

INSTEEL INDUSTRIES INC  
Form 10-Q  
July 24, 2012

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

FORM 10-Q

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended June 30, 2012

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  
(State or other jurisdiction of  
incorporation or organization)

56-0674867  
(I.R.S. Employer  
Identification No.)

1373 Boggs Drive, Mount Airy, North  
Carolina  
(Address of principal executive offices)

27030  
(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.

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Large accelerated filer ☐

Accelerated filer ☒

Non-accelerated filer ☐ (Do not check if a smaller reporting company)

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 July 23, 2012 was 17,690,518.

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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)

|                                             | Three Months Ended |                 | Nine Months Ended |                 |
|---------------------------------------------|--------------------|-----------------|-------------------|-----------------|
|                                             | June 30,<br>2012   | July 2,<br>2011 | June 30,<br>2012  | July 2,<br>2011 |
| Net sales                                   | \$93,598           | \$98,579        | \$265,438         | \$237,818       |
| Cost of sales                               | 87,194             | 86,050          | 248,881           | 213,821         |
| Gross profit                                | 6,404              | 12,529          | 16,557            | 23,997          |
| Selling, general and administrative expense | 4,835              | 4,947           | 14,333            | 13,638          |
| Gain on early extinguishment of debt        | -                  | -               | (425)             | -               |
| Restructuring charges, net                  | 30                 | 1,970           | 832               | 8,573           |
| Acquisition costs                           | -                  | -               | -                 | 3,518           |
| Bargain purchase gain                       | -                  | -               | -                 | (500)           |
| Other income, net                           | -                  | (27)            | (214)             | (96)            |
| Interest expense                            | 102                | 260             | 474               | 664             |
| Interest income                             | (18)               | (18)            | (20)              | (37)            |
| Earnings (loss) before income taxes         | 1,455              | 5,397           | 1,577             | (1,763)         |
| Income taxes                                | 561                | 1,747           | 601               | (404)           |
| Net earnings (loss)                         | \$894              | \$3,650         | \$976             | \$(1,359)       |
|                                             |                    |                 |                   |                 |
| Net earnings (loss) per share:              |                    |                 |                   |                 |
| Basic                                       | \$0.05             | \$0.21          | \$0.06            | \$(0.08)        |
| Diluted                                     | 0.05               | 0.20            | 0.05              | (0.08)          |
|                                             |                    |                 |                   |                 |
| Weighted average shares outstanding         |                    |                 |                   |                 |
| Basic                                       | 17,690             | 17,587          | 17,650            | 17,550          |
| Diluted                                     | 17,993             | 17,855          | 17,989            | 17,550          |
|                                             |                    |                 |                   |                 |
| Cash dividends declared per share           | \$0.03             | \$0.03          | \$0.09            | \$0.09          |

See accompanying notes to consolidated financial statements.

INSTEEL INDUSTRIES, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
(In thousands)

|                                            | (Unaudited)<br>June 30,<br>2012 | (Audited)<br>October 1,<br>2011 |
|--------------------------------------------|---------------------------------|---------------------------------|
| Assets                                     |                                 |                                 |
| Current assets:                            |                                 |                                 |
| Cash and cash equivalents                  | \$10                            | \$10                            |
| Accounts receivable, net                   | 40,714                          | 41,971                          |
| Inventories, net                           | 77,388                          | 76,374                          |
| Other current assets                       | 5,326                           | 4,093                           |
| Total current assets                       | 123,438                         | 122,448                         |
| Property, plant and equipment, net         | 86,937                          | 89,484                          |
| Other assets                               | 5,646                           | 4,598                           |
| Total assets                               | \$216,021                       | \$216,530                       |
| Liabilities and shareholders' equity       |                                 |                                 |
| Current liabilities:                       |                                 |                                 |
| Accounts payable                           | \$32,226                        | \$38,607                        |
| Accrued expenses                           | 5,867                           | 7,377                           |
| Current portion of long-term debt          | -                               | 675                             |
| Total current liabilities                  | 38,093                          | 46,659                          |
| Long-term debt                             | 18,615                          | 13,481                          |
| Other liabilities                          | 10,191                          | 7,916                           |
| Commitments and contingencies              |                                 |                                 |
| Shareholders' equity:                      |                                 |                                 |
| Common stock                               | 17,691                          | 17,609                          |
| Additional paid-in capital                 | 49,903                          | 48,723                          |
| Retained earnings                          | 83,543                          | 84,157                          |
| Accumulated other comprehensive loss       | (2,015 )                        | (2,015 )                        |
| Total shareholders' equity                 | 149,122                         | 148,474                         |
| Total liabilities and shareholders' equity | \$216,021                       | \$216,530                       |

See accompanying notes to consolidated financial statements.

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

(In thousands)

(Unaudited)

|                                                                                                       | Nine Months Ended |                 |
|-------------------------------------------------------------------------------------------------------|-------------------|-----------------|
|                                                                                                       | June 30,<br>2012  | July 2,<br>2011 |
| <b>Cash Flows From Operating Activities:</b>                                                          |                   |                 |
| Net earnings (loss)                                                                                   | \$976             | \$(1,359 )      |
| Adjustments to reconcile net earnings (loss) to net cash provided by (used for) operating activities: |                   |                 |
| Depreciation and amortization                                                                         | 7,295             | 7,062           |
| Amortization of capitalized financing costs                                                           | 70                | 61              |
| Stock-based compensation expense                                                                      | 1,464             | 1,898           |
| Gain on early extinguishment of debt                                                                  | (425 )            | -               |
| Asset impairment charges                                                                              | (11 )             | 4,135           |
| Deferred income taxes                                                                                 | 565               | (474 )          |
| Excess tax benefits from stock-based compensation                                                     | (120 )            | (81 )           |
| Gain on sale of property, plant and equipment                                                         | (74 )             | (10 )           |
| Gain from life insurance proceeds                                                                     | -                 | (357 )          |
| Increase in cash surrender value of life insurance policies over premiums paid                        | (570 )            | (357 )          |
| Net changes in assets and liabilities (net of assets and liabilities acquired):                       |                   |                 |
| Accounts receivable, net                                                                              | 1,257             | (18,721 )       |
| Inventories                                                                                           | (1,014 )          | (5,950 )        |
| Accounts payable and accrued expenses                                                                 | (7,907 )          | 15,587          |
| Other changes                                                                                         | 228               | (1,529 )        |
| Total adjustments                                                                                     | 758               | 1,264           |
| Net cash provided by (used for) operating activities                                                  | 1,734             | (95 )           |
| <b>Cash Flows From Investing Activities:</b>                                                          |                   |                 |
| Capital expenditures                                                                                  | (4,361 )          | (6,292 )        |
| Increase in cash surrender value of life insurance policies                                           | (456 )            | (460 )          |
| Proceeds from surrender of life insurance policies                                                    | 16                | 19              |
| Proceeds from sale of property, plant and equipment                                                   | 96                | 164             |
| Proceeds from life insurance claims                                                                   | -                 | 1,063           |
| Acquisition of business                                                                               | -                 | (37,308 )       |
| Net cash used for investing activities                                                                | (4,705 )          | (42,814 )       |
| <b>Cash Flows From Financing Activities:</b>                                                          |                   |                 |
| Proceeds from long-term debt                                                                          | 79,679            | 12,607          |
| Principal payments on long-term debt                                                                  | (74,795 )         | (12,607 )       |
| Financing costs                                                                                       | (161 )            | -               |
| Excess tax benefits from stock-based compensation                                                     | 120               | 81              |
| Cash received from exercise of stock options                                                          | 2                 | 21              |
| Cash dividends paid                                                                                   | (1,590 )          | (1,055 )        |
| Other                                                                                                 | (284 )            | (64 )           |
| Net cash provided by (used for) financing activities                                                  | 2,971             | (1,017 )        |

|                                                      |      |           |
|------------------------------------------------------|------|-----------|
| Net increase (decrease) in cash and cash equivalents | -    | (43,926 ) |
| Cash and cash equivalents at beginning of period     | 10   | 45,935    |
| Cash and cash equivalents at end of period           | \$10 | \$2,009   |

Supplemental Disclosures of Cash Flow Information:

Cash paid during the period for:

|                                                                |       |        |
|----------------------------------------------------------------|-------|--------|
| Interest                                                       | \$687 | \$439  |
| Income taxes, net                                              | 171   | 654    |
| Non-cash investing and financing activities:                   |       |        |
| Purchases of property, plant and equipment in accounts payable | 398   | 7      |
| Declaration of cash dividends to be paid                       | -     | 528    |
| Restricted stock surrendered for withholding taxes payable     | 324   | 86     |
| 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 |           | Additional         | Retained  | Accumulated                    | Total                   |
|--------------------------------------------------------|--------------|-----------|--------------------|-----------|--------------------------------|-------------------------|
|                                                        | Shares       | Amount    | Paid-In<br>Capital | Earnings  | Other<br>Comprehensive<br>Loss | Shareholders'<br>Equity |
| Balance at October 1, 2011                             | 17,609       | \$ 17,609 | \$ 48,723          | \$ 84,157 | \$ (2,015 )                    | \$ 148,474              |
| Comprehensive income:                                  |              |           |                    |           |                                |                         |
| Net income                                             |              |           |                    | 976       |                                | 976                     |
| Comprehensive income                                   |              |           |                    |           |                                | 976                     |
| Stock options exercised                                | 12           | 12        | (10 )              |           |                                | 2                       |
| Vesting of restricted stock units                      | 70           | 70        | (70 )              |           |                                | -                       |
| Restricted stock units withheld for taxes              |              |           | (324 )             |           |                                | (324 )                  |
| Compensation expense associated with stock-based plans |              |           | 1,464              |           |                                | 1,464                   |
| Excess tax benefits from stock-based compensation      |              |           | 120                |           |                                | 120                     |
| Cash dividends declared                                |              |           |                    | (1,590 )  |                                | (1,590 )                |
| Balance at June 30, 2012                               | 17,691       | \$ 17,691 | \$ 49,903          | \$ 83,543 | \$ (2,015 )                    | \$ 149,122              |

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,” “the 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 (“GAAP”) 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 1, 2011 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 GAAP 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 1, 2011 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 nine-month period ended June 30, 2012 are not necessarily indicative of the results that may be expected for the fiscal year ending September 29, 2012 or future periods.

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 June 2011, the Financial Accounting Standards Board (“FASB”) issued an update that amends the guidance provided in Accounting Standards Codification (“ASC”) Topic 220, Comprehensive Income, by requiring that all nonowner changes in shareholders’ equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This update is effective for the Company beginning in the first quarter of fiscal 2013 and must be applied retrospectively. The Company does not expect the adoption of this update will have a material effect on its consolidated financial statements.

(3) Business Combination

On November 19, 2010, the Company purchased certain of the assets and assumed certain of the liabilities of Ivy Steel and Wire, Inc. (“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 9 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 addition of Ivy’s facilities has enhanced 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    |
| Total assets acquired         | \$ 57,796 |
| Liabilities assumed:          |           |
| Accounts payable              | \$ 6,263  |
| Accrued expenses              | 725       |
| Total liabilities assumed     | 6,988     |
| Net assets acquired           | 50,808    |
| Purchase price                | 50,308    |
| Bargain purchase gain         | \$ 500    |

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 performed such a reassessment and concluded that the values assigned for the Ivy Acquisition were reasonable. Consequently, the Company recorded a \$500,000 bargain purchase gain on the Ivy Acquisition in fiscal 2011.

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 nine-month periods ended July 2, 2011 were approximately \$26.8 million and \$50.2 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 nine-month periods ended July 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 2011. 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 prior year 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 2011, nor is it intended to represent or be indicative of future results of operations. The pro forma combined results of operations for the prior year periods are as follows:

|                |              |             |
|----------------|--------------|-------------|
| (In thousands) | Three Months | Nine Months |
|                | Ended        | Ended       |
|                | July 2,      | July 2,     |

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|                                     | 2011      | 2011       |
|-------------------------------------|-----------|------------|
| Net sales                           | \$ 98,579 | \$ 254,529 |
| Earnings (loss) before income taxes | 5,397     | (1,003 )   |
| Net earnings (loss)                 | 3,650     | (786 )     |

(4) Restructuring Charges and Acquisition Costs

Restructuring charges. Subsequent to the Ivy Acquisition, the Company elected to consolidate certain of its welded wire reinforcement operations in order to reduce its operating costs, which involved the closure of facilities in Wilmington, Delaware and Houston, Texas. These actions were taken 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 was completed in May 2011.

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Following are summaries of the restructuring activities and associated costs that were incurred during the three- and nine-month periods ended June 30, 2012 and July 2, 2011:

| (In thousands)                    | Severance<br>and other<br>employee costs | Asset<br>impairment<br>charges | Facility<br>closure costs | Equipment<br>relocation<br>costs | Total    |
|-----------------------------------|------------------------------------------|--------------------------------|---------------------------|----------------------------------|----------|
| <b>2012</b>                       |                                          |                                |                           |                                  |          |
| Liability as of October 1, 2011   | \$65                                     | \$-                            | \$77                      | \$112                            | \$254    |
| Restructuring charges             | (40 )                                    | (11 )                          | 139                       | 511                              | 599      |
| Cash payments                     | (25 )                                    | -                              | (216 )                    | (456 )                           | (697 )   |
| Non-cash charges                  | -                                        | 11                             | -                         | -                                | 11       |
| Liability as of December 31, 2011 | \$-                                      | \$-                            | \$-                       | \$167                            | \$167    |
| Restructuring charges             | -                                        | -                              | -                         | 203                              | 203      |
| Cash payments                     | -                                        | -                              | -                         | (208 )                           | (208 )   |
| Liability as of March 31, 2012    | \$-                                      | \$-                            | \$-                       | \$162                            | \$162    |
| Restructuring charges             | -                                        | -                              | -                         | 30                               | 30       |
| Cash payments                     | -                                        | -                              | -                         | (192 )                           | (192 )   |
| Liability as of June 30, 2012     | \$-                                      | \$-                            | \$-                       | \$-                              | \$-      |
| <b>2011</b>                       |                                          |                                |                           |                                  |          |
| Liability as of October 2, 2010   | \$-                                      | \$-                            | \$-                       | \$-                              | \$-      |
| 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    |
| Restructuring charges             | 118                                      | 683                            | 615                       | 554                              | 1,970    |
| Cash payments                     | (152 )                                   | -                              | (758 )                    | (579 )                           | (1,489 ) |
| Non-cash charges                  | -                                        | (683 )                         | -                         | -                                | (683 )   |
| Liability as of July 2, 2011      | \$325                                    | \$-                            | \$172                     | \$59                             | \$556    |

During the nine-month period ended June 30, 2012, all of the remaining restructuring liabilities were satisfied and the final proceeds were received from the sale of previously impaired machinery and equipment, which have been included in asset impairment charges.

As of July 2, 2011, the Company recorded restructuring liabilities amounting to \$556,000 on its consolidated balance sheet, including \$59,000 in accounts payable and \$497,000 in accrued expenses.

Acquisition costs. During the nine-month period ended July 2, 2011, the Company recorded \$3.5 million of acquisition-related costs associated with the Ivy Acquisition for advisory, accounting, legal and other professional fees. The Company did not record any acquisition costs during the three-month period ended July 2, 2011 or the three-

and nine-month periods ended June 30, 2012.

(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 June 30, 2012, 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:

| (In thousands)                                  | Total           | Quoted Prices<br>in Active<br>Markets<br>(Level 1) | Observable<br>Inputs<br>(Level 2) |
|-------------------------------------------------|-----------------|----------------------------------------------------|-----------------------------------|
| <b>Other assets:</b>                            |                 |                                                    |                                   |
| Cash surrender value of life insurance policies | \$ 4,976        | -                                                  | \$ 4,976                          |
| <b>Total</b>                                    | <b>\$ 4,976</b> | <b>\$ -</b>                                        | <b>\$ 4,976</b>                   |

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 June 30, 2012.

As of June 30, 2012, the Company had no nonfinancial assets that are required to be measured at fair value on a nonrecurring basis. The carrying amount for accounts receivable, accounts payable and accrued expenses approximates fair value due to the short-term maturities of these financial instruments.

#### (6) 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. Effective February 21, 2012, the Company's 2005 Equity Incentive Plan was amended to increase the number of shares available for future grants by 900,000 shares. As of June 30, 2012, there were 933,000 shares available for future grants under the plans.

Stock options. 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 nine-month periods ended June 30, 2012 and July 2, 2011 are as follows:

| (In thousands)                        | Three Months Ended |                 | Nine Months Ended |                 |
|---------------------------------------|--------------------|-----------------|-------------------|-----------------|
|                                       | June 30,<br>2012   | July 2,<br>2011 | June 30,<br>2012  | July 2,<br>2011 |
| <b>Stock options:</b>                 |                    |                 |                   |                 |
| Compensation expense                  | \$ 132             | \$ 266          | \$ 580            | \$ 773          |
| Excess tax deficiencies<br>(benefits) | 11                 | -               | (120 )            | (81 )           |

As of June 30, 2012, the remaining unamortized compensation cost related to unvested stock option awards was \$469,000, which is expected to be recognized over a weighted average period of 1.47 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 nine-month periods ended June 30, 2012 and July 2, 2011 was \$6.06 and \$5.86, respectively, based on the following assumptions:

|                          | Nine Months Ended |   |                 |   |
|--------------------------|-------------------|---|-----------------|---|
|                          | June 30,<br>2012  |   | July 2,<br>2011 |   |
| Risk-free interest rate  | 1.18              | % | 2.40            | % |
| Dividend yield           | 0.92              | % | 0.97            | % |
| Expected volatility      | 54.67             | % | 56.49           | % |
| Expected term (in years) | 5.75              |   | 5.11            |   |

The following table summarizes stock option activity for the nine-month period ended June 30, 2012:

|                                                               | Options<br>Outstanding<br>(in<br>thousands) |         | Exercise Price Per Share<br>Range |          | Contractual<br>Term - |                     | Aggregate<br>Intrinsic<br>Value<br>(in<br>thousands) |
|---------------------------------------------------------------|---------------------------------------------|---------|-----------------------------------|----------|-----------------------|---------------------|------------------------------------------------------|
|                                                               |                                             |         |                                   |          | Weighted<br>Average   | Weighted<br>Average |                                                      |
| Outstanding at October 1, 2011                                | 994                                         | \$ 0.18 | -                                 | \$ 20.27 | \$ 10.89              |                     |                                                      |
| Granted                                                       | 76                                          | 13.06   | -                                 | 13.06    | 13.06                 |                     |                                                      |
| Exercised                                                     | (12 )                                       | 0.18    | -                                 | 0.18     | 0.18                  |                     | \$ 147                                               |
| Outstanding at June 30, 2012                                  | 1,058                                       | 0.36    | -                                 | 20.27    | 11.17                 | 6.57 years          | 1,372                                                |
| Vested and anticipated to vest in the future at June 30, 2012 | 1,037                                       |         |                                   |          | 11.17                 | 6.53 years          | 1,357                                                |
| Exercisable at June 30, 2012                                  | 713                                         |         |                                   |          | 11.19                 | 5.54 years          | 1,140                                                |

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 nine-month periods ended June 30, 2012 and July 2, 2011 are as follows:

| (In thousands)                | Three Months Ended |                 | Nine Months Ended |                 |
|-------------------------------|--------------------|-----------------|-------------------|-----------------|
|                               | June 30,<br>2012   | July 2,<br>2011 | June 30,<br>2012  | July 2,<br>2011 |
| Restricted stock unit grants: |                    |                 |                   |                 |
| Units                         | -                  | 19              | 54                | 71              |
| Market value                  | \$ -               | \$ 276          | \$ 703            | \$ 928          |
| Amortization expense          | 206                | 417             | 884               | 976             |

As of June 30, 2012, the remaining unrecognized compensation cost related to unvested RSUs was \$884,000, which is expected to be recognized over a weighted average vesting period of 1.64 years.

The following table summarizes RSU activity during the nine-month period ended June 30, 2012:

| (Unit amounts in thousands) | Restricted<br>Stock Units<br>Outstanding | Weighted<br>Average<br>Grant Date<br>Fair Value |
|-----------------------------|------------------------------------------|-------------------------------------------------|
| Balance, October 1, 2011    | 328                                      | \$ 10.25                                        |
| Granted                     | 54                                       | 13.06                                           |
| Released                    | (92 )                                    | 9.59                                            |
| Balance, June 30, 2012      | 290                                      | 10.98                                           |

Restricted stock. 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. The vesting period for RSAs is generally one to three years from the date of the grant. There were no RSAs granted during the three- and nine-month periods ended June 30, 2012 and July 2, 2011. Amortization expense for RSAs for the three- and nine-month periods ended June 30, 2012 and July 2, 2011 is as follows:

| (In thousands)       | Three Months Ended |                 | Nine Months Ended |                 |
|----------------------|--------------------|-----------------|-------------------|-----------------|
|                      | June 30,<br>2012   | July 2,<br>2011 | June 30,<br>2012  | July 2,<br>2011 |
| Amortization expense | \$ -               | \$ 33           | \$ -              | \$ 149          |

There were no unvested RSAs as of June 30, 2012.

#### (7) Income Taxes

Effective income tax rate. The Company's effective income tax rate was 38.1% for the nine-month period ended June 30, 2012 compared with 22.9% for the nine-month period ended July 2, 2011. The year-over-year increase in the effective rate was primarily due to changes in permanent book versus tax differences in the current year period together with the establishment of a valuation allowance in the prior year against certain state net operating losses and state tax credits that the Company does not expect to realize. The effective income tax rates for both periods were based upon the estimated effective income tax rate applicable for the entire fiscal year after giving effect to any significant items related specifically to interim periods.

Deferred income taxes. As of June 30, 2012, the Company has recorded a current deferred tax asset (net of valuation allowance) of \$3.5 million in other current assets and a non-current deferred tax liability of \$3.6 million in other liabilities on its consolidated balance sheet. The deferred tax asset primarily relates to pre-tax losses that were incurred in prior fiscal years. The Company has \$28.1 million of state net operating loss carryforwards ("NOLs") that begin to expire in 2016, but principally expire between 2016 and 2031, and \$1.9 million of federal NOLs that expire in 2031. The Company has also recorded \$262,000 of deferred tax assets for various state tax credits that begin to expire in 2014, but principally expire between 2014 and 2019.

In accordance with ASC Topic 740, the Company evaluates its deferred tax assets to determine if a valuation allowance is required based on the consideration of all available evidence using a "more likely than not" standard, with significant weight being given to evidence that can be objectively verified. The realization of the Company's deferred tax assets is entirely dependent upon the Company's ability to generate future taxable income in applicable jurisdictions. Since the Company operates in multiple jurisdictions, it assesses the need for a valuation allowance on a jurisdiction-by-jurisdiction basis, considering the applicable tax laws. As of June 30, 2012 and October 1, 2011, the Company recorded valuation allowances of \$688,000 and \$727,000, 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. If the Company should utilize the state NOLs and tax credits against which an allowance has previously been provided or if it is determined that it is "more likely than not" that the Company will realize any of these state NOLs and tax credits, an income tax benefit would be recognized at that time.

Uncertainty in income taxes. The Company has established contingency reserves for material, known tax exposures, including potential tax audit adjustments based on its judgment as to the estimated liabilities that would be incurred in connection with the resolution of these matters. As of June 30, 2012, the Company had approximately \$55,000 of total gross unrecognized tax benefits that would reduce its income tax rate in future periods, if recognized. The Company

anticipates the gross unrecognized tax benefits of \$55,000 will be resolved within the next twelve months.

The Company recognizes interest and penalties related to unrecognized tax benefits as a component of income tax expense. As of June 30, 2012, the Company had \$55,000 of accrued interest and penalties related to unrecognized tax benefits.

The Company files U.S. federal income tax returns as well as state and local income tax returns in various jurisdictions. Federal and certain state tax returns filed by the Company subsequent to fiscal year 2007 remain subject to examination together with certain state tax returns subsequent to fiscal year 2003.

#### (8) 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 \$88,000 and \$164,000 to the Delaware Plan during the three- and nine-month periods ended June 30, 2012, respectively, and expects to contribute an additional \$42,000 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 was recorded in restructuring charges in fiscal 2011.

Net periodic pension costs and related components for the Delaware Plan for the three- and nine-month periods ended June 30, 2012 and July 2, 2011 are as follows:

| (In thousands)                 | Three Months Ended |                 | Nine Months Ended |                 |
|--------------------------------|--------------------|-----------------|-------------------|-----------------|
|                                | June 30,<br>2012   | July 2,<br>2011 | June 30,<br>2012  | July 2,<br>2011 |
| Interest cost                  | \$ 35              | \$ 48           | \$ 109            | \$ 144          |
| Expected return on plan assets | (32 )              | (52 )           | (100 )            | (156 )          |
| Recognized net actuarial loss  | 9                  | 58              | 37                | 174             |
| Net periodic pension cost      | \$ 12              | \$ 54           | \$ 46             | \$ 162          |

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 nine-month periods ended June 30, 2012 and July 2, 2011 are as follows:

| (In thousands)                     | Three Months Ended |                 | Nine Months Ended |                 |
|------------------------------------|--------------------|-----------------|-------------------|-----------------|
|                                    | June 30,<br>2012   | July 2,<br>2011 | June 30,<br>2012  | July 2,<br>2011 |
| Service cost                       | \$ 63              | \$ 44           | \$ 163            | \$ 132          |
| Interest cost                      | 84                 | 71              | 226               | 213             |
| Amortization of prior service cost | 56                 | 65              | 170               | 195             |
| Recognized net actuarial loss      | 38                 | -               | 68                | -               |
| Net periodic benefit cost          | \$ 241             | \$ 180          | \$ 627            | \$ 540          |

#### (9) Long-Term Debt

Revolving Credit Facility. The Company has a revolving credit facility (the “Credit Facility”) that is used to supplement its operating cash flow and fund its working capital, capital expenditure, general corporate and growth requirements. On February 6, 2012, the Company and each of its wholly-owned subsidiaries entered into an amendment agreement that, among other changes, increased the commitment amount of the Credit Facility from \$75.0 million to \$100.0 million and extended the maturity date from June 2, 2015 to June 2, 2016. Advances under the Credit Facility are limited to the lesser of the revolving loan commitment amount (currently \$100.0 million) or a borrowing base amount that is calculated based upon a percentage of eligible receivables and inventories. As of June 30, 2012, \$18.6 million of borrowings were outstanding on the Credit Facility, \$67.2 million of additional borrowing capacity was available and outstanding letters of credit totaled \$1.3 million.

Interest rates on the Credit Facility 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 Credit Facility within the range of 0.50% - 1.25% for index rate loans and 1.50% - 2.50% 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 under the terms of the Credit Facility. Based on the Company's excess availability as of June 30, 2012, the applicable interest rate margins on the Credit Facility were 0.50% for index rate loans and 1.50% for LIBOR loans.

The Company's ability to borrow available amounts under the 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 under the terms of the Credit Facility. The Company is required to maintain a fixed charge coverage ratio of not less than 1.10 at the end of each fiscal quarter for the twelve-month period then ended when the amount of liquidity on the Credit Facility is less than \$13.5 million. In addition, the terms of the Credit Facility 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. The terms of the Credit Facility also 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 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. As of June 30, 2012, the Company was in compliance with all of the financial and negative covenants under the Credit Facility and there have not been any events of default.

Amortization of capitalized financing costs associated with the Credit Facility was \$25,000 and \$20,000 for the three-month periods ended June 30, 2012 and July 2, 2011, respectively, and \$70,000 and \$61,000 for the nine-month periods ended June 30, 2012 and July 2, 2011, respectively. Accumulated amortization of capitalized financing costs was \$4.1 million as of June 30, 2012 and October 1, 2011.

**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 required semi-annual interest payments in arrears, and annual principal payments payable on November 19 of each year during the period 2011 - 2015. The Note yielded interest on the unpaid principal balance at a fixed rate of 6.0% per annum and was collateralized by certain of the real property and equipment acquired from Ivy. On December 12, 2011, the Company prepaid the remaining balance that was outstanding on the Note for \$12.4 million, which represented a discount of \$425,000 that was recorded as a gain on the early extinguishment of debt in the consolidated statement of operations for the nine-month period ended June 30, 2012.

## (10) Earnings (Loss) Per Share

The computations of basic and diluted earnings (loss) per share attributable to common shareholders for the three- and nine-month periods ended June 30, 2012 and July 2, 2011 are as follows:

| (In thousands except per share amounts)     | Three Months Ended |              | Nine Months Ended |              |
|---------------------------------------------|--------------------|--------------|-------------------|--------------|
|                                             | June 30, 2012      | July 2, 2011 | June 30, 2012     | July 2, 2011 |
| Net earnings (loss)                         | \$ 894             | \$ 3,650     | \$ 976            | \$ (1,359 )  |
| Less allocation to participating securities | -                  | (6 )         | -                 | -            |
| Available to Insteel common shareholders    | \$ 894             | \$ 3,644     | \$ 976            | \$ (1,359 )  |
| Basic weighted average shares outstanding   | 17,690             | 17,587       | 17,650            | 17,550       |
| Dilutive effect of stock-based compensation | 303                | 268          | 339               | -            |
| Diluted weighted average shares outstanding | 17,993             | 17,855       | 17,989            | 17,550       |
| Per share basic:                            |                    |              |                   |              |
| Net earnings (loss)                         | \$ 0.05            | \$ 0.21      | \$ 0.06           | \$ (0.08 )   |
| Per share diluted:                          |                    |              |                   |              |
| Net earnings (loss)                         | \$ 0.05            | \$ 0.20      | \$ 0.05           | \$ (0.08 )   |

Options and RSUs representing 637,000 and 348,000 shares for the three-month periods ended June 30, 2012 and July 2, 2011, respectively, were antidilutive and were not included in the diluted earnings per share calculation. Options and RSUs representing 533,000 and 496,000 shares for the nine-month periods ended June 30, 2012 and July 2, 2011, respectively, were antidilutive and were not included in the diluted earnings per share calculation. Options, RSAs and RSUs representing 236,000 shares for the nine-month period ended July 2, 2011 were not included in the diluted earnings per share calculation due to the net loss that was incurred.

## (11) 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 June 30, 2012, there was \$24.8 million remaining available for future share repurchases under this authorization. No repurchases of common stock were made during the three- and nine-month periods ended June 30, 2012. During the nine-month period ended July 2, 2011, the Company repurchased \$86,000 or 6,757 shares of its common stock through restricted stock net-share settlements. No repurchases of common stock were made during the three-month period ended July 2, 2011.



## (12) Other Financial Data

## Balance sheet information:

| (In thousands)                                                                   | June 30,<br>2012 | October 1,<br>2011 |
|----------------------------------------------------------------------------------|------------------|--------------------|
| Accounts receivable, net:                                                        |                  |                    |
| Accounts receivable                                                              | \$ 41,626        | \$ 42,732          |
| Less allowance for doubtful accounts                                             | (912 )           | (761 )             |
| Total                                                                            | \$ 40,714        | \$ 41,971          |
| Inventories, net:                                                                |                  |                    |
| Raw materials                                                                    | \$ 44,000        | \$ 40,536          |
| Work in process                                                                  | 3,343            | 3,771              |
| Finished goods                                                                   | 30,045           | 32,067             |
| Total                                                                            | \$ 77,388        | \$ 76,374          |
| Other current assets:                                                            |                  |                    |
| Current deferred tax asset                                                       | \$ 3,489         | \$ 2,156           |
| Capitalized financing costs, net                                                 | 100              | 82                 |
| Other                                                                            | 1,737            | 1,855              |
| Total                                                                            | \$ 5,326         | \$ 4,093           |
| Property, plant and equipment, net:                                              |                  |                    |
| Land and land improvements                                                       | \$ 8,589         | \$ 8,586           |
| Buildings                                                                        | 41,582           | 40,773             |
| Machinery and equipment                                                          | 121,324          | 118,518            |
| Construction in progress                                                         | 2,778            | 2,078              |
|                                                                                  | 174,273          | 169,955            |
| Less accumulated depreciation                                                    | (87,336 )        | (80,471 )          |
| Total                                                                            | \$ 86,937        | \$ 89,484          |
| Other assets:                                                                    |                  |                    |
| Cash surrender value of life insurance policies, net of loans of \$486 and \$446 | \$ 4,976         | \$ 4,006           |
| Capitalized financing costs, net                                                 | 292              | 218                |
| Other                                                                            | 378              | 374                |
| Total                                                                            | \$ 5,646         | \$ 4,598           |
| Accrued expenses:                                                                |                  |                    |
| Salaries, wages and related expenses                                             | \$ 1,516         | \$ 1,656           |
| Pension plan                                                                     | 1,453            | 1,571              |
| Customer rebates                                                                 | 829              | 791                |
| Property taxes                                                                   | 801              | 1,234              |
| Worker's compensation                                                            | 344              | 333                |
| Interest                                                                         | 16               | 387                |
| Deferred revenues                                                                | -                | 387                |
| Other                                                                            | 908              | 1,018              |
| Total                                                                            | \$ 5,867         | \$ 7,377           |

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Other liabilities:

|                       |    |        |    |       |
|-----------------------|----|--------|----|-------|
| Deferred compensation | \$ | 6,582  | \$ | 6,149 |
| Deferred income taxes |    | 3,609  |    | 1,711 |
| Other                 |    | -      |    | 56    |
| Total                 | \$ | 10,191 | \$ | 7,916 |

(13) Business Segment Information

All of the Company's operations are 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 prestressed concrete strand. Based on the criteria specified in ASC Topic 280, Segment Reporting, the Company has one reportable segment.

(14) Contingencies

Legal proceedings. On November 19, 2007, Dywidag 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 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 second quarter of 2011, the Company paid the \$600,000 settlement 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 is 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 1, 2011, filed with the U.S. Securities and Exchange Commission (“SEC”). 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 in realizing the anticipated synergies, including reduced operating costs, associated with the acquisition of certain of the assets of Ivy Steel and Wire, Inc. (“Ivy Acquisition”) and reconfiguration of our welded wire reinforcement operations;

- 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 and the impact on demand for our products;
- the impact of the new federal transportation funding authorization on spending for infrastructure construction and demand for our products;
- the severity and duration of the downturn in residential construction 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 1, 2011 and in other filings that we make with the SEC.

## Overview

Insteel Industries, Inc. is the nation’s largest manufacturer of steel wire reinforcing products for concrete construction applications. We manufacture and market prestressed concrete 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 Steel and Wire, Inc. ("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 Pennsylvania, Florida, Arizona and Missouri, in addition to the production equipment located at a leased facility in Texas. We also entered into a short-term sublease with Ivy for the Texas facility. Subsequent to the acquisition, we elected to consolidate certain of our welded wire reinforcement operations in order to reduce our operating costs, which involved the closure of facilities in Wilmington, Delaware and Houston, Texas. These actions were taken 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.

## Results of Operations

Statements of Operations – Selected Data  
(Dollars in thousands)

|                                             | Three Months Ended |          |                 | Nine Months Ended |           |                 |
|---------------------------------------------|--------------------|----------|-----------------|-------------------|-----------|-----------------|
|                                             | June 30,<br>2012   | Change   | July 2,<br>2011 | June 30,<br>2012  | Change    | July 2,<br>2011 |
| Net sales                                   | \$ 93,598          | (5.1 %)  | \$ 98,579       | \$ 265,438        | 11.6 %    | \$ 237,818      |
| Gross profit                                | 6,404              | (48.9 %) | 12,529          | 16,557            | (31.0 %)  | 23,997          |
| Percentage of net sales                     | 6.8 %              |          | 12.7 %          | 6.2 %             |           | 10.1 %          |
| Selling, general and administrative expense | \$ 4,835           | (2.3 %)  | \$ 4,947        | \$ 14,333         | 5.1 %     | \$ 13,638       |
| Percentage of net sales                     | 5.2 %              |          | 5.0 %           | 5.4 %             |           | 5.7 %           |
| Gain on early extinguishment of debt        | \$ -               | N/M      | \$ -            | \$ (425 )         | N/M       | \$ -            |
| Restructuring charges, net                  | 30                 | (98.5 %) | 1,970           | 832               | (90.3 %)  | 8,573           |
| Acquisition costs                           | -                  | N/M      | -               | -                 | (100.0 %) | 3,518           |
| Bargain purchase gain                       | -                  | N/M      | -               | -                 | (100.0 %) | (500 )          |
| Interest expense                            | 102                | (60.8 %) | 260             | 474               | (28.6 %)  | 664             |
| Interest income                             | (18 )              | -        | (18 )           | (20 )             | (45.9 %)  | (37 )           |
| Effective income tax rate                   | 38.6 %             |          | 32.4 %          | 38.1 %            |           | 22.9 %          |
| Net earnings (loss)                         | \$ 894             | (75.5 %) | \$ 3,650        | \$ 976            | N/M       | \$ (1,359 )     |

"N/M" = not meaningful

## Third Quarter of Fiscal 2012 Compared to Third Quarter of Fiscal 2011

## Net Sales

Net sales for the third quarter of 2012 decreased 5.1% to \$93.6 million from \$98.6 million in the same year-ago period. Shipments for the quarter decreased 4.5% primarily due to the continuation of recessionary conditions in our construction end-markets while average selling prices decreased 0.6% from the prior year levels.

## Gross Profit

Gross profit for the third quarter of 2012 decreased 48.9% to \$6.4 million, or 6.8% of net sales, from \$12.5 million, or 12.7% of net sales, in the same year-ago period. The year-over-year decrease was primarily due to narrower spreads between average selling prices and raw material costs due to competitive pricing pressures and the consumption of higher cost inventory, the reduction in shipments and higher unit conversion costs. 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 third quarter of 2012 decreased 2.3% to \$4.8 million, or 5.2% of net sales from \$4.9 million, or 5.0% of net sales in the same year-ago period primarily due to lower compensation expense (\$230,000), partially offset by the relative year-over-year change in the cash surrender value of life insurance policies (\$193,000). The decrease in compensation expense was primarily due to lower stock-based compensation expense. The cash surrender of life insurance policies decreased \$167,000 in the current year period compared to an increase of \$26,000 in the prior year period due to the related changes in the value of the underlying investments.

#### Restructuring Charges, Net

Net restructuring charges for the third quarter of 2012 decreased 98.5% to \$30,000 from \$2.0 million in the same year-ago period primarily due to reduced restructuring activities within the current year period. Net restructuring charges for the third quarter of 2012 were related to equipment relocation costs. Net restructuring charges of \$2.0 million in the prior year period included \$683,000 for impairment charges related to plant closures and the decommissioning of equipment, \$615,000 for facility closure costs, \$554,000 for equipment relocation costs and \$118,000 for employee separation costs associated with plant closures and other staffing reductions. The plant closure costs were associated with the consolidation of our Texas and Northeast operations, which involved the closure of facilities in Houston, Texas and Wilmington, Delaware and absorption of the business by other Insteel facilities. 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.

### Interest Expense

Interest expense for the third quarter of 2012 decreased 60.8% to \$102,000 from \$260,000 in the same year-ago period primarily due to the lower interest rate on borrowings on the revolving credit facility in the current year period relative to the secured subordinated promissory note associated with the Ivy Acquisition that was outstanding in the prior year.

### Income Taxes

The effective income tax rate for the third quarter of 2012 increased to 38.6% from 32.4% in the same year-ago period due to changes in permanent book versus tax differences.

### Net Earnings

Net earnings for the third quarter of 2012 were \$894,000, or \$0.05 per share, compared to \$3.7 million, or \$0.20 per diluted share, in the same year-ago period primarily due to the decrease in gross profit partially offset by decreases in net restructuring charges and acquisition costs incurred in connection with the Ivy Acquisition.

### First Nine Months of Fiscal 2012 Compared to First Nine Months of Fiscal 2011

#### Net Sales

Net sales for the first nine months of 2012 increased 11.6% to \$265.4 million from \$237.8 million in the same year-ago period. Shipments for the period increased 5.5% and average selling prices for the period increased 5.8% from the prior year levels. The increase in shipments was primarily due to the contribution of the Ivy facilities for the entire period in the current year. The increase in average selling prices was driven by price increases that were implemented following the prior year period to recover higher raw material costs. Sales for both periods reflect severely depressed volumes due to the continuation of recessionary conditions in our construction end-markets.

#### Gross Profit

Gross profit for the first nine months of 2012 decreased 31.0% to \$16.6 million, or 6.2% of net sales, from \$24.0 million, or 10.1% of net sales, in the same year-ago period. The year-over-year decrease was primarily due to narrower spreads between average selling prices and raw material costs due to competitive pricing pressures. 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 nine months of 2012 increased 5.1% to \$14.3 million, or 5.4% of net sales, from \$13.6 million, or 5.7% of net sales, in the same year-ago period primarily due to increases in compensation expense (\$258,000) and employee benefit costs (\$243,000) together with a gain on the settlement of life insurance policies in the prior year (\$357,000), partially offset by the relative year-over-year change in the cash surrender value of life insurance policies (\$113,000). The increase in compensation expense was primarily due to staffing additions related to the Ivy Acquisition. The increase in employee benefit costs was primarily related to an increase in supplemental retirement plan expense. The cash surrender of life insurance policies increased \$529,000 in the current year period compared to \$416,000 in the prior year period due to the related changes in the value of the underlying investments.

#### Gain on Early Extinguishment of Debt

A gain on the early extinguishment of debt of \$425,000 was recorded in the first nine months of 2012 for the discount on our prepayment of the remaining balance outstanding on the subordinated note that was issued in connection with the Ivy Acquisition.

#### Restructuring Charges, Net

Net restructuring charges for the first nine months of 2012 decreased 90.3% to \$832,000 from \$8.6 million in the same year-ago period primarily due to reduced restructuring activities within the current year period. Net restructuring charges for the first nine months of 2012 included \$744,000 for equipment relocation costs and \$139,000 for facility closure costs less \$11,000 of net proceeds from the sale of decommissioned equipment and a \$40,000 adjustment related to the remaining employee separation costs associated with plant closures and other staffing reductions. Net restructuring charges of \$8.6 million in the prior year period included \$4.1 million for impairment charges related to plant closures and the decommissioning of equipment, \$2.3 million for employee separation costs associated with plant closures and other staffing reductions, \$839,000 for facility closure costs, \$793,000 for equipment relocation costs and \$533,000 for the future lease obligations associated with the closed Houston facility. The plant closure costs were associated with the consolidation of our Texas and Northeast operations, which involved the closure of facilities in Houston, Texas and Wilmington, Delaware and absorption of the business by other Insteel facilities. 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.

#### Acquisition Costs

Acquisition costs amounting to \$3.5 million were incurred during the first nine months of 2011 for advisory, accounting, legal and other professional fees directly related to the Ivy Acquisition. There were no acquisition costs incurred in the first nine months of 2012.

#### Bargain Purchase Gain

A bargain purchase gain of \$500,000 was recorded during the first nine months 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 nine months of 2012 decreased 28.6% to \$474,000 from \$664,000 in the same year-ago period primarily due to the lower interest rate on borrowings on the revolving credit facility in the current year period relative to the secured subordinated promissory note associated with the Ivy Acquisition that was outstanding in the prior year and prepaid in December 2011.

#### Income Taxes

Our effective income tax rate for the first nine months of 2012 increased to 38.1 % from 22.9% in the prior year period due to changes in permanent book versus tax differences in the current year period together with the establishment of a valuation allowance in the prior year against certain state net operating losses and state tax credits that we do not expect to realize.

#### Net Earnings (Loss)

Net earnings for the first nine months of 2012 were \$976,000, or \$0.06 per share, compared to a net loss of \$1.4 million, or \$0.08 per share in the same year-ago period primarily due to the reductions in net restructuring charges and acquisition costs incurred in connection with the Ivy Acquisition partially offset by the decrease in gross profit.



## Liquidity and Capital Resources

Selected Financial Data  
(Dollars in thousands)

## Cash Flow Analysis

|                                                      | Nine Months Ended |                 |
|------------------------------------------------------|-------------------|-----------------|
|                                                      | June 30,<br>2012  | July 2,<br>2011 |
| Net cash provided by (used for) operating activities | \$ 1,734          | \$ (95 )        |
| Net cash used for investing activities               | (4,705 )          | (42,814 )       |
| Net cash provided by (used for) financing activities | 2,971             | (1,017 )        |
| Net working capital                                  | 85,345            | 70,959          |
| Total debt                                           | 18,615            | 13,500          |
| Percentage of total capital                          | 11.1 %            | 8.4 %           |
| Shareholders' equity                                 | \$ 149,122        | \$ 146,848      |
| Percentage of total capital                          | 88.9 %            | 91.6 %          |
| Total capital (total debt + shareholders' equity)    | \$ 167,737        | \$ 160,348      |

Operating activities provided \$1.7 million of cash during the first nine months of 2012 while using \$95,000 during the same period last year. The year-over-year change was primarily due to the relative changes in the net working capital components of accounts receivable, inventories, and accounts payable and accrued expenses, which used \$7.7 million in the current year period compared to \$9.1 million in the same period last year. The prior year results were negatively impacted by the net restructuring charges and acquisition costs associated with the Ivy Acquisition. The cash used for net working capital in the current year period was due to a \$1.0 million increase in inventories and a \$7.9 million decrease in accounts payable and accrued expenses resulting from the timing of payments related to raw material purchases, which was partially offset by a \$1.3 million decrease in accounts receivable. The cash used by net working capital in the prior year period was due to a \$18.7 million increase in accounts receivable largely related to the incremental sales provided by the Ivy Acquisition and a \$6.0 million increase in inventory driven by higher raw material purchases and unit costs, which was partially offset by a \$15.6 million increase in accounts payable and accrued expenses also resulting from the higher raw material purchases and unit costs. We may elect to make additional adjustments in our operating activities should the current recessionary conditions in our construction end markets 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 \$4.7 million of cash during the first nine months of 2012 compared to \$42.8 million during the same period last year. The decrease in cash used was primarily related to the \$37.3 million payment for the Ivy Acquisition in the prior year period. Capital expenditures are not expected to exceed \$10.0 million during fiscal 2012 or 2013. 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 provided \$3.0 million of cash during the first nine months of 2012 while using \$1.0 million during the same period last year. The year-over-year change was primarily due to increased borrowings on our revolving credit facility to fund working capital needs, which was partially offset by the prepayment of the balance outstanding on the subordinated note that was issued in connection with the Ivy Acquisition and the inclusion of three quarterly cash dividend payments in the current year period compared with two in the prior year as a result of the timing of such payments.

## Credit Facilities

We have a revolving credit facility (the “Credit Facility”) that is used to supplement our operating cash flow and fund our working capital, capital expenditure, general corporate and growth requirements. The Credit Facility provides for up to \$100.0 million of financing and matures in June 2016. As of June 30, 2012, \$18.6 million of borrowings were outstanding on the Credit Facility, \$67.2 million of additional borrowing capacity was available and outstanding letters of credit totaled \$1.3 million.

As part of the consideration for the Ivy Acquisition (See Note 3 to the consolidated financial statements), on November 19, 2010 we entered into a \$13.5 million secured subordinated promissory note (the “Note”) payable to Ivy over five years. The Note required semi-annual interest payments in arrears, and annual principal payments payable on November 19 of each year during the period 2011 - 2015. The Note yielded interest on the unpaid principal balance at a fixed rate of 6.0% per annum and was collateralized by certain of the real property and equipment acquired from Ivy. On December 12, 2011, we prepaid the remaining balance that was outstanding on the Note for \$12.4 million, which represented a discount of \$425,000 that was recorded as a gain on the early extinguishment of debt in the consolidated statement of operations for the nine-month period ended June 30, 2012.

We believe that, in the absence of significant unanticipated cash demands, cash and cash equivalents, net cash generated by operating activities, and the borrowing availability provided under the Credit Facility will be sufficient to satisfy our expected requirements for working capital, capital expenditures, dividends and share repurchases, if any. We expect to have access to the amounts available under the Credit Facility as required. However, further deterioration in our construction end-markets could result in additional reductions in demand from our customers, which would likely reduce our operating cash flows. 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 the 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 2011 and 2012, our ability to fully recover higher wire rod prices has been mitigated by competitive pricing pressures resulting from the ongoing weakness in demand. During the third quarter of 2012, wire rod prices declined primarily due to reductions in the cost of scrap for wire rod producers and weakening demand. The timing and magnitude of any future increases or decreases 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 prepayment of the remaining amount outstanding on the Note and the related increase in borrowings on the revolving credit facility (See Note 9 to the consolidated financial statements), 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 1, 2011 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 ("GAAP"). 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.

**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 evaluate the carrying value of our inventory on a continuous basis. 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.

**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 2011, 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 2012. 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 SERPs 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 GAAP, 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.

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 was recorded as a restructuring charge in the second quarter of 2011. We currently expect net periodic pension costs for both plans to total \$898,000 during 2012. Cash contributions to the plans during 2012 are expected to total \$206,000 for the Delaware Plan and \$244,000 for the SERPs, matching the required benefit payments.

#### Recent Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board ("FASB") issued an update that amends the guidance provided in Accounting Standards Codification ("ASC") Topic 220, Comprehensive Income, by requiring that all nonowner changes in shareholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This update is effective for us beginning in the first quarter of fiscal 2013 and must be applied retrospectively. We do not expect the adoption of this update will have a material effect on our consolidated financial statements.

#### Outlook

As we look ahead to the remainder of 2012, certain of the macro indicators for our construction end-markets are beginning to show signs of improvement following the recessionary conditions of recent years. We believe, however, that business conditions are likely to remain challenging pending a more pronounced and sustained recovery in the economy and employment market.

Prices for our primary raw material, hot-rolled steel wire rod, have fallen in recent months primarily due to decreases in the cost of scrap for steel producers and weakening demand. The impact of these reductions on our margins is uncertain at this time depending upon the relative changes in the future selling prices for our products.

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. We expect the contributions from the Ivy Acquisition to increase through the realization of the remainder of the anticipated operational synergies and the anticipated benefits from the reconfiguration of our combined welded wire reinforcement operations. 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 nine months of 2012, a 10% increase in the price of steel wire rod would have resulted in a \$6.6 million decrease in our pre-tax earnings for the nine months ended June 30, 2012 (assuming there was not a corresponding change in our selling prices).

#### Interest Rates

Borrowings under our revolving credit facility are subject to a variable rate of interest and are sensitive to changes in interest rates. Based on the Company’s interest rate exposure and the outstanding borrowings on its revolving credit facility as of June 30, 2012, a 25 basis point change in interest rates would have an estimated \$47,000 impact on pre-tax earnings over a one-year period.

#### 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 June 30, 2012.

#### Item 4. Controls and Procedures

We have conducted an evaluation of the effectiveness of our disclosure controls and procedures as of June 30, 2012. 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 June 30, 2012 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

We are involved in various 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

Except as set forth below, there are no material changes 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 1, 2011. 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 1, 2011, 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.

The risk factor entitled “Demand for our products could be significantly impacted by the timing in resolving a new federal transportation funding authorization and the magnitude of the infrastructure-related funding that is provided for requiring the use of our products.” is no longer applicable in view of the passage of a new multi-year federal transportation funding authorization, MAP-21, on July 6, 2012.

### 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 June 30, 2012, there was \$24.8 million remaining available for future share repurchases under this authorization. We did not repurchase any of our common stock during the three-month period ended June 30, 2012.

### Item 6. Exhibits

- 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.

101\* The following financial information from the Quarterly Report on Form 10-Q of Insteel Industries, Inc. for the quarter ended June 30, 2012, formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Statements of Operations for the three and nine months ended June 30, 2012 and July 2, 2011, (ii) the Consolidated Balance Sheets as of June 30, 2012 and October 1, 2011, (iii) the Consolidated Statements of Cash Flows for the nine months ended June 30, 2012 and July 2, 2011, (iv) the Consolidated Statements of Shareholders' Equity as of June 30, 2012 and October 1, 2011, and (v) the Notes to Consolidated Financial Statements.

\* The XBRL-related information has been furnished electronically herewith. This exhibit, regardless of whether it is an exhibit to a document incorporated by reference into any of our filings and except to the extent specifically stated otherwise, is deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

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: July 24, 2012

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

EXHIBIT INDEX

| Exhibit<br>Number | Description                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |
|-------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
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