

FLEXSTEEL INDUSTRIES INC

Form 10-K

September 06, 2018

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, 2018**

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)

Minnesota

(State or other jurisdiction of incorporation or organization)

42-0442319

(I.R.S. Employer Identification No.)

385 Bell Street, Dubuque, Iowa

(Address of principal executive offices)

52001

(Zip Code)

Registrant's telephone number, including area code:

(563) 556-7730

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

Title of each class	Name of each exchange on which registered
Common Stock, \$1.00 Par Value	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 whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). 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, a smaller reporting company, or an emerging growth company. See definitions of "large accelerated filer," "accelerated

Edgar Filing: FLEXSTEEL INDUSTRIES INC - Form 10-K

filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act (check one).
Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company Emerging growth
company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 31, 2017 (which was the last business day of the registrant’s most recently completed second quarter) was \$297,116,387.

Indicate the number of shares outstanding of each of the registrant’s classes of Common Stock, as of the latest practicable date. 7,872,150 Common Shares (\$1 par value) as of August 28, 2018.

DOCUMENTS INCORPORATED BY REFERENCE

In Part III, portions of the registrant’s 2018 Proxy Statement to be filed with the Securities and Exchange Commission within 120 days of the Registrant’s fiscal year end.

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 the Company’s 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, supply chain disruptions, litigation, the effectiveness of new product introductions and distribution channels, the product mix of sales, pricing pressures, the cost of raw materials and fuel, retention and recruitment of key employees, actions by governments including laws, regulations, taxes and tariffs, the amount of sales generated and the profit margins thereon, competition (both U.S. and foreign), credit exposure with customers, participation in multi-employer pension plans 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”) incorporated in 1929 is celebrating its 125th anniversary of the Company’s founding in 1893. Flexsteel Industries, Inc. is one of the oldest and largest manufacturers, importers and marketers of residential and contract upholstered and wooden furniture products in the United States. Over the generations the Company has built a committed retail and consumer following based on its patented, guaranteed-for-life Blue Steel SpringTM – the all-riveted, high-carbon, steel-banded seating platform that gives

upholstered and leather furniture the strength and comfort to last a lifetime. With offerings for use in home, hotel, healthcare, recreational vehicle, marine and office, the Company distributes its furniture throughout the United States & Canada through the Company's sales force and various independent representatives.

In April 2018, Flexsteel Industries, Inc. merged its wholly owned subsidiary, DMI Furniture, Inc. into the parent company. In June 2018, the DMI Management, Inc. subsidiary was dissolved. The Company expects to reduce administrative and compliance expenses with these corporate structure changes.

The Company operates in one reportable segment, furniture products. The Company's furniture products business involves the distribution of manufactured and imported products consisting of a broad line of upholstered and wooden furniture for residential and contract markets. 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)	FOR THE YEARS ENDED		
	JUNE 30,		
	2018	2017	2016
Residential	\$413,664	\$396,099	\$420,884
Contract	75,516	72,665	79,222
	\$489,180	\$468,764	\$500,106

Manufacturing and Offshore Sourcing

The Company operates manufacturing facilities located in Arkansas, California, Georgia, Iowa, Mississippi and Juarez, Mexico. These manufacturing operations are integral to the Company's product offerings and distribution strategy by offering smaller and more frequent product runs of a wider product selection. The Company identifies and eliminates manufacturing inefficiencies and adjusts manufacturing schedules on a daily basis to meet customer requirements. The Company has established relationships with key suppliers to ensure prompt delivery of quality component parts. The Company's production includes the use of selected component parts sourced offshore to enhance value in the marketplace.

The Company integrates manufactured products with finished products acquired from offshore suppliers who can meet quality specifications and scheduling requirements. The Company 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. This blended focus on products allows the Company to provide a wide range of price points, styles and product categories to satisfy customer requirements.

Competition

The furniture industry is highly competitive and includes a large number of U.S. and foreign manufacturers and distributors, none of which dominates the market. The Company competes in markets with a large number of relatively small manufacturers; however, certain competitors have substantially greater sales volumes than the Company. The Company's products compete based on style, quality, price, delivery, service and durability. The Company believes its patented, guaranteed-for-life Blue Steel Spring, manufacturing and sourcing capabilities, facility locations, commitment to customers, product quality, delivery, service, value and experienced production, sales, marketing and management teams, are some of its competitive advantages.

Seasonality

The Company's business is not considered seasonal.

Foreign Operations

The Company makes minimal export sales. At June 30, 2018, the Company had approximately 100 employees located in Asia to ensure Flexsteel's quality standards are met and to coordinate the delivery of purchased products. The Company leases and operates a 225,000 square foot production facility in Juarez, Mexico utilizing contracted labor. The Company also leases a 39,000 square foot bonded warehouse in Binh Duong, Vietnam to facilitate efficient consolidation and shipment to its U.S. warehouses and customers.

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):

June 30, 2018	June 30, 2017	June 30, 2016
\$53,700	\$55,000	\$46,700

Raw Materials

The Company utilizes various types of wood, fabric, leather, 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 U.S. and foreign, it is not dependent upon any single source of supply. The costs of certain raw materials fluctuate, but all continue to be readily available.

Working Capital Practices

For a discussion of the Company's working capital practices, see "Liquidity and Capital Resources" in Item 7 of this Annual Report on Form 10-K.

Industry Factors

The Company has exposure to actions by governments, including tariffs, see "Risk Factors" in Item 1A of this Annual Report on Form 10-K.

Government Regulations

The Company is subject to various local, state, and federal laws, regulations and agencies that affect businesses generally, see "Risk Factors" in Item 1A of this Annual Report on Form 10-K.

Environmental Matters

The Company is subject to environmental laws and regulations with respect to product content and industrial waste, see "Risk Factors" in Item 1A and "Legal Proceedings" in Item 3 of this Annual Report on Form 10-K.

Trademarks and Patents

The Company owns the American and Canadian improvement patents to its Flexsteel guaranteed-for-life Blue Steel Spring – the all-riveted, high-carbon, steel-banded seating platform that gives upholstered and leather furniture the strength and comfort to last a lifetime, as well as patents on convertible beds. The Company has patents and owns certain trademarks in connection with its furniture products which are due to expire on dates ranging from 2019-2035.

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 third-party 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):

Fiscal Year Ended June 30,	Expenditures
2018	\$3,910
2017	\$3,700
2016	\$4,170

Employees

The Company had 1,530 employees as of June 30, 2018, including 180 employees that are covered by collective bargaining agreements. Management believes it has good relations with employees.

Website and Available Information

The Company's website is located at 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 its *Guidelines for Business Conduct* are available, without charge, on the

Company's website at www.flexsteel.com or by writing to the Office of the Secretary, Flexsteel Industries, Inc., P. O. Box 877, Dubuque, IA 52004-0877.

Executive Officers

The executive officers of the Company, their ages, positions (in each case as of August 10, 2018), and the year they were first elected or appointed an officer of the registrant, are as follows:

Name (age)	Position (date first became officer)
Karel K. Czanderna (62)	President & Chief Executive Officer (2012)
Marcus D. Hamilton (44)	Chief Financial Officer, Secretary & Treasurer (2018)
Steven K. Hall (48)	Senior Vice President Global Supply Chain (2014)
Richard J. Stanley (46)	Senior Vice President Contract Group & Home Styles (2014)

Item 1A. Risk Factors

The Company 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, the Company's business, financial condition, and future prospects could be negatively impacted. There may be additional factors that are presently unknown to the Company or that the Company currently believes to be immaterial that could affect its business.

Business information systems could be impacted by disruptions and security breaches.

The Company employs information technology systems to support global business. Security breaches and other disruptions to the Company's information technology infrastructure could interfere with operations, compromise information belonging to the Company and its customers and suppliers and expose the Company to liability which could adversely impact the Company's business and reputation. In the ordinary course of business, the Company relies on information technology networks and systems to process, transmit and store electronic information, and to manage or support a variety of business processes and activities. Additionally, the Company collects and stores certain data, including proprietary business information, and may have access to confidential or personal information in certain areas of its businesses that is subject to privacy and security laws, regulations and customer-imposed controls. While security breaches and other disruptions to the Company's information technology networks and infrastructure could happen, none have occurred to date that have had a material impact to the Company. Any such events could result in legal claims or proceedings, liability or penalties under privacy laws, disruption in operations, and damage to the Company's reputation, which could adversely affect the Company's business.

The implementation of a new business information system could disrupt the business.

The Company completed the first of two deployments of its new business information system, SAP S/4 HANA in fiscal fourth quarter of 2018 retiring one of the Company's legacy systems. The second deployment is expected during fiscal year 2020. Once fully implemented, SAP S/4 HANA will enable the Company to better meet market conditions, customer requirements and increase operating efficiency.

An ineffective implementation of the new business information system may result in the following:

- Disruption of the Company's domestic and international supply chain;
- Inability to fill customer orders accurately and on a timely basis;
- Inability to process payments to suppliers and vendors;
- Negative impact on financials;
- Inability to fulfill federal, state and local tax filing requirements in a timely and accurate matter; and
- Increased demands of management and associates to the detriment of other corporate initiatives.

Future success depends on the Company's ability to manage its global supply chain.

The Company acquires raw materials, component parts and certain finished products from external suppliers, both U.S. and foreign. Many of these suppliers are dependent upon other suppliers in countries other than where they are located. This global interdependence within the Company's supply chain is subject to delays in delivery, availability, quality, pricing, and changes in international trade policies including tariffs. The delivery of goods from these suppliers may be delayed by customs, labor issues, changes in political, economic and social conditions, weather, laws and regulations. Unfavorable fluctuations in price, international trade policies, quality, delivery and availability of these products could adversely affect the Company's ability to meet demands of customers and cause negative impacts to the Company's cost structure, profitability and its cash flow.

Competition from U.S. and foreign finished product manufacturers may adversely affect the business, operating results or financial condition.

The furniture industry is very competitive and fragmented. The Company competes with U.S. and foreign manufacturers and distributors. As a result, the Company may not be able to maintain or raise the prices of its products in response to competitive pressures or increasing costs. Also, due to the large number of competitors and their wide range of product offerings, the Company may not be able to significantly differentiate its products (through styling, finish and other construction techniques) from those of its competitors. As a result, the Company is

continually subject to the risk of losing market share, which may lower its sales and earnings.

Future costs of complying with various laws and regulations may adversely impact future operating results.

The Company's business is subject to various laws and regulations which could have a significant impact on operations and the cost to comply with such laws and regulations could adversely impact the Company's financial position, results of operations and cash flows. In addition, inadvertently failing to comply with such laws and regulations could produce negative consequences which could adversely impact the Company's operations.

The Company's participation in multi-employer pension plans may have exposures under those plans that could extend beyond what its obligations would be with respect to its employees.

The Company participates in, and makes periodic contributions to, three multi-employer pension plans that cover union employees. Multi-employer pension plans are managed by trustee boards comprised of participating employer and labor union representatives, and the employers participating in a multi-employer pension plan are jointly responsible for maintaining the plan's funding requirements. Based on the most recent information available to the Company, the present value of actuarially accrued liabilities in one of the multi-employer pension plans substantially exceeds the value of the assets held in trust to pay benefits. As a result of the Company's participation, it could experience greater volatility in the overall pension funding obligations. The Company's obligations may be impacted by the funded status of the plans, the plans' investment performance, changes in the participant demographics, financial stability of contributing employers and changes in actuarial assumptions. See Note 9 to the consolidated financial statements.

Future results may be affected by various legal proceedings and compliance risk, including those involving product liability, environmental, or other matters.

The Company faces the risk of exposure to product liability claims in the event the use of any of its products results in personal injury or property damage. In the event any of the Company's products prove to be defective, it may be required to recall or redesign such products. The Company is also subject to various laws and regulations relating to environmental protection and the discharge of materials into the environment. The Company could incur substantial costs, including legal expenses, as a result of the noncompliance with, or liability for cleanup or other costs or damages under, environmental laws. Given the inherent uncertainty of litigation, these various legal proceedings and compliance matters could have a material impact on the business, operating results and financial condition. See Note 11 to the consolidated financial statements.

The Company's success depends on its ability to recruit and retain key employees and highly-skilled workers in a competitive labor market.

If the Company is not successful in recruiting and retaining key employees and highly-skilled workers or experiences the unexpected loss of those employees, the operations may be negatively impacted.

Failure to anticipate or respond to changes in consumer or designer tastes and fashions in a timely manner could adversely affect the Company's business and decrease sales and earnings.

Furniture is a styled product and is subject to rapidly changing consumer and end-user trends and tastes and is highly fashion oriented. If the Company is not able to acquire sufficient fabric variety or if the Company is unable to predict or respond to changes in fashion trends, it may lose sales and have to sell excess inventory at reduced prices.

The Company's products are considered deferrable purchases for consumers during economic downturns. Prolonged negative economic conditions could impact the business.

Economic downturns and prolonged negative economic conditions could affect consumer spending habits by decreasing the overall demand for home furnishings and contract products. These events could impact retailers, offices, hospitality, recreational vehicle seating and healthcare businesses resulting in an impact on the Company's business. A recovery in the Company's sales could lag significantly behind a general economic recovery due to the deferrable nature and relatively significant cost of home furnishings and contract products purchases.

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

Terms of collective bargaining agreements that prevent the Company from competing effectively could adversely affect its financial condition, results of operations and cash flows. The Company is committed to working with those groups to avert or resolve conflicts as they arise. However, there can be no assurance that these efforts will be successful.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

The Company owns the following facilities as of June 30, 2018:

Location	Approximate Size (square feet)	Principal Operations
Harrison, Arkansas	221,000	Manufacturing
Riverside, California	236,000	Manufacturing and Distribution
Dublin, Georgia	315,000	Manufacturing
Huntingburg, Indiana	611,000	Distribution
Dubuque, Iowa (1)	719,000	Manufacturing
Dubuque, Iowa (2)	250,000	Construction in process
Dubuque, Iowa	40,000	Corporate Office
Edgerton, Kansas	500,000	Distribution
Starkville, Mississippi	349,000	Manufacturing
Lancaster, Pennsylvania	216,000	Distribution

(1) The Dubuque, Iowa manufacturing facility and land will be donated to a not-for-profit entity when vacated by the Company, which is expected to occur during fiscal year 2019.

(2) The Company is constructing a 250,000 square foot manufacturing facility in Dubuque, Iowa and expects to occupy the facility during fiscal year 2019.

The Company leases the following facilities as of June 30, 2018:

Location	Approximate Size (square feet)	Principal Operations
Cerritos, California	75,000	Distribution
Riverside, California	211,000	Distribution
Dublin, Georgia	50,000	Distribution
Louisville, Kentucky	10,000	Administrative Offices
Juarez, Mexico	225,000	Manufacturing
Binh Duong, Vietnam	39,000	Warehouse

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

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.

Item 3. Legal Proceedings

Environmental Matters – In March 2016, the Company received a General Notice Letter for the Lane Street Groundwater Superfund Site (the “Lane Street Site”) located in Elkhart, Indiana from the U.S. Environmental Protection Agency (EPA). In April 2016, the EPA issued their proposed clean-up plan for groundwater pollution and request for public comment. The Company responded to the request for public comment in May 2016. The EPA issued a Record Decision selecting a remedy in August 2016 and estimated total costs to remediate of \$3.6 million. In July 2017, the EPA issued a Special Notice Letter to the Company demanding that the Company perform the remedy selected and pay for the remediation cost and past response costs of \$5.5 million. On October 12, 2017, the Company, after consultation with its insurance carriers, offered an amount, fully reimbursable by insurance coverage, to the EPA to resolve this matter. On November 6, 2017, the settlement offer extended on October 12, 2017 was rejected.

In April 2018, the EPA issued a Unilateral Administrative Order for Remedial Design and Remedial Action (the “Order”) against the Company. The Order was issued under Section 106(a) of the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), 42 U.S.C. §9606(a). The Order directs the Company to perform remedial design and remedial action for the Lane Street Site. The Order was to be effective May 29, 2018. To ensure completion of the remediation work, the EPA required the Company to secure financial assurance in the initial amount of \$3.6 million, which as noted above, is the estimated cost of remedial work. The Company believes that financial assurance is not required because it meets the relevant financial test criteria as provided in the Order. In May 2018, the EPA agreed to suspend enforcement of the Order so that the Company could conduct environmental testing

upgradient to its former manufacturing location pursuant to an Administrative Order on Consent (AOC). On July 5, 2018, the EPA proposed a draft AOC, to which the Company provided revisions. As of August 31, 2018, the Company has not finalized the AOC with the EPA. The Company maintains its position that it did not cause nor contribute to the contamination. However, in accordance with Financial Accounting Standards Board (FASB) issued Asset Retirement and Environmental Obligations (ASC 410-30), the Company accrued and reflected \$3.6 million in the financial results for the fiscal year ended June 30, 2018. The Company continues to evaluate the Order, its legal options and insurance coverages to assert its defense and recovery of current and future expenses related to this matter.

Indiana Civil Litigation – In December 2013, the Company entered into a confidential agreement to settle the Indiana Civil Litigation. The Company paid \$6.25 million to Plaintiffs to settle the matter without admission of wrongdoing. The Company received \$1.2 million and \$2.3 million during the fiscal years ended June 30, 2017 and 2016, respectively, for recovery of litigation settlement costs from insurers. These amounts are recorded as “Litigation settlement reimbursements” in the consolidated statements of income. The recovery of litigation settlement and defense costs from insurance carriers was completed during the fiscal year ended June 30, 2017.

Other Proceedings – During the quarter ended March 31, 2018, the Company initiated a voluntary field modification program for certain switches in residential motion furniture. The Company provided retailers with notice of the field modification, provided information on its website, reported its field modification actions with the Consumer Product Safety Commission (CPSC), and replaced switches in the field. The Company received notification from the CPSC in August 2018 that no further action was required by the CPSC and that it would not institute and oversee a recall.

From time to time, the Company is subject to various other 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 other proceedings that are currently pending, individually or in the aggregate, to be material to its business or likely to result in a material effect on its consolidated operating results, financial condition, or cash flows.

Item 4. Mine Safety Disclosures

None.

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 shows changes over the past five-year period in the value of \$100 invested in: (1) Flexsteel's common stock (FLXS); (2) The NASDAQ Global Market; and (3) an industry peer group of the following: American Woodmark Corp, Bassett Furniture Ind., Culp Inc., Dixie Group Inc., Ethan Allen Interiors Inc., Hooker Furniture Corp., Johnson Outdoors Inc., Kimball International, Knoll Inc., La-Z-Boy Inc., Lifetime Brands Inc., Patrick Industries Inc., and Sleep Number Corp.

2013 2014