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

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**FORM 10-Q**

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**Quarterly Report Pursuant to Section 13 or 15(d) of the  
Securities Exchange Act of 1934 [No Fee Required]**  
For the quarterly period ended December 31, 2005

or

**Transition Report Pursuant to Section 13 or 15(d) of the  
Securities Exchange Act of 1934 [No Fee Required]**  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number **0-5151**

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**FLEXSTEEL INDUSTRIES, INC.**

Incorporated in State of Minnesota      I.R.S. Identification No. 42-0442319

P.O. BOX 877  
DUBUQUE, IOWA 52004-0877

Area code 563 Telephone 556-7730

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Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

Large accelerated filer       Accelerated filer       Non-accelerated filer

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

Common Stock — \$1.00 Par Value  
Shares Outstanding as of December 31, 2005

6,561,190

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

FLEXSTEEL INDUSTRIES, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS (UNAUDITED)

	December 31, 2005	June 30, 2005
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 1,856,229	\$ 1,706,584
Investments	1,546,693	1,508,751
Trade receivables – less allowance for doubtful accounts:		
December 31, 2005, \$3,225,000;		
June 30, 2005, \$3,060,000	50,175,351	48,355,070
Inventories	88,438,515	69,945,400
Deferred income taxes	4,450,000	4,430,000
Other	2,122,394	1,851,869
<b>Total current assets</b>	<b>148,589,182</b>	<b>127,797,674</b>
<b>NON-CURRENT ASSETS:</b>		
Property, plant and equipment, net	26,542,587	26,140,914
Deferred income taxes	2,330,000	1,830,000
Other assets	10,984,578	10,889,090
<b>TOTAL</b>	<b>\$ 188,446,347</b>	<b>\$ 166,657,678</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable – trade	\$ 21,524,954	\$ 16,259,905
Current maturities of long-term debt	434,800	
Notes payable	19,065,353	5,000,000
Accrued liabilities:		
Payroll and related items	6,575,967	7,278,474
Insurance	7,501,855	7,622,551
Other	6,143,558	6,248,403
<b>Total current liabilities</b>	<b>61,246,487</b>	<b>42,409,333</b>
<b>LONG-TERM LIABILITIES:</b>		
Long-term debt	15,105,963	12,800,000
Deferred compensation	5,177,409	5,061,951
Other liabilities	1,588,674	1,588,674
<b>Total liabilities</b>	<b>83,118,533</b>	<b>61,859,958</b>
<b>SHAREHOLDERS' EQUITY:</b>		
Cumulative preferred stock – \$50 par value; authorized 60,000 shares; outstanding - none		
Undesignated (subordinated) stock – \$1 par value; authorized 700,000 shares; outstanding – none		
Common stock – \$1 par value; authorized 15,000,000 shares; outstanding December 31, 2005, 6,561,190 shares; outstanding June 30, 2005, 6,541,436 shares	6,561,190	6,541,436
Additional paid-in capital	3,636,689	2,954,398
Retained earnings	94,965,105	95,196,022
Accumulated other comprehensive income	164,830	105,864
<b>Total shareholders' equity</b>	<b>105,327,814</b>	<b>104,797,720</b>
<b>TOTAL</b>	<b>\$ 188,446,347</b>	<b>\$ 166,657,678</b>

See accompanying Notes to Consolidated Financial Statements (Unaudited).

FLEXSTEEL INDUSTRIES, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

Three Months Ended December 31,		Six Months Ended December 31,	
2005	2004	2005	2004

NET SALES	\$ 106,301,259	\$ 105,050,826	\$ 203,736,422	\$ 202,906,383
COST OF GOODS SOLD	(86,598,189)	(84,650,206)	(164,890,157)	(164,650,909)
GROSS MARGIN	19,703,070	20,400,620	38,846,265	38,255,474
SELLING, GENERAL AND ADMINISTRATIVE	(18,610,560)	(17,670,182)	(36,097,226)	(34,010,070)
GAIN ON SALE OF FACILITY				608,613
OPERATING INCOME	1,092,510	2,730,438	2,749,039	4,854,017
OTHER INCOME (EXPENSE):				
Interest and other income	137,630	161,000	306,935	294,686
Interest expense	(371,123)	(266,870)	(631,404)	(543,993)
Total	(233,493)	(105,870)	(324,469)	(249,307)
INCOME BEFORE INCOME TAXES	859,017	2,624,568	2,424,570	4,604,710
PROVISION FOR INCOME TAXES	(370,000)	(1,020,000)	(950,000)	(1,800,000)
NET INCOME	\$ 489,107	\$ 1,604,568	\$ 1,474,570	\$ 2,804,710
AVERAGE NUMBER OF COMMON SHARES OUTSTANDING:				
Basic	6,560,190	6,537,071	6,553,776	6,522,729
Diluted	6,583,053	6,617,606	6,573,116	6,600,727
EARNINGS PER SHARE OF COMMON STOCK:				
Basic	\$ 0.07	\$ 0.25	\$ 0.22	\$ 0.43
Diluted	\$ 0.07	\$ 0.24	\$ 0.22	\$ 0.42

See accompanying Notes to Consolidated Financial Statements (Unaudited).

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

	Six Months Ended December 31,	
	2005	2004
OPERATING ACTIVITIES:		
Net income	\$ 1,474,570	\$ 2,804,710
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	2,699,355	2,937,938
Stock based compensation expense	427,000	
Gain on disposition of capital assets	(24,447)	(608,513)
Deferred income taxes	(520,000)	60,000
Changes in operating assets and liabilities:		
Trade receivables	(1,820,281)	1,109,010
Inventories	(18,493,115)	(3,414,754)
Other current assets	(270,525)	1,211,330
Other assets	(275,872)	(117,826)
Accounts payable - trade	5,265,049	1,251,964
Accrued liabilities	137,514	(3,157,983)
Other long-term liabilities	42,928	(22,790)
Deferred compensation	115,458	66,973
Net cash (used in) provided by operating activities	(11,242,366)	2,120,059
INVESTING ACTIVITIES:		
Purchases of investments	(168,855)	(206,274)

Proceeds from sales of investments	257,355	250,504
Proceeds from sale of capital assets	58,086	1,581,575
Capital expenditures	(3,064,688)	(2,508,987)
<b>Net cash used in investing activities</b>	<b>(2,918,102)</b>	<b>(883,182)</b>
<b>FINANCING ACTIVITIES:</b>		
Repayment of borrowings	(36,156,113)	(19,971,176)
Proceeds from borrowings	52,962,229	19,515,749
Dividends paid	(2,555,874)	(1,693,817)
Proceeds from issuance of common stock	59,871	80,967
<b>Net cash provided by (used in) financing activities</b>	<b>14,310,113</b>	<b>(2,068,277)</b>
Increase (decrease) in cash and cash equivalents	149,645	(831,400)
Cash and cash equivalents at beginning of period	1,706,584	2,476,521
Cash and cash equivalents at end of period	\$ 1,856,229	\$ 1,645,121

See accompanying Notes to Consolidated Financial Statements (Unaudited).

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FLEXSTEEL INDUSTRIES, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)  
FOR THE PERIOD ENDED DECEMBER 31, 2005

- The consolidated financial statements included herein have been prepared by Flexsteel Industries, Inc. (the Company or Flexsteel), without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). The information furnished in the consolidated financial statements includes normal recurring adjustments and reflects all adjustments, which are, in the opinion of management, necessary for a fair presentation of such consolidated financial statements. Operating results for the six-month period ended December 31, 2005 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2006. Certain information and footnote disclosures normally included in the consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to make the information presented not misleading. It is suggested that these consolidated financial statements be read in conjunction with the consolidated financial statements for the year ended June 30, 2005, and the notes thereto, included in Flexsteel's Annual Report on Form 10-K as filed with the SEC.

**DESCRIPTION OF BUSINESS** – Flexsteel Industries, Inc. and Subsidiaries (the “Company”) is one of the oldest and largest manufacturers and marketers, as well as an importer, of residential, recreational vehicle, hospitality and healthcare 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. Furniture products include sofas, love seats, chairs, reclining and rocker-reclining chairs, swivel rockers, sofa beds, convertible bedding units, bedroom, dining room, occasional tables, and home and commercial office furniture. The Company has two wholly owned subsidiaries: (1) Desert Dreams, Inc. which owns and leases a commercial building to an unrelated entity, and (2) DMI Furniture, Inc. (“DMI”), a Louisville, Kentucky-based, vertically integrated manufacturer, importer and marketer of residential and commercial furniture with manufacturing plants and warehouses in Indiana and manufacturing sources in Asia. DMI's divisions are WYNWOOD, Homestyles and DMI Commercial Office Furniture.

- 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. Inventories valued on the LIFO method would have been approximately \$3.7 million and \$3.6 million higher at December 31, 2005 and June 30, 2005, respectively if they had been valued on the FIFO method. At December 31, 2005 and June 30, 2005 the total value of LIFO inventory was \$3.1 million and \$3.3 million, respectively. A comparison of inventories is as follows (in millions):

	December 31, 2005	June 30, 2005
Raw materials	\$ 19.8	\$ 19.7
Work in process and finished parts	8.3	8.3
Finished goods	60.3	41.9
Total	\$ 88.4	\$ 69.9

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- BORROWINGS AND CREDIT ARRANGEMENTS** – At December 31, 2005, outstanding borrowings consisted of the following (in millions):

Current:

Current maturities of long-term debt	\$ 434,800
Overnight interest rate at prime minus 1%; unsecured	565,353
\$20.0 million working capital line of credit through June 29, 2006; interest rate at LIBOR +0.75%; unsecured	18,500,000
<b>Long-Term:</b>	
\$20.0 million revolving note; expires September 30, 2007; interest rate at LIBOR +0.75%; unsecured	13,000,000
\$2.6 million fixed rate note; requiring payments through December 2010; interest rate at 5.0%; secured by certain delivery equipment; net of current portion	2,105,963
<b>Total</b>	<b>\$ 34,606,116</b>

The Company has lines of credit of \$52.0 million with banks, borrowings at differing rates based on the date and type of financing utilized. The credit facilities provide for \$44.0 million in unsecured credit and provide the Company with flexibility between long-term and short-term financing. The short-term portion of the credit facility provides working capital financing up to \$20.0 million, of which \$18.5 million was outstanding at December 31, 2005, with interest selected at the option of the Company at prime (7.25% at December 31, 2005) or LIBOR (4.38% at December 31, 2005) plus 0.75%. The short-term portion also provides overnight credit when required for operations at prime minus 1%. The short-term line of credit expires June 29, 2006. The long-term portion of the credit facility provides up to \$20.0 million, of which \$13.0 million was outstanding at December 31, 2005, and expires September 30, 2007. Variable interest is set monthly at the option of the Company at prime or LIBOR plus 0.75%. The credit facility also provides \$8.0 million to support letters of credit issued by the Company, of which \$4.1 million was outstanding at December 31, 2005. 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%. The Company has effectively fixed the interest rates at 4.23% on approximately \$17.1 million of its long-term debt through the use of interest rate swaps.

The credit agreement contains certain restrictive covenants that require the Company, among other things, to maintain an interest coverage ratio, leverage ratio, consolidated net worth ratio, and limitations on capital disposals, all as defined in the financing agreements. At December 31, 2005, the Company was in compliance with all financial covenants contained in the credit agreement. During fiscal 2006, the Company has begun the process of obtaining an extension or refinancing their working capital line of credit that expires June 29, 2006. The Company believes that they will be able to successfully refinance or extend the terms of the current agreement prior to its expiration date; however, there can be no assurance that the Company will be successful in these endeavors or that completion of such extension or refinancing will be on terms acceptable to the Company.

The Company financed the purchase of \$2.6 million of delivery equipment through a five-year fixed rate note at 4.99%. The note requires payments through December 2010. The delivery equipment purchased with the note proceeds secures the note.

Two officers of the Company are directors at one of the banks where the Company maintains a \$4.0 million line of credit and where its routine daily banking transactions are processed. This line of credit is at a rate of prime minus 1% and is unsecured. There was \$0.6 million borrowed against this line of credit at December 31, 2005. The Company receives no special services or pricing on the services performed by the bank due to the directorships of the two officers.

4. **DERIVATIVE INSTRUMENTS & HEDGING ACTIVITIES** – Related to its variable debt, the Company has interest rate swaps utilized to hedge against adverse changes in interest rates. The notional principal amounts of the outstanding interest rate swaps totaled \$17.1 million with a weighted average fixed rate of 4.23% at December 31, 2005. The interest rate swaps are not utilized to take speculative positions. The Board of Directors established the Company's policies with regard to activities involving derivative instruments. Management, along with the Board of Directors, periodically reviews those policies, along with the actual derivative related results. The Company recorded the fair market value of its interest rate swaps as cash flow hedges on its balance sheet and has marked them to fair value through other comprehensive income. The fair values of the swaps were an asset of \$0.1 million as of December 31, 2005 and are reflected as non-current other assets on the accompanying consolidated balance sheet.
5. **ACCRUED WARRANTY COSTS** – The Company estimates the amount of warranty claims on sold product that may be incurred based on current and historical data. The actual warranty expense could differ from the estimates made by the Company based on product performance. The following table presents the changes in the Company's product warranty liability for the six months ended December 31, 2005 (in millions):

Accrued warranty costs at June 30, 2005	\$ 1.2
Payments made for warranty and related costs	(1.8)
Accrual for product warranty	1.7
<b>Accrued warranty costs at December 31, 2005</b>	<b>\$ 1.1</b>

6. **STOCK-BASED COMPENSATION** – The Company has two stock-based compensation methods available when determining employee compensation.

(1) **Management Incentive Plan** – This plan provides for shares of common stock to be awarded to key employees based on targeted rate of earnings to common equity as established by the Board of Directors. Shares awarded to employees are subject to the restriction of continued employment, with one-third of the stock received by the employee on the award date and the remaining shares vested after one and two years. Under the plan no shares were awarded, granted or vested during the six-months ended December 31, 2005 and 2004. As of June 30, 2005 and December 31, 2005, there were 23,032 unvested shares outstanding with a weighted average grant date fair value of \$0.4 million. Compensation cost related to these awards was not material during the three and six month periods ended December 31, 2005 and is not expected to be material over the weighted average remaining life of 0.8 years. The Company

expects forfeitures under this plan to be nominal and there were no forfeitures in the six months ended December 31, 2005 and 2004. At December 31, 2005, 69,357 shares were available for future grants.

(2) Stock Options Plans – The stock option plans for key employees and directors that provide for the granting of incentive and nonqualified stock options. Under the plans, options are granted at an exercise price equal to the fair market value of the underlying common stock at the date of grant, and may be exercisable for up to 10 years. All options are exercisable when granted. The Company’s shareholders have approved all stock option plans.

Accounting Principles Applied – Prior to July 1, 2005, the Company had elected to apply Accounting Principles Board (“APB”) Opinion No. 25 and related interpretations in accounting for its stock option plans, as permitted under Statement of Financial Accounting Standards (SFAS) No. 123 “Accounting for Stock-Based Compensation” and SFAS No. 148 “Accounting for Stock-Based Compensation-Transition and Disclosure”. Accordingly, no compensation cost was recognized for its stock option plans, as the exercise price was equal to the market price of the Company’s stock on the date of grant.

On July 1, 2005, the Company adopted the fair value recognition provisions of SFAS No. 123 (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).

In December 2005 the Company issued options for 159,500 common shares at an exercise price of \$14.40 (the fair market value on the date of grant). 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 \$0.4 million. The Company also recorded a reduction of its income tax expense of \$0.1 million related to the issuance of these options. The assumptions used in determining the compensation expense and related income tax impacts are discussed below.

Had the compensation expense for the quarter and six month periods ended December 31, 2004 for the Company’s incentive stock option plans been determined based on the fair value at the grant dates for awards under those plans consistent with the fair-value methodology of SFAS No. 123, the Company’s net income and earnings per share would have been reduced to the following pro forma amounts:

	Three Months Ended December 31, 2004	Six Months Ended December 31, 2004
Net income, as reported	\$ 1,604,568	\$ 2,804,710
Deduct: Total stock-based employee compensation expense determined under fair value method for all awards, net of related tax effects	(394,000)	(394,000)
<b>Pro forma net income</b>	<b>\$ 1,210,568</b>	<b>\$ 2,410,710</b>
Earnings per share:		
Basic – as reported	\$ 0.25	\$ 0.43
Basic – pro forma	0.19	0.37
Diluted – as reported	0.24	0.42
Diluted – pro forma	0.18	0.36

The fair value of each option grant is estimated on the date of grant using the Black-Sholes option-pricing model with the following weighted-average assumptions used for grants in fiscal 2006 and 2005, respectively; dividend yield of 3.6% and 3.2%; expected volatility of 23.3% and 22.2%; risk-free interest rate of 4.5% and 4.2%; and an expected life of 5 years on all options. The expected volatility is determined based on historical data. The expected life is based on the “simplified” method described in the SEC Staff Accounting Bulletin, Topic 14: Share-Based Payment.

The weighted-average grant date fair value of stock options granted during the three months and six months ended December 31, 2005 and 2004 was \$2.68 and \$3.05, 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 three months and six months ended December 31, 2005 and 2004 respectively was not material.

At December 31, 2005, 126,200 shares were available for future grants. The Company does not anticipate that additional options will be granted during fiscal 2006. It is the Company’s policy to issue new shares upon exercise of stock options. The Company does not expect to repurchase any shares during fiscal year 2006 related to stock option exercises. 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 December 31, 2005, and the changes from June 30, 2004, are presented below:

	Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value (in millions)
Outstanding and exercisable at June 30, 2004	355,641	\$ 16.47	\$ 2.5
Granted	153,450	16.49	
Exercised	(4,595)	12.68	
Canceled	(895)	20.26	
Outstanding and exercisable at June 30, 2005	503,601	16.50	1.0
Granted	159,500	14.40	
Exercised	(2,000)	11.25	
Canceled	(0)		
Outstanding and exercisable at December 31, 2005	661,101	\$ 16.01	\$ 1.0

The following table summarizes information for options outstanding and exercisable at December 31, 2005:

Range of Prices	Options Outstanding	Weighted Average	
		Remaining Life (Years)	Exercise Price
\$10.30 - 11.44	26,200	5.0	\$ 10 .65
12.66 - 13.59	55,200	3.6	13 .18
14.40 - 16.52	431,806	8.7	15 .56
19.21 - 20.27	147,895	7.9	19 .32
\$10.30 - 22.35	661,101	8.0	\$ 16 .01

7. CONTINGENCIES – The Company has guaranteed the future lease payments of a third party ending August 2007. The annual minimum lease payments are approximately \$0.2 million and the remaining minimum payments are approximately \$0.4 million at December 31, 2005. The Company has not been required to make any payments and has not recorded any amount in its financial statements related to this guarantee.

8. SUPPLEMENTAL CASH FLOW INFORMATION – Cash paid during the period for (in millions):

	Six Months Ended December 31,	
	2005	2004
Interest	\$ 672	\$ 603
Income taxes	\$ 1,583	\$ 824

9. EARNINGS PER SHARE – Basic earnings per share (EPS) is computed based upon the weighted-average number of common shares outstanding for each period. Diluted EPS is computed based on the weighted-average number of common shares and common equivalent shares. Common equivalent shares represent the effect of stock options during each period presented, which if exercised, would dilute EPS. In computing EPS for the quarters and six month periods ended December 31, 2005 and 2004, net income as reported for each respective period is divided by:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2005	2004	2005	2004
Basic shares outstanding	6,560,190	6,537,071	6,553,776	6,522,729
Dilutive effect of stock options	22,863	80,535	19,340	77,998
Diluted shares outstanding	6,583,053	6,617,606	6,573,116	6,600,727

Stock options excluded from the calculation of

diluted EPS because the option exercise price was greater than the average market price of the common shares

420,201	15,895	420,201	15,895
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10. COMPREHENSIVE INCOME – The components of comprehensive income, net of income taxes, for the quarters and six months ended, were as follows (in thousands):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2005	2004	2005	2004
Net income	\$ 489	\$ 1,605	\$ 1,475	\$ 2,805
Other comprehensive income (OCI):				
Change in fair value of derivatives, net of income taxes of \$10, \$(34), \$(20) and \$27, respectively	(18)	51	34	(42)
Change in fair value of available-for-sale, securities, net of income taxes of \$(6), \$(111), \$(15) and \$(104), respectively	9	171	25	159
Total other comprehensive income	(9)	222	59	117
Total comprehensive income	\$ 480	\$ 1,827	\$ 1,534	\$ 2,922

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

### GENERAL:

The following analysis of the results of operations and financial condition of Flexsteel Industries, Inc. and Subsidiaries (the Company) should be read in conjunction with the consolidated financial statements and related notes included elsewhere in this document.

### 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. Actual results may differ from these estimates under different assumptions or conditions.

*Use of estimates* – 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 collectability of trade accounts receivable, inventory valuation, depreciable lives, self-insurance programs, warranty costs and income taxes.

*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 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. 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.

*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.

*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.

*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.

*Income taxes* – deferred income taxes result from temporary differences between the tax basis of an asset or liability and its reported amount in the consolidated financial statements.

*Revenue recognition* – is upon delivery of product to our customer. 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.

## Overview

The following table has been prepared as an aid in understanding the Company's results of operations on a comparative basis for the three months and six months ended December 31, 2005 and 2004. Amounts presented are percentages of the Company's net sales.

	Three Months Ended December 31,		Six Months Ended December 31,	
	2005	2004	2005	2004
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of goods sold	(81.5)	(80.6)	(80.9)	(81.1)
Gross margin	18.5	19.4	19.1	18.9
Selling, general and administrative	(17.5)	(16.9)	(17.7)	(16.8)
Gain on sale of facility				0.3
Operating income	1.0	2.6	1.4	2.4
Other income, net	(0.3)	(0.1)	(0.2)	(0.1)
Income before income taxes	0.8	2.5	1.2	2.3
Income tax expense	(0.3)	(1.0)	(0.5)	(0.9)
Net income	0.5%	1.5%	0.7%	1.4%

## Results of Operations for the Quarter Ended December 31, 2005 vs. 2004

Net sales for the quarter ended December 31, 2005 were \$106.3 million compared to the prior year quarter of \$105.1 million, an increase of 1.2%. Residential net sales were \$69.6 million, compared to \$70.6 million, a decrease of 1.5% from the prior year quarter. Residential net sales were down slightly from the prior periods due to lower demand at the retail level. Recreational vehicle net sales were \$15.9 million, compared to \$18.9 million, a decrease of 15.8% from the prior year quarter. The decline in recreational vehicle net sales is due primarily to a weaker wholesale market environment. Commercial net sales were \$20.8 million, compared to \$15.5 million in the prior year quarter, an increase of 34.1%. The increase in commercial net sales is primarily due to improved commercial office product offerings and improved industry performance for hospitality products.

Gross margin for the quarter ended December 31, 2005 was 18.5% compared to 19.4% in the prior year quarter. Gross margin erosion in the current quarter in comparison to the prior year quarter was caused by rampant increases in raw material costs, particularly those with petrochemical content, and transportation costs which the Company was able to partially offset through selected sell price increases.

Selling, general and administrative expenses as a percentage of net sales were 17.5% and 16.8% for the current quarter and prior year quarter, respectively. The increase in selling, general and administrative costs on a quarterly basis in comparison to prior year is due to the recording of approximately \$0.4 million in stock-based compensation related to stock option grants as required under Statement of Financial Accounting Standards ("SFAS") No. 123(R) Share-Based Payment, increases in royalties and general increases in other fixed expenses.

The effective tax rate was 43.1% and 38.9% in the current and prior year fiscal quarters, respectively. The Company anticipates its effective tax rate for the fiscal year to be approximately 39.2%. The primary difference between the federal statutory rate and the expected rate is the result of state taxes and application of SFAS No. 123(R) in recording compensation expense related to qualified incentive stock options for which the Company does not receive a tax benefit unless there is a disqualifying disposition.

The above factors resulted in current quarter net income of \$0.5 million or \$0.7 per share, compared to the prior year quarter of \$1.6 million or \$0.24 per share.

All earnings per share amounts are on a diluted basis.

## Results of Operations for the Six Months Ended December 31, 2005 vs. 2004

Net sales for the six months ended December 31, 2005 were \$203.7 million compared to \$202.9 million in the prior year six months, an increase of 0.4%. Residential net sales were \$127.7 million, compared to \$129.6 million, a decrease of 1.5% from the prior year six months. Residential net sales were down slightly from the prior periods due to lower demand at the retail level. Recreational vehicle net sales were \$34.2 million, compared to \$40.7 million, a decrease of 19.1% from the prior year six months. The decline in recreational vehicle net sales is due primarily to a weaker wholesale market environment. Commercial net sales were \$41.9 million, compared to \$32.6 million in the prior year quarter, an increase of 22.2%. The increase in commercial net sales is primarily due to improved commercial office product offerings and improved industry performance for hospitality products.

Gross margin increased \$0.6 million to \$38.8 million or 19.1% of net sales in the current period from \$38.3 million or 18.9% of sales in the prior year period. The gross margin improvement for the six-month period is a result of changes in product mix, primarily through increased sales of commercial office and other

imported products, which were not significantly impacted by raw material cost increases.

Selling, general and administrative expenses as a percentage of sales were 17.7% and 16.8% for the current year and prior year, respectively. The increase in selling, general and administrative costs on a year-to-date basis in comparison to prior year is due to the recording of approximately \$0.4 million in stock-based compensation related to stock option grants as required under SFAS No. 123(R), increases in royalties and general increases in other fixed expenses.

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During the six months ended December 31, 2004, the Company recorded a net gain (after tax) of \$0.4 million or \$0.06 per share on the sale of a former manufacturing facility.

The effective tax rate was 39.2% and 39.1% in the current and prior six-month period, respectively.

The above factors resulted in current fiscal year to date net income of \$1.5 million or \$0.22 per share compared to \$2.8 million or \$0.42 per share in the prior year period, a decrease of \$1.3 million or \$0.22 per share from the prior year six-month period.

All earnings per share amounts are on a diluted basis.

#### Liquidity and Capital Resources

Working capital (current assets less current liabilities) at December 31, 2005 was \$87.3 million, which includes cash, cash equivalents and investments of \$3.4 million. Working capital increased by \$2.0 million from June 30, 2005. Inventories increased \$18.5 million primarily to meet current and anticipated future demand for import product. Accounts receivable increased \$1.8 million due to expected timing fluctuations in collections. Short-term borrowings increased by \$14.5 million and accounts payable increased \$5.3 million to meet cash requirements related to increase in inventories and accounts receivable.

Net cash used in operating activities was \$11.2 million in the six months ended December 31, 2004. Net cash provided by operating activities was \$2.1 million in the six months ended December 31, 2004. Fluctuations in net cash provided by operating activities were primarily the result of changes in net income, accounts receivable, inventories, accounts payable and notes payable.

Capital expenditures were \$3.1 million and \$2.5 million during the first six months of fiscal 2006 and 2005, respectively. During the next six months, it is anticipated that approximately \$1.0 million will be used for the acquisition of capital assets. Cash generated from operations and available lines of credit are expected to provide funds necessary for projected capital expenditures.

The Company has adequate cash, cash equivalents, short-term investments and credit arrangements to meet its operating and capital requirements. 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. During fiscal 2006, the Company has begun the process of obtaining an extension or refinancing their working capital line of credit that expires June 29, 2006. The Company believes that they will be able to successfully refinance or extend the terms of the current agreement prior to its expiration date; however, there can be no assurance that the Company will be successful in these endeavors or that completion of such extension or refinancing will be on terms acceptable to the Company.

#### Outlook

Flexsteel Industries, Inc., and the furniture industry in general, continue to be impacted by increases in raw material and energy costs. The second quarter ended December 31, 2005, was dominated by news of unprecedented cost increases for poly foam and other materials with petrochemical content, which are major components in our seating products, as well as increases or expected increases in other key components such as fabric, steel and plywood. At the same time, U. S. furniture manufacturers are faced with competition and pricing pressures from imported products. The Company expects these challenging business conditions to continue to have an impact on its results of operations through the remainder of the fiscal year.

In response to the aforementioned challenges, the Company will implement sell price increases for seating products, as warranted, and continue to explore cost control opportunities in all facets of its business. The Company believes it has the necessary inventories, product offerings and commitments in place to take advantage of opportunities for expansion of certain markets, such as commercial office and hospitality. The Company believes that its strategy of providing furniture from a wide selection of domestically manufactured and imported products is sound business practice and will continue.

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### Item 3. Quantitative and Qualitative Disclosures About Market Risk

*General* – Market risk represents the risk of changes in 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 and disruptions associated with shipping distances. Other risks related to furniture product importation include government imposition of regulations and/or quotas; duties and taxes on imports; and significant fluctuation in the value of the U. S. dollar against foreign currencies. Any of these factors could interrupt supply, increase costs and decrease earnings.

*Foreign Currency Risk* – During the six-month periods ended December 31, 2005 and 2004, 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 December 31, 2005, 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 at December 31, 2005. The Company has effectively fixed the interest rates on approximately \$17.1 million of its long-term debt through the use of interest rate swaps at 4.23%, and fixed the interest rate on an additional \$2.0 million through fixed rate equipment financing. The estimated earnings reduction takes the interest rate swaps and fixed interest financing into account. As of December 31, 2005, the fair value of the swaps is an asset of approximately \$0.1 million and is included in non-current other assets.

*Tariffs* – The Company has exposure to actions by governments, including tariffs. Tariffs are a possibility on any imported or exported products. The annual review of the tariffs related to wooden bedroom furniture manufactured in the People’s Republic of China by the U.S. Department of Commerce began January 4, 2006. According to the Department of Commerce’s schedule, the preliminary administrative review is expected to last 245 days from the end of January 2006, and the final review will be completed 372 days from the end of January 2006. The preliminary review can be extended 120 days and the final review can be extended by 60 days. The Company continues to review alternate sources of product supply to minimize the impact of the tariffs. The tariffs apply to less than 3% of the Company’s net sales.

#### Item 4. Controls and Procedures

(a) *Evaluation of disclosure controls and procedures.* Based on their evaluation as of the filing date of this Quarterly Report on Form 10-Q, the Company’s chief executive officer and chief financial officer have concluded that the Company’s disclosure controls and procedures (as defined in Rules 13a-15(b) under the Securities Exchange Act of 1934, as amended) were effective as of the date of such evaluation to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

(b) *Changes in internal controls.* There were no changes in our internal control over financial reporting that occurred during the quarter ended December 31, 2005, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

#### CAUTIONARY STATEMENT RELEVANT TO FORWARD-LOOKING INFORMATION FOR THE PURPOSE OF “SAFE HARBOR” PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

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

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Statements, including those in this report, 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 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, the product mix of sales, the cost of raw materials, foreign currency valuations, actions by governments including taxes and tariffs, 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.

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

#### PART II OTHER INFORMATION

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

At the annual meeting of stockholders on December 12, 2005, Proposal 1 set forth in the Board of Directors’ definitive Proxy Statement dated November 1, 2005 was approved and adopted by the stockholders as follows:

Proposal 1 (Election of Directors): Thomas E. Holloran: For 5,574,815, Withheld 117,975, Abstentions and Broker Non-votes 34,779. K. Bruce Lauritsen: For 5,648,630, Withheld 44,160, Abstentions and Broker Non-votes 34,779. L. Bruce Boylen: For 5,686,734, Withheld 6,056, Abstentions and Broker Non-votes 34,779. Ronald J. Klosterman: For 5,621,951, Withheld 70,839, Abstentions and Broker Non-votes 34,779. The names of each Director whose term of office as a Director continued after the meeting are as follows: K. Bruce Lauritsen, Ronald J. Klosterman, Jeffrey T. Bertsch, Mary C. Bottie, L. Bruce Boylen, Lynn J. Davis, Thomas E. Holloran, James R. Richardson, Patrick M. Crahan, Robert E. Deignan and Eric S. Rangen.

##### Item 5. Other Information

The registrant filed the following reports on Form 8-K during the quarter ended December 31, 2005:

- Press Release dated October 19, 2005 – Flexsteel Announces First Quarter Operating Results

##### Item 6. Exhibits

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| 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. |
| 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.

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.

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

FLEXSTEEL INDUSTRIES, INC.

Date: February 9, 2006

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By: */s/ Timothy E. Hall*

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Timothy E. Hall  
Chief Financial Officer &  
Principal Financial Officer

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, K. Bruce Lauritsen, Chief Executive Officer of Flexsteel Industries, Inc., and Subsidiaries (the "Registrant"), certify that:

1. I have reviewed this report on Form 10-Q of the Registrant;
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 we have:
  - a) designed such disclosure controls and procedures 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: February 9, 2006

By: */s/ K. Bruce Lauritsen*

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K. Bruce Lauritsen  
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, Chief Financial Officer of Flexsteel Industries, Inc. and Subsidiaries (the "Registrant"), certify that:

1. I have reviewed this report on Form 10-Q of the Registrant;
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 we have:
  - a) designed such disclosure controls and procedures 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: February 9, 2006

By: */s/ Timothy E. Hall*

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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 quarterly report of Flexsteel Industries, Inc. and Subsidiaries (the "Company") on Form 10-Q for the quarter ended December 31, 2005 as filed with the Securities and Exchange Commission (the "Report"), we, K. Bruce Lauritsen, 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: February 9, 2006

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By: /s/ K. Bruce Lauritsen

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K. Bruce Lauritsen  
Chief Executive Officer

By: /s/ Timothy E. Hall

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Timothy E. Hall  
Chief Financial Officer