

INSTEEL INDUSTRIES INC  
Form 10-Q  
April 26, 2011

**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 April 2, 2011**  
**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: 1-9929**

**Insteel Industries, Inc.**

(Exact name of registrant as specified in its charter)

**North Carolina**

**56-0674867**

(State or other jurisdiction of  
incorporation or organization)

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

**1373 Boggs Drive, Mount Airy, North Carolina**

**27030**

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code: **(336) 786-2141**

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 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

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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting  
company

(Do not check if a 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

No

The number of shares outstanding of the registrant's common stock as of April 25, 2011 was 17,614,100.

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**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****INSTEEL INDUSTRIES, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS**

(In thousands except for per share data)

(Unaudited)

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>April 2, 2011</b>	<b>April 3, 2010</b>	<b>April 2, 2011</b>	<b>April 3, 2010</b>
Net sales	\$ 86,933	\$ 52,268	\$ 139,239	\$ 93,469
Cost of sales	75,330	46,049	127,771	83,575
Inventory write-downs				1,933
Gross profit	11,603	6,219	11,468	7,961
Selling, general and administrative expense	4,523	4,182	8,691	7,924
Restructuring charges	2,213		6,603	
Acquisition costs	768		3,518	
Bargain purchase gain	(500)		(500)	
Other income, net	(56)	(97)	(69)	(250)
Interest expense	253	147	404	295
Interest income	(6)	(14)	(19)	(26)
Earnings (loss) from continuing operations before income taxes	4,408	2,001	(7,160)	18
Income taxes	1,789	357	(2,151)	(503)
Earnings (loss) from continuing operations	2,619	1,644	(5,009)	521
Loss from discontinued operations net of income taxes of \$ - , (\$6), \$ - and (\$14)		(10)		(23)
Net earnings (loss)	\$ 2,619	\$ 1,634	\$ (5,009)	\$ 498
Per share amounts:				
Basic:				
Earnings (loss) from continuing operations	\$ 0.15	\$ 0.09	\$ (0.29)	\$ 0.03
Loss from discontinued operations				
Net earnings (loss)	\$ 0.15	\$ 0.09	\$ (0.29)	\$ 0.03
Diluted:				
Earnings (loss) from continuing operations	\$ 0.15	\$ 0.09	\$ (0.29)	\$ 0.03
Loss from discontinued operations				
Net earnings (loss)	\$ 0.15	\$ 0.09	\$ (0.29)	\$ 0.03

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Cash dividends declared	\$ 0.03	\$ 0.03	\$ 0.06	\$ 0.06
Weighted average shares outstanding				
Basic	17,551	17,458	17,531	17,434
Diluted	17,802	17,647	17,531	17,643

*See accompanying notes to consolidated financial statements.*

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**INSTEEL INDUSTRIES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**

(In thousands)

	(Unaudited) April 2, 2011	October 2, 2010
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 3,893	\$ 45,935
Accounts receivable, net	37,418	24,970
Inventories, net	61,717	43,919
Other current assets	4,930	3,931
Total current assets	107,958	118,755
Property, plant and equipment, net	93,169	58,653
Other assets	5,770	5,097
Total assets	\$ 206,897	\$ 182,505
<b>Liabilities and shareholders equity</b>		
Current liabilities:		
Accounts payable	\$ 35,870	\$ 20,689
Accrued expenses	8,555	5,929
Current portion of long-term debt	675	
Current liabilities of discontinued operations		210
Total current liabilities	45,100	26,828
Long-term debt	12,825	
Other liabilities	5,970	7,521
Long-term liabilities of discontinued operations		280
Commitments and contingencies		
Shareholders equity:		
Common stock	17,614	17,579
Additional paid-in capital	47,105	45,950
Retained earnings	80,592	86,656
Accumulated other comprehensive loss	(2,309)	(2,309)
Total shareholders equity	143,002	147,876
Total liabilities and shareholders equity	\$ 206,897	\$ 182,505

*See accompanying notes to consolidated financial statements.*

**INSTEEL INDUSTRIES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)

(Unaudited)

	<b>Six Months Ended</b>	
	<b>April 2, 2011</b>	<b>April 3, 2010</b>
<b>Cash Flows From Operating Activities:</b>		
Net earnings (loss)	\$ (5,009)	\$ 498
Loss from discontinued operations		23
Earnings (loss) from continuing operations	(5,009)	521
Adjustments to reconcile earnings (loss) from continuing operations to net cash provided by operating activities of continuing operations:		
Depreciation and amortization	4,553	3,458
Amortization of capitalized financing costs	40	249
Stock-based compensation expense	1,182	1,103
Asset impairment charges	3,451	
Inventory write-downs		1,933
Excess tax benefits from stock-based compensation	(81)	(3)
Loss on sale of property, plant and equipment	16	11
Deferred income taxes	(2,276)	(217)
Gain from life insurance proceeds	(357)	
Increase in cash surrender value of life insurance policies over premiums paid	(298)	(284)
Net changes in assets and liabilities (net of assets and liabilities acquired):		
Accounts receivable, net	(12,448)	(1,922)
Inventories	2,787	4,449
Accounts payable and accrued expenses	9,360	(4,076)
Other changes	(878)	14,258
Total adjustments	5,051	18,959
Net cash provided by operating activities – continuing operations	42	19,480
Net cash used for operating activities – discontinued operations		(40)
Net cash provided by operating activities	42	19,440
<b>Cash Flows From Investing Activities:</b>		
Acquisition of business	(37,308)	
Capital expenditures	(4,902)	(902)
Proceeds from life insurance claims	1,063	
Proceeds from sale of property, plant and equipment	18	
Increase in cash surrender value of life insurance policies	(425)	(410)
Net cash used for investing activities – continuing operations	(41,554)	(1,312)
Net cash used for investing activities	(41,554)	(1,312)

**Cash Flows From Financing Activities:**

Proceeds from long-term debt	5,908	150
Principal payments on long-term debt	(5,908)	(150)
Cash received from exercise of stock options	13	84
Excess tax benefits from stock-based compensation	81	3
Cash dividends paid	(527)	(1,053)
Other	(97)	(1)
Net cash used for financing activities continuing operations	(530)	(967)
Net cash used for financing activities	(530)	(967)
Net increase (decrease) in cash and cash equivalents	(42,042)	17,161
Cash and cash equivalents at beginning of period	45,935	35,102
Cash and cash equivalents at end of period	\$ 3,893	\$ 52,263

**Supplemental Disclosures of Cash Flow Information:**

Cash paid during the period for:

Interest	\$ 66	\$ 46
Income taxes	760	2
Non-cash investing and financing activities:		
Purchases of property, plant and equipment in accounts payable	441	98
Declaration of cash dividends to be paid	527	
Restricted stock surrendered for withholding taxes payable	86	52
Note payable issued as consideration for business acquired	13,500	
Post-closing purchase price adjustment for business acquired	500	

*See accompanying notes to consolidated financial statements.*



**INSTEEL INDUSTRIES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY**

(In thousands)

(Unaudited)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders Equity
Balance at October 2, 2010	17,579	\$ 17,579	\$ 45,950	\$ 86,656	\$ (2,309)	\$ 147,876
Comprehensive loss:						
Net loss				(5,009)		(5,009)
Comprehensive loss						(5,009)
Stock options exercised	12	12	1			13
Vesting of restricted stock units	30	30	(30)			
Compensation expense associated with stock-based plans			1,182			1,182
Excess tax benefits from stock-based compensation			81			81
Restricted stock surrendered for withholding taxes payable	(7)	(7)	(79)			(86)
Cash dividends declared				(1,055)		(1,055)
Balance at April 2, 2011	17,614	\$ 17,614	\$ 47,105	\$ 80,592	\$ (2,309)	\$ 143,002

*See accompanying notes to consolidated financial statements.*

**INSTEEL INDUSTRIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**

**(1) Basis of Presentation**

The accompanying unaudited interim consolidated financial statements of Insteel Industries, Inc. ( we, us, our, Company or Insteel ) have been prepared pursuant to the rules and regulations of the U.S. Securities and Exchange Commission ( SEC ) for quarterly reports on Form 10-Q. Certain information and note disclosures normally included in the audited financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures made are adequate to make the information not misleading. The October 2, 2010 consolidated balance sheet was derived from the audited consolidated financial statements at that date, but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. These financial statements should therefore be read in conjunction with the consolidated financial statements and notes for the fiscal year ended October 2, 2010 included in the Company s Annual Report on Form 10-K filed with the SEC.

The accompanying unaudited interim consolidated financial statements reflect all adjustments of a normal recurring nature that the Company considers necessary for a fair presentation of results for these interim periods. The results of operations for the six-month period ended April 2, 2011 are not necessarily indicative of the results that may be expected for the fiscal year ending October 1, 2011 or future periods.

On November 19, 2010, the Company purchased certain of the assets and assumed certain of the liabilities of Ivy Steel and Wire, Inc. ( Ivy ) (see Note 3 to the consolidated financial statements).

The Company has evaluated subsequent events through the time of filing this Quarterly Report on Form 10-Q and has concluded that there are no significant events that occurred subsequent to the balance sheet date but prior to the filing of this report that would have a material impact on the consolidated financial statements.

**(2) Recent Accounting Pronouncements**

In December 2010, the Financial Accounting Standards Board ( FASB ) issued an update that clarifies the guidance provided in Accounting Standards Codification ( ASC ) Topic 805, *Business Combinations*, regarding the disclosure requirements for the pro forma presentation of revenue and earnings related to a business combination. The Company elected to early adopt this guidance during the first quarter of fiscal 2011.

**(3) Business Combination**

On November 19, 2010, the Company purchased certain of the assets and assumed certain of the liabilities of Ivy for a preliminary purchase price of approximately \$51.1 million, consisting of \$37.6 million of cash and a \$13.5 million secured subordinated promissory note payable to Ivy (see Note 10 to the consolidated financial statements)(the Ivy Acquisition ). Subsequent to the date of the Ivy Acquisition, the Company recorded \$780,000 of post-closing adjustments which reduced the final adjusted purchase price to \$50.3 million.

Ivy was one of the nation s largest producers of welded wire reinforcement and wire products for concrete construction applications. The Company believes the addition of Ivy s facilities will enhance the Company s competitiveness in its Northeast, Midwest and Florida markets, in addition to providing a platform to serve the West Coast markets more effectively. The assets purchased included Ivy s production facilities in Arizona, Florida, Missouri and Pennsylvania; production equipment in Texas; and certain related inventories. In addition, the Company assumed certain of Ivy s accounts payable and employee benefit obligations.

Following is a summary of the Company s final allocation of the adjusted purchase price to the fair values of the assets acquired and liabilities assumed as of the date of the Ivy Acquisition:

*(In thousands)*

Assets acquired:	
Inventories	\$ 20,585
Property, plant and equipment	37,211
<b>Total assets acquired</b>	<b>\$ 57,796</b>
Liabilities assumed:	
Accounts payable	\$ 6,263
Accrued expenses	725
<b>Total liabilities assumed</b>	<b>6,988</b>
Net assets acquired	50,808
Purchase price	50,308
<b>Bargain purchase gain</b>	<b>\$ 500</b>

Accounting standards require that when the fair value of the net assets acquired exceeds the purchase price, resulting in a bargain purchase gain, the acquirer must reassess the reasonableness of the values assigned to all of the assets acquired, liabilities assumed and consideration transferred. The Company has performed such a reassessment and has concluded that the values assigned for the Ivy Acquisition are reasonable. Consequently, the Company has recorded a \$500,000 bargain purchase gain on the Ivy Acquisition.

The Ivy Acquisition was accounted for as a business purchase pursuant to ASC Topic 805, *Business Combinations*. Acquisition and integration costs are not included as components of consideration transferred, but are accounted for as expenses in the period in which the costs are incurred (See Note 4 to the consolidated financial statements).

Following the Ivy Acquisition, net sales for the Ivy facilities for the three- and six-month periods ended April 2, 2011 were approximately \$18.9 million and \$23.4 million, respectively. The actual amount of net sales specifically attributable to the Ivy Acquisition, however, cannot be quantified due to the integration actions that have been taken by the Company involving the transfer of business between the former Ivy facilities and the Company's existing facilities. The Company has determined that the presentation of Ivy's earnings for the three- and six-month periods ended April 2, 2011 is impractical due to the integration of Ivy's operations into the Company following the Ivy Acquisition.

The following unaudited supplemental pro forma financial information reflects the combined results of operations of the Company had the Ivy Acquisition occurred at the beginning of fiscal 2010. The pro forma information reflects certain adjustments related to the Ivy Acquisition, including adjusted depreciation expense based on the fair value of the assets acquired, interest expense related to the secured subordinated promissory note and an appropriate adjustment in the current period for the acquisition-related costs. The pro forma information does not reflect any operating efficiencies or potential cost savings which may result from the Ivy Acquisition. Accordingly, this pro forma information is for illustrative purposes and is not intended to represent or be indicative of the actual results of operations of the combined company that may have been achieved had the Ivy Acquisition occurred at the beginning of fiscal 2010, nor is it intended to represent or be indicative of future results of operations. The pro forma combined results of operations for the current and comparative prior year periods are as follows:

<i>(In thousands)</i>	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>April 2, 2011</b>	<b>April 3, 2010</b>	<b>April 2, 2011</b>	<b>April 3, 2010</b>

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Net sales	\$ 86,933	\$ 75,023	\$ 155,950	\$ 135,378
Earnings (loss) from continuing operations before income taxes	4,671	(2,848)	(6,400)	(13,452)
Net earnings (loss)	2,775	(1,886)	(4,436)	(8,366)

**(4) Restructuring Charges and Acquisition Costs**

**Restructuring charges.** Subsequent to the Ivy Acquisition, the Company elected to proceed with the consolidation of certain of its welded wire reinforcement operations to reduce its operating costs, including the closure of facilities in Wilmington, Delaware and Houston, Texas. These actions were in response to the close proximity of Ivy's facilities in Hazleton, Pennsylvania and Houston, Texas to the Company's existing facilities in Wilmington, Delaware and Dayton, Texas. The Houston plant closure was completed in December 2010 and the Wilmington plant closure is expected to be completed by the end of April 2011.

Following is a summary of the restructuring activities and associated costs that were incurred during the six-month period ended April 2, 2011:

<i>(In thousands)</i>	<b>Severance and other employee costs</b>	<b>Asset impairment</b>	<b>Facility closure costs</b>	<b>Equipment relocation</b>	<b>Total</b>
Restructuring charges	\$ 979	\$ 2,868	\$ 533	\$ 10	\$ 4,390
Cash payments	(310)		(75)	(10)	(395)
Non-cash charges		(2,868)			(2,868)
Liability as of January 1, 2011	\$ 669	\$	\$ 458	\$	\$ 1,127
Restructuring charges	1,176	584	224	229	2,213
Cash payments	(1,486)		(367)	(145)	(1,998)
Non-cash charges		(584)			(584)
Liability as of April 2, 2011	\$ 359	\$	\$ 315	\$ 84	\$ 758

As of April 2, 2011, the Company recorded a liability of \$758,000 on its consolidated balance sheet for restructuring liabilities, including \$84,000 in accounts payable and \$674,000 in accrued expenses. The Company currently expects to incur approximately \$1.0 million of additional restructuring charges for equipment relocation and employee separation costs over the remainder of the current fiscal year and that substantially all of the cash payments related to the restructuring charges will be made before the end of the current fiscal year.

**Acquisition costs.** During the three- and six-month periods ended April 2, 2011, the Company recorded \$768,000 and \$3.5 million, respectively, of acquisition-related costs associated with the Ivy Acquisition for advisory, accounting, legal and other professional fees. The Company does not expect to incur any additional acquisition costs related to the Ivy Acquisition over the remainder of the fiscal year.

##### **(5) Fair Value Measurements**

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The authoritative guidance for fair value measurements establishes a three-level fair value hierarchy that encourages an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The three levels of inputs used to measure fair value are as follows:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities, including certain pricing models, discounted cash flow methodologies and similar techniques that use significant unobservable inputs.

As of April 2, 2011, the Company held financial assets that are required to be measured at fair value on a recurring basis. The financial assets held by the Company and the fair value hierarchy used to determine their fair values are as follows:

<i>(In thousands)</i>	<b>Total</b>	<b>Quoted Prices in Active Markets (Level 1)</b>	<b>Observable Inputs (Level 2)</b>

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Current assets:				
Cash equivalents	\$ 3,621	\$	3,621	\$
Other assets:				
Cash surrender value of life insurance policies	4,634			4,634
Total	\$ 8,255	\$	3,621	\$ 4,634

Cash equivalents, which include all highly liquid investments with original maturities of three months or less, are classified as Level 1 of the fair value hierarchy. The carrying amount of the Company's cash equivalents, which consist of investments in money market funds, approximates fair value due to their short maturities. Cash surrender value of life insurance policies are classified as Level 2. The fair value of the life insurance policies was determined by the underwriting insurance company's valuation models and represents the guaranteed value the Company would receive upon surrender of these policies as of April 2, 2011.

As of April 2, 2011, the Company had no nonfinancial assets that are required to be measured at fair value on a nonrecurring basis other than the assets and liabilities acquired from Ivy (see Note 3 to the consolidated financial statements) that were acquired at fair value. The carrying amounts of accounts receivable, accounts payable and accrued expenses approximate fair value due to the short-term maturities of these financial instruments. The Company believes that the carrying amount of the \$13.5 million secured subordinated promissory note approximates fair value based on comparable debt with similar terms, conditions and proximity to the issue date, which would be considered a level 2 input.

#### **(6) Discontinued Operations**

In April 2006, the Company decided to exit the industrial wire business with the closure of its Fredericksburg, Virginia facility, which manufactured tire bead wire and other industrial wire for commercial and industrial applications. The Company's decision was based on the weakening in the business outlook for the facility and the expected continuation of difficult market conditions and reduced operating levels. Manufacturing activities at the Virginia facility ceased in June 2006 and the Company liquidated the remaining assets of the business in fiscal 2010. The results of operations and related non-recurring closure costs associated with the industrial wire business have been reported as discontinued operations for the prior year period.

Liabilities of discontinued operations as of October 2, 2010 are as follows:

<i>(In thousands)</i>	<b>October 2, 2010</b>
<b>Liabilities:</b>	
Current liabilities:	
Accrued expenses	\$ 210
Total current liabilities	210
Other liabilities	280
Total liabilities	\$ 490

#### **(7) Stock-Based Compensation**

Under the Company's equity incentive plans, employees and directors may be granted stock options, restricted stock, restricted stock units and performance awards. As of April 2, 2011, there were 286,000 shares available for future grants under the plans.

**Stock option awards.** Under the Company's equity incentive plans, employees and directors may be granted options to purchase shares of the Company's common stock at the fair market value on the date of the grant. Options granted under these plans generally vest over three years and expire ten years from the date of the grant. Compensation expense and excess tax deficiencies (benefits) associated with stock options for the three- and six-month periods ended April 2, 2011 and April 3, 2010 are as follows:

<i>(In thousands)</i>	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>April</b>	<b>April 3,</b>	<b>April</b>	<b>April 3,</b>
	<b>2,</b>	<b>2010</b>	<b>2,</b>	<b>2010</b>
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
Stock options:				

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Compensation expense	\$ 280	\$ 268	\$ 507	\$ 481
Excess tax deficiencies (benefits)	(81)	8	(81)	(3)

As of April 2, 2011, the remaining unamortized compensation cost related to unvested stock option awards was \$803,000, which is expected to be recognized over a weighted average period of 1.30 years.

The fair value of each option grant is estimated on the date of grant using a Monte Carlo valuation model based upon assumptions that are evaluated and revised, as necessary, to reflect market conditions and actual historical experience.



The risk-free interest rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of the grant. The dividend yield is calculated based on the Company's annual dividend as of the option grant date. The expected volatility is derived using a term structure based on historical volatility and the volatility implied by exchange-traded options on the Company's common stock. The expected term for options is based on the results of a Monte Carlo simulation model, using the model's estimated fair value as an input to the Black-Scholes-Merton model, and then solving for the expected term.

The estimated fair value of stock options granted during the three- and six-month periods ended April 2, 2011 and April 3, 2010 was \$5.86 and \$4.62, respectively, based on the following assumptions:

	<b>Six Months Ended</b>	
	<b>April 2, 2011</b>	<b>April 3, 2010</b>
Risk-free interest rate	2.40%	2.69%
Dividend yield	0.97%	1.29%
Expected volatility	56.49%	60.68%
Expected term (in years)	5.11	5.71

The following table summarizes stock option activity for the six-month period ended April 2, 2011:

	<b>Options Outstanding (in thousands)</b>	<b>Exercise Price Per Share</b>			<b>Weighted Average</b>	<b>Contractual Term - Weighted Average</b>	<b>Aggregate Intrinsic Value (in thousands)</b>
		<b>Range</b>					
Outstanding at October 2, 2010	847	\$ 0.18	-	\$ 20.27	\$ 10.63		
Granted	77	12.43	-	12.43	12.43		
Expired			-				
Exercised	(12)	1.06	-	1.06	1.06		
Outstanding at April 2, 2011	912	0.18	-	20.27	10.91	7.19 years	\$ 3,737
Vested and anticipated to vest in the future at April 2, 2011	894				10.91	7.16 years	3,665
Exercisable at April 2, 2011	571				11.16	6.11 years	2,372

**Restricted stock awards.** Under the Company's equity incentive plans, employees and directors may be granted restricted stock awards (RSAs) which are valued based upon the fair market value on the date of the grant. Restricted stock granted under these plans generally vests one to three years from the date of the grant. There were no restricted stock grants during the three- and six-month periods ended April 2, 2011 and April 3, 2010. Amortization expense for restricted stock for the three- and six-month periods ended April 2, 2011 and April 3, 2010 is as follows:

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>April 2, 2011</b>	<b>April 3, 2010</b>	<b>April 2, 2011</b>	<b>April 3, 2010</b>
<i>(In thousands)</i>				

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Amortization expense	\$ 50	\$ 139	\$ 116	\$ 269
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As of April 2, 2011, the remaining unrecognized compensation cost related to unvested restricted stock awards was \$50,000, which is expected to be recognized over a weighted average vesting period of 0.38 years.

During the six-month periods ended April 2, 2011 and April 3, 2010, 40,580 and 26,620 shares, respectively, of employee restricted stock awards vested. Upon vesting, employees have the option of remitting payment for the minimum tax obligation to the Company or net-share settling such that the Company will withhold shares with a value equivalent to the respective employee's minimum tax obligation. A total of 6,757 and 5,225 shares were withheld during the six-month periods ended April 2, 2011 and April 3, 2010, respectively, to satisfy employees' minimum tax obligations.

The following table summarizes restricted stock activity during the six-month period ended April 2, 2011:

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<i>(Share amounts in thousands)</i>	<b>Restricted Stock Awards Outstanding</b>	<b>Weighted Average Grant Date Fair Value</b>
Balance, October 2, 2010	67	\$ 13.37
Granted		
Released	(40)	11.15
Balance, April 2, 2011	27	\$ 16.69

**Restricted stock units.** On January 21, 2009, the Executive Compensation Committee of the Board of Directors approved a change in the equity compensation program such that awards of restricted stock units ( RSUs ) to employees and directors would be made in lieu of awards of restricted stock. RSUs granted under these plans are valued based upon the fair market value on the date of the grant and provide for a dividend equivalent payment which is included in compensation expense. The vesting period for RSUs is generally one to three years from the date of the grant. RSUs do not have voting rights. RSU grants and amortization expense for the three- and six-month periods ended April 2, 2011 and April 3, 2010, respectively, are as follows:

<i>(In thousands)</i>	<b>Three Months Ended April</b>		<b>Six Months Ended April</b>	
	<b>2, 2011</b>	<b>April 3, 2010</b>	<b>2, 2011</b>	<b>April 3, 2010</b>
Restricted stock unit grants:				
Units	52	78	52	78
Market value	\$ 652	\$ 732	\$ 652	\$ 732
Amortization expense	313	209	559	353

As of April 2, 2011, the remaining unrecognized compensation cost related to unvested RSUs was \$1.2 million, which is expected to be recognized over a weighted average vesting period of 1.59 years.

The following table summarizes RSU activity during the six-month period ended April 2, 2011:

<i>(Unit amounts in thousands)</i>	<b>Restricted Stock Units Outstanding</b>	<b>Weighted Average Grant Date Fair Value</b>
Balance, October 2, 2010	239	\$ 9.23
Granted	52	12.43
Released	(30)	9.39
Balance, April 2, 2011	261	\$ 9.85

#### **(8) Income Taxes**

The Company has recorded the following amounts for deferred income taxes and accrued income taxes on its consolidated balance sheet as of April 2, 2011: a current deferred tax asset (net of valuation allowance) of \$2.6 million in other current assets, a non-current deferred tax asset (net of valuation allowance) of \$0.5 million in other assets, accrued non-current income taxes payable of \$55,000 in other liabilities, and income taxes receivable of \$1.4 million in other current assets. As of April 2, 2011, the Company has \$27.3 million of gross state operating loss carryforwards

( NOLs ) that begin to expire in 2017, but principally expire in 2017 to 2030. The Company has also recorded deferred tax assets for various state tax credits of \$300,000, which will begin to expire in 2014 and principally expire in 2014 to 2019. The effective income tax rate for the three-month period ended April 2, 2011 was 40.6% compared with 17.8% in the same year-ago period as a result of changes in permanent book versus tax differences together with a \$500,000 increase in the tax refund received in the prior year as the result of changes in the federal tax regulations regarding the carryback of net operating losses.

The realization of the Company's deferred income tax assets is entirely dependent upon the Company's ability to generate future taxable income in applicable jurisdictions. GAAP requires that the Company periodically assess the need to establish a valuation allowance against its deferred income tax assets to the extent that it no longer believes it is more likely than not they will be fully utilized. As of April 2, 2011 and October 2, 2010, the Company recorded a valuation allowance of \$697,000 and \$461,000, respectively, pertaining to various state NOLs and tax credits that were not expected to be utilized.

The valuation allowance established by the Company is subject to periodic review and adjustment based on changes in facts and circumstances and would be reduced should the Company utilize the state NOLs and tax credits against which an allowance had been provided or determine that such utilization is more likely than not. The increase in the valuation allowance for the six-month period ended April 2, 2011 is primarily due to a change in the Company's expectations regarding the future realization of deferred tax assets related to certain state NOLs and tax credits.

The Company has established contingency reserves for material, known tax exposures, including potential tax audit adjustments. The Company's tax reserves reflect management's judgment as to the estimated liabilities that would be incurred in connection with the resolution of these matters. As of April 2, 2011, the Company had approximately \$9,000 of gross unrecognized tax benefits classified in other current assets and \$33,000 of gross unrecognized tax benefits classified as other liabilities on its consolidated balance sheet, of which \$31,000, if recognized, would reduce its income tax rate in future periods. The Company anticipates the gross unrecognized tax benefit of \$9,000 will be resolved during the next twelve months.

The Company recognizes interest and penalties related to unrecognized tax benefits as a component of income tax expense. As of April 2, 2011, the Company had accrued interest and penalties related to unrecognized tax benefits of \$80,000.

The Company files U.S. federal income tax returns as well as state and local income tax returns in various jurisdictions. Federal and various state tax returns filed by the Company subsequent to fiscal year 2006 remain subject to examination together with certain state tax returns filed by the Company subsequent to fiscal year 2003. The Company's 2007 fiscal year return is currently under examination by the U.S. Internal Revenue Service ( IRS ). Additionally, the IRS is conducting a Joint Committee Review of the 2009 fiscal year return.

#### **(9) Employee Benefit Plans**

**Retirement plans.** The Company has one defined benefit pension plan, the Insteel Wire Products Company Retirement Income Plan for Hourly Employees, Wilmington, Delaware (the Delaware Plan ). The Delaware Plan provides benefits for eligible employees based primarily upon years of service and compensation levels. The Delaware Plan was frozen effective September 30, 2008 whereby participants will no longer earn additional service benefits. The Company's funding policy is to contribute amounts at least equal to those required by law. The Company made contributions totaling \$343,000 and \$411,000 to the Delaware Plan during the three- and six-month periods ended April 2, 2011, respectively, and expects to contribute an additional \$67,000 during the remainder of the current fiscal year.

In February 2011, as part of the planned closure of the Wilmington, Delaware facility, the Company amended the Delaware Plan granting certain participants additional service credit. The amendment resulted in a one-time charge of \$306,000 that has been included within the restructuring charges for the three- and six-month periods ended April 2, 2011.

Net periodic pension costs and related components for the Delaware Plan for the three- and six-month periods ended April 2, 2011 and April 3, 2010 are as follows:

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>April 2, 2011</b>	<b>April 3, 2010</b>	<b>April 2, 2011</b>	<b>April 3, 2010</b>
<i>(In thousands)</i>				
Interest cost	\$ 48	\$ 52	\$ 96	\$ 104
Expected return on plan assets	(52)	(50)	(104)	(100)
Recognized net actuarial loss	58	49	116	98
Net periodic pension cost	\$ 54	\$ 51	\$ 108	\$ 102

**Supplemental employee retirement plan.** The Company maintains supplemental employee retirement plans (each, a SERP ) with certain of its employees (each, a Participant ). Under the SERPs, if the Participant remains in continuous service with the Company for a period of at least 30 years, the Company will pay to the Participant a supplemental

retirement benefit for the 15-year period following the Participant's retirement equal to 50% of the Participant's highest average annual base salary for five consecutive years in the 10-year period preceding the Participant's retirement. If the Participant retires prior to the later of age 65 or the completion of 30 years of continuous service with the Company, but has completed at least 10 years of continuous service with the Company, the amount of the supplemental retirement benefit will be reduced by 1/360th for each month short of 30 years that the Participant was employed by the Company.

Net periodic benefit costs and related components for the SERPs for the three- and six-month periods ended April 2, 2011 and April 3, 2010 are as follows:

	Three Months Ended		Six Months Ended	
	April 2, 2011	April 3, 2010	April 2, 2011	April 3, 2010
<i>(In thousands)</i>				
Service cost	\$ 44	\$ 41	\$ 88	\$ 82
Interest cost	71	70	142	140
Amortization of prior service cost	65	64	130	128
Net periodic benefit cost	\$ 180	\$ 175	\$ 360	\$ 350

### (10) Long-Term Debt

**Revolving Credit Facility.** On June 2, 2010, the Company and each of its wholly-owned subsidiaries entered into the Second Amended and Restated Credit Agreement (the Credit Agreement) which amends and restates in its entirety the previous agreement pertaining to its revolving credit facility that had been in effect since January 2006. The Credit Agreement, which matures on June 2, 2015, provides the Company with up to \$75.0 million of financing on the credit facility to supplement its operating cash flow and fund its working capital, capital expenditure, general corporate and growth requirements. As of April 2, 2011, no borrowings were outstanding on the credit facility, \$70.7 million of additional borrowing capacity was available and outstanding letters of credit totaled \$1.1 million.

Advances under the credit facility are limited to the lesser of the revolving credit commitment or a borrowing base amount that is calculated based upon a percentage of eligible receivables and inventories. Interest rates on the revolver are based upon (1) an index rate that is established at the highest of the prime rate, 0.50% plus the federal funds rate or the LIBOR rate plus the excess of the then-applicable margin for LIBOR loans over the then-applicable margin for index rate loans, or (2) at the election of the Company, a LIBOR rate, plus in either case, an applicable interest rate margin. The applicable interest rate margins are adjusted on a quarterly basis based upon the amount of excess availability on the revolver within the range of 0.75% - 1.50% for index rate loans and 2.25% - 3.00% for LIBOR loans. In addition, the applicable interest rate margins would be increased by 2.00% upon the occurrence of certain events of default provided for in the Credit Agreement. Based on the Company's excess availability as of April 2, 2011, the applicable interest rate margins on the revolver were 0.75% for index rate loans and 2.25% for LIBOR loans.

The Company's ability to borrow available amounts under the revolving credit facility will be restricted or eliminated in the event of certain covenant breaches, events of default or if the Company is unable to make certain representations and warranties provided for in the Credit Agreement.

#### *Financial Covenants*

The terms of the Credit Agreement require the Company to maintain a Fixed Charge Coverage Ratio (as defined in the Credit Agreement) of not less than 1.10 at the end of each fiscal quarter for the twelve-month period then ended when the amount of excess availability on the revolving credit facility is less than \$10.0 million. As of April 2, 2011, the Company was in compliance with all of the financial covenants under the Credit Agreement.

#### *Negative Covenants*

In addition, the terms of the Credit Agreement restrict the Company's ability to, among other things: engage in certain business combinations or divestitures; make investments in or loans to third parties, unless certain conditions are met with respect to such investments or loans; pay cash dividends or repurchase shares of the Company's stock subject to certain minimum borrowing availability requirements; incur or assume indebtedness; issue securities; enter into certain transactions with affiliates of the Company; or permit liens to encumber the Company's property and assets. As of April 2, 2011, the Company was in compliance with all of the negative covenants under the Credit Agreement.

#### *Events of Default*

Under the terms of the Credit Agreement, an event of default will occur with respect to the Company upon the occurrence of, among other things: defaults or breaches under the loan documents, subject in certain cases to cure periods; defaults or breaches by the Company or any of its subsidiaries under any agreement resulting in the acceleration of amounts above certain thresholds or payment defaults above certain thresholds; certain events of bankruptcy or insolvency with



respect to the Company; certain entries of judgment against the Company or any of its subsidiaries, which are not covered by insurance; or a change of control of the Company.

Amortization of capitalized financing costs associated with the credit facility was \$20,000 and \$125,000 for the three-month periods ended April 2, 2011 and April 3, 2010, respectively, and \$40,000 and \$249,000 for the six-month periods ended April 2, 2011 and April 3, 2010, respectively. Accumulated amortization of capitalized financing costs was \$4.0 million as of April 2, 2011 and October 2, 2010.

**Subordinated Note.** As part of the consideration for the Ivy Acquisition, on November 19, 2010 (see Note 3 to the consolidated financial statements) the Company entered into a \$13.5 million secured subordinated promissory note (the Note) payable to Ivy over five years. The Note requires semi-annual interest payments in arrears, and annual principal payments payable on November 19 of each year during the period 2011–2015. The Note bears interest on the unpaid principal balance at a fixed rate of 6.00% per annum and is collateralized by certain of the real property and equipment acquired from Ivy. Based on the terms of the Note, the Company expects to make cash payments of approximately \$405,000 for interest and no principal payments during fiscal 2011. As of April 2, 2011, \$675,000 of the outstanding balance on the Note is recorded as the current portion of long-term debt on the Company's consolidated balance sheet.

As of April 2, 2011, the aggregate maturities of the Note are as follows:

Fiscal years(s)	<i>(In thousands)</i>
2012	\$ 675
2013	675
2014	675
2015	5,737
2016	5,738
Total future maturities	\$ 13,500
Less: Current portion	(675)
	\$ 12,825

The scheduled principal payments will become immediately due and payable together with interest in the event of certain covenant breaches, events of default or if the Company is unable to make certain representations and warranties provided for in the Note. Additionally, there are certain non-financial covenants associated with the Note that require the Company to effect its corporate existence and all material rights and grant a perfected, first priority security interest in all of the real and personal property representing collateral for the Note. The terms of the Note provide that an event of default will occur with respect to the Company upon the occurrence of, among other things: defaults or breaches under the loan document, subject in certain cases to cure periods; certain events of bankruptcy or insolvency with respect to the Company; or a change of control of the Company. As of April 2, 2011, the Company was in compliance with all of the covenants under the Note.

#### **(11) Earnings (Loss) Per Share**

Effective October 4, 2009, the Company adopted certain provisions of ASC Topic 260, *Earnings Per Share*, which requires unvested share-based payment awards that contain non-forfeitable rights to dividends (whether paid or unpaid) to be treated as participating securities and included in the computation of basic earnings per share. The Company's participating securities are its unvested restricted stock awards. As required under the provisions that were adopted, prior periods have been retrospectively adjusted. Because the Company's unvested RSAs do not contractually participate in its losses, the Company has not allocated such losses to the unvested RSAs in computing basic earnings per share, using the two-class method, for the six-month periods ended April 2, 2011.

The computations of basic and diluted earnings (loss) per share attributable to common shareholders for the three- and six-month periods ended April 2, 2011 and April 3, 2010 are as follows:



<i>(In thousands except per share amounts)</i>	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>April 2, 2011</b>	<b>April 3, 2010</b>	<b>April 2, 2011</b>	<b>April 3, 2010</b>
Earnings (loss) from continuing operations	\$ 2,619	\$ 1,644	\$ (5,009)	\$ 521
Less allocation to participating securities	(7)	(8)		
Available to Insteel common shareholders	\$ 2,612	\$ 1,636	\$ (5,009)	\$ 521
Loss from discontinued operations net of income taxes	\$	\$ (10)	\$	\$ (23)
Less allocation to participating securities				
Available to Insteel common shareholders	\$	\$ (10)	\$	\$ (23)
Net earnings (loss)	\$ 2,619	\$ 1,634	\$ (5,009)	\$ 498
Less allocation to participating securities	(7)	(8)		
Available to Insteel common shareholders	\$ 2,612	\$ 1,626	\$ (5,009)	\$ 498
Basic weighted average shares outstanding	17,551	17,458	17,531	17,434
Dilutive effect of stock-based compensation	251	189		209
Diluted weighted average shares outstanding	17,802	17,647	17,531	17,643
Per share basic:				
Earnings (loss) from continuing operations	\$ 0.15	\$ 0.09	\$ (0.29)	\$ 0.03
Loss from discontinued operations				
Net earnings (loss)	\$ 0.15	\$ 0.09	\$ (0.29)	\$ 0.03
Per share diluted:				
Earnings (loss) from continuing operations	\$ 0.15	\$ 0.09	\$ (0.29)	\$ 0.03
Loss from discontinued operations				
Net earnings (loss)	\$ 0.15	\$ 0.09	\$ (0.29)	\$ 0.03

Options and RSUs representing 444,000 and 628,000 shares for the three-month periods ended April 2, 2011 and April 3, 2010, respectively, were antidilutive and were not included in the diluted earnings per share calculation. Options and RSUs representing 570,000 and 496,000 shares for the six-month periods ended April 2, 2011 and April 3, 2010, respectively, were antidilutive and were not included in the diluted earnings per share calculation. Options, RSAs and RSUs representing 220,000 shares for the six-month period ended April 2, 2011 were not included in the diluted earnings per share calculation due to the net losses that were incurred.

#### **(12) Share Repurchases**

On November 18, 2008, the Company's board of directors approved a new share repurchase authorization to buy back up to \$25.0 million of the Company's outstanding common stock in the open market or in privately negotiated transactions (the New Authorization). Repurchases may be made from time to time in the open market or in privately negotiated transactions subject to market conditions, applicable legal requirements and other factors. The Company is not obligated to acquire any particular amount of common stock and the program may be commenced or suspended at any time at the Company's discretion without prior notice. The New Authorization continues in effect until terminated by the Board of Directors. As of April 2, 2011, there was \$24.8 million remaining available for future share repurchases under this authorization. During the three- and six-month periods ended April 2, 2011, the Company repurchased \$86,000 or 6,757 shares of its common stock under the repurchase program through restricted stock net-share settlements. During the three- and six-month periods ended April 3, 2010, the Company repurchased \$45,000 or 4,673 shares and \$51,000 or 5,225 shares, respectively, of its common stock through restricted stock net-share settlements.

**(13) Other Financial Data**

Balance sheet information:

<i>(In thousands)</i>	<b>April 2, 2011</b>	<b>October 2, 2010</b>
Accounts receivable, net:		
Accounts receivable	\$ 38,244	\$ 27,266
Less allowance for doubtful accounts	(826)	(2,296)
Total	\$ 37,418	\$ 24,970
Inventories, net:		
Raw materials	\$ 30,951	\$ 23,817
Work in process	4,170	1,899
Finished goods	26,596	18,203
Total	\$ 61,717	\$ 43,919
Other current assets:		
Current deferred tax asset	\$ 2,603	\$ 2,612
Income taxes receivable	1,369	547
Capitalized financing costs, net	82	82
Other	876	690
Total	\$ 4,930	\$ 3,931
Other assets:		
Cash surrender value of life insurance policies, net of loans \$542 and \$505	\$ 4,634	\$ 4,525
Non-current deferred tax assets	507	
Capitalized financing costs, net	259	300
Other	370	272
Total	\$ 5,770	\$ 5,097
Property, plant and equipment, net:		
Land and land improvements	\$ 9,507	\$ 5,571
Buildings	43,166	32,433
Machinery and equipment	117,606	97,813
Construction in progress	4,276	239
	174,555	136,056
Less accumulated depreciation	(81,386)	(77,403)
Total	\$ 93,169	\$ 58,653

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Accrued expenses:		
Salaries, wages and related expenses	\$ 2,113	\$ 1,210
Pension plan	1,266	1,263
Deferred revenues	1,164	321
Restructuring	674	
Dividends payable	527	
Customer rebates	524	506
Worker s compensation	490	683
Property taxes	434	846
Interest	297	
Legal settlement		600
Other	1,066	500
Total	\$ 8,555	\$ 5,929
Other liabilities:		
Deferred compensation	\$ 5,915	\$ 5,688
Deferred income taxes		1,778
Other	55	55
Total	\$ 5,970	\$ 7,521

#### **(14) Business Segment Information**

Following the Company's exit from the industrial wire business (see Note 6 to the consolidated financial statements), the Company's operations are entirely focused on the manufacture and marketing of concrete reinforcing products for the concrete construction industry. The Company's concrete reinforcing products consist of welded wire reinforcement and PC strand. Based on the criteria specified in ASC Topic 280, *Segment Reporting*, the Company has one reportable segment. The results of operations for the industrial wire products business have been reported as discontinued operations for the prior year periods presented.

#### **(15) Contingencies**

**Legal proceedings.** On November 19, 2007, Dwyidag Systems International, Inc ( DSI ) filed a third-party lawsuit in the Ohio Court of Claims alleging that certain epoxy-coated strand sold by the Company to DSI in 2002, and supplied by DSI to the Ohio Department of Transportation ( ODOT ) for a bridge project, was defective. The third-party action sought recovery of any damages which could have been assessed against DSI in the action filed against it by ODOT, which allegedly could have been in excess of \$8.3 million, plus \$2.7 million in damages allegedly incurred by DSI. In 2009, the Ohio court granted the Company's motion for summary judgment as to the third-party claim against it on the grounds that the statute of limitations had expired, but DSI filed an interlocutory appeal of that ruling. In addition, the Company previously filed a lawsuit against DSI in the North Carolina Superior Court in Surry County seeking recovery of \$1.4 million (plus interest) owed for other products sold by the Company to DSI, which action was removed by DSI to the U.S. District Court for the Middle District of North Carolina.

On October 7, 2010, the Company participated in a structured mediation with ODOT and DSI which led to settlement of all of the above legal matters. The parties dismissed the action in the Middle District of North Carolina on December 23, 2010, and the Ohio Court of Claims action was dismissed on January 21, 2011. Pursuant to the settlement agreement, which was approved by the Ohio Court of Claims on January 5, 2011, the parties have released each other from all liability arising out of the sale of strand for the bridge project. In connection with the settlement, the Company reserved the remaining outstanding balance that it was owed by DSI and agreed to make a cash payment of \$600,000 to ODOT. During the current quarter, the Company paid \$600,000 to ODOT and wrote off the DSI receivables against the previously established reserve. The resolution of this matter has enabled the Company to reinstate its commercial relationship with DSI that had existed prior to the initiation of the legal proceedings. The Company's fourth quarter fiscal 2010 results reflect a pre-tax charge of \$1.5 million relating to the net effect of the settlement.

The Company is also involved in other lawsuits, claims, investigations and proceedings, including commercial, environmental and employment matters, which arise in the ordinary course of business. The Company does not expect that the ultimate costs to resolve these matters will have a material adverse effect on its financial position, results of operations or cash flows.

#### **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations** **Cautionary Note Regarding Forward-Looking Statements**

This report contains forward-looking statements within the meaning of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, particularly under the caption "Outlook" below. When used in this report, the words believes, anticipates, expects, estimates, intends, may, should and similar expressions are intended to identify forward-looking statements. Although we believe that our plans, intentions and expectations reflected in or suggested by such forward-looking statements are reasonable, such forward-looking statements are subject to a number of risks and uncertainties, and we can provide no assurances that such plans, intentions or expectations will be implemented or achieved. All forward-looking statements are based on information that is current as of the date of this report. Many of these risks and uncertainties are discussed in detail, and where appropriate, updated in our periodic and other reports and statements, in particular under the caption "Risk Factors" in our Annual Report on Form 10-K for the year ended October 2, 2010, filed with the U.S. Securities and Exchange Commission. You should carefully review these risks and uncertainties.

All forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by these cautionary statements. All forward-looking statements speak only to the respective dates on which such statements are made and we do not undertake and specifically decline any obligation to publicly release the

results of any revisions to these forward-looking statements that may be made to reflect any future events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events, except as may be required by law.



It is not possible to anticipate and list all risks and uncertainties that may affect our future operations or financial performance; however, they would include, but are not limited to, the following:

potential difficulties that may be encountered in integrating the Ivy Acquisition into our existing business;

potential difficulties in realizing synergies, including reduced operating costs, with respect to the Ivy Acquisition and the cessation of operations at the Wilmington, Delaware facility;

competitive and customer responses to our expanded business following the Ivy Acquisition;

general economic and competitive conditions in the markets in which we operate;

credit market conditions and the relative availability of financing for us, our customers and the construction industry as a whole;

the continuation of reduced spending for nonresidential construction, particularly commercial construction, and the impact on demand for our products;

the timing of the resolution of a new multi-year federal transportation funding authorization and the magnitude of the infrastructure-related funding provided for that requires the use of our products;

the severity and duration of the downturn in residential construction activity and the impact on those portions of our business that are correlated with the housing sector;

the cyclical nature of the steel and building material industries;

fluctuations in the cost and availability of our primary raw material, hot-rolled steel wire rod, from domestic and foreign suppliers;

competitive pricing pressures and our ability to raise selling prices in order to recover increases in wire rod costs;

changes in United States ( U.S. ) or foreign trade policy affecting imports or exports of steel wire rod or our products;

unanticipated changes in customer demand, order patterns and inventory levels;

the impact of weak demand and reduced capacity utilization levels on our unit manufacturing costs;

our ability to further develop the market for engineered structural mesh ( ESM ) and expand our shipments of ESM;

legal, environmental, economic or regulatory developments that significantly impact our operating costs;

unanticipated plant outages, equipment failures or labor difficulties;

continued escalation in certain of our operating costs; and

the Risk Factors discussed in our Annual Report on Form 10-K for the year ended October 2, 2010 and in other filings that we make with the SEC.

## Overview

Insteel Industries, Inc. is one of the nation's largest manufacturers of steel wire reinforcing products for concrete construction applications. We manufacture and market PC strand and welded wire reinforcement, including ESM, concrete pipe reinforcement and standard welded wire reinforcement. Our products are sold primarily to manufacturers of concrete products that are used in nonresidential construction. We market our products through sales representatives who are our employees. Our products are sold nationwide as well as into Canada, Mexico, and Central and South America, and delivered primarily by truck, using common or contract carriers. Our business strategy is focused on: (1) achieving leadership positions in our markets; (2) operating as the lowest cost producer; and (3) pursuing growth opportunities within our core businesses that further our penetration of current markets served or expand our geographic reach.

On November 19, 2010, we, through our wholly-owned subsidiary, Insteel Wire Products Company, purchased certain of the assets of Ivy for approximately \$50.3 million, after giving effect to post-closing adjustments. Ivy was one of the nation's largest producers of welded wire reinforcement and wire products for concrete construction applications (see Note 3 to the consolidated financial statements). Among other assets, we acquired certain of Ivy's inventories and its production facilities located in Hazleton, Pennsylvania; Jacksonville, Florida; Kingman, Arizona; and St. Joseph, Missouri, in addition to the production equipment located at the Houston, Texas facility. We also entered into a short-term sublease with Ivy for the Houston, Texas facility. Subsequent to the acquisition, we elected to proceed with the consolidation of certain of our welded

wire reinforcement operations to reduce operating costs, including the closure of facilities in Wilmington, Delaware and Houston, Texas. These actions were in response to the close proximity of Ivy's facilities in Hazleton, Pennsylvania and Houston, Texas to our existing facilities in Wilmington, Delaware and Dayton, Texas.

Following our exit from the industrial wire business (see Note 6 to the consolidated financial statements), our operations are entirely focused on the manufacture and marketing of concrete reinforcing products. The results of operations for the industrial wire products business have been reported as discontinued operations for all periods presented.

## Results of Operations

### Statements of Operations Selected Data

(Dollars in thousands)

	Three Months Ended			Six Months Ended		
	April 2, 2011	Change	April 3, 2010	April 2, 2011	Change	April 3, 2010
Net sales	\$ 86,933	66.3%	\$ 52,268	\$ 139,239	49.0%	\$ 93,469
Gross profit	11,603	86.6%	6,219	11,468	44.1%	7,961
<i>Percentage of net sales</i>	13.3%		11.9%	8.2%		8.5%
Selling, general and administrative expense	\$ 4,523	8.2%	\$ 4,182	\$ 8,691	9.7%	\$ 7,924
<i>Percentage of net sales</i>	5.2%		8.0%	6.2%		8.5%
Restructuring charges	\$ 2,213	N/M	\$	\$ 6,603	N/M	\$
Acquisition costs	768	N/M		3,518	N/M	
Bargain purchase gain	(500)	N/M		(500)	N/M	
Interest expense	253	72.1%	147	404	36.9%	295
Interest income	(6)	(57.1%)	(14)	(19)	(26.9%)	(26)
Effective income tax rate	40.6%		17.8%	30.0%		N/M
Earnings (loss) from continuing operations	\$ 2,619	59.3%	\$ 1,644	\$ (5,009)	N/M	\$ 521
Loss from discontinued operations		N/M	(10)		N/M	(23)
Net earnings (loss)	2,619	60.3%	1,634	(5,009)	N/M	498

*N/M = not meaningful*

### Second Quarter of Fiscal 2011 Compared to Second Quarter of Fiscal 2010

#### Net Sales

Net sales for the second quarter of 2011 increased 66.3% to \$86.9 million from \$52.3 million in the same year-ago period. Shipments for the quarter increased 42.6% and average selling prices increased 16.7% from the prior year levels. The increase in shipments was primarily due to the addition of the Ivy facilities in the current fiscal year. The increase in average selling prices was driven by price increases that were implemented during the current year quarter to recover higher raw material costs. Sales for both periods reflect severely depressed volumes due to the continuation of recessionary conditions in the construction industry.

#### Gross Profit

Gross profit for the second quarter of 2011 was \$11.6 million, or 13.3% of net sales, compared with \$6.2 million, or 11.9% of net sales, in the same year-ago period. The year-over-year improvement was primarily due to higher spreads between average selling prices and raw material costs and the addition of the Ivy facilities in the current fiscal year. Gross profit for both periods was unfavorably impacted by depressed shipment volumes and elevated unit conversion costs resulting from reduced operating schedules.

#### Selling, General and Administrative Expense

Selling, general and administrative expense ( SG&A expense ) for the second quarter of 2011 increased 8.2% to \$4.5 million, or 5.2% of net sales from \$4.2 million, or 8.0% of net sales in the same year-ago period primarily due to increases in staffing (\$355,000) and other transition-related costs (\$80,000) largely related to the Ivy Acquisition and higher

travel expense (\$115,000). These increases were partially offset by a net gain on the settlement of life insurance policies (\$357,000) and a reduction in legal expenses (\$100,000) primarily due to the prior year costs associated with the PC strand trade cases.

#### *Restructuring Charges*

Restructuring charges of \$2.2 million were recorded during the second quarter of 2011 including \$1.2 million for employee separation costs associated with plant closures and other staffing reductions, \$583,000 for impairment charges related to plant closures and the decommissioning of equipment, \$229,000 for equipment relocation costs and \$224,000 for facility closure costs. The plant closure costs were associated with the consolidation of our Texas and Northeast operations, which involves the closure of facilities in Houston, Texas and Wilmington, Delaware, and relocation of the manufacturing to plants in Dayton, Texas and Hazleton, Pennsylvania, respectively. The employee separation costs were related to the staffing reductions that were implemented across our sales, administration and manufacturing support functions to address the redundancies resulting from the Ivy Acquisition and in connection with the plant closures. We currently expect to incur approximately \$1.0 million of additional restructuring charges for equipment relocation and employee separation costs over the remainder of the fiscal year.

#### *Acquisition Costs*

Acquisition costs of \$768,000 were incurred during the second quarter of 2011 for advisory, accounting, legal and other professional fees directly related to the Ivy Acquisition. The accounting requirements for business combinations require that acquisition costs be expensed in the period in which they are incurred. We do not expect to incur any additional acquisition costs related to the Ivy Acquisition over the remainder of the fiscal year.

#### *Bargain Purchase Gain*

A bargain purchase gain of \$500,000 was recorded during the second quarter of 2011 based on the excess of the fair value of the net assets acquired in the Ivy Acquisition over the purchase price.

#### *Interest Expense*

Interest expense for the second quarter of 2011 increased \$106,000 or 72.1% to \$253,000 from \$147,000 in the same year-ago period primarily due to the interest related to the new secured subordinated promissory note associated with the Ivy Acquisition, which was partially offset by lower amortization of capitalized financing costs.

#### *Income Taxes*

The effective income tax rate for the second quarter of 2011 increased to 40.6% from 17.8% in the same year-ago period as a result of changes in permanent book versus tax differences. Our effective income tax rate for the prior year period was reduced by a \$500,000 increase in a tax refund as the result of changes in the federal tax regulations regarding the carryback of net operating losses together with changes in permanent book versus tax differences largely related to lower non-deductible life insurance expense.

#### *Earnings From Continuing Operations*

Earnings from continuing operations for the second quarter of 2011 was \$2.6 million, or \$0.15 per share compared to \$1.6 million, or \$0.09 per share in the same year-ago period primarily due to the increase in gross profit, which was partially offset by the restructuring charges and acquisition costs incurred in connection with the Ivy Acquisition.

#### *Loss From Discontinued Operations*

The \$10,000 loss from discontinued operations in the prior year period, which did not have an effect on the net loss per share, resulted from facility-related costs associated with the real estate held for sale of the discontinued industrial wire business that was sold during the fourth quarter of 2010.

#### *Net Earnings*

The net earnings for the second quarter of 2011 were \$2.6 million, or \$0.15 per share, compared to \$1.6 million, or \$0.09 per share, in the same year-ago period primarily due to the increase in gross profit partially offset by the restructuring charges and acquisition costs incurred in connection with the Ivy Acquisition.

***First Half of Fiscal 2011 Compared to First Half of Fiscal 2010***

*Net Sales*

Net sales for the first half of 2011 increased 49.0% to \$139.2 million from \$93.5 million in the same year-ago period. Shipments for the period increased 30.8% while average selling prices for the period increased 13.9% from the prior year levels. The increase in shipments was primarily due to the addition of the Ivy facilities in the current fiscal year. The increase in average selling prices was driven by price increases that were implemented during the current period to recover higher raw material costs. Sales for both periods reflect severely depressed volumes due to the continuation of recessionary conditions in the construction industry.

*Gross Profit*

Gross profit for the first half of 2011 was \$11.5 million, or 8.2% of net sales, compared to \$8.0 million, or 8.5% of net sales, in the same year-ago period. Gross profit for the current year period was unfavorably impacted by the sale of the higher cost inventory acquired from Ivy that was valued at fair value in accordance with purchase accounting requirements. Gross profit for the prior year period includes a pre-tax charge of \$1.9 million for inventory write-downs to reduce the carrying value of inventory to the lower of cost or market. Gross profit for both periods was unfavorably impacted by depressed shipment volumes and elevated unit conversion costs resulting from reduced operating schedules.

*Selling, General and Administrative Expense*

SG&A expense for the first half of 2011 increased 9.7% to \$8.7 million, or 6.2% of net sales from \$7.9 million, or 8.5% of net sales in the same year-ago period. The increase was primarily due to increases in staffing (\$593,000) and other transition-related costs (\$153,000) largely related to the Ivy Acquisition together with higher travel expense (\$139,000), payroll taxes (\$127,000) and stock-based compensation (\$101,000). These increases were partially offset by a net gain on the settlement of life insurance policies (\$357,000) and a reduction in legal expenses (\$234,000) primarily due to the prior year costs associated with the PC strand trade cases.

*Restructuring Charges*

Restructuring charges of \$6.6 million were recorded during the first half of 2011, including \$3.4 million for impairment charges related to plant closures and the decommissioning of equipment, \$2.2 million for employee separation costs associated with plant closures and other staffing reductions, \$533,000 for the future lease obligations associated with the closed Houston facility, \$239,000 for equipment relocation costs and \$224,000 for facility closure costs. The plant closure costs were associated with the consolidation of our Texas and Northeast operations, which involves the closure of facilities in Houston, Texas and Wilmington, Delaware, and relocation of the manufacturing to plants in Dayton, Texas and Hazleton, Pennsylvania, respectively. The employee separation costs were related to the staffing reductions that were implemented across our sales, administration and manufacturing support functions to address the redundancies resulting from the Ivy Acquisition and in connection with the plant closures. We currently expect to incur approximately \$1.0 million of additional restructuring charges for equipment relocation and employee separation costs over the remainder of the fiscal year.

*Acquisition Costs*

Acquisition costs of \$3.5 million were incurred during the first half of 2011 for advisory, accounting, legal and other professional fees directly related to the Ivy Acquisition. The accounting requirements for business combinations require that acquisition costs be expensed in the period in which they are incurred. We do not expect to incur any additional acquisition costs related to the Ivy Acquisition over the remainder of the fiscal year.

*Bargain Purchase Gain*

A bargain purchase gain of \$500,000 was recorded during the first half of 2011 based on the excess of the fair value of the net assets acquired in the Ivy Acquisition over the purchase price.

*Interest Expense*

Interest expense for the first half of 2011 increased \$109,000 or 36.9% to \$404,000 from \$295,000 in the same year-ago period. The increase was primarily due to the interest related to the new secured subordinated promissory note associated with the Ivy Acquisition, which was partially offset by lower amortization of capitalized financing costs.



*Income Taxes*

Our effective income tax rate for the first half of 2011 was 30.0% and reflects the establishment of a valuation allowance against certain state net operating losses and state tax credits that we do not expect to realize together with changes in permanent book versus tax differences. Our effective income tax rate for the prior year period was reduced by a \$500,000 increase in a tax refund as the result of changes in the federal tax regulations regarding the carryback of net operating losses together with changes in permanent book versus tax differences largely related to lower non-deductible life insurance expense.

*Earnings (Loss) From Continuing Operations*

The loss from continuing operations for the first half of 2011 was \$5.0 million, or \$0.29 per share compared with earnings of \$521,000, or \$0.03 per share in the same year-ago period primarily due to the restructuring charges and acquisition costs incurred in connection with the Ivy Acquisition, which were partially offset by the increase in gross profit.

*Loss From Discontinued Operations*

The \$23,000 loss from discontinued operations in the prior year period, which did not have an effect on the net loss per share, resulted from facility-related costs associated with the real estate held for sale of the discontinued industrial wire business that was sold during the fourth quarter of 2010.

*Net Earnings (Loss)*

The net loss for the first half of 2011 was \$5.0 million, or \$0.29 per share compared with earnings of \$498,000, or \$0.03 per share in the same year-ago period primarily due to the restructuring charges and acquisition costs incurred in connection with the Ivy Acquisition, which were partially offset by the increase in gross profit.

**Liquidity and Capital Resources****Selected Financial Data**

(Dollars in thousands)

**Cash Flow Analysis**

	<b>Six Months Ended</b>	
	<b>April 2, 2011</b>	<b>April 3, 2010</b>
Net cash provided by operating activities of continuing operations	\$ 42	\$ 19,480
Net cash used for investing activities	(41,554)	(1,312)
Net cash used for financing activities	(530)	(967)
Net cash used for operating activities of discontinued operations		(40)
Working capital	62,858	84,614
Long-term debt	12,825	
<i>Percentage of total capital</i>	8.2%	
Shareholders' equity	\$ 143,002	\$ 147,647
<i>Percentage of total capital</i>	91.8%	100.0%
Total capital (total long-term debt + shareholders' equity)	\$ 155,827	\$ 147,647

Operating activities of continuing operations provided \$42,000 of cash during the first half of 2011 compared to \$19.5 million during the same period last year. The year-over-year change was primarily due to the prior year receipt of a \$13.3 million income tax refund associated with the carryback of net operating losses, the current year loss of \$5.0 million and the change in deferred taxes. The current year loss includes a pre-tax charge of \$3.5 million for asset impairment charges related to restructuring activities and the prior year earnings include a pre-tax charge of \$1.9 million for inventory write-downs. The net working capital components of accounts receivable, inventories, and accounts payable and accrued expenses used \$301,000 in the current year compared to \$1.5 million in the prior year. The cash used by net working capital in the current year was largely due to the \$12.5 million increase in accounts receivable as a result of the increases in shipments and selling prices, which was partially offset by a \$2.8 million



decrease in inventory and an \$9.4 million increase in accounts payable and accrued expenses resulting from higher raw material purchases. The cash used by net working capital in the prior year was largely due to the \$4.1 million decrease in accounts payable and accrued expenses primarily related to reduced raw

material purchases and the \$4.4 million decrease in inventories (excluding the impact of the \$1.9 million of inventory write-downs) resulting from higher shipments. We may elect to make additional adjustments in our operating activities should the current recessionary conditions in our construction end market persist, which could materially impact our cash requirements. While a downturn in the level of construction activity adversely affects sales to our customers, it generally reduces our working capital requirements.

Investing activities used \$41.6 million of cash during the first half of 2011 compared to \$1.3 million during the same period last year. The increase in cash used was primarily related to the Ivy Acquisition and an increase in capital expenditures to \$4.9 million in the current year compared to \$0.9 million in the prior year. Capital expenditures are expected to total less than \$10.0 million for fiscal 2011. Our investing activities are largely discretionary, which gives us the ability to significantly curtail future outlays should future business conditions warrant that such actions be taken.

Financing activities used \$530,000 of cash during the first half of 2011 compared to \$967,000 during the same period last year. The year-over-year change was primarily due to the inclusion of two quarterly cash dividend payments in the prior year compared with one in the current year.

#### **Credit Facilities**

On June 2, 2010, we and each of our wholly-owned subsidiaries entered into the Second Amended and Restated Credit Agreement (the "Credit Agreement") which amends and restates in its entirety the previous agreement pertaining to our revolving credit facility that had been in effect since January 2006. The Credit Agreement, which matures on June 2, 2015, provides us with up to \$75.0 million of financing on the credit facility to supplement our operating cash flow and fund our working capital, capital expenditure, general corporate and growth requirements. As of April 2, 2011, no borrowings were outstanding on the credit facility, \$70.7 million of additional borrowing capacity was available and outstanding letters of credit totaled \$1.1 million.

As part of the consideration for purchasing certain assets of Ivy on November 19, 2010 (See Note 3 to the consolidated financial statements), the Company entered into a \$13.5 million secured subordinated promissory note (the "Note") payable to Ivy over five years. The Note requires semi-annual interest payments in arrears, and annual principal payments payable on November 19 of each year during the period 2011-2015. The Note bears interest on the unpaid principal balance at a fixed rate of 6.00% per annum and is collateralized by certain of the real property and equipment acquired from Ivy. Based on the terms of the Note, the Company expects to make cash payments of approximately \$405,000 for interest and no principal payments during fiscal 2011.

We believe that, in the absence of significant unanticipated cash demands, cash and cash equivalents, and net cash generated by operating activities will be sufficient to satisfy our expected requirements for working capital, capital expenditures, dividends, principal and interest payments on the Note and share repurchases, if any. We also expect to have access to the amounts available under our revolving credit facility as required. However, further deterioration of market conditions in the construction sector could result in additional reductions in demand from our customers, which would likely reduce our operating cash flows. Our operating cash flows could also be unfavorably impacted by unanticipated cash requirements arising in connection with the Ivy Acquisition. Under such circumstances, we may need to curtail capital and operating expenditures, delay or restrict share repurchases, cease dividend payments and/or realign our working capital requirements.

Should we determine, at any time, that we require additional short-term liquidity, we would evaluate the alternative sources of financing that are potentially available to provide such funding. There can be no assurance that any such financing, if pursued, would be obtained, or if obtained, would be adequate or on terms acceptable to us. However, we believe that our strong balance sheet, flexible capital structure and borrowing capacity available to us under our revolving credit facility position us to meet our anticipated liquidity requirements for the foreseeable future.

#### **Seasonality and Cyclical**

Demand in our markets is both seasonal and cyclical, driven by the level of construction activity, but can also be impacted by fluctuations in the inventory positions of our customers. From a seasonal standpoint, the highest level of sales within the year typically occurs when weather conditions are the most conducive to construction activity. As a result, sales and profitability are usually higher in the third and fourth quarters of the fiscal year and lower in the first and second quarters. From a cyclical standpoint, the level of construction activity tends to be correlated with general

economic conditions although there can be significant differences between the relative performance of the nonresidential versus residential construction sectors for extended periods.

### **Impact of Inflation**

We are subject to inflationary risks arising from fluctuations in the market prices for our primary raw material, hot-rolled steel wire rod, and, to a much lesser extent, freight, energy and other consumables that are used in our manufacturing processes. We have generally been able to adjust our selling prices to pass through increases in these costs or offset them through various cost reduction and productivity improvement initiatives. However, our ability to raise our selling prices depends on market conditions and competitive dynamics, and there may be periods during which we are unable to fully recover increases in our costs. During 2010, our ability to fully recover higher wire rod prices was mitigated by competitive pricing pressures resulting from the ongoing weakness in demand. Since December 2010, wire rod prices have risen due to the escalation in the cost of scrap and other raw materials for wire rod producers and increased demand from non-construction applications, and could continue to trend higher. The timing and magnitude of any future increases in the prices for wire rod and the impact on selling prices for our products is uncertain at this time.

### **Off-Balance Sheet Arrangements**

We do not have any material transactions, arrangements, obligations (including contingent obligations), or other relationships with unconsolidated entities or other persons, as defined by Item 303(a)(4) of Regulation S-K of the SEC, that have or are reasonably likely to have a material current or future impact on our financial condition, results of operations, liquidity, capital expenditures, capital resources or significant components of revenues or expenses.

### **Contractual Obligations**

Except with respect to the debt maturity schedule described in Note 10 to our consolidated financial statements herein, there have been no material changes in our contractual obligations and commitments as disclosed in our Annual Report on Form 10-K as of October 2, 2010 other than those which occur in the ordinary course of business.

### **Critical Accounting Policies**

Our financial statements have been prepared in accordance with accounting principles generally accepted in the United States. Our discussion and analysis of our financial condition and results of operations are based on these financial statements. The preparation of our financial statements requires the application of accounting policies in addition to certain estimates and judgments based on current available information, actuarial estimates, historical results and other assumptions believed to be reasonable. Actual results could differ from these estimates.

Following is a discussion of our most critical accounting policies, which are those that are both important to the depiction of our financial condition and results of operations and that require judgments, assumptions and estimates.

**Revenue recognition.** We recognize revenue from product sales when products are shipped and risk of loss and title has passed to the customer. Sales taxes collected from customers are recorded on a net basis and are thus excluded from revenue.

**Concentration of credit risk.** Financial instruments that subject us to concentrations of credit risk consist principally of cash and cash equivalents and trade accounts receivable. Our cash is concentrated primarily at one financial institution, which at times exceeds federally insured limits. We are exposed to credit risk in the event of default by institutions in which our cash and cash equivalents are held and by customers to the extent of the amounts recorded on the balance sheet. We invest excess cash primarily in money market funds, which are highly liquid securities that bear minimal risk.

Most of our accounts receivable are due from customers that are located in the U.S. and we generally require no collateral depending upon the creditworthiness of the account. We provide an allowance for doubtful accounts based upon our assessment of the credit risk of specific customers, historical trends and other information. There is no disproportionate concentration of credit risk.

**Allowance for doubtful accounts.** We maintain allowances for doubtful accounts for estimated losses resulting from the potential inability of our customers to make required payments on outstanding balances owed to us. Significant management judgments and estimates are used in establishing the allowances. These judgments and estimates consider such factors as customers' financial position, cash flows and payment history as well as current and expected business conditions. It is reasonably likely that actual collections will differ from our estimates, which may result in increases or decreases in the allowances. Adjustments to the allowances may also be required if there are significant changes in the financial condition of our customers.



**Inventory valuation.** We periodically evaluate the carrying value of our inventory. This evaluation includes assessing the adequacy of allowances to cover losses in the normal course of operations, providing for excess and obsolete inventory, and ensuring that inventory is valued at the lower of cost or estimated net realizable value. Our evaluation considers such factors as the cost of inventory, future demand, our historical experience and market conditions. In assessing the realization of inventory values, we are required to make judgments and estimates regarding future market conditions. Because of the subjective nature of these judgments and estimates, it is reasonably likely that actual outcomes will differ from our estimates. Adjustments to these reserves may be required if actual market conditions for our products are substantially different than the assumptions underlying our estimates.

**Self insurance.** We are self-insured for certain losses relating to medical and workers' compensation claims. Self-insurance claims filed and claims incurred but not reported are accrued based upon management's estimates of the discounted ultimate cost for uninsured claims incurred using actuarial assumptions followed in the insurance industry and historical experience. These estimates are subject to a high degree of variability based upon future inflation rates, litigation trends, changes in benefit levels and claim settlement patterns. Because of uncertainties related to these factors as well as the possibility of changes in the underlying facts and circumstances, future adjustments to these reserves may be required.

**Litigation.** From time to time, we may be involved in claims, lawsuits and other proceedings. Such matters involve uncertainty as to the eventual outcomes and the potential losses that we may ultimately incur. We record expenses for litigation when it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. We estimate the probability of such losses based on the advice of legal counsel, the outcome of similar litigation, the status of the lawsuits and other factors. Due to the numerous factors that enter into these judgments and assumptions, it is reasonably likely that actual outcomes will differ from our estimates. We monitor our potential exposure to these contingencies on a regular basis and may adjust our estimates as additional information becomes available or as there are significant developments.

**Assumptions for employee benefit plans.** We have two defined employee benefit plans: the Insteel Wire Products Company Retirement Income Plan for Hourly Employees, Wilmington, Delaware (the Delaware Plan) and the supplemental employee retirement plans (each, a SERP). We recognize net periodic pension costs and value pension assets or liabilities based on certain actuarial assumptions, principally the assumed discount rate and the assumed long-term rate of return on plan assets.

The discount rates we utilize for determining net periodic pension costs and the related benefit obligations for our plans are based, in part, on current interest rates earned on long-term bonds that receive one of the two highest ratings assigned by recognized rating agencies. Our discount rate assumptions are adjusted as of each valuation date to reflect current interest rates on such long-term bonds. The discount rates are used to determine the actuarial present value of the benefit obligations as of the valuation date as well as the interest component of the net periodic pension cost for the following year.

The assumed long-term rate of return on plan assets for the Delaware Plan represents the estimated average rate of return expected to be earned on the funds invested or to be invested in the plan's assets to fund the benefit payments inherent in the projected benefit obligations. Unlike the discount rate, which is adjusted each year based on changes in current long-term interest rates, the assumed long-term rate of return on plan assets will not necessarily change based upon the actual short-term performance of the plan assets in any given year. The amount of net periodic pension cost that is recorded each year for the plan is based on the assumed long-term rate of return on plan assets and the actual fair value of the plan assets as of the beginning of the year. We regularly review our actual asset allocation and, when appropriate, rebalance the investments in the plan to more accurately reflect the targeted allocation.

For 2010, the assumed long-term rate of return utilized for plan assets of the Delaware Plan was 8%. We currently expect to use the same assumed rate for the long-term return on plan assets in 2011. In determining the appropriateness of this assumption, we considered the historical rate of return of the plan assets, the current and projected asset mix, our investment objectives and information provided by our third-party investment advisors.

The projected benefit obligations and net periodic pension cost for the Delaware Plan are based in part on expected increases in future compensation levels. Our assumption for the expected increase in future compensation levels is based upon our average historical experience and management's intentions regarding future compensation increases.

which generally approximates average long-term inflation rates.

Assumed discount rates and rates of return on plan assets are reevaluated annually. Changes in these assumptions can result in the recognition of materially different pension costs over different periods and materially different asset and liability amounts in our consolidated financial statements. A reduction in the assumed discount rate generally results in an actuarial loss, as the actuarially-determined present value of estimated future benefit payments will increase. Conversely, an

increase in the assumed discount rate generally results in an actuarial gain. In addition, an actual return on plan assets for a given year that is greater than the assumed return on plan assets results in an actuarial gain, while an actual return on plan assets that is less than the assumed return results in an actuarial loss. Other actual outcomes that differ from previous assumptions, such as individuals living longer or shorter lives than assumed in the mortality tables that are also used to determine the actuarially-determined present value of estimated future benefit payments, changes in such mortality tables themselves or plan amendments will also result in actuarial losses or gains. Under accounting principles generally accepted in the United States, actuarial gains and losses are deferred and amortized into income over future periods based upon the expected average remaining service life of the active plan participants (for plans for which benefits are still being earned by active employees) or the average remaining life expectancy of the inactive participants (for plans for which benefits are not still being earned by active employees). However, any actuarial gains generated in future periods reduce the negative amortization effect of any cumulative unamortized actuarial losses, while any actuarial losses generated in future periods reduce the favorable amortization effect of any cumulative unamortized actuarial gains.

The amounts recognized as net periodic pension cost and as pension assets or liabilities are based upon the actuarial assumptions discussed above. We believe that all of the actuarial assumptions used for determining the net periodic pension costs and pension assets or liabilities related to the Delaware Plan are reasonable and appropriate. The funding requirements for the Delaware Plan are based upon applicable regulations, and will generally differ from the amount of pension cost recognized for financial reporting purposes. No contributions were required to be made to the Delaware Plan in the prior year.

In February 2011, as part of the planned closure of the Wilmington, Delaware facility, we amended the Delaware Plan granting certain participants additional service credit. The amendment resulted in a one-time charge of \$306,000 that has been included within the restructuring charges for the three- and six-month periods ended April 2, 2011. We currently expect net periodic pension costs for both plans to total \$1.0 million during 2011. Cash contributions to the plans during 2011 are expected to total \$478,000 for the Delaware Plan and \$244,000 for the SERPs, matching the required benefit payments.

#### **Recent Accounting Pronouncements**

In December 2010, the Financial Accounting Standards Board ( FASB ) issued an update that clarified the guidance provided in Accounting Standards Codification ( ASC ) Topic 805, *Business Combinations*, regarding the disclosure requirements for the pro forma presentation of revenue and earnings related to a business combination. We elected to early adopt this guidance during the first quarter of fiscal 2011.

#### **Outlook**

Our visibility for business conditions through the remainder of fiscal 2011 is clouded by the continued uncertainty regarding future economic conditions and the prospects for a pronounced recovery in the economy and in the job market, the availability of financing in the credit markets and the timing and magnitude of the next federal transportation funding authorization. We expect nonresidential construction, our primary demand driver, to remain at depressed levels particularly for commercial projects which have been the most severely impacted by the economic downturn. We believe the favorable impact from the infrastructure-related funding provided for under the American Recovery and Reinvestment Act has largely been mitigated by the project mix, which is skewed towards pavement resurfacing and repairs that do not require the use of our products together with reduced spending at the state and local government level. We expect that residential construction will remain weak, but gradually improve over the course of the year, favorably impacting shipments to customers that have greater exposure to the housing sector.

In spite of the ongoing weakness in market conditions, prices for our primary raw material, hot-rolled steel wire rod, have spiked higher since December 2010 driven by the sharp escalation in scrap costs for steel producers. Although we have announced price increases for our products to recover these additional costs, the net impact on margins is uncertain at this time.

In response to the challenges facing us, we will continue to focus on the operational fundamentals of our business: closely managing and controlling our expenses; aligning our production schedules with demand in a proactive manner as there are changes in market conditions to minimize our cash operating costs; and pursuing further improvements in the productivity and effectiveness of all of our manufacturing, selling and administrative activities. As we move into



the second half of the year, we expect the contributions from the Ivy Acquisition to increase through the realization of the anticipated operational synergies and the completion of our transition and integration activities. As market conditions improve, we also expect gradually increasing contributions from the substantial investments we have made in our facilities in the form of reduced operating costs and additional capacity to support future growth (see Cautionary Note Regarding Forward-Looking

Statements and Risk Factors ). In addition, we will continue to evaluate further potential acquisitions in our existing businesses that expand our penetration of markets we currently serve or expand our geographic footprint.

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

Our cash flows and earnings are subject to fluctuations resulting from changes in commodity prices, interest rates and foreign exchange rates. We manage our exposure to these market risks through internally established policies and procedures and, when deemed appropriate, through the use of derivative financial instruments. We do not use financial instruments for trading purposes and we are not a party to any leveraged derivatives. We monitor our underlying market risk exposures on an ongoing basis and believe that we can modify or adapt our hedging strategies as necessary.

#### *Commodity Prices*

We are subject to significant fluctuations in the cost and availability of our primary raw material, hot-rolled steel wire rod, which we purchase from both domestic and foreign suppliers. We negotiate quantities and pricing for both domestic and foreign steel wire rod purchases for varying periods (most recently monthly for domestic suppliers), depending upon market conditions, to manage our exposure to price fluctuations and to ensure adequate availability of material consistent with our requirements. We do not use derivative commodity instruments to hedge our exposure to changes in prices as such instruments are not currently available for steel wire rod. Our ability to acquire steel wire rod from foreign sources on favorable terms is impacted by fluctuations in foreign currency exchange rates, foreign taxes, duties, tariffs and other trade actions. Although changes in wire rod costs and our selling prices may be correlated over extended periods of time, depending upon market conditions and competitive dynamics, there may be periods during which we are unable to fully recover increased wire rod costs through higher selling prices, which would reduce our gross profit and cash flow from operations. Additionally, should wire rod costs decline, our financial results may be negatively impacted if the selling prices for our products decrease to an even greater degree and to the extent that we are consuming higher cost material from inventory. Based on our shipments and average wire rod cost reflected in cost of sales for the first six months of fiscal 2011, a 10% increase in the price of steel wire rod would have resulted in a \$9.0 million decrease in our pre-tax earnings for the six months ended April 2, 2011 (assuming there was not a corresponding change in our selling prices).

#### *Interest Rates*

Although the interest rate on our Note is fixed and we did not have any balances outstanding on our revolving credit facility as of April 2, 2011, future borrowings under the facility would be sensitive to changes in interest rates.

#### *Foreign Exchange Exposure*

We have not typically hedged foreign currency exposures related to transactions denominated in currencies other than U.S. dollars, as such transactions have not been material historically. We will occasionally hedge firm commitments for certain equipment purchases that are denominated in foreign currencies. The decision to hedge any such transactions is made by us on a case-by-case basis. There were no forward contracts outstanding as of April 2, 2011.

### **Item 4. Controls and Procedures**

We have conducted an evaluation of the effectiveness of our disclosure controls and procedures as of April 2, 2011. This evaluation was conducted under the supervision and with the participation of management, including our principal executive officer and our principal financial officer. Based upon that evaluation, our principal executive officer and our principal financial officer concluded that our disclosure controls and procedures were effective to ensure that information required to be disclosed in the reports that we file or submit under the Securities Exchange Act of 1934, as amended (the Exchange Act ), is recorded, processed, summarized and reported within the time periods specified in the Commission's rules and forms. Further, we concluded that our disclosure controls and procedures were effective to ensure that information is accumulated and communicated to management, including our principal executive officer and our principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

There has been no change in our internal control over financial reporting that occurred during the quarter ended April 2, 2011 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.



## PART II OTHER INFORMATION

### Item 1. Legal Proceedings

On November 19, 2007, Dwyidag Systems International, Inc ( DSI ) filed a third-party lawsuit in the Ohio Court of Claims alleging that certain epoxy-coated strand sold by us to DSI in 2002, and supplied by DSI to the Ohio Department of Transportation ( ODOT ) for a bridge project, was defective. The third-party action sought recovery of any damages which could have been assessed against DSI in the action filed against it by ODOT, which allegedly could have been in excess of \$8.3 million, plus \$2.7 million in damages allegedly incurred by DSI. In 2009, the Ohio court granted our motion for summary judgment as to the third-party claim against it on the grounds that the statute of limitations had expired, but DSI filed an interlocutory appeal of that ruling. In addition, we previously filed a lawsuit against DSI in the North Carolina Superior Court in Surry County seeking recovery of \$1.4 million (plus interest) owed for other products sold by us to DSI, which action was removed by DSI to the U.S. District Court for the Middle District of North Carolina.

On October 7, 2010, we participated in a structured mediation with ODOT and DSI which led to settlement of all of the above legal matters. The parties dismissed the action in the Middle District of North Carolina on December 23, 2010, and the Ohio Court of Claims action was dismissed on January 21, 2011. Pursuant to the settlement agreement, which was approved by the Ohio Court of Claims on January 5, 2011, the parties have released each other from all liability arising out of the sale of strand for the bridge project. In connection with the settlement, we reserved the remaining outstanding balance that was owed to us by DSI and agreed to make a cash payment of \$600,000 to ODOT. During the current quarter, we paid \$600,000 to ODOT and wrote off the DSI receivables against the previously established reserve. The resolution of this matter has enabled us to reinstate our commercial relationship with DSI that had existed prior to the initiation of the legal proceedings. Our fourth quarter fiscal 2010 results reflect a pre-tax charge of \$1.5 million relating to the net effect of the settlement.

We are also involved in other lawsuits, claims, investigations and proceedings, including commercial, environmental and employment matters, which arise in the ordinary course of business. We do not expect that the ultimate costs to resolve these matters will have a material adverse effect on our financial position, results of operations or cash flows.

### Item 1A. Risk Factors

There were no material changes during the quarter ended April 2, 2011 from the risk factors set forth under Part I, Item 1A., Risk Factors in our Annual Report on Form 10-K for the fiscal year ended October 2, 2010. You should carefully consider these factors in addition to the other information set forth in this report which could materially affect our business, financial condition or future results. The risks and uncertainties described in this report and in our Annual Report on Form 10-K for the year ended October 2, 2010, as well as other reports and statements that we file with the SEC, are not the only risks and uncertainties facing us. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial may also have a material adverse effect on our financial position, results of operations or cash flows.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

On November 18, 2008, our Board of Directors approved a new share repurchase authorization to buy back up to \$25.0 million of our outstanding common stock in the open market or in privately negotiated transactions (the New Authorization ). The New Authorization replaces the previous authorization to repurchase up to \$25.0 million of our common stock, which was scheduled to expire on December 5, 2008. Repurchases may be made from time to time in the open market or in privately negotiated transactions subject to market conditions, applicable legal requirements and other factors. We are not obligated to acquire any particular amount of common stock and the program may be commenced or suspended at any time at our discretion without prior notice. The New Authorization continues in effect until terminated by the Board of Directors. As of April 2, 2011, there was \$24.8 million remaining available for future share repurchases under this authorization. During the three- and six-month periods ended April 2, 2011, we repurchased \$86,000 or 6,757 shares of our common stock under the repurchase program through restricted stock net-share settlements. During the three- and six-month periods ended April 3, 2010, we repurchased \$45,000 or 4,673 shares and \$51,000 or 5,225 shares, respectively, of our common stock through restricted stock net-share settlements.



The following table summarizes our repurchases of common stock during the quarter ended April 2, 2011:

	Total Number of Shares Purchased as Part of Publicly	Average Price Paid per Share	Announced Plan or Program	Maximum Number (or Approximate Dollar Value) of Shares That May Yet Be Purchased Under the Plan or Program
<i>(In thousands except per share amounts)</i>				
January 2, 2011 - February 5, 2011				\$ 24,897(1)
February 6, 2011 - March 5, 2011 (2)	6,757	\$ 12.60	6,757	24,812(1)
March 6, 2011 - April 2, 2011				24,812(1)
<b>Total</b>	<b>6,757</b>		<b>6,757</b>	<b>24,812(1)</b>

- (1) Under the \$25.0 million share repurchase authorization announced on November 18, 2008, which continues in effect until terminated by the Board of Directors.
- (2) Represents 6,757 shares surrendered by employees to satisfy tax withholding obligations upon the vesting of restricted stock awards.

**Item 6. Exhibits**

- 10.4 Second Amended and Restated Credit Agreement dated as of June 2, 2010, among Insteel Wire Products Company, as Borrower; Insteel Industries, Inc., as a Credit Party; Intercontinental Metals Corporation, as a Credit Party; and General Electric Capital Corporation, as Agent and Lender.
- 31.1 Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of the 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.

INSTEEL INDUSTRIES, INC.

Registrant

Date: April 26, 2011

By: /s/ Michael C. Gazmarian  
Michael C. Gazmarian  
Vice President, Chief Financial Officer and  
Treasurer  
(Duly Authorized Officer and  
Principal Financial Officer)

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**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Description</b>
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