u>Additional Paid-In Capital</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income</u>	<u>Total</u>
Balance at June 30, 2005 (as previously reported).....	\$ 6,541,436	\$ 2,954,398	\$ 95,196,022	\$ 105,864	\$ 104,797,720
Restatement adjustment (see Note 19).....	—	—	(1,436,479)	—	(1,436,479)
Balance at July 1, 2005 (as restated) .....	6,541,436	2,954,398	93,759,543	105,864	103,361,241
Issuance of common stock: .....					
Stock options exercised, net.....	2,000	20,500	—	—	22,500
401(k) plan and management incentive shares .....	20,314	268,254	—	—	288,568
Unrealized loss on available for sale investments, net of tax....	—	—	—	(221)	(221)
Stock-based compensation .....	—	427,000	—	—	427,000
Interest rate swaps valuation adjustment, net of tax .....	—	—	—	116,910	116,910
Minimum pension liability adjustment, net of tax .....	—	—	—	543,559	543,559
Cash dividends declared.....	—	—	(3,411,894)	—	(3,411,894)
Net income .....	—	—	4,718,183	—	4,718,183
Balance at June 30, 2006 (as restated) .....	6,563,750	3,670,152	95,065,832	766,112	106,065,846
Issuance of common stock: .....					
Stock options exercised, net.....	1,566	10,891	—	—	12,457
401(k) plan shares.....	5,151	58,413	—	—	63,564
Unrealized gain on available for sale investments, net of tax....	—	—	—	301,611	301,611
Stock-based compensation .....	—	274,000	—	—	274,000
Interest rate swaps valuation adjustment, net of tax .....	—	—	—	(168,137)	(168,137)
SFAS No. 87 minimum pension liability .....	—	—	—	254,638	254,638
SFAS No. 158 transition adjustment .....	—	—	—	(44,093)	(44,093)
Cash dividends declared.....	—	—	(3,415,242)	—	(3,415,242)
Net income .....	—	—	9,333,987	—	9,333,987
Balance at June 30, 2007 (as restated) .....	6,570,467	4,013,456	100,984,577	1,110,131	112,678,631
Adoption of FIN 48.....			(110,000)		(110,000)
Issuance of common stock: .....					
Stock options exercised, net.....	1,642	13,314	—	—	14,956
401(k) plan shares.....	3,524	43,226	—	—	46,750
Unrealized loss on available for sale investments, net of tax....	—	—	—	(84,342)	(84,342)
Stock-based compensation .....	—	186,000	—	—	186,000
Interest rate swaps valuation adjustment, net of tax .....	—	—	—	(273,062)	(273,062)
Minimum pension liability adjustment, net of tax .....	—	—	—	(524,400)	(524,400)
Cash dividends declared.....	—	—	(3,418,551)	—	(3,418,551)
Net income .....	—	—	4,236,405	—	4,236,405
Balance at June 30, 2008.....	\$ 6,575,633	\$ 4,255,996	\$ 101,692,431	\$ 228,327	\$ 112,752,387

*See accompanying Notes to Consolidated Financial Statements.*

**FLEXSTEEL INDUSTRIES, INC. AND SUBSIDIARIES**  
**Consolidated Statements of Cash Flows**

	<b>FOR THE YEARS ENDED JUNE 30,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b> <b>(As Restated)</b>
<b>OPERATING ACTIVITIES:</b>			
Net income.....	\$ 4,236,405	\$ 9,333,987	\$ 4,718,183
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation and amortization .....	4,437,903	5,270,651	5,485,884
Deferred income taxes .....	349,294	1,464,664	(948,000)
Stock-based compensation expense .....	186,000	274,000	427,000
Other non-cash, net .....	(88,309)	—	—
Gain on disposition of capital assets .....	(49,180)	(4,407,682)	(55,504)
Changes in operating assets and liabilities:			
Trade receivables .....	12,490,650	(5,094,083)	(2,824,721)
Inventories .....	(7,034,415)	6,012,987	(12,538,093)
Other current assets .....	(655,486)	255,076	(162,251)
Other assets .....	(292,485)	57,919	(582,112)
Accounts payable – trade .....	(2,188,444)	(2,160,950)	(2,777,949)
Accrued liabilities .....	(2,272,811)	(631,804)	3,076,331
Other long-term liabilities .....	(197,497)	(411,588)	(1,218,862)
Deferred compensation .....	(191,568)	327,938	145,225
Net cash provided by (used in) operating activities .....	<u>8,730,057</u>	<u>10,291,115</u>	<u>(7,254,869)</u>
<b>INVESTING ACTIVITIES:</b>			
Purchases of investments .....	(631,704)	(774,964)	(1,118,446)
Proceeds from sales of investments .....	762,783	476,840	1,773,698
Proceeds from sale of capital assets .....	73,847	6,039,946	89,786
Capital expenditures .....	<u>(1,227,863)</u>	<u>(10,839,479)</u>	<u>(850,444)</u>
Net cash used in investing activities .....	<u>(1,022,937)</u>	<u>(5,097,657)</u>	<u>(105,406)</u>
<b>FINANCING ACTIVITIES:</b>			
(Repayments of) proceeds from short-term borrowings, net .....	(1,912,683)	(2,470,729)	4,000,000
Repayment of long-term borrowings .....	(500,186)	(475,889)	(247,441)
Proceeds from long-term borrowings .....	—	—	7,200,000
Dividends paid .....	(3,414,960)	(3,414,369)	(3,408,994)
Proceeds from issuance of common stock .....	61,706	82,087	95,894
Net cash (used in) provided by financing activities .....	<u>(5,766,123)</u>	<u>(6,278,900)</u>	<u>7,639,459</u>
Increase (decrease) in cash and cash equivalents .....	1,940,997	(1,085,442)	279,184
Cash and cash equivalents at beginning of year .....	900,326	1,985,768	1,706,584
Cash and cash equivalents at end of year .....	<u>\$ 2,841,323</u>	<u>\$ 900,326</u>	<u>\$ 1,985,768</u>

	<b>FOR THE YEARS ENDED JUNE 30,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
<b>SUPPLEMENTAL INFORMATION</b>			
<b>CASH PAID DURING THE PERIOD FOR:</b>			
Interest .....	\$ 1,473,000	\$ 1,517,000	\$ 1,598,000
Income taxes .....	\$ 3,205,000	\$ 3,551,000	\$ 3,244,000

*See accompanying Notes to Consolidated Financial Statements.*

## **FLEXSTEEL INDUSTRIES, INC. AND SUBSIDIARIES**

### **Notes to Consolidated Financial Statements**

#### **1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**DESCRIPTION OF BUSINESS** – Flexsteel Industries, Inc. and subsidiaries (the “Company”) is one of the oldest and largest manufacturers, importers and marketers of residential, recreational vehicle and commercial upholstered and wooden furniture products in the country. The Company’s furniture products include a broad line of quality upholstered and wooden furniture for residential, recreational vehicle and commercial use. 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, bedroom furniture and home and commercial office furniture. The Company has one active wholly-owned subsidiary: DMI Furniture, Inc. (“DMI”), acquired effective September 17, 2003, which is a Louisville, Kentucky-based, 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. The Company has two inactive wholly owned subsidiaries: (1) Desert Dreams, Inc., which owned and leased a commercial building to an unrelated entity until it was sold in June 2007 and (2) Four Seasons, Inc.

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

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

**FAIR VALUE** – the Company’s cash, investments, accounts receivable, other assets, accounts payable, accrued liabilities, notes payable, interest rate swaps and other liabilities are carried at amounts, which reasonably approximate their fair value due to their short-term nature. The Company’s notes payable are at variable interest rates that approximate market. Fair values of investments in debt and equity securities are disclosed in Note 2.

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

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

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

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

**VALUATION OF LONG-LIVED ASSETS** – the Company periodically reviews the carrying value of long-lived assets and estimated depreciable or amortizable lives for continued appropriateness. This review is based upon projections of anticipated future cash flows and is performed whenever events or changes in circumstances indicate that asset carrying values may not be recoverable or that the estimated depreciable or amortizable lives may have changed. These evaluations could result in a change in estimated useful lives in future periods. No impairments or changes occurred during the fiscal year ended June 30, 2008.

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

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

**ADVERTISING COSTS** – are charged to selling, general and administrative expense in the periods incurred. The Company conducts no direct-response advertising programs and there are no assets related to advertising recorded on the consolidated balance sheet. Advertising expenditures, primarily shared customer advertising in which an identifiable benefit is received and national trade-advertising programs, were approximately \$4.6 million, \$4.6 million and \$4.4 million in fiscal 2008, 2007 and 2006, respectively.

**DESIGN, RESEARCH AND DEVELOPMENT COSTS** – are charged to selling, general and administrative expense in the periods incurred. Expenditures for design, research and development costs were approximately \$3.1 million, \$3.3 million and \$3.0 million in fiscal 2008, 2007 and 2006, respectively.

**DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES** – the Company utilizes interest rate swaps to hedge against adverse changes in interest rates relative to its variable rate debt. The notional principal amounts of the outstanding interest rate swaps totaled \$15.0 million with a weighted average fixed rate of 4.5% at June 30, 2008. On July 31, 2008, a \$5.0 million swap matured. Excluding the subsequently matured swap, the Company has effectively fixed its interest rate at 5.0% on approximately \$10.0 million of its variable rate debt. The interest rate swaps are not utilized to take speculative positions. The Board of Directors established the Company's policies with regards to activities involving derivative instruments. Management, along with the Board of Directors, periodically reviews those policies, along with the actual derivative related results. The Company recorded the fair market value of its interest rate swaps as cash flow hedges on its balance sheet and has marked them to fair value through other comprehensive income. The cumulative fair value of the swaps was a liability of approximately \$0.3 million as of June 30, 2008 and is reflected as other liabilities on the accompanying consolidated balance sheet. 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.

**INSURANCE** – the Company is self-insured for health care and most workers' compensation up to predetermined amounts above which third party insurance applies. The Company purchases specific stop-loss insurance for individual health care claims in excess of \$150,000 per plan year, with a \$1.0 million individual lifetime maximum. For workers' compensation the Company retains the first \$350,000 per claim and purchases excess coverage up to the statutory limits for amounts in excess of the retention limit. Losses are accrued based upon the Company's estimates of the aggregate liability for claims incurred using certain actuarial assumptions followed in the insurance industry and based on Company experience. The Company records these insurance accruals within the accrued liabilities insurance account on the balance sheet.

**INCOME TAXES** – the Company accounts for income taxes in accordance with the provisions SFAS No. 109, *Accounting for Income Taxes* and evaluates uncertainties in income taxes in accordance with FIN 48, *Accounting for Uncertainty in Income Taxes*. In the preparation of the Company's consolidated financial statements, management calculates income taxes. This includes estimating the Company's current tax liability as well as assessing temporary differences resulting from different treatment of items for tax and book accounting purposes. These differences result in deferred tax assets and liabilities, which are recorded on the balance sheet. These assets and liabilities are analyzed regularly and management assesses the likelihood that deferred tax assets will be realized from future taxable income. The Company adopted the provisions of FIN 48 on July 1, 2007. The impact of the adoption was not significant and is discussed in Note 8, Income Taxes.

**EARNINGS PER SHARE** – basic earnings per share of common stock is based on the weighted-average number of common shares outstanding during each fiscal year. Diluted earnings per share of common stock includes the dilutive effect of potential common shares outstanding. The Company's only potential common shares outstanding are stock options, which resulted in a dilutive effect of 37,137 shares, 15,036 shares and 18,838 shares in fiscal 2008, 2007 and 2006, respectively. The Company calculates the dilutive effect of outstanding options using the treasury stock method.



Options to purchase 567,411 shares, 572,200 shares and 420,201 shares of common stock were outstanding in fiscal 2008, 2007 and 2006, respectively, but were not included in the computation of diluted earnings per share as their exercise prices were greater than the average market price of the common shares.

**STOCK-BASED COMPENSATION** –The Company utilizes the fair value recognition provisions of SFAS No. 123 “Accounting for Stock-Based Compensation” (revised 2004), “Share-Based Payment” (123(R)), requiring the Company to recognize expense related to the fair value of stock-based compensation. The modified prospective transition method was used as allowed under SFAS No. 123(R). Under this method, the stock-based compensation expense includes: (a) compensation expense for all stock-based compensation awards granted prior to, but not yet vested as of July 1, 2005, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, “Accounting for Stock-Based Compensation”; and (b) compensation expense for all stock-based compensation awards granted subsequent to July 1, 2005, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123(R). See Note 9 Stock-Based Compensation.

**ACCOUNTING DEVELOPMENTS** – In July 2006, the Financial Accounting Standards Board (“FASB”) issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109* (“FIN 48”), which clarifies the accounting for uncertainty in tax positions. FIN 48 requires that the Company recognize in its consolidated financial statements, the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. The provisions of FIN 48 were effective as of the beginning of the Company’s 2008 fiscal year, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. The Company recognized an adjustment in the liability for unrecognized income tax benefit of \$0.1 million, which is reported as an adjustment to the beginning balance of retained earnings. See Note 8, Income Taxes.

In September 2006, the FASB issued Statement of Financial Accounting Standards (“SFAS”) No. 157, *Fair Value Measurements*, which defines fair value, establishes a framework for measuring the fair value of assets and liabilities. This framework is intended to provide increased consistency in how fair value determinations are made under various existing accounting standards, which permit, or in some cases require, estimates of fair market value. The provisions of SFAS No. 157 are effective as of the beginning of the Company’s 2009 fiscal year. In February 2008, the FASB issued FSP No. FAS 157-1, *Application of SFAS No. 157 to SFAS No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under SFAS No. 13*, and FSP No. 157-2, *Effective Date of SFAS No. 157*. Collectively, the FSPs defer the effective date of SFAS No. 157 to fiscal years beginning after December 15, 2008, for non-financial assets and non-financial liabilities except for items that are recognized or disclosed at fair value on a recurring basis at least annually, and amend the scope of SFAS 157. The Company is currently evaluating the impact of adopting SFAS No. 157 on its consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (“SFAS No. 159”). SFAS No. 159 permits entities to choose to measure many financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected will be reported in earnings. The provisions of SFAS No. 159 are effective as of the beginning of the Company’s 2009 fiscal year. The Company is currently evaluating the impact of adopting SFAS No. 159 on its consolidated statements.

## **2. INVESTMENTS**

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

Realized gains on the sale of securities were approximately \$0.2 million, \$0.3 million, and \$0.1 million at June 30, 2008, June 30, 2007, and June 30, 2006, respectively. A summary of the carrying values and fair values of the Company's investments is as follows (in thousands):

	<b>June 30, 2008</b>			
	<b>Cost Basis</b>	<b>Gross Unrealized</b>		<b>Fair Value</b>
		<b>Gains</b>	<b>Losses</b>	
Debt securities	\$ 2,198	\$ 27	\$ -	\$ 2,225
Equity securities	2,619	1,545	-	4,164
	<u>\$ 4,817</u>	<u>\$ 1,572</u>	<u>\$ -</u>	<u>\$ 6,389</u>

	<b>June 30, 2007</b>			
	<b>Cost Basis</b>	<b>Gross Unrealized</b>		<b>Fair Value</b>
		<b>Gains</b>	<b>Losses</b>	
Debt securities	\$ 2,292	\$ -	\$ (30)	\$ 2,262
Equity securities	2,656	1,741	-	4,397
	<u>\$ 4,948</u>	<u>\$ 1,741</u>	<u>\$ (30)</u>	<u>\$ 6,659</u>

	<b>June 30, 2008</b>		<b>June 30, 2007</b>	
	<b>Investments</b>	<b>Other Assets</b>	<b>Investments</b>	<b>Other Assets</b>
	Debt securities	\$ -	\$ 2,225	\$ -
Equity securities	1,160	3,004	976	3,421
	<u>\$ 1,160</u>	<u>\$ 5,229</u>	<u>\$ 976</u>	<u>\$ 5,683</u>

As of June 30, 2008, all debt securities mature within one year.

### 3. INVENTORIES

Inventories valued on the LIFO method would have been approximately \$3.3 million and \$3.7 million higher at June 30, 2008 and 2007, respectively, if they had been valued on the FIFO method. At June 30, 2008 and 2007 the total value of LIFO inventory was \$2.7 million and \$3.1 million, respectively. A comparison of inventories is as follows (in thousands):

	<b>June 30,</b>	
	<b>2008</b>	<b>2007</b>
Raw materials .....	\$ 15,272	\$ 16,389
Work in process and finished parts .....	8,082	7,589
Finished goods .....	62,437	54,779
Total .....	<u>\$ 85,791</u>	<u>\$ 78,757</u>

### 4. PROPERTY, PLANT AND EQUIPMENT

(in thousands)	<b>Estimated Life (Years)</b>	<b>June 30,</b>	
		<b>2008</b>	<b>2007</b>
Land .....		\$ 4,049	\$ 4,049
Buildings and improvements .....	3-39	41,138	40,242
Machinery and equipment .....	3-20	31,322	34,010
Delivery equipment .....	3-10	19,103	19,711
Furniture and fixtures .....	3-5	4,251	4,564
Total .....		<u>99,863</u>	<u>102,576</u>
Less accumulated depreciation .....		<u>(73,491)</u>	<u>(74,408)</u>
Net .....		<u>\$ 26,372</u>	<u>\$ 28,168</u>

## 5. OTHER ASSETS

(in thousands)	June 30,	
	2008	2007
Cash value of life insurance.....	\$ 6,232	\$ 5,940
Investments designated for deferred compensation plans ..	5,229	5,683
Other.....	41	587
Total.....	<u>\$ 11,502</u>	<u>\$ 12,210</u>

## 6. ACCRUED LIABILITIES – OTHER

(in thousands)	June 30,	
	2008	2007
Dividends .....	\$ 855	\$ 854
Advertising .....	1,309	1,327
Warranty .....	1,090	1,040
Income taxes payable * .....	–	987
Other .....	2,806	3,186
Total.....	<u>\$ 6,060</u>	<u>\$ 7,394</u>

\* At June 30, 2008, the Company has an income tax receivable that is included in the balance sheet within our other current assets.

## 7. BORROWINGS AND CREDIT ARRANGEMENTS

At June 30, 2008, borrowings and credit arrangements consisted of the following (in thousands):

Current:	
Current maturities of long-term debt .....	\$ 526
Overnight borrowing interest rate at prime minus 1%; unsecured .....	1,079
\$12.0 million working capital line of credit through June 30, 2009; interest rate at LIBOR + 0.75%; unsecured .....	3,538
Long-Term:	
\$20.0 million revolving note; expires September 30, 2012; interest rate at LIBOR + 0.75%; unsecured .....	20,000
\$2.6 million fixed rate note; requiring payments through December 2010; interest rate at 4.99%; secured by certain delivery equipment; net of current portion .....	811
Total .....	<u>\$ 25,954</u>

The Company had unsecured credit facilities of \$32.1 million with a bank, with borrowings at differing rates based on the date and type of financing utilized. The unsecured credit facilities provided \$12.0 million short-term (renewed annually), \$20.0 million long-term (expires September 30, 2012) and \$0.1 million in letters of credit that are used primarily for international inventory purchases. The credit facilities provided for interest selected at the option of the Company at prime or LIBOR plus an add-on percentage, based on a rolling four-quarter leverage ratio calculation. The short-term facility expired on June 30, 2008.

The short-term portion of the credit facility provides working capital financing up to \$12.0 million, of which \$3.5 million was outstanding at June 30, 2008, with interest selected at the option of the Company at prime (5% at June 30, 2008) or LIBOR (2.5% at June 30, 2008) plus 0.75%. The short-term portion also provides overnight credit when required for operations at prime minus 1.0%. At June 30, 2008, no amount was outstanding related to overnight credit. The long-term portion of the credit facility provides up to \$20.0 million, of which \$20.0 million was outstanding at June 30, 2008. Variable interest is set monthly at the option of the Company at prime or LIBOR plus 0.75%. The credit facility also provides \$0.1 million to support letters of credit issued by the Company of which no amount was outstanding as of June 30, 2008. All interest rates are adjusted monthly, except for the overnight portion of the short-term line of credit, which varies daily at the prime rate minus 1.0%. As of June 30, 2008, the Company has effectively fixed the interest rates at

4.5% on approximately \$15.0 million of its long-term debt through the use of interest rate swaps. On July 31, 2008, a \$5.0 million swap matured. As of the date of this filing, the Company has effectively fixed its interest rate at 5.0% on approximately \$10.0 million.

The credit agreement contains certain restrictive covenants that require the Company, among other things, to maintain an interest coverage ratio, leverage ratio, and limitations on capital disposals, all as defined in the credit agreement. At June 30, 2008, the Company was in compliance with all financial covenants contained in the credit agreement.

An officer of the Company is a director at a bank where the Company maintains a \$4.0 million line of credit, cumulative letter of credit facilities of \$5.2 million and where its routine daily banking transactions are processed. 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 \$5.2 million. The Company receives no special services or pricing on the services performed by the bank due to the directorship of this officer. At June 30, 2008, \$1.1 million was outstanding on the line of credit at prime minus 1 %.

## 8. INCOME TAXES

In determining the provision for income taxes, the Company uses an estimated annual effective tax rate that is based on the annual income, statutory tax rates and tax planning opportunities available in the various jurisdictions in which the Company operates. This includes recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns to the extent pervasive evidence exists that they will be realized in future periods. The deferred tax balances are adjusted to reflect tax rates by tax jurisdiction, based on currently enacted tax laws, which are expected to be in effect in the years in which the temporary differences are expected to reverse. In accordance with the Company's income tax policy, significant or unusual items are separately recognized when they occur.

The Company adopted the provisions of FIN 48 on July 1, 2007. As a result of the implementation of FIN 48, the Company recognized an adjustment in the liability for unrecognized income tax benefits of \$0.1 million, which is reported as a cumulative effect of a change in accounting principle and is reported as an adjustment to the beginning balance of retained earnings as of July 1, 2007. At the adoption date of July 1, 2007, the Company had approximately \$0.8 million of gross liabilities related to unrecognized tax benefits (composed of \$0.6 million of gross unrecognized tax benefits and accrued interest and penalties of \$0.2 million) and related deferred tax assets of approximately \$0.2 million. At June 30, 2008, the Company had approximately \$0.7 million of gross liabilities related to unrecognized tax benefits (composed of \$0.5 million of gross unrecognized tax benefits and accrued interest and penalties of \$0.2 million) and related deferred tax assets of approximately \$0.2 million, all of which would affect our effective tax rate if recognized. The Company does not expect that there will be any positions for which it is reasonably possible that the total amounts of unrecognized tax benefits will significantly increase or decrease within the next twelve months. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (in thousands):

Balance at July 1, 2007.....	\$ 617
Additions (reductions) based on tax positions related to the current year .....	(68)
Balance at June 30, 2008 .....	<u>\$ 549</u>

Consistent with prior periods and upon adoption of FIN 48 the Company records interest and penalties related to income taxes as income tax expense in the Consolidated Statements of Income. As of July 1, 2007 and June 30, 2008, the Company had approximately \$0.2 million of accrued interest and penalties related to uncertain tax positions. The total income tax provision in fiscal years 2008, 2007 and 2006 was 35.8%, 35.6% and 39.3%, respectively, of income before income taxes. The rate increased by approximately 0.2% from fiscal year 2007 to 2008 due primarily to the decrease in nontaxable life insurance proceeds received in the current year compared to the prior year.

The provision for income taxes is as follows for the years ended June 30 (in thousands):

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Federal – current .....	\$ 1,510	\$ 6,045	\$ 1,762
State – current .....	270	570	350
Deferred .....	580	(1,465)	948
Total.....	<u>\$ 2,360</u>	<u>\$ 5,150</u>	<u>\$ 3,060</u>



A reconciliation between the U.S. federal statutory tax rate and the effective tax rate is as follows for the years ended June 30:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Federal statutory tax rate .....	34.0%	35.0%	34.0%
State taxes, net of federal effect.....	2.7	2.6	2.8
Other .....	(0.9)	(2.0)	2.5
Effective tax rate.....	<u>35.8%</u>	<u>35.6%</u>	<u>39.3%</u>

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

	<u>June 30, 2008</u>		<u>June 30, 2007</u>	
	<u>Current</u>	<u>Long-term</u>	<u>Current</u>	<u>Long-term</u>
Investments.....	\$ (580)	\$ -	\$ (650)	\$ -
Accounts receivable.....	780	-	800	-
Inventory .....	1,730	-	1,590	-
Self insurance.....	1,040	-	1,165	-
Employee benefits.....	540	-	760	-
Accrued expenses .....	700	-	1,035	-
Property, plant and equipment .....	-	(940)	-	(900)
Deferred compensation.....	-	2,030	-	2,130
Other .....	-	302	-	40
Total.....	<u>\$ 4,210</u>	<u>\$ 1,392</u>	<u>\$ 4,700</u>	<u>\$ 1,270</u>

The Company is subject to U.S. federal income tax as well as income tax of multiple state and foreign jurisdictions. Generally, tax years 2004–2007 remain open to examination by the Internal Revenue Service or other taxing jurisdictions to which we are subject.

## 9. STOCK-BASED COMPENSATION

The Company has three stock-based compensation methods available when determining employee compensation. The Company's shareholders have approved all stock-based compensation and stock option plans.

- (1) Management Incentive Plan – This plan provides for shares of common stock to be awarded to key employee based on targeted rate of earnings to common equity as established by the Board of Directors. Shares awarded to employees are subject to the restriction of continued employment, with one-third of the stock received by the employee on the award date and the remaining shares vested after one and two years. Under the plan no shares were awarded during the fiscal years ended June 30, 2008, 2007 or 2006. There were no shares forfeited in the fiscal years ended June 30, 2008, 2007 and 2006. This plan expired on June 30, 2008, there are no awards outstanding and all prior year awards are fully vested.
- (2) 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 has selected consolidated operating results for organic net sales growth and fully-diluted earnings per share for the two-year transition period beginning July 1, 2007 and ending on June 30, 2009 and the three-year performance periods beginning July 1, 2007 and ending on June 30, 2010 and beginning July 1, 2008 and ending on June 30, 2011. The Committee has also specified that payouts, if any, for awards earned under the 2007-2009, 2007-2010 and 2008-2011 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.

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:

Performance Period	At Target		At Maximum	
	Stock	Cash	Stock	Cash
July 1, 2007 – June 30, 2009	22,212	\$ 210,567	35,544	\$ 336,820
July 1, 2007 – June 30, 2010	33,330	\$ 315,881	53,329	\$ 505,395
July 1, 2008 – June 30, 2011	44,621	\$ 334,714	71,398	\$ 535,573

No compensation costs were accrued at June 30, 2008. 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 per year based on the estimated fair values at June 30, 2008. At June 30, 2008, 500,000 shares were available for awards.

- (3) 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.

In fiscal years 2008, 2007 and 2006, the Company issued options for 120,000, 135,000 and 159,500 common shares at an exercise price of \$12.40, \$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 \$0.2 million, \$0.3 million and \$0.4 million, respectively. The Company also recorded a reduction of its income tax expense of \$28,000, \$43,000 and \$63,000, respectively, related to the issuance of these options. The assumptions used in determining the compensation expense and related income tax impacts are discussed below.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants in fiscal 2008, 2007 and 2006, respectively; dividend yield of 4.2%, 4.1% and 3.6%; expected volatility of 19.5%, 21.6% and 23.3%; risk-free interest rate of 3.3%, 4.5% and 4.5%; and an expected life of 5, 6 and 6 years, respectively. The expected volatility and expected life are determined based on historical data.

The weighted-average grant date fair value of stock options granted during the fiscal years ended June 30, 2008, 2007 and 2006, was \$1.55, \$2.03 and \$2.68, respectively. The cash proceeds, income tax benefit and aggregate intrinsic value of options (the amount by which the market price of the stock on the date of exercise exceeded the market price of stock on the date of grant) exercised during the fiscal years ended June 30, 2008, 2007 and 2006, respectively, was not material.

At June 30, 2008, 381,700 shares were available for future grants. It is the Company's policy to issue new shares upon exercise of stock options. The Company accepts shares of the Company's common stock as payment for exercise of options. These shares received as payment are retired upon receipt.

A summary of the status of the Company's stock option plans as of June 30, 2007, 2006 and 2005 and the changes during the years then ended is presented below:

	<u>Shares</u>	<u>Weighted Average Exercise Price</u>	<u>Aggregate Intrinsic Value (in millions)</u>
Outstanding and exercisable at July 1, 2005 .....	503,601	\$ 16.50	\$ 0.2
Granted .....	159,500	14.40	
Exercised .....	(2,000)	11.25	
Canceled .....	-	-	
Outstanding and exercisable at June 30, 2006 .....	661,101	\$ 16.01	\$ 0.1
Granted .....	135,000	12.63	
Exercised .....	(4,427)	12.60	
Canceled .....	(9,500)	15.60	
Outstanding and exercisable at June 30, 2007 .....	782,174	\$ 15.45	\$ 0.4
Granted .....	120,000	12.40	
Exercised .....	(3,400)	11.80	
Canceled .....	(5,790)	16.07	
Outstanding and exercisable at June 30, 2008 .....	<u>892,984</u>	\$ 15.05	\$ 0.0

The following table summarizes information for options outstanding and exercisable at June 30, 2008:

	<u>Range of Prices</u>	<u>Options Outstanding</u>	<u>Weighted Average</u>	
			<u>Remaining Life (Years)</u>	<u>Exercise Price</u>
\$	10.30 – 10.75	23,800	2.9	\$ 10.57
	12.35 – 13.59	301,773	7.6	12.64
	14.40 – 16.52	423,016	6.3	15.56
	19.21 – 20.27	144,395	5.4	19.33
\$	10.30 – 20.27	<u>892,984</u>	6.5	\$ 15.05

## 10. ACCRUED WARRANTY COSTS

The following table presents the changes in the Company's product warranty liability for the fiscal years ended June 30 (in thousands):

	<u>2008</u>	<u>2007</u>
Accrued warranty costs at beginning of year .....	\$ 1,040	\$ 1,140
Payments made for warranty and related costs .....	(3,331)	(3,558)
Accrual for product warranty and related costs.....	3,381	3,458
Accrued warranty costs at end of year.....	<u>\$ 1,090</u>	<u>\$ 1,040</u>

## 11. BENEFIT AND RETIREMENT PLANS

The Company sponsors various defined contribution pension and retirement plans, which cover substantially all employees, other than employees covered by multi-employer pension plans under collective bargaining agreements. It is the Company's policy to fund all pension costs accrued. Total pension and retirement plan expense was \$2.0 million in each of the fiscal years 2008, 2007, and 2006. The amounts include \$0.5 million in each of the fiscal years 2008, 2007 and 2006, for the Company's matching contribution to retirement savings plans. The Company's cost for pension plans is generally determined as 2% - 6% of each covered employee's wages. The Company's matching contribution for the retirement savings plans is generally 25% - 50% of employee contributions (up to 4% of employee earnings). In addition to the above, amounts charged to pension expense and contributed to multi-employer defined benefit pension plans administered by others under collective bargaining agreements were \$0.8 million, \$0.9 million and \$1.0 million in fiscal 2008, 2007 and 2006, respectively. The cumulative cost to exit the Company's multi-employer plans was approximately \$3.5 million on June 30, 2008.

The Company has unfunded post-retirement benefit and deferred compensation plans with executive officers. The plans require various annual contributions for the participants based upon compensation levels and age. All participants are fully vested. For fiscal 2008, 2007 and 2006, the benefit obligation was increased by interest expense of \$0.3 million, \$0.2 million and \$0.2 million, service costs of \$0.3 million, \$0.5 million and \$0.3 million, and decreased by payments of \$0.8 million, \$0.5 million and \$0.4 million, respectively. For fiscal 2008, 2007 and 2006, the discount rate was 6.10%,

6.25%, 6.25%, respectively and the rate of return on assets was 8.25%, 8.25%, and 8.25%, respectively. At June 30, 2008, the benefit obligation was \$5.3 million, including \$0.3 million for defined benefits.

Under provisions of the Company's Voluntary Deferred Compensation Plan, executive officers may defer common stock awards received as participants of the Management Incentive Plan until retirement. Under the plan, no shares were deferred during the fiscal years ended June 30, 2008 and 2007. At June 30, 2008 and 2007, 53,575 shares and 60,853 shares with an award date value of \$0.8 million and \$0.9 million, respectively, had been deferred and are being held on behalf of the employees. Under the plan, 7,278 shares were distributed in fiscal years 2008 and 2007, respectively.

The Company's defined benefit pension plan covers 78 active hourly production employees of DMI. There are a total of 484 participants in the plan. Retirement benefits are based on years of credited service multiplied by a dollar amount negotiated under collective bargaining agreements. The Company's policy is to fund normal costs and amortization of prior service costs at a level that is equal to or greater than the minimum required under the Employee Retirement Income Security Act of 1974 (ERISA). According to an agreement reached with the collective bargaining unit, all benefits and participants are fixed. Future benefits will accrue to current participants; however, new participants cannot be added to the plan. As of June 30, 2008, the Company recorded an accrued benefit liability related to the funded status of the defined benefit pension plan recognized on the Company's balance sheet of \$0.3 million and as of June 30, 2007 an accrued asset was recorded on the Company's consolidated balance sheet of \$0.4 million. The accumulated benefit obligation was \$5.2 million and \$4.9 million at fiscal years ended June 30, 2008 and 2007, respectively.

## 12. COMPREHENSIVE INCOME

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

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Net income.....	\$ 4,236	\$ 9,334	\$ 4,718
Other comprehensive income (OCI):			
Change in fair value of derivatives, net of income taxes of \$176, \$70 and \$(73), respectively .....	(273)	(168)	117
Change in fair value of available-for-sale, Securities, net of income taxes of \$54, \$(205), \$-, respectively .....	(84)	301	-
Change in minimum pension liability, net of income taxes of \$321, \$(140) and \$(305), respectively.....	(524)	255	543
Total other comprehensive income.....	<u>(881)</u>	<u>388</u>	<u>660</u>
Total comprehensive income.....	<u>\$ 3,355</u>	<u>\$ 9,722</u>	<u>\$ 5,378</u>

The components of accumulated other comprehensive income, net of income taxes, are as follows (in thousands):

	<u>June 30,</u>	
	<u>2008</u>	<u>2007</u>
Available-for-sale securities .....	\$ 975	\$ 1,059
Interest rate swaps.....	(178)	95
Pension and other post-retirement benefit adjustments.....	(569)	(44)
Total accumulated other comprehensive income.....	<u>\$ 228</u>	<u>\$ 1,110</u>

## 13. LITIGATION

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



#### 14. COMMITMENTS AND CONTINGENCIES

FACILITY LEASES – the Company leases certain facilities and equipment under various operating leases. These leases require the Company to pay the lease cost, operating costs, including property taxes, insurance, and maintenance. Total lease expense related to the various operating leases was approximately \$4.0 million, \$3.6 million and \$3.4 million in fiscal 2008, 2007 and 2006, respectively.

Expected future minimum commitments under operating leases as of June 30, 2008 were as follows (in thousands):

<u>Fiscal Year Ended June 30</u>	
2009	2,601
2010	1,748
2011	983
2012	628
2013	284
	<u>\$ 6,244</u>

As described in Note 19, the Company identified certain errors in the reconciliation of accounts payable during its 2008 closing period. As a result of these errors, the Company restated, in this Annual Report on Form 10-K, certain of its previously filed financial statements. The Company could be subject to litigation or other contingent liabilities, which may result in cash and noncash charges, any or all of which could have a material adverse effect on the consolidated financial statements.

#### 15. SUPPLEMENTAL CASH FLOW INFORMATION

*Non-Cash Financing Activities* – During fiscal year 2006, the Company purchased delivery equipment of \$2.6 million financed by a note payable. During fiscal year 2006, the Company issued shares with an award date value of \$0.2 million in settlement of management incentive compensation plan liabilities.

#### 16. SEGMENTS

The Company operates in one reportable operating segment, furniture products. Our operations involve the distribution of manufactured and imported products consisting of a broad line of upholstered and wood furniture such as sofas, loveseats, chairs, reclining and rocker-reclining chairs, swivel rockers, sofa beds, convertible bedding units, occasional tables, desks, dining tables and chairs and bedroom furniture for residential, recreational vehicle, and commercial markets. The Company's furniture products are sold primarily throughout the United States by the Company's internal sales force and various independent representatives. The Company makes minimal export sales. No single customer accounted for more than 10% of net sales. The Company has no foreign manufacturing operations and all of our long-lived assets are located within the United States.

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

	<u>FOR THE YEARS ENDED JUNE 30,</u>		
	<u>2008</u>	<u>2007</u>	<u>2006</u>
Residential .....	\$ 258,084	\$ 259,710	\$ 267,714
Recreational Vehicle .....	56,090	66,165	71,981
Commercial .....	91,481	99,525	86,713
	<u>\$ 405,655</u>	<u>\$ 425,400</u>	<u>\$ 426,408</u>

## 17. SUPPLEMENTARY QUARTERLY FINANCIAL INFORMATION – UNAUDITED

The previously issued condensed consolidated balance sheets as of March 31, 2008, December 31, 2007, September 30, 2007, March 31, 2007, December 31, 2006 and September 30, 2006 contained an error as discussed in Note 19. The effect of the restatement on certain of the Company's previously reported quarterly financial statements on Form 10-Q are as follows (amounts in thousands):

### Consolidated Balance Sheets

#### Quarter Ended March 31, 2008

	As Reported	Adjustment	As Restated
Deferred income taxes	\$ 3,420	\$ 850	\$ 4,270
Total current assets	135,358	850	136,208
Total assets	174,767	850	175,617
Accounts payable	9,672	2,287	11,959
Total current liabilities	32,010	2,287	34,297
Total liabilities	59,670	2,287	61,957
Retained earnings	103,648	(1,437)	102,211
Total shareholders' equity	115,097	(1,437)	113,660
Total liabilities and shareholders' equity	174,767	850	175,617

### Consolidated Balance Sheets

#### Quarter Ended December 31, 2007

	As Reported	Adjustment	As Restated
Deferred income taxes	\$ 3,670	\$ 850	\$ 4,520
Total current assets	144,470	850	145,320
Total assets	184,793	850	185,643
Accounts payable	12,752	2,287	15,039
Total current liabilities	41,740	2,287	44,027
Total liabilities	69,290	2,287	71,577
Retained earnings	103,653	(1,437)	102,216
Total shareholders' equity	115,503	(1,437)	114,066
Total liabilities and shareholders' equity	184,793	850	185,643

### Consolidated Balance Sheets

#### Quarter Ended September 30, 2007

	As Reported	Adjustment	As Restated
Deferred income taxes	\$ 3,720	\$ 850	\$ 4,570
Total current assets	142,491	850	143,341
Total assets	183,291	850	184,141
Accounts payable	11,904	2,287	14,191
Total current liabilities	41,617	2,287	43,904
Total liabilities	68,956	2,287	71,243
Retained earnings	102,640	(1,437)	101,203
Total shareholders' equity	114,335	(1,437)	112,898
Total liabilities and shareholders' equity	183,291	850	184,141

### Consolidated Balance Sheets

#### Quarter Ended March 31, 2007

	As Reported	Adjustment	As Restated
Deferred income taxes	\$ 4,190	\$ 850	\$ 5,040
Total current assets	134,554	850	135,404
Total assets	179,532	850	180,382
Accounts payable	13,851	2,287	16,138
Total current liabilities	43,518	2,287	45,805
Total liabilities	70,689	2,287	72,976
Retained earnings	97,435	(1,437)	95,998
Total shareholders' equity	108,843	(1,437)	107,406
Total liabilities and shareholders' equity	179,532	850	180,382

**Consolidated Balance Sheets****Quarter Ended December 31, 2006**

	As Reported	Adjustment	As Restated
Deferred income taxes	\$ 4,480	\$ 850	\$ 5,330
Total current assets	137,214	850	138,064
Total assets	175,865	850	176,715
Accounts payable	16,256	2,287	18,543
Total current liabilities	40,418	2,287	42,705
Total liabilities	67,717	2,287	70,004
Retained earnings	96,767	(1,437)	95,330
Total shareholders' equity	108,148	(1,437)	106,711
Total liabilities and shareholders' equity	175,865	850	176,715

**Consolidated Balance Sheets****Quarter Ended September 30, 2006**

	As Reported	Adjustment	As Restated
Deferred income taxes	\$ 4,220	\$ 850	\$ 5,070
Total current assets	142,127	850	142,977
Total assets	179,092	850	179,942
Accounts payable	15,131	2,287	17,418
Total current liabilities	44,604	2,287	46,891
Total liabilities	71,904	2,287	74,191
Retained earnings	96,212	(1,437)	94,775
Total shareholders' equity	107,188	(1,437)	105,751
Total liabilities and shareholders' equity	179,092	850	179,942

(in thousands, except per share amounts)

**FOR THE QUARTER ENDED**

	September 30	December 31	March 31	June 30
<b>Fiscal 2008:</b>				
Net sales .....	\$ 100,900	105,986	98,138	100,630
Gross margin.....	19,763	22,070	18,019	18,637
Net income (1) (2) (3) .....	1,183	1,868	849	336
Earnings per share:				
Basic.....	0.18	0.28	0.13	0.05
Diluted .....	0.18	0.28	0.13	0.05

(in thousands, except per share amounts)

**FOR THE QUARTER ENDED**

	September 30	December 31	March 31	June 30
<b>Fiscal 2007:</b>				
Net sales .....	\$ 101,340	\$ 105,700	\$ 104,071	\$ 114,289
Gross margin.....	18,405	19,774	20,478	22,566
Net income (4) .....	563	1,409	1,522	5,841
Earnings per share:				
Basic.....	0.09	0.21	0.23	0.89
Diluted .....	0.09	0.21	0.23	0.89

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

- (1) The quarter ended December 31, 2007 includes the recording of stock-based compensation expense of \$0.2 million (after tax) for stock options under SFAS No. 123 (R) or \$0.03 per share.
- (2) The quarter ended December 31, 2006 includes the recording of stock-based compensation expense of \$0.2 million (after tax) for stock options under SFAS No. 123 (R) or \$0.04 per share.
- (3) The quarter ended March 31, 2007 includes a \$0.4 million pre-tax gain from the sale of vacant land or \$0.06 per share.
- (4) The quarter ended June 30, 2007 includes a \$0.6 million non-taxable gain on life insurance (\$0.08 per share) and \$2.5 million (after tax) gain from the sale of a property (\$0.37 per share).

## 18. SUBSEQUENT EVENT – UNAUDITED

On September 8, 2008, the Board of Directors approved the closure of its New Paris, Indiana. recreational vehicle seating manufacturing facility and the end of manufacturing operations at its Lancaster, Pennsylvania. facility. The Company announced the closures on September 10, 2008. The Company expects manufacturing at both locations to cease November 9, 2008. The Company intends to continue its warehousing and shipping operations in Lancaster.

Approximately 250 employees will be affected by this consolidation of manufacturing operations over the next two to three months. The Company estimates the manufacturing consolidation and transition will be completed by December 31, 2008 and anticipates pre-tax restructuring and impairment charges in the first half of fiscal year 2009 to be in the range of \$2.0 million to \$2.5 million.

## 19. ERROR CORRECTIONS

The Company has restated the consolidated financial statements as of and for the fiscal years ended June 30, 2007 and 2006.

During the 2008 fiscal year-end closing process the Company identified unsupported reconciling amounts that reduced accounts payable balances at a material consolidated subsidiary. After completing analysis of these unsupported reconciling amounts, it was determined that they principally related to the historical accounting at the subsidiary for the capitalization of inventory costs and the clearing of accruals from the accounts payable relating to transactions occurring in fiscal years 2004 and 2005. The historical subsidiary inventory standard costing system, established prior to the warehousing of inventory in China, did not appropriately differentiate the costing of inventory balances warehoused in China versus the United States. The warehoused inventories in China inappropriately included freight-in costs for shipments to the United States that had not been incurred. During fiscal year 2006, the Company modified the subsidiary's inventory costing process which rectified the costing error in inventory on a prospective basis but resulted in the reclassification of the historical error in inventory freight costs as a reduction to accounts payable with the erroneous belief that the reduction to accounts payable would offset future freight invoices. As a result of this error, the \$2.287 million reduction within accounts payable remained until identified during the fiscal year 2008 closing process.

The effect of the restatement on the Company's previously reported consolidated financial statements are as follows (amounts in thousands, except per share data):

### Consolidated Statements of Changes in Shareholders' Equity

	<b>Fiscal Year Ended June 30, 2006</b>		
	<u>As Reported</u>	<u>Adjustment</u>	<u>As Restated</u>
Retained earnings	\$ 96,502	\$ (1,437)	\$ 95,065
Total shareholders' equity	107,502	(1,437)	106,065

### Consolidated Statements of Cash Flows

	<b>Fiscal Year Ended June 30, 2006</b>		
	<u>As Reported</u>	<u>Adjustment</u>	<u>As Restated</u>
<b>OPERATING ACTIVITIES:</b>			
Changes in operating assets and liabilities:			
Inventories	\$ (14,825)	\$ 2,287	\$ (12,538)
Accounts payable	(492)	(2,287)	(2,779)

### Consolidated Balance Sheets

	<b>Fiscal Year Ended June 30, 2007</b>		
	<u>As Reported</u>	<u>Adjustment</u>	<u>As Restated</u>
Deferred income taxes	\$ 3,850	\$ 850	\$ 4,700
Total current assets	142,516	850	143,366
Total assets	184,164	850	185,014
Accounts payable	13,607	2,287	15,894
Total current liabilities	43,177	2,287	45,464
Total liabilities	70,049	2,287	72,336
Retained earnings	102,421	(1,437)	100,984
Total shareholders' equity	114,115	(1,437)	112,678
Total liabilities and shareholders' equity	184,164	850	185,014



## Consolidated Statements of Changes in Shareholders' Equity

	Fiscal Year Ended June 30, 2007		
	As Reported	Adjustment	As Restated
Retained earnings	\$ 102,421	\$ (1,437)	\$ 100,984
Total shareholders' equity	114,115	(1,437)	112,678

In addition, the opening retained earnings restatement adjustment \$1,437 thousand was comprised of \$1,138 thousand and \$299 thousand for the fiscal years ended June 30, 2005 and 2004, respectively.

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

None.

### Item 9A. Controls and Procedures

Evaluation of disclosure controls and procedures – Based on their evaluation as of the end of the period covered by this Annual Report on Form 10-K, the Company's Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") have concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e)) under the Securities Act of 1934, as amended) were not effective as of June 30, 2008 because of a material weakness in our internal control over financial reporting.

Changes in internal control over financial reporting – During the quarter ended June 30, 2008, there was no change in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934) that has materially affected, or is reasonably likely to materially affect the Company's internal control over financial reporting.

Management's Annual Report on Internal Control Over Financial Reporting – Management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rules 13a-15(f) or 15d-15(f) of the Securities Exchange Act of 1934, as amended. We performed an evaluation under the supervision and with the participation of our management, including the CEO and CFO, to assess the effectiveness of the design and operation of our disclosure controls and procedures under the Exchange Act as of June 30, 2008. In making this assessment, we used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control—Integrated Framework*. Based on that criteria, the material weakness described below has caused our management to conclude we did not maintain effective internal control over financial reporting as of June 30, 2008.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis.

As a result of their assessment, the Company's CEO and CFO identified a material weakness in the Company's internal control over financial reporting. The material weakness is related to the design and operating effectiveness of controls over the Company's material consolidated subsidiary's reconciliation of accounts payable records to the general ledger. Specifically, the subsidiary maintained an overly complex accounts payable account structure, which when combined with the processing of a large volume of transactions led to the subsidiary's inability to perform adequate review procedures to timely identify reconciling amounts and the related reversals. This deficiency obscured the existence of unsupported reconciling amounts resulting in the untimely identification of the errors in the restatement discussed in Note 19 to the Consolidated Financial Statements in this Annual Report on Form 10-K.

The Company's management is committed to continuing efforts aimed at improving the design adequacy and operational effectiveness of its system of internal control and intends to take all necessary steps to address this material weakness. Subsequent to June 30, 2008, the Company began taking the following measures to address the material weakness identified above and to enhance internal control over monthly, quarterly and year-end financial reporting:

- simplifying the account structure surrounding the accounts payable transactions by reducing the number of general ledger accounts used to record accounts payable,
- improving the accounts payable reconciliation process by revising the automatic postings to accounts payable, and
- enhancing the review and approval of the accounts payable reconciliation process with our subsidiary associates.

The Company believes that these remediation actions, once they are fully implemented and operating for a sufficient period of time, will improve the Company's internal controls over financial reporting and are sufficient to remediate the material weakness described above. While steps have been taken to remediate the material weakness, additional measures may be required. Management will assess the effectiveness of the remediation efforts in connection with management's tests of internal control over financial reporting during fiscal year 2009.

Deloitte & Touche LLP, the independent registered public accounting firm that has audited our consolidated financial statements included in this Annual Report on Form 10-K, has issued their attestation report on our internal control over financial reporting, a copy of which is included in this Annual Report on Form 10-K.

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders of Flexsteel Industries, Inc.

We have audited Flexsteel Industries, Inc. and subsidiaries (the "Company's") internal control over financial reporting as of June 30, 2008, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Controls over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on that risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

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

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

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis. The following material weakness has been identified and included in management's assessment: the design and operating effectiveness of controls over the Company's material consolidated subsidiary's reconciliation of accounts payable records to the general ledger were not effective. This matter represents a design and operating deficiency, and, based upon misstatements requiring correction to the consolidated financial statements that impacted accounts payable, retained earnings, and deferred income tax accounts, constitutes a material weakness. This material weakness was considered in determining the nature, timing, and extent of audit tests applied in our audit of the consolidated financial statements as of and for the year ended June 30, 2008, of the Company and this report does not affect our report on such financial statements and financial statement schedule.

In our opinion, because of the effect of the material weakness identified above on the achievement of the objectives of the control criteria, the Company has not maintained effective internal control over financial reporting as of June 30, 2008, based on the criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We do not express an opinion on any other form of assurance on management's statements regarding the measures taken to address the material weakness identified in Management's Annual Report over Financial Reporting, and the statements made by management regarding the remediation efforts.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements and financial statement schedules as of and for the year ended June 30, 2008, of the Company and our report dated September 10, 2008 expressed an unqualified opinion on those financial statements and financial statement schedule.

DELOITTE & TOUCHE LLP

Minneapolis, Minnesota  
September 10, 2008

## Item 9B. Other Information

None.

## PART III

### Item 10. Directors, Executive Officers and Corporate Governance

The information identifying directors of the Company, the Audit and Ethics Committee, the Audit and Ethics Committee Expert and Section 16(a) beneficial ownership reporting compliance, will be contained in the Company's fiscal 2008 definitive proxy statement to be filed with the Securities and Exchange Commission under the sections captioned "Proposal 1 Election of Directors," "Corporate Governance – Audit and Ethics Committee of the Board of Directors" and "Compliance with Section 16(a) of the Securities Exchange Act of 1934" and are incorporated herein by reference.

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

The executive officers of the Company, their ages, positions (in each case as of June 30, 2008), and the month and year they were first elected or appointed an officer of the registrant, are as follows:

<u>Name (age)</u>	<u>Position (date first became officer)</u>
Ronald J. Klosterman (60)	President & Chief Executive Officer (June 1989)
James R. Richardson (64)	Senior Vice President of Residential Sales and Marketing (November 1979)
Thomas D. Burkart (65)	Senior Vice President of Vehicle Seating (February 1984)
Patrick M. Crahan (60)	Senior Vice President of Commercial Seating (June 1989)
Jeffrey T. Bertsch (53)	Senior Vice President of Corporate Services (June 1989)
Donald D. Dreher (59)	Senior Vice President, President & CEO of DMI Furniture, Inc. (December 2004)
James E. Gilbertson (58)	Vice President of Vehicle Seating (June 1989)
Timothy E. Hall (50)	Vice President-Finance, Chief Financial Officer & Secretary (December 2000)

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

### Item 11. Executive Compensation

The information identifying executive compensation will be contained in the Company's fiscal year 2008 definitive proxy statement to be filed with the Securities and Exchange Commission under the sections captioned "Executive Compensation," "Director Compensation," and "Corporate Governance - Compensation Committee Interlocks and Insider Participation" and are incorporated herein by reference.

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

The information identifying beneficial ownership of stock and supplementary data will be contained in the Company's fiscal year 2008 definitive proxy statement to be filed with the Securities and Exchange Commission under the sections captioned "Ownership of Stock By Directors and Executive Officers," "Ownership of Stock by Certain Beneficial Owners," and "Equity Compensation Plan Information" and are incorporated herein by reference.

### Item 13. Certain Relationships and Related Transactions, and Director Independence

This information will be contained under the heading "Interest of Management and Others in Certain Transactions" and "Corporate Governance – Board of Directors" in the Company's fiscal year 2008 definitive proxy statement to be filed with the Securities and Exchange Commission and is incorporated herein by reference.

### Item 14. Principal Accountant Fees and Services

Deloitte & Touche LLP was the Company's independent registered public accounting firm in fiscal 2008. In addition to performing the audit of the Company's consolidated financial statements, Deloitte & Touche LLP provided various audit-related services during fiscal 2008.



The Audit and Ethics Committee pre-approves both the type of services to be provided by Deloitte & Touche LLP and the estimated fees related to these services. The Audit and Ethics Committee reviewed professional services and the possible effect on Deloitte & Touche LLP's independence was considered. The Audit and Ethics Committee has considered and found the provision of services for non-audit services compatible with maintaining Deloitte & Touche LLP's independence. All services provided by Deloitte & Touche LLP during fiscal 2008 were pre-approved by the Audit and Ethics Committee.

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

	<u>2008</u>	<u>2007</u>
Audit Fees <sup>(1)</sup> .....	\$ 578,000	\$ 409,000
Audit Related Fees <sup>(2)</sup> .....	38,000	50,000
Tax Fees <sup>(3)</sup> .....	22,000	-
All Other Fees <sup>(4)</sup> .....	-	-
Total.....	<u>\$ 638,000</u>	<u>\$ 459,000</u>

- (1) Professional fees and expenses for audit of financial statements and internal control over financial reporting services for fiscal 2008 and 2007 and consisted of (i) audit of the Company's annual consolidated financial statements; (ii) reviews of the Company's quarterly consolidated financial statements; (iii) consents and other services related to Securities and Exchange Commission matters; and (iv) consultations on financial accounting and reporting matters arising during the course of the audit and reviews.
- (2) Professional fees and expenses for audit-related services billed in fiscal 2008 and 2007 consisted of employee benefit plan audits, \$38,000 and \$31,000, respectively, and \$19,000 in fiscal 2007 for other SEC-related matters.
- (3) Professional fees and expenses for tax services billed in fiscal 2008 consisted of tax planning and advice services totaling \$22,000 and consisted of (i) tax advice related to structuring certain proposed transactions; and (ii) general tax planning matters.
- (4) No other professional services were provided during fiscal 2008 and 2007.

## PART IV

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

- (a) (1) Financial Statements

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

- (2) Schedules

The following financial statement schedules for the years ended June 30, 2008, 2007 and 2006 are submitted herewith:

### SCHEDULE II RESERVES

*For the Years Ended June 30, 2008, 2007 and 2006*

<u>Description</u>	<u>Balance at Beginning of Year</u>	<u>Additions Charged to Income</u>	<u>Deductions from Reserves</u>	<u>Balance at End of Year</u>
Allowance for Doubtful Accounts: 2008.....	\$ <u>2,090,000</u>	\$ <u>1,050,000</u>	\$ <u>(1,030,000)</u>	\$ <u>2,110,000</u>
2007.....	\$ <u>2,820,000</u>	\$ <u>-</u>	\$ <u>(730,000)</u>	\$ <u>2,090,000</u>
2006.....	\$ <u>3,060,000</u>	\$ <u>850,000</u>	\$ <u>(1,090,000)</u>	\$ <u>2,820,000</u>

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

- (3) Exhibit No.
- 3.1 The 1983 Restated Articles of Incorporation of the Company, as amended through February 14, 2007 (incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2007).
- 3.2 By-Laws of the Company (incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 1993).
- 3.3 Amendments to Restated By-Laws of the Company (incorporated by reference to Exhibit 3.1 to the Company's Form 8-K filed on June 8, 2007).
- 10.1 1995 Stock Option Plan incorporated by reference from the 1995 Flexsteel definitive proxy statement. \*
- 10.2 Management Incentive Plan incorporated by reference from the 1980 Flexsteel definitive proxy statement - commission file #0-5151.\*
- 10.3 1999 Stock Option Plan incorporated by reference from the 1999 Flexsteel definitive proxy statement.\*
- 10.4 Flexsteel Industries, Inc. Voluntary Deferred Compensation Plan incorporated by reference to Exhibit No. 10.5 to the Annual Report on Form 10-K for the fiscal year ended June 30, 2001. \*
- 10.5 Flexsteel Industries, Inc. Restoration Retirement Plan incorporated by reference to Exhibit No. 10.6 to the Annual Report on Form 10-K for the fiscal year ended June 30, 2001. \*
- 10.6 Flexsteel Industries, Inc. Senior Officer Supplemental Retirement Plan incorporated by reference to Exhibit No. 10.7 to the Annual Report on Form 10-K for the fiscal year ended June 30, 2001. \*
- 10.7 2002 Stock Option Plan incorporated by reference to Appendix A from the 2002 Flexsteel definitive proxy statement. \*
- 10.8 Agreement and Plan of Merger, dated as of August 12, 2003, by and among Flexsteel, Churchill Acquisition Corp. and DMI (incorporated by reference to Exhibit 99(d)(1) of Flexsteel Industries, Inc.'s Tender Offer Statement on Schedule TO filed with the Securities and Exchange Commission on August 20, 2003) incorporated by reference to Form 8-K and Amendments No. 1 to Form 8-K, as filed with Securities and Exchange Commission on October 2, 2003.
- 10.9 Credit Facility Agreement dated June 30, 2004 as amended or modified on June 10, 2005, August 19, 2005, December 23, 2005, January 3, 2006, and May 19, 2006 incorporated by reference to Exhibit 10.9 to Flexsteel Industries, Inc. Annual Report on Form 10-K for the fiscal year ended June 30, 2006.
- 10.10 Flexsteel Industries, Inc. 2006 Stock Option Plan incorporated by reference to Appendix C from the 2006 Flexsteel Proxy Statement filed with the Securities, and Exchange Commission on October 31, 2006.
- 10.11 Note Modification Agreement date June 25, 2007 (long-term facility) between Flexsteel Industries, Inc. and JPMorgan Chase Bank, N.A. incorporated by reference to Exhibit 10.1 to Flexsteel's Form 8-K filed with the Securities and Exchange Commission on June 26, 2007.
- 10.12 Note Modification Agreement date June 25, 2007 (short-term facility) between Flexsteel Industries, Inc. and JPMorgan Chase Bank, N.A. incorporated by reference to Exhibit 10.1 to Flexsteel's Form 8-K filed with the Securities and Exchange Commission on June 26, 2007.
- 10.13 Credit Agreement date June 25, 2007 between Flexsteel Industries, Inc. and JPMorgan Chase Bank, N.A. incorporated by reference to Exhibit 10.3 to Flexsteel's Form 8-K filed with the Securities and Exchange Commission on June 26, 2007.

- 10.14 Employment Agreement dated October 1, 2006 between Flexsteel Industries, Inc. and Donald D. Dreher incorporated by reference to Exhibit 10.1 to Flexsteel's Form 8-K filed with the Securities and Exchange Commission on October 5, 2006. \*
- 10.15 Note Modification Agreement dated June 26, 2008 (short-term facility) between Flexsteel Industries, Inc. and JPMorgan Chase Bank, N.A. incorporated by reference to Exhibit 10.1 to Flexsteel's Form 8-K filed with the Securities and Exchange Commission on June 27, 2008.
- 10.16 Credit Agreement dated June 26, 2008 between Flexsteel Industries, Inc. and JPMorgan Chase Bank, N.A. incorporated by reference to Exhibit 10.2 to Flexsteel's Form 8-K filed with the Securities and Exchange Commission on June 27, 2008.
- 10.17 Amendment to Employment Agreement dated June 27, 2008 between Flexsteel Industries, Inc. and Donald D. Dreher incorporated by reference to Exhibit 10.3 to Flexsteel's Form 8-K filed with the Securities and Exchange Commission on June 27, 2008.\*
- 10.18 Flexsteel Industries, Inc. 2007 Long-Term Management Compensation Plan (incorporated by reference to Appendix C to the Definitive Proxy Statement on Schedule 14A filed with the Commission on November 1, 2007). \*
- 21.1 Subsidiaries of the Company. Filed herewith.
- 23 Consent of Independent Registered Public Accounting Firm. Filed herewith.
- 31.1 Certification by Chief Executive Officer Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. Filed herewith.
- 31.2 Certification by Chief Financial Officer Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. Filed herewith.
- 32 Certification by Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. Filed herewith.

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

#### SIGNATURES

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

Date: September 15, 2008

FLEXSTEEL INDUSTRIES, INC.

By: /s/ Ronald J. Klosterman  
**Ronald J. Klosterman**  
*Chief Executive Officer*  
 and  
*Principal Executive Officer*

By: /s/ Timothy E. Hall  
**Timothy E. Hall**  
*Chief Financial Officer*  
 and  
*Principal Financial Officer*

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

Date: September 15, 2008 \_\_\_\_\_  
*/s/ L. Bruce Boylen*  
L. Bruce Boylen  
*Chairman of the Board of Directors*

Date: September 15, 2008 \_\_\_\_\_  
*/s/ Ronald J. Klosterman*  
Ronald J. Klosterman  
*Director*

Date: September 15, 2008 \_\_\_\_\_  
*/s/ Jeffrey T. Bertsch*  
Jeffrey T. Bertsch  
*Director*

Date: September 15, 2008 \_\_\_\_\_  
*/s/ Mary C. Bottie*  
Mary C. Bottie  
*Director*

Date: September 15, 2008 \_\_\_\_\_  
*/s/ Patrick M. Crahan*  
Patrick M. Crahan  
*Director*

Date: September 15, 2008 \_\_\_\_\_  
*/s/ Lynn J. Davis*  
Lynn J. Davis  
*Director*

Date: September 15, 2008 \_\_\_\_\_  
*/s/ Robert E. Deignan*  
Robert E. Deignan  
*Director*

Date: September 15, 2008 \_\_\_\_\_  
*/s/ Thomas E. Holloran*  
Thomas E. Holloran  
*Director*

Date: September 15, 2008 \_\_\_\_\_  
*/s/ Eric S. Rangen*  
Eric S. Rangen  
*Director*

Date: September 15, 2008 \_\_\_\_\_  
*/s/ James R. Richardson*  
James R. Richardson  
*Director*



**Subsidiaries of Flexsteel Industries, Inc.**

DMI Furniture, Inc

DMI Management, Inc. \*

DMI Sourcing Company, LLC \*

DMI Business Consulting Company (Shenzhen) Co. Ltd.\*

Home Styles Furniture Co., Ltd (Thailand) (99.99% interest) \*

Vietnam Representative Office \*

Desert Dreams, Inc. \*\*

Four Seasons Inc. \*\*

\* Subsidiaries of DMI Furniture, Inc.

\*\* Inactive subsidiaries

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference in Registration Statements Nos. 33-1836, 33-26267, 333-109374, 333-140811, 333-1413, 333-45768, 333-105951, and 333-151865 on Form S-8 of our reports dated September 10, 2008, relating to the consolidated financial statements and financial statement schedule of Flexsteel Industries, Inc. and Subsidiaries (the “Company”) (which report expresses an unqualified opinion and includes an explanatory paragraph relating to restatement of the consolidated financial statements as discussed in Note 19 to the consolidated financial statements), and the effectiveness of the Company’s internal control over financial reporting (which report expresses an adverse opinion on the effectiveness of the Company’s internal control over financial reporting) appearing in the Annual Report on Form 10-K of the Company for the year ended June 30, 2008.

DELOITTE & TOUCHE LLP

Minneapolis, Minnesota  
September 10, 2008

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

I, Ronald J. Klosterman, certify that:

1. I have reviewed this annual report on Form 10-K 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: September 15, 2008

By: /s/ Ronald J. Klosterman  
Ronald J. Klosterman  
Chief Executive Officer

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

I, Timothy E. Hall, certify that:

1. I have reviewed this annual report on Form 10-K 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: September 15, 2008

By: /s/ Timothy E. Hall  
Timothy E. Hall  
Chief Financial Officer



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

In connection with the Annual Report of Flexsteel Industries, Inc. (the "Company") on Form 10-K for the fiscal year ended June 30, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), we, Ronald J. Klosterman, Chief Executive Officer, and Timothy E. Hall, 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: September 15, 2008

By:                   /S/Ronald J. Klosterman                    
Ronald J. Klosterman  
Chief Executive Officer

By:                   /S/ Timothy E. Hall                    
Timothy E. Hall  
Chief Financial Officer

## 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 40223**  
(502) 426-4351  
D. D. Dreher, President & CEO

## Directors & Officers

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

**Ronald J. Klosterman**  
President & Chief Executive 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  
Retired 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  
Senior Vice President and  
Chief Accounting Officer  
United Health Group

**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

**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  
Mary C. Bottie  
Lynn J. Davis  
Thomas E. Holloran  
Eric S. Rangen

## Transfer Agent and Registrar

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

## General Counsels

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

## NASDAQ Global Market NASDAQ Symbol

FLXS

## Annual Meeting

December 8, 2008, 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  
www.flexsteelhospitality.com  
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



home furnishings



hospitality furniture



vehicle seating

Photography used by permission of Neumar Corp. / Kountry Aire



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

P.O. Box 877 • Dubuque IA 52004-0877

PRST STD  
U.S. Postage Paid  
Permit # 477  
Dubuque, IA