FLEXSTEEL INDUSTRIES INC
Form 10-Q
April 19, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2012

or

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

For the transition period from to

Commission file number **0-5151**

FLEXSTEEL INDUSTRIES, INC.

(Exact Name of Registrant as Specified in Its Charter)

Incorporated in State of (State or other Jurisdiction of Incorporation or Organization)	42-0442319 (I.R.S. Identification No.)

3400 JACKSON STREET
DUBUQUE, IOWA 52004-0877

(Address of Principal Executive Offices) (Zip Code)

(563) 556-7730

(Registrant's Telephone Number, Including Area Code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes . No o.

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 definition of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act (check one).

Large accelerated filer o Accelerated filer o Non-accelerated filer o Smaller reporting company

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

Yes o. No .

Common Stock - $1.00 Par Value
Shares Outstanding as of March 31, 2012 6,795,506

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

FLEXSTEEL INDUSTRIES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Amounts in thousands, except share and per share data)

	March 31, 2012 (UNAUDITED)	June 30, 2011
ASSETS		
CURRENT ASSETS:		
Cash	$ 19,273	$17,889
Trade receivables – less allowance for doubtful accounts:		
March 31, 2012, $1,920; June 30, 2011, $2,000	33,835	31,451
Inventories	75,479	73,680
Deferred income taxes	4,050	3,700
Other	1,735	1,633
Total current assets	134,372	128,353
NON-CURRENT ASSETS:		
Property, plant and equipment, net	25,731	21,387
Deferred income taxes	2,490	2,560
Other assets	12,831	12,377
TOTAL	$ 175,424	$164,677
LIABILITIES AND SHAREHOLDERS’ EQUITY		
CURRENT LIABILITIES:		
Accounts payable – trade	$ 9,322	$9,899
Accrued liabilities:		
Payroll and related items	7,983	6,922
Insurance	5,614	5,645
Other	7,843	5,204
Total current liabilities	30,762	27,670
LONG-TERM LIABILITIES:		
Deferred compensation	5,473	5,270
Other liabilities	2,946	3,164
Total liabilities	39,181	36,104
SHAREHOLDERS’ EQUITY:		
Cumulative preferred stock – $50 par value;		
authorized 60,000 shares; outstanding – none		

Undesignated (subordinated) stock – $1 par value; authorized 700,000 shares; outstanding – none		
Common stock – $1 par value; authorized 15,000,000 shares; outstanding March 31, 2012, 6,795,506 shares; outstanding June 30, 2011, 6,710,612 shares	6,795	6,711
Additional paid-in capital	7,568	6,698
Retained earnings	122,336	115,699
Accumulated other comprehensive loss	(456)	(535)
Total shareholders' equity	136,243	128,573
TOTAL	$ 175,424	$ 164,677

See accompanying Notes to Consolidated Financial Statements (Unaudited).

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FLEXSTEEL INDUSTRIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

(Amounts in thousands, except per share data)

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2012	2011	2012	2011
NET SALES	$91,631	$85,175	$258,153	$255,226
COST OF GOODS SOLD	(69,533)	(66,968)	(196,633)	(198,589)
GROSS MARGIN	22,098	18,207	61,520	56,637
SELLING, GENERAL AND ADMINISTRATIVE	(16,975)	(14,561)	(48,071)	(44,966)
FACILITY CLOSING COSTS	—	—	—	(1,016)
OPERATING INCOME	5,123	3,646	13,449	10,655
OTHER INCOME	140	129	310	244
INCOME BEFORE INCOME TAXES	5,263	3,775	13,759	10,899
PROVISION FOR INCOME TAXES	(1,920)	(1,320)	(5,090)	(3,970)
NET INCOME	$3,343	$2,455	$8,669	$6,929
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING:				
Basic	6,777	6,710	6,756	6,687
Diluted	7,017	6,968	6,970	6,910
EARNINGS PER SHARE OF COMMON STOCK:				
Basic	$0.49	$0.37	$1.28	$1.04
Diluted	$0.48	$0.35	$1.24	$1.00
DIVIDENDS DECLARED PER COMMON SHARE	$0.10	$0.075	$0.30	$0.225

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

(Amounts in thousands)

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2012	2011	2012	2011
NET INCOME	$3,343	$2,455	$8,669	$6,929
UNREALIZED GAINS ON SECURITIES	334	82	127	575
INCOME TAX EXPENSE RELATED TO SECURITIES GAINS	(127)	(31)	(48)	(218)
OTHER COMPREHENSIVE INCOME, NET OF TAX	207	51	79	357

COMPREHENSIVE INCOME	$3,550	$2,506	$8,748	$7,286

See accompanying Notes to Consolidated Financial Statements (Unaudited).

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FLEXSTEEL INDUSTRIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(Amounts in thousands)

	Nine Months Ended March 31,	
	2012	2011
OPERATING ACTIVITIES:		
Net income	$8,669	$6,929
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	2,113	2,028
Change in provision for (gains) losses on accounts receivable	(180)	890
Deferred income taxes	(328)	(809)
Stock-based compensation expense	767	844
Gain on disposition of capital assets	(32)	(108)
Changes in operating assets and liabilities:		
Trade receivables	(2,205)	(754)
Inventories	(1,799)	(2,100)
Other current assets	(102)	(394)
Other assets	17	(5)
Accounts payable – trade	(578)	52
Accrued liabilities	2,292	(970)
Other long-term liabilities	(217)	345
Deferred compensation	203	71
Net cash provided by operating activities	8,620	6,019
INVESTING ACTIVITIES:		
Proceeds from sales of investments	346	307
Purchases of investments	(690)	(537)
Proceeds from sale of capital assets	32	143
Capital expenditures	(5,255)	(991)
Net cash used in investing activities	(5,567)	(1,078)
FINANCING ACTIVITIES:		
Dividends paid	(1,856)	(1,336)
Proceeds from issuance of common stock	187	318
Net cash used in financing activities	(1,669)	(1,018)
Increase in cash	1,384	3,923
Cash at beginning of period	17,889	8,278
Cash at end of period	$19,273	$12,201

SUPPLEMENTAL CASH FLOW INFORMATION (Amounts in thousands)

	Nine Months Ended March 31,	
	2012	2011
Cash paid for:		
Income taxes paid, net	$3,980	$6,039
Non-cash transactions:		
Capital expenditures included in current liabilities	1,200	—

See accompanying Notes to Consolidated Financial Statements (Unaudited).

FLEXSTEEL INDUSTRIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

FOR THE PERIOD ENDED MARCH 31, 2012

1. The consolidated financial statements included herein have been prepared by Flexsteel Industries, Inc. and Subsidiaries (the "Company" or "Flexsteel"), without audit, pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). The information furnished in the consolidated financial statements includes normal recurring adjustments and reflects all adjustments, which are, in the opinion of management, necessary for a fair presentation of such consolidated financial statements. Operating results for the three and nine month periods ended March 31, 2012 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2012. 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. Except to the extent updated or described below, the significant accounting policies set forth in Note 1 to the consolidated financial statements in the Company's Annual Report on Form 10-K for the year ended June 30, 2011, appropriately represent, in all material respects, the current status of accounting policies and are incorporated by reference.

DESCRIPTION OF BUSINESS – Flexsteel was incorporated in 1929 and is one of the oldest and largest manufacturers, importers and marketers of 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, hospitality, health care and motor vehicle 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, 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.

2. INVENTORIES

The Company values inventory at the lower of cost or market. Raw steel is 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 $1.8 million higher at March 31, 2012 and $1.9 million higher at June 30, 2011, if they had been valued on the FIFO method. At March 31, 2012 and June 30, 2011, the total value of LIFO inventory was $2.2 million and $1.5 million, respectively. A comparison of inventories is as follows (in thousands):

	March 31,	June 30, 2011

	2012	
Raw materials	$8,854	$9,235
Work in process and finished parts	4,555	3,951
Finished goods	62,070	60,494
Total	$75,479	$73,680

3. BORROWINGS AND CREDIT ARRANGEMENTS

The Company maintains a credit agreement which provides short-term working capital financing of $15.0 million with interest of LIBOR plus 1% with availability of $10.0 million for letters of credit. No amounts were outstanding at March 31, 2012 and June 30, 2011 under the working capital facility. 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 $2.5 million. The credit agreement contains financial covenants. The primary covenant is an interest coverage ratio of 3.0 to 1.0. The ratio is computed as net income plus interest expense and stock-based compensation expense less dividends, divided by interest expense. In addition, the Company must maintain working capital of $60 million. At March 31, 2012, the Company was in compliance with all of the financial covenants contained in the credit agreement.

An officer of the Company is a director at a bank where the Company maintains an unsecured $8.0 million line of credit at prime minus 1%, but not less than 2.5%, and where its routine daily banking transactions are processed. No amount was outstanding on the line of credit at March 31, 2012 and June 30, 2011. In addition, the Rabbi Trust assets of $6.0 million are administered by this bank's trust department. The Company receives no special services or pricing on the services performed by the bank due to the directorship of this officer.

4. STOCK-BASED COMPENSATION

The Company has two stock-based compensation methods available when determining employee compensation.

(1) 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 Company's shareholders approved 500,000 shares to be issued under the plan. As of March 31, 2012, 38,944 shares have been issued. The Committee selected consolidated operating results for organic net sales growth and fully-diluted earnings per share for the three-year performance periods beginning July 1, 2009 and ending on June 30, 2012, beginning July 1, 2010 and ending on June 30, 2013, and beginning July 1, 2011 and ending on June 30, 2014. The Committee has also specified that payouts, if any, for awards earned in these 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 subject to Committee approval and verification of results. The compensation cost related to the number of shares to be granted under each performance period is fixed on the grant date, which is the date the performance period begins. The compensation cost related to the cash portion of the award is re-measured based on the equity award's estimated fair value at the end of each reporting period. The accrual is based on the probable outcomes of the performance conditions. The short-term portion of the recorded cash award payable is classified within current liabilities, payroll and related items, and the long-term portion of the recorded cash award payable is classified within other long-term liabilities in the Consolidated Balance Sheets. As of March 31, 2012 and June 30, 2011, the Company has recorded cash awards payable of $0.9 million and $0.4 million within current liabilities and $0.5 million and $0.7 million within long-term liabilities, respectively. During the quarters ended March 31, 2012 and 2011, the Company recorded expense of $0.7 million and $0.2 million, respectively. For the nine month periods ended March 31, 2012 and 2011, the Company recorded expense of $1.1 million and $1.0 million, respectively.

If the target performance goals would be achieved, the total amount of compensation cost recognized over the requisite service periods would be $1.2 million (2010-2012), $1.1 million (2011-2013) and $1.0 million (2012-2014) based on the estimated fair values at March 31, 2012.

(2) Stock Option 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.

At March 31, 2012, 343,850 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 the exercise price of options. These shares received as payment are retired upon receipt.

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A summary of the status of the Company's stock option plans as of June 30, 2010 and 2011 and March 31, 2012 and the changes during the periods then ended is presented below:

	Shares (in thousands)	Weighted Average Exercise Price	Aggregate Intrinsic Value (in thousands)
Outstanding and exercisable at June 30, 2010	1,052	$ 12.70	$ 1,168
Granted	88	17.23	
Exercised	(91)	7.41	
Canceled	(3)	17.30	
Outstanding and exercisable at June 30, 2011	1,046	13.56	2,271
Granted	83	13.87	
Exercised	(71)	8.30	
Canceled	(5)	17.12	
Outstanding and exercisable at March 31, 2012	1,053	$ 13.94	4,535

The following table summarizes information for options outstanding and exercisable at March 31, 2012:

Range of Prices	Options Outstanding (in thousands)	Weighted Average Remaining Life (Years)	Exercise Price
$6.81 – 8.55	191	7.3	$ 7.80
12.35 – 13.90	307	6.4	12.88
14.40 – 16.52	346	2.6	15.55
17.23 – 20.27	209	4.6	18.46
$6.81 – 20.27	1,053	5.0	$ 13.94

5. INCOME TAXES

In determining the quarterly provision for income taxes, the Company uses an estimated annual effective tax rate, which is based on the expected annual income, statutory tax rates and tax planning opportunities available to the Company in the various jurisdictions in which it 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 in the quarter in which they occur.

The components of the gross liabilities related to unrecognized tax benefits and the related deferred tax assets are as follows (in thousands):

	March 31, 2012	June 30, 2011
Gross unrecognized tax benefits	$975	$970
Accrued interest and penalties	375	340
Gross liabilities related to unrecognized tax benefits	$1,350	$1,310
Deferred tax assets	$340	$330

The recognition of the above amounts would impact the Company's effective tax rate. 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 twelve months. The Company records interest and penalties related to income taxes as income tax expense in the Consolidated Statements of Operations.

6. EARNINGS PER SHARE

Basic earnings per share ("EPS") of common stock are based on the weighted-average number of common shares outstanding for each period. Diluted EPS of common stock includes the dilutive effect of potential common shares outstanding. The Company's potential common shares outstanding are stock options and shares associated with the long-term management incentive compensation plan. The Company calculates the dilutive effect of outstanding options using the treasury stock method. The anti-dilutive shares were not included in the computation of diluted EPS as their exercise prices were greater than the average closing market price of the common shares for the three and nine month periods ended March 31, 2012. The Company calculates the dilutive effect of shares related to the long-term management incentive compensation plan based on the number of shares, if any, that would be issuable if the end of the fiscal year were the end of the contingency period.

In computing EPS for the three and nine months ended March 31, 2012 and 2011, net income as reported for each respective period is divided by (in thousands):

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2012	2011	2012	2011
Basic shares	6,777	6,710	6,756	6,687
Potential common shares:				
Stock options	165	162	136	142
Long-term incentive plan	75	96	78	81
	240	258	214	223
Diluted shares	7,017	6,968	6,970	6,910
Anti-dilutive shares	420	424	420	424

7. LITIGATION

The Company has been named as one of several defendants in an Indiana civil lawsuit related to groundwater contamination. The lawsuit alleges that the contamination source is a property once owned by the Company. The Company does not believe that it caused or contributed to the contamination. This lawsuit is in its preliminary stages. Plaintiffs have not identified a dollar amount of their alleged damages and the status of insurance coverage has not been determined. We are unable to estimate a range of reasonably possible outcomes or losses at this time. Accordingly, no accrual related to this matter has been recorded in the March 31, 2012 financial statements. During the three and nine months ended March 31, 2012, legal and other related expenses of $0.8 million and $1.9 million have been incurred responding to this lawsuit and are included in Selling, General and Administrative expense in the

Consolidated Statement of Operations.

Other Proceedings – 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.

8. ACCOUNTING DEVELOPMENTS

In September 2011, the FASB issued ASU 2011-09 which pertains to employer's participation in multiemployer benefit plans, amending ASC 715-80. ASU 2011-09 enhances the disclosures about significant multiemployer plans in which an employer participates, the level of the employer's participation, the financial health of the plans and the nature of the employer's commitments to the plans. The new disclosure requirements are required for fiscal years ending after December 15, 2011 and there will be no financial impact on the Company.

9. FACILITY CLOSING COSTS

During the nine months ended March 31, 2011, the Company closed a manufacturing facility and recorded pre-tax charges for facility closing costs of $1.0 million. The charges represented employee separation costs of $0.6 million and other closing costs of $0.4 million with no future benefit to the Company and are classified as “Facility Closing Costs” in the Consolidated Statements of Operations. At March 31, 2011, $0.1 million remained to be paid and was included in other current liabilities. The $1.0 million was fully paid as of June 30, 2011.

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 the Company should be read in conjunction with the consolidated financial statements and related notes included elsewhere in this quarterly report on Form 10-Q.

CRITICAL ACCOUNTING POLICIES:

There have been no material changes to our critical accounting policies and estimates from the information provided in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations", included in our 2011 annual report on Form 10-K.

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 and nine months ended March 31, 2012 and 2011. Amounts presented are percentages of the Company’s net sales.

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2012	2011	2012	2011
Net sales	100.0%	100.0%	100.0%	100.0%

Cost of goods sold	(75.9)	(78.6)	(76.2)	(77.8)
Gross margin	24.1	21.4	23.8	22.2
Selling, general and administrative	(18.5)	(17.1)	(18.6)	(17.6)
Facility closing costs	—	—	—	(0.4)
Operating income	5.6	4.3	5.2	4.2
Other income	0.1	0.1	0.1	0.1
Income before income taxes	5.7	4.4	5.3	4.3
Income tax expense	(2.1)	(1.5)	(1.9)	(1.6)
Net income	3.6 %	2.9 %	3.4 %	2.7 %

Results of Operations for the Quarter Ended March 31, 2012 vs. 2011

The following table compares net sales in total and by area of application for the quarter ended March 31, 2012 to the prior year quarter.

	Net Sales (in thousands) Quarter Ended March 31,		$ Change	
Area of Application	2012	2011	(in thousands)	% Change
Residential	$71,183	$64,938	$ 6,245	9.6 %
Commercial	20,448	20,237	211	1.0 %
Total	$91,631	$85,175	$ 6,456	7.6 %

Gross margin for the quarter ended March 31, 2012 was 24.1% compared to 21.4% in the prior year quarter. This improvement is due to better absorption of fixed costs and the adverse impact of increases in materials costs in the prior year quarter.

Selling, general and administrative expenses for the quarter ended March 31, 2012 were $17.0 million or 18.5% of net sales compared to $14.6 million or 17.1% of net sales in the prior year quarter. The current year quarter includes an increase in legal and professional fees of $0.9 million, or 1% of sales, primarily related to an Indiana civil lawsuit.

Operating income for the current quarter was $5.1 million compared to operating income of $3.6 million in the prior year quarter reflecting the aforementioned factors.

The effective income tax expense rate for the current fiscal quarter was 36.5% compared to an income tax expense rate of 35.0% in the prior year fiscal quarter. The effective rates include the federal statutory rate as well as the effect of the various state taxing jurisdictions.

The above factors resulted in current quarter net income of $3.3 million or $0.48 per share, compared to net income of $2.5 million or $0.35 per share in the prior year quarter.

All earnings per share amounts are on a diluted basis.

<u>Results of Operations for the Nine Months Ended March 31, 2012 vs. 2011</u>

The following table compares net sales in total and by area of application for the nine months ended March 31, 2012 to the prior year nine month period.

	Net Sales (in thousands) Nine Months Ended March 31,		$ Change	
Area of Application	2012	2011	(in thousands)	% Change
Residential	$200,674	$193,691	$ 6,983	3.6 %
Commercial	57,479	61,535	(4,056)	(6.6 %)
Total	$258,153	$255,226	$ 2,927	1.1 %

Gross margin for the nine months ended March 31, 2012 was 23.8% compared to 22.2% in the prior year nine-month period. Gross margin for the prior year nine-month period was adversely impacted by inventory write-downs of $0.6 million associated with closing a facility and increases in materials costs.

Selling, general and administrative expenses were $48.1 million or 18.6% of net sales, including a $2.0 million increase in legal and professional fees, primarily related to an Indiana civil lawsuit, and a $1.1 million decrease in bad debt expense compared to the prior year. Selling, general and administrative expenses were $45.0 million or 17.6% of net sales in the prior year nine-month period ended March 31, 2011.

Operating income for the current nine month period was $13.4 million compared to operating income of $10.7 million in the prior year nine-month period reflecting the aforementioned factors**.** During the prior year nine-month period the Company recorded a pre-tax charge of $1.0 million to facility closing costs for employee separation and other closing costs.

The effective income tax expense rate for the current nine month period was 37.0% compared to an income tax expense rate of 36.4% in the prior year nine-month period. The effective rates include the federal statutory rate as well as the effect of the various state taxing jurisdictions.

The above factors resulted in net income for the current nine-month period of $8.7 million or $1.24 per share, compared to net income of $6.9 million or $1.00 per share in the prior year nine-month period.

All earnings per share amounts are on a diluted basis.

Liquidity and Capital Resources

At March 31, 2012, the Company had $19.3 million in cash and borrowing availability of $20 million.

Operating Activities:

Working capital (current assets less current liabilities) at March 31, 2012 was $103.6 million. Net cash provided by operating activities was $8.6 million during the nine months ended March 31, 2012. Net income of $8.7 million, increased accrued liabilities of $2.3 million and depreciation of $2.1 million were offset by a $2.4 million increase in accounts receivable and a $1.8 million increase in inventory. Depreciation expense was $2.1 million and $2.0 million in the nine-month periods ended March 31, 2012 and 2011, respectively.

The Company expects that due to the nature of our operations that there will be continuing fluctuations in accounts receivable, inventory, accounts payable, and cash flows from operations due to the following: (i) we purchase inventory from overseas suppliers with long lead times and depending on the timing of the delivery of those orders, inventory levels can be greatly impacted, and (ii) we have various customers that purchase large quantities of inventory periodically 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.

Investing Activities:

Net cash used in investing activities was $5.6 million during the nine-month period ended March 31, 2012. During the nine months ended March 31, 2012 capital expenditures were $5.3 million, including $3.6 million related to the on-going construction of a corporate office building. The Company expects that capital expenditures will be approximately $7.0 million for the remainder of the 2012 fiscal year including costs related to construction, furnishing and equipping the corporate office building which is expected to be completed by August 2012.

Financing Activities:

Net cash used in financing activities was $1.7 million during the nine-month period ended March 31, 2012. Dividends of $1.9 million were paid during the nine-month period partially offset by cash received from the exercise of stock options.

Management believes that the Company has adequate cash and credit arrangements to meet its operating and capital requirements for fiscal year 2012. In the opinion of management, the Company’s liquidity and credit resources provide it with the ability to react to opportunities as they arise, to pay quarterly dividends to its shareholders, and to purchase productive capital assets that enhance safety and improve operations. The Company has begun the process of

obtaining a renewal of its working capital line of credit that expires June 30, 2012. The Company believes that it will be able to successfully renew the terms of the current agreement prior to its expiration date.

Outlook

The Company believes that modest overall top line growth will continue through the end of calendar year 2012. Orders for residential upholstered products have improved significantly in relation to prior year levels and we expect that trend to continue through the end of the calendar year. Our commercial office order rate has increased modestly. The Company is expecting flat order trends for vehicle and hospitality seating products for the remainder of the calendar year.

The Company remains committed to its core strategies, which include a wide range of quality product offerings and price points to the residential and commercial markets, combined with a conservative approach to business. We will maintain our focus on a strong balance sheet through emphasis on cash flow and improving profitability. We believe these core strategies are in the best interest of our shareholders.

Item 3. 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.

Foreign Currency Risk – During the three and nine months ended March 31, 2012 and 2011, the Company did not have sales, purchases, or other expenses denominated in foreign currencies. As such, the Company is not exposed to material 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. The Company does not have any debt outstanding at March 31, 2012.

Inflation – Increased operating costs are reflected in product or services pricing with any limitations on price increases determined by the marketplace. Inflation or other pricing pressures could impact raw material costs, labor costs and interest rates which are important components of costs for the Company and could have an adverse effect on our profitability, especially where increases in these costs exceed price increases on finished products.

Item 4. Controls and Procedures

(a) *Evaluation of disclosure controls and procedures.* Based on their evaluation as of the end of the period covered by this Quarterly Report on Form 10-Q, our chief executive officer and chief financial officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) were effective as of March 31, 2012.

(b) *Changes in internal control over financial reporting.* During the quarter ended March 31, 2012, there were no significant changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934, as amended) that has materially affected, or is reasonably likely to materially affect the Company's 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.

Statements, including those in this Quarterly Report on Form 10-Q, 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, 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, inflation, 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 our most recent 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.

PART II OTHER INFORMATION

Item 1A. Risk Factors

There has been no material change in the risk factors set forth under Part 1, Item 1A “Risk Factors” in the Company’s Annual Report on Form 10-K for the fiscal year ended June 30, 2011.

Item 6. Exhibits

31.1	Certification
31.2	Certification
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.

SIGNATURES

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: April 19, 2012 By: */S/ Timothy E. Hall*
Timothy E. Hall
Chief Financial Officer
(Principal Financial & Accounting Officer)

>FINEP Mar/2012 65,944 65,944 Mortgage of industrial
plant Prepayments Apr/2014 482,852 1,249,993 Promissory notes Other institutions Nov/2007 to
Dec/2012 15,804 632,669 Promissory notes **Total** 1,457,229 2,917,944

In December 2006, the Company and Petroquisa, entered into a supporting agreement with BNDES, under which Braskem and Petroquisa undertake to provide, in proportion to their respective interests in the capital of Petroquímica Paulínia, the required funds to meet any insufficiencies arising from delinquency on the part of this company. Following the merger of shares of Grust (Note 1(c)) and consequent increase to 100% in the voting capital of this subsidiary, the Company assumed this full debt and may be required to disburse R$ 515.413 at the maximum to Petroquímica Paulínia, as capital contribution or loan.

(d) Capitalized interest

The Company adopts the accounting practice of capitalizing interest on financing during the period of asset construction. The Company policy is to apply the weighted average financial charge rate on the debt, including exchange variation, to the balance of projects in progress.

The average used during the period, including exchange variation, was 4.43% p.a. and the amounts capitalized are stated below:

Gross financial charges	(231,252)
(-) Capitalized interest	32,147
Net financial charges	(199,105)

(e) Loan covenants

Certain loan agreements entered into by the Company establish limits for a number or ratios relating to the ability to incur debts and pay interest. The ratios are as follows:

- Debentures of 13th and 14th Issues: Net Debt/EBITDA(*).
- NEXI financing: Net Debt/EBITDA(**) and EBITDA(**)/net interest on debt.
- MTN: Net Debt/EBITDA(**).

(*) EBITDA - Operating profit before financial results and shareholdings plus depreciation and amortization.
(**) EBITDA - Operating profit before financial results and shareholdings plus depreciation, amortization, dividends and interest on shareholders equity received from unconsolidated companies.

The above covenants are calculated on a consolidated basis for the past 12 months on a quarterly basis. Penalty for noncompliance is the potential acceleration of the debt. All commitments have been accomplished by the Company and its subsidiaries.

15 Debentures

Composition of transactions:

Issue	**Unit value**	**Maturity**	**Remuneration**	**Remuneration payment**	
13th(i)	R$ 10	Jun/2010	104.1% of CDI	Biannually as from Dec/2005	306,327
14th(i)	R$ 10	Sep/2011	103.5% of CDI	Biannually as from Mar/2007	524,373
Total					**830,700**
Current liabilities					**30,700**
Long-term liabilities					**800,000**

(i) Public issues of Company non-convertible debentures.

16 Taxes and contributions payable - Long-term liabilities

IPI credits offset		
IPI - export credit	(i)	711,183
IPI - zero rate	(ii)	320,988
IPI - consumption materials and property, plant and equipment		43,805
Other taxes and contributions payable		
PIS/COFINS - Law 9718/98	(iii)	52,800
Education contribution, SAT and INSS		43,037
PAES-Law 10684	(iv)	26,765
Other		20,315
Total		1,218,894

The Company has brought suit in court against some changes in tax laws, and the updated amounts at dispute are duly accrued for. Therefore, no contingent assets are recorded.

(i) IPI tax credit on exports (*Crédito-prêmio)*

The Company - by itself and through absorbed companies - challenges the term of effectiveness of the IPI tax credit (*crédito-prêmio*) introduced by Decree-law 491 of 1969 as an incentive to manufactured product exports. Lower courts have granted most lawsuits to that end, but such favorable decisions may still be appealed.

In hearing the appeal lodged by another taxpayer seeking court recognition of its entitlement to use such tax benefit until present, the Superior Court of Justice (STJ) upheld its rejection to such prospective use and affirmed that the aforementioned tax benefit expired in 1990. As this it a constitution-related matter, the discussion was escalated to the Supreme Court of Justice (STF), which has already recognized and applied the general effect. STF will revisit the right to use those tax credits after 1990, based on the application of Temporary Constitutional Provisions Act (ADCT) 41.

According to its legal advisors, the Company stands reasonably possible chances of success in these suits.

(ii) IPI - Zero rate

Merged companies OPP Química, Trikem and Polialden have filed lawsuits claiming IPI tax credits from the acquisition of raw materials and inputs that are exempt, non-taxed or taxed at a zero rate. Lower courts have granted most lawsuits to that end.

In a decision rendered in February 2007 on a case unrelated to the Company, the STF found against the right to offset zero-rate IPI credits by a tight majority. In the same claim, in June 2007, the STF Full Bench decided, by majority opinion (6 vs. 5), that prospective-only effects could not be given to an STF decision that later reversed an erstwhile taxpayer-friendly determination made by the STF Full Bench itself. This ruling had a negative bearing on judgment of the cases involving merged companies OPP Química and Trikem in Bahia, leading to payments in the amount of R$ 127,317 (August 2007). By the same token, a portion of the amount underlying the lawsuit involving merged company Polialden (R$ 99,641) was settled in October 2007. The outstanding value relating to such case will be challenged in court.

The Company still enjoys a favorable court decision on the lawsuit lodged by its merged company Trikem in Alagoas, allowing the Company to use these tax credits. The Company will have to pay out the offset sums when the court decision on this case is reversed. It should be stressed that all of these amounts have been provisioned for, which will avoid an adverse impact on the Company s results.

(iii) PIS/COFINS - Laws 9718 of 1998

The Company - by itself and through absorbed companies - has brought a number of lawsuits to challenge the constitutionality of the changes in the PIS and COFINS tax bases deriving from Law 9718 of 1998.

In November 2005, the STF Full Bench had definitively ruled that the increase in PIS and COFINS tax basis under such law was unconstitutional. At the same time, STF ruled that the COFINS rate increase from 2% to 3% was constitutional.

As the Company external legal advisors believe that the chances of a successful outcome are remote on this matter and in the light of the recent STF unfavorable decision, the Company filed for voluntary dismissal of this claim in most suits and settled the debt in cash on December 15, 2006. The Company, however, still discusses the matter in a small number of claims.

(iv) Special Installment Program - PAES - Law 10684 of 2003

In August 2003, merged company Trikem opted to file for voluntary dismissal of its lawsuit against the COFINS rate increase from 2% to 3% under Law 9718 of 1998, thus qualifying for the more favorable payment conditions under the PAES program instituted by Federal Law 10684 of 2003. The amount due is being paid in 120 monthly installments. At July 31, 2008, the outstanding debt is R$ 31,711, being R$ 4,916 in current liabilities and R$ 26,765 in noncurrent liabilities.

Even though the Company had met all legal requirements and payments were being made as and when due, the National Treasury Attorney s Office (PFN) disqualified the Company for PAES on two different occasions, and the Company obtained a court relief reinstating it to PAES in these two events. In reliance on the opinion of its legal advisors, Management believes that the Company s eligibility for these installment payments will be upheld as originally requested.

17 Income and social contribution taxes

(a) Current income tax

Income (loss) before income taxes	721,234
Income tax at the 25% rate	(180,309)
Income tax on equity results	123,598
Other permanent differences	2,199
Amortization of goodwill	12,876
Taxes challenged in court	(78)
Tax losses	15,722
Provisions and other temporary differences	(9,718)
Other	(537)
Income tax expense	(36,327)

Out of the income tax expense, R$ 5,507 is entitled to income tax exemption/abatement.

(b) Deferred income tax

(i) Composition of deferred income tax

In accordance with the provisions of CVM Deliberation 273/98, which approved the Institute of Independent Auditors of Brazil (IBRACON) standards on the accounting of income tax, supplemented by CVM Instruction 371/02, the Company has the following accounting balances of deferred income tax:

Composition of calculated deferred income tax:

Tax loss carryforward	541,819
Amortized goodwill on investment in merged companies	529,247
Temporarily non-deductible expenses	426,807
Potential calculation basis of deferred income tax	1,497,873
Potential deferred income tax (25%)	374,468
Unrecorded portion of deferred income tax	(2,723)
Deferred income tax - assets	371,745
Current assets	(36,725)
Long-term receivables	335,020
Activity:	
Opening balance for the year	403,205
Realization of deferred income tax on tax losses	(10,989)
Realization of income tax on amortized goodwill of merged companies	(21,267)
Deferred income tax on temporary provisions	796
Closing balance	371,745
Deferred income tax liabilities:	
Opening balance for the year	(7,346)
Realization of deferred income tax	(344)
Closing balance for the year	(7,002)
Deferred income tax in statements of income	(31,116)

Deferred income tax assets arising from tax losses and temporary differences are recorded taking into account analyses of future tax profits, supported by studies prepared based on internal and external assumptions and current macroeconomic and business scenarios approved by Company's management.

(c) Social Contribution on Income (CSL)

In view of the discussions over the constitutionality of Law 7689 of 1988, the Company and its absorbed companies OPP Química, Trikem and Polialden filed civil lawsuits against payment of CSL. The resulting court decision favorable to these companies became final and conclusive.

However, the Federal Government filed a suit on the judgment (*ação rescisória*) challenging the decisions on the lawsuits filed by the Company, Trikem and Polialden, on the argument that - after the final decision favorable to those companies - the Full Bench of STF declared the constitutionality of this tax except for 1988. As the Federal Government did not file a suit on the judgment in the case of OPP Química, the first final and conclusive decision remained in force.

The suit on the judgment is pending the STJ and STF review of a number of appeals concerning this specific matter. Even though the suit on the judgment and tax payments are still on hold, the Federal Revenue Office has issued tax infraction notices against the Company and its absorbed companies, and administrative defenses have been filed against such notices.

Based on the opinion of its legal advisors, Management believes that the following is likely to occur: (i) the courts will eventually release the Company from paying this tax; and (ii) even if the suit on the judgment is held invalid, the effects of said judgment cannot retroact to the year of enactment of the law, the reason why the Company has created no provisions for this tax.

If retrospective collection is required by court order (contrary to the opinion of its legal advisors), the Company believes that the possibility of being imposed a fine is remote. Accordingly, the amount payable, restated for inflation and accruing Brazil s SELIC benchmark rate, would be approximately R$ 850,000, net of fine.

18 Tax incentives (a) Income tax

To 2011, the Company is entitled to reduce by 75% the income tax on the profit arising from the sale of basic petrochemical products and utilities produced at the Camaçari plant. The three polyethylene plants at Camaçari have the same right up to base years 2011, 2012 and 2016. The PVC plant at Camaçari also has this right up to base year 2013. The PVC plants in Alagoas and the PET plant at Camaçari are exempt from corporate income tax on the results of their industrial operations until 2008.

Productions of caustic soda, chloride, ethylene dichloride and caprolactam enjoy the benefit of the 75% decrease in the income tax rate up to 2012.

Until December 2007, the income tax amount covered by the incentive was recorded as expense for the year, as a contra entry to a specific capital reserve account. Law 11638/07 revoked the article of Law 6404/76 that classified such incentive as a capital reserve. Pursuant to CVM Instruction 469, issued on May 2, 2008, these incentives should be temporarily recorded as deferred income .

(b) Value-added tax - ICMS

The Company has ICMS tax incentives granted by the States of Rio Grande do Sul and Alagoas, through the Company Operation Fund - FUNDOPEM and State of Alagoas Integrated Development Program - PRODESIN, respectively. Such incentives are designed to foster the installation and expansion of industrial facilities in those States. The incentive is stated in income for the year, under Other operating income . The incentive determined for the period ended July 31, 2008 was R$ 683.

19 Shareholders equity

(a) Capital

At July 31, 2008, the Company s subscribed and paid-up capital is R$ 5,361,656, divided into 522,885,593 shares with no pr value, comprising 196,714,190 common, 325,368,337 class A preferred, and 803,066 class B preferred shares. At the same date, the Company s authorized capital comprises 488,000,000 shares, of which 175,680,000 are common, 307,440,000 are class A preferred, and 4,880,000 are class B preferred shares.

At the Extraordinary Shareholders Meeting held on May 30, 2008, a capital increase was approved, as a result of the merger of Grust shares (Note 1(b)), through the issue of 46,903,320 common and 43,144,662 class A preferred shares. As such, the Company s capital went from R$ 4,640,947 to R$ 5,361,656.

(b) Rights attaching to shares

Preferred shares carry no voting rights, but qualify for a non-cumulative priority dividend at 6% per annum on their unit value, if profits are available for distribution. Only Class A preferred shares are on a par with common shares for entitlement to remaining profits; dividends are earmarked to common shares only after the priority dividend has been paid to preferred shares. Further, only Class A preferred shares rank equally with common shares in the distribution of shares resulting from capitalization of other reserves. Only Class A preferred shares are convertible into common shares, by resolution of the majority voting stock at general meetings. Class B preferred shares may be converted into Class A preferred shares at a ratio of two Class B preferred shares to each Class A preferred share, upon written notice to the Company at any time (after expiration of the non-convertibility period prescribed in special legislation that authorized the issuance and payment of such shares by using tax incentive funds.

If the Company is wound up, Class A and B preferred shares are accorded priority treatment in repayment of capital.

The shareholders are entitled to a minimum compulsory dividend at 25% of the net profits at yearend, adjusted as per the Brazilian Corporation Law.

According to the Memorandums of Understanding for Execution of Shareholders Agreement, the Company is required to distribute dividends not lower than 50% of the yearend net profits, to the extent that the reserves necessary for its effective operation in the ordinary course of business are maintained at a sufficient level.

As agreed at the time of issuance of Medium-Term Notes, the payment of dividends or interest on equity is capped at twofold the minimum dividends accorded to preferred shares under the Company s bylaws.

(c) Treasury shares

At July 31, 2008, shares held in treasury comprised 8,886,457 shares, comprising 6,251,744 common, 2,425,465 class A preferred, and 209,048 class B preferred shares, for the total value of R$ 120,037. The total value of these shares, based on the average quotation of Bovespa s session of June 30, 2008, is R$ 122,811. These shares arise from the following events:

- On February 19, 2008, a new share repurchase program was approved, with a 12-month term and approximate investment of R$ 252,000, for the repurchase of up to 19,862,411 class A preferred shares. Until July 31, 2008, 1,669,000 A preferred shares were acquired, at the average cost of R$ 13.17 per share. The low and high amounts of these purchases were R$ 12.61 and R$ 13.85 per share.
- On March 6, 2008, the cancellation of 16,595,000 class A preferred shares of the Company was approved. These shares had been maintained in Treasury and recorded for at R$ 244,456. The amount was written-off from the profits for expansion reserve.
- On April 28, 2008, the dissidence of shareholders owning 2,108,823 common and 209,048 class B preferred shares in the Company was communicated to the market, concerning the ratification of the transaction to acquire the control of the Ipiranga Group petrochemical assets. These shares were redeemed on March 11, 2008, for its book value as of December 31, 2007, of R$ 13.50 per share, for a total of R$ 31,292.
- On May 30, 2008, the shareholders of Braskem Participações approved a capital reduction and transfer to the Company of 580,331 common and 290,165 class A preferred shares issued by the Company, for a total of R$ 13,110.

(d) Appropriation of net income

The Shareholders Annual Meeting held on March 26, 2008 approved the appropriation of net income for year 2007, totaling R$ 543,220, as follows: (i) R$ 278,457 as dividends for common, and classes A and B preferred shares, at the ratio of R$ 0.644 per share; (ii) R$ 27,161 to the legal reserve, and (iii) R$ 237,602 to the profits for expansion reserve.

20 Contingencies

(a) Collective Bargaining Agreement - Section 4

The Petrochemical, Plastics, Chemicals and Related Industry Workers Union in the State of Bahia (SINDIQUÍMICA) and the Employers Association of the Petrochemical and Synthetic Resins Industries in the State of Bahia (SINPEQ) are disputing in court the validity of a wage and salary indexation clause contained in the collective bargaining agreement (*convenção coletiva de trabalho*), given the matter of public policy involved, namely, the adoption of an economic stabilization plan in 1990 that put a limit on wage adjustments. The Company ran plants in the region in 1990, and is a member of SINPEQ.

The employees labor union seeks retrospective adjustment of wages and salaries. In December 2002, the STF affirmed an erstwhile decision from the Superior Labor Court (TST), determining that an economic policy legislation should prevail over collective bargaining agreements and, as such, no adjustment was due. In 2003, SINDIQUÍMICA appealed this decision by means of a motion for clarification, which was rejected by unanimous opinion on May 31, 2005.

On October 24, 2005, SINDIQUÍMICA filed a plea known as *embargos de divergência*. This plea was forwarded to the General Prosecutor Office of the Republic, which rendered an opinion fully favorable to SINPEQ in November 2006. Judgment on this appeal started on June 28, 2007, but was adjourned as one of the judges asked for further access to the case docket.

In reliance on the opinion of its legal advisors, Management believes that SINPEQ is likely to prevail in this suit and, as such, no amount was provisioned for.

(b) Offsetting of tax credits

From May through October 2000, absorbed companies OPP Química and Trikem offset their own federal tax debts with IPI tax credits (créditos-prêmio) assigned by an export trading company (Assignor). These offsetting procedures were recognized by the São Paulo tax officials (DERAT/SP) through offset supporting certificates (DCC s) issued in response to an injunctive relief entered in a motion for writ of mandamus (MS SP). Assignor also filed a motion for writ of mandamus against the Rio de Janeiro tax officials (DERAT/RJ) (MS RJ) for recovery of IPI tax credits and their use for offsetting with third-party tax debts, among others. The MS SP was dismissed without prejudice, confirming the Rio de Janeiro administrative and jurisdictional authority to rule on Assignor s tax credits.

In June 2005, DERAT/SP issued ordinances (*portarias*) canceling the DCC s. Based on said ordinances, the Federal Revenue Office unit in Camaçari/BA sent collection letters to the Company. Notices of dispute were presented by the Company, but the administrative authorities declined to process them. As a result, past-due federal tax liabilities (*dívida ativa*) at R$ 276,620 were posted in December 2005 concerning the Company s tax debts originating from purportedly undue offsetting procedures.

Both Assignor and the Company commenced a number of judicial and administrative proceedings to defend the lawfulness and validity of those offsetting procedures, and the legal counsels to both companies labeled the likelihood of success in those cases as probable, mostly in light of the indisputable certainty and validity of those credits as confirmed in a specific audit conducted by DERAT/RJ.

On October 3, 2005, the Federal Supreme Court (STF) held the MS RJ favorably to Assignor in a final and conclusive manner, confirming Assignor s definite right to use the IPI tax credits from all its exports and their availability for offsetting with third-party debts. As a result, the legal advisors to Assignor and to the Company believe that the offsetting procedures carried out by the absorbed companies and duly recognized by DERAT/SP are confirmed, and for this reason they also hold that the tax liabilities being imputed to the Company are not due. Despite the final and conclusive decision in MS RJ, the legal advisors to Assignor and to the Company, in addition to a jurist when inquired of his opinion on this specific issue, feel that the tax liabilities purportedly related to offsetting procedures carried out by the absorbed companies have become time-barred and, as such, can no longer be claimed by the tax authorities.

In January 2006, the Company was ordered to post bond in aid of execution of the tax claim referred to above; this bond was tendered in the form of an insurance policy.

The Company s legal advisors have labeled the likelihood of success in all claims listed above as probable; nevertheless, if the Company is eventually defeated in all those cases, it will be entitled to full recourse against Assignor concerning all amounts paid to the National Treasury, as per the assignment agreement executed in 2000.

(c) National Social Security Institute - INSS

The Company is party to several social security disputes in the administrative and judicial spheres, totaling R$ 347,176 (updated by the SELIC rate) as of July 31, 2008.

In reliance on the legal advisors opinion that the Company stands good chances of success in these cases, Management believes that no sum is payable in connection with these notices and, as such, no amount was provisioned for.

(d) Other court disputes involving the Company and its subsidiaries

- The Company figures as defendant in civil lawsuits filed by the controlling person of a former caustic soda distributor and by a carrier that rendered services to the latter, totaling R$ 27,926 at July 31, 2008. Said plaintiffs seek redress of damages caused by the Company s alleged non-fulfillment of the distributor agreement. In reliance on the opinion of legal advisors sponsoring the Company in these lawsuits, Management believes that the cases will possibly be rejected, and for this reason the respective sums have not been provisioned for.
- In the second quarter of 2005, the Chemical and Petrochemical Industry Workers Unions in Triunfo (RS) and Camaçari (BA) filed several lawsuits for recovery of unpaid overtime. The Company has presented its answers accordingly, and - in reliance on the legal advisors opinion - the Company s Management does not expect to be defeated.
- As of July 31, 2008, the Company was defendant in 1,282 suits for damages and labor claims (already including those mentioned above), totaling approximately R$ 223,282. According to the opinion of legal advisors, most of these suits are likely to be found for the Company. For the cases entailing a probable defeat, the Company has provisioned R$ 20,605.

21 Financial Instruments

(a) Risk management

Since the Company operates in the domestic and international markets, obtaining funds for its operations and investments, it is exposed to market risks mainly arising from changes in the foreign exchange and interest rates, and commodities.

The Company s policy to manage risks has been approved and reviewed by management. These rules prohibit speculative trading and selling short, and provide for the diversification of instruments and counterparties. Counterparties limits and creditworthiness are reassessed on a regular basis and set up in accordance with rules approved by management. Gains and losses on hedge transactions are taken to income on a monthly basis. Adjustments of these instruments to market value are recorded in Asset Valuation adjustment, under shareholders equity, before being taken to income for the period.

To cover the exposure to market risk, the Company utilizes various types of currency hedges, some involving the use of cash and others not. The most common types which use cash, as adopted by the Company, are financial investments abroad (certificates of deposit, securities in U.S. dollars, investment funds, among other instruments) in U.S. dollars. The forms of currency hedge which do not involve the use of cash are swaps, forwards and options.

To hedge its exposure to exchange and interest risks arising from loan and financing agreements, the Company adopted the following methodology: hedging of the principal and interest falling due in the next 12 months in, at least (i) 60% of the debt linked to exports (trade finance), except for Advances on Exchange Contracts (ACCs) of up to six months and Advances on Export Contracts (ACEs); and (ii) 75% of the debt not linked to exports (non-trade finance).

(b) Exposure to foreign exchange risks

The Company has long-term loans and financing to finance its operations, including cash flows and project financing. Part of the long-term loans is linked to foreign currencies (Note 14).

(c) Exposure to interest rate risks

The Company is exposed to interest rate risks on its debt. The debt in foreign currency, bearing floating interest rates, is mainly subject to LIBOR variation, while the domestic debt, bearing floating interest rates, is mainly subject to fluctuations in the Long-term Interest Rate (TJLP) and the Interbank Deposit Certificate (CDI) rate.

(d) Exposure to commodities risks

The Company is exposed to fluctuations in the price of several petrochemical commodities, especially its main raw material, naphtha. Since the Company seeks to transfer to its own selling prices the effect of price changes in its raw material, arising from changes in the naphtha international quotation, part of its sales may be carried out under fixed-price contracts or contracts stating maximum and/or minimum fluctuation ranges. Such contracts are commercial agreements or derivative contracts relating to future sales.

(e) Exposure to credit risks

The operations that subject the Company to concentration of credit risk are mainly bank accounts, financial investments and other accounts receivable, exposing Braskem to the risk of the financial institution involved. In order to manage the credit risk, the Company keeps its bank accounts and financial investments with large financial institutions.

In relation to customer credit risk, the Company protects itself by performing detailed analyses before granting credit and by obtaining real and personal guarantees, when necessary.

(f) Derivative instrument transactions

To determine the estimated market value of financial instruments, the Company uses transaction quotations or public information available in the financial market, as well as valuation methodologies generally accepted and utilized by counterparties. These estimates do not necessarily guarantee that such operations could be realized in the market at the indicated amounts. The use of different market information and/or valuation methodologies could have a significant effect on the estimated market value.

22 Financial Income (Expenses)

Financial income:	
Interest income	61,844
Monetary variation	9,852
Exchange variation	(105,804)
Gains on derivative transactions	1,706
SELIC on tax credits	1,614
Other	4,998
	(25,789)
Financial expenses:	
Interest expenses	(223,187)
Monetary variation	(114,491)
Exchange variation	622,025
Losses on derivative transactions	(33,434)
SELIC on tax expenses	(49,583)
Tax exémses	(23,348)
Discounts granted	(21,312)
Other	(33,495)
	123,176
Net financial result	97,387

23 Non-operating income (Expenses)

Non-operating income (expenses) for the seven-month period ended July 2008 includes R$ 252,105 relating to the disposal of the investment in Petroflex (Note 1(b)), net of the investment cost of R$ 121,557, and including the effects of income in the earnings of subsidiary and associated companies up to March 31, 2008.

24 Insurance coverage

The Company has a broadly-based risk management program designed to provide cover and protection for all assets, as well as possible losses caused by production stoppages, through an "all risks" insurance policy. This policy establishes the amount for maximum probable damage, considered sufficient to cover possible losses, taking into account the nature of the Company s activities and the advice of insurance consultants. At July 31, 2008, amounts insured are as follows:

Coverage:

Maximum indemnity limit of the insurance coverage for inventories, property, plant and equipment, and loss of profits, per claim - (US$ thousand)	1,900,000
Amount of insured assets - R$ (thousand)	13,035,547

Additionally, the Company has transportation, group life, sundry risks and vehicle insurance policies. The risk assumptions adopted are not part of the scope of the audit and, as such, were not examined by our independent auditors.

25 Private pension plans

The actuarial obligations relating to the pension and retirement plans are accrued in conformity with the procedures established by CVM Deliberation 371/2000.

(a) ODEPREV

The Company has a defined-contribution plan for its employees. The plan is managed by ODEPREV - Odebrecht Previdência which was set up by Odebrecht S.A. as a closed private pension entity. ODEPREV offers its participants, employees of the sponsoring companies, the Optional Plan, a defined-contribution plan, under which monthly and sporadic participant contributions and annual and monthly sponsor contributions are accumulated and managed in individual retirement savings accounts.

At July 31, 2008, the active participants in ODEPREV amounted to 2,551 (Jul/07 - 2,536), and the Company s contributions in the first half of 2008 amounted to R$ 6.695 (first half of 2007 - R$ 3.129) and R$ 10,624 (first half of 2007 - R$ 8,893).

26 Raw material purchase commitments

The Company has contracts for consumption of electric energy for its industrial plants located in the States of Alagoas, Bahia and Rio Grande do Sul. The minimum commitment for consumption under these four-year contracts amounts to R$ 725,895.

Braskem purchases naphtha and condensate under contracts establishing a minimum annual purchase volume equal to R$ 3,194,486, based on market prices as of July 31, 2008.

27 Law 11638/07 - Changes in the Brazilian Corporation Law

Law 11638, enacted on December 28, 2007, introduced a number of provisions and amended other provisions of Law 6404 (Brazilian Corporation Law). The Law is mainly intended to update the Brazilian Corporate law in order to harmonize accounting practices adopted in Brazil with international accounting standards issued by International Accounting Standard Board (IASB). Such changes should be applied to financial statements for the end of fiscal year initiated on January 1, 2008.

Although the above mentioned Law is already effective, the application by companies of certain changes introduced by it depends on rules to be issued by the regulatory agencies. Accordingly, the interim financial statements as of July 31, 2008 were prepared in accordance with specific CVM instructions and do not give effect to all changes in accounting practices established by Law 11638/07.

SIGNATURES

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.

Date: October 09, 2008

BRASKEM S.A.

By: /s/ Carlos José Fadigas de Souza Filho

Name: Carlos José Fadigas de Souza Filho
Title: Chief Financial Officer

FORWARD-LOOKING STATEMENTS

This press release may contain forward-looking statements. These statements are statements that are not historical facts, and are based on management's current view and estimates offuture economic circumstances, industry conditions, company performance and financial results. The words "anticipates", "believes", "estimates", "expects", "plans" and similar expressions, as they relate to the company, are intended to identify forward-looking statements. Statements regarding the declaration or payment of dividends, the implementation of principal operating and financing strategies and capital expenditure plans, the direction of future operations and the factors or trends affecting financial condition, liquidity or results of operations are examples of forward-looking statements. Such statements reflect the current views of management and are subject to a number of risks and uncertainties. There is no guarantee that the expected events, trends or results will a ctually occur. The statements are based on many assumptions and factors, including general economic and market conditions, industry conditions, and operating factors. Any changes in such assumptions or factors could cause actual results to differ materially from current expectations.