

INSTEEL INDUSTRIES INC
Form 10-Q
April 18, 2013

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

FORM 10-Q

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

For the Quarterly Period Ended March 30, 2013

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 April 17, 2013 was 18,020,472.

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

INSTEEL INDUSTRIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
(In thousands except for per share data)
(Unaudited)

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|-------------------|-------------------|-------------------|
| | March 30, 2013 | March 31, 2012 | March 30, 2013 | March 31, 2012 |
| Net sales | \$82,873 | \$87,029 | \$168,760 | \$171,840 |
| Cost of sales | 71,822 | 81,535 | 149,116 | 161,687 |
| Gross profit | 11,051 | 5,494 | 19,644 | 10,153 |
| Selling, general and administrative expense | 5,245 | 4,906 | 10,087 | 9,498 |
| Gain on early extinguishment of debt | - | - | - | (425) |
| Restructuring charges, net | - | 203 | - | 802 |
| Other income, net | (85) | (144) | (85) | (214) |
| Interest expense | 53 | 119 | 125 | 372 |
| Interest income | (2) | (2) | (2) | (2) |
| Earnings before income taxes | 5,840 | 412 | 9,519 | 122 |
| Income taxes | 2,126 | 150 | 3,403 | 40 |
| Net earnings | \$3,714 | \$262 | \$6,116 | \$82 |
| | | | | |
| Net earnings per share: | | | | |
| Basic | \$0.21 | \$0.01 | \$0.34 | \$- |
| Diluted | 0.20 | 0.01 | 0.34 | - |
| | | | | |
| Weighted average shares outstanding: | | | | |
| Basic | 17,846 | 17,649 | 17,785 | 17,630 |
| Diluted | 18,286 | 18,038 | 18,187 | 17,986 |
| | | | | |
| Cash dividends declared per share | \$0.03 | \$0.03 | \$0.31 | \$0.06 |
| | | | | |
| Comprehensive income | \$3,714 | \$262 | \$6,116 | \$82 |

See accompanying notes to consolidated financial statements.

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

| | (Unaudited) March 30, 2013 | (Audited) September 29, 2012 |
|---|----------------------------------|------------------------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$7,903 | \$10 |
| Accounts receivable, net | 33,586 | 42,138 |
| Inventories, net | 66,215 | 65,774 |
| Other current assets | 4,906 | 7,146 |
| Total current assets | 112,610 | 115,068 |
| Property, plant and equipment, net | 86,944 | 87,716 |
| Other assets | 6,385 | 5,768 |
| Total assets | \$205,939 | \$208,552 |
| Liabilities and shareholders' equity | | |
| Current liabilities: | | |
| Accounts payable | \$33,728 | \$30,126 |
| Accrued expenses | 5,709 | 5,877 |
| Total current liabilities | 39,437 | 36,003 |
| Long-term debt | - | 11,475 |
| Other liabilities | 12,982 | 11,574 |
| Commitments and contingencies | | |
| Shareholders' equity: | | |
| Common stock | 18,021 | 17,717 |
| Additional paid-in capital | 53,489 | 50,379 |
| Retained earnings | 84,451 | 83,845 |
| Accumulated other comprehensive loss | (2,441) | (2,441) |
| Total shareholders' equity | 153,520 | 149,500 |
| Total liabilities and shareholders' equity | \$205,939 | \$208,552 |

See accompanying notes to consolidated financial statements.

INSTEEL INDUSTRIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

| | Six Months Ended | |
|---|-------------------|-------------------|
| | March 30, 2013 | March 31, 2012 |
| Cash Flows From Operating Activities: | | |
| Net earnings | \$6,116 | \$82 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | |
| Depreciation and amortization | 4,739 | 4,835 |
| Amortization of capitalized financing costs | 51 | 45 |
| Stock-based compensation expense | 1,093 | 1,126 |
| Gain on early extinguishment of debt | - | (425) |
| Asset impairment charges | - | (11) |
| Deferred income taxes | 2,913 | 39 |
| Excess tax benefits from stock-based compensation | (331) | (131) |
| Gain on sale of property, plant and equipment | (67) | (74) |
| Gain from life insurance proceeds | (45) | - |
| Increase in cash surrender value of life insurance policies over premiums paid | (291) | (737) |
| Net changes in assets and liabilities: | | |
| Accounts receivable, net | 8,552 | 5,447 |
| Inventories | (441) | 7,149 |
| Accounts payable and accrued expenses | 3,803 | (6,819) |
| Other changes | (13) | 1,058 |
| Total adjustments | 19,963 | 11,502 |
| Net cash provided by operating activities | 26,079 | 11,584 |
| Cash Flows From Investing Activities: | | |
| Capital expenditures | (3,724) | (4,005) |
| Proceeds from life insurance claims | 505 | - |
| Increase in cash surrender value of life insurance policies | (26) | (427) |
| Proceeds from surrender of life insurance policies | 3 | 16 |
| Proceeds from sale of property, plant and equipment | 100 | 96 |
| Net cash used for investing activities | (3,142) | (4,320) |
| Cash Flows From Financing Activities: | | |
| Proceeds from long-term debt | 4,385 | 51,894 |
| Principal payments on long-term debt | (15,860) | (57,625) |
| Cash dividends paid | (5,510) | (1,059) |
| Cash received from exercise of stock options | 2,257 | 2 |
| Excess tax benefits from stock-based compensation | 331 | 131 |
| Financing costs | - | (161) |
| Other | (647) | (223) |
| Net cash used for financing activities | (15,044) | (7,041) |
| Net increase in cash and cash equivalents | 7,893 | 223 |
| Cash and cash equivalents at beginning of period | 10 | 10 |

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| | | |
|--|---------|-------|
| Cash and cash equivalents at end of period | \$7,903 | \$233 |
|--|---------|-------|

Supplemental Disclosures of Cash Flow Information:

Cash paid during the period for:

| | | |
|----------|------|-------|
| Interest | \$20 | \$618 |
|----------|------|-------|

| | | |
|-------------------|-----|----|
| Income taxes, net | 721 | 73 |
|-------------------|-----|----|

Non-cash investing and financing activities:

| | | |
|--|-----|----|
| Purchases of property, plant and equipment in accounts payable | 276 | 97 |
|--|-----|----|

| | | |
|--|-----|-----|
| Restricted stock surrendered for withholding taxes payable | 267 | 263 |
|--|-----|-----|

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 Capital | Earnings | Other Comprehensive Loss | Shareholders' Equity |
| Balance at September 29, 2012 | 17,717 | \$ 17,717 | \$ 50,379 | \$ 83,845 | \$ (2,441) | \$ 149,500 |
| Net income | | | | 6,116 | | 6,116 |
| Stock options exercised | 254 | 254 | 2,003 | | | 2,257 |
| Vesting of restricted stock units | 50 | 50 | (50) | | | - |
| Compensation expense associated with stock-based plans | | | 1,093 | | | 1,093 |
| Excess tax benefits from stock-based compensation | | | 331 | | | 331 |
| Restricted stock surrendered for withholding taxes payable | | | (267) | | | (267) |
| Cash dividends declared | | | | (5,510) | | (5,510) |
| Balance at March 30, 2013 | 18,021 | \$ 18,021 | \$ 53,489 | \$ 84,451 | \$ (2,441) | \$ 153,520 |

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 September 29, 2012 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 September 29, 2012 included in the Company’s Annual Report on Form 10-K filed with the SEC.

The accompanying unaudited interim consolidated financial statements reflect all adjustments of a normal recurring nature that the Company considers necessary for a fair presentation of results for these interim periods. The results of operations for the six-month period ended March 30, 2013 are not necessarily indicative of the results that may be expected for the fiscal year ending September 28, 2013 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

Current Adoptions

In June 2011, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2011-05 “Comprehensive Income – Presentation of Comprehensive Income.” ASU No. 2011-05 changes the presentation of comprehensive income in the financial statements for all periods reported and eliminates the option under the previous guidance that allowed for the presentation of other comprehensive income as part of the statement of shareholders’ equity. The update allows two options for the presentation of comprehensive income: (1) a single statement of comprehensive income, which includes all components of net income and other comprehensive income; or (2) a statement of income followed immediately by a statement of comprehensive income, which includes summarized net income and all components of other comprehensive income. Additionally, the update requires the presentation of reclassification adjustments out of accumulated other comprehensive income on the face of the statement of income and the statement of comprehensive income. The amendments in this update are effective retrospectively for annual reporting periods, and interim periods within those years, beginning after December 15, 2011. The Company adopted ASU No. 2011-05 in the first quarter of fiscal 2013 and chose to present a single statement of comprehensive income. The adoption of ASU 2011-05 did not impact the Company’s consolidated financial statements except for the change in presentation.

Recently Issued

In February 2013, the FASB issued ASU No. 2013-02 “Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income.” ASU No. 2013-02 requires an entity to disaggregate the total change of each component of

other comprehensive income either on the face of the income statement or as a separate disclosure in the notes. This update is effective for the Company beginning in the first quarter of fiscal 2014. The Company does not expect the adoption of this update will have a material effect on its consolidated financial statements.

(3) Restructuring Charges

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 final adjusted purchase price of \$50.3 million (the “Ivy Acquisition”). 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.

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. All of the restructuring activities associated with the Ivy Acquisition were concluded during fiscal 2012.

Following is a summary of the restructuring activities and associated costs that were incurred during the three- and six-month periods ended March 31, 2012:

| (In thousands) | Severance and other employee costs | Asset impairment charges | Facility closure costs | Equipment relocation costs | Total |
|--------------------------------------|--|--------------------------------|---------------------------|----------------------------------|--------|
| 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 |

During the six-month period ended March 31, 2012, all of the remaining severance liabilities were satisfied and the final proceeds were received from the sale of previously impaired machinery and equipment, which have been included within asset impairment charges. As of March 31, 2012, the Company recorded restructuring liabilities amounting to \$162,000 on its consolidated balance sheet, including \$54,000 in accounts payable and \$108,000 in accrued expenses.

(4) 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 March 30, 2013 and September 29, 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:

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| (In thousands) | Total at March 30, 2013 | Quoted Prices in Active Markets (Level 1) | Observable Inputs (Level 2) |
|---|-------------------------------|--|-----------------------------------|
| Current assets: | | | |
| Cash equivalents | \$ 7,375 | \$ 7,375 | \$ - |
| Other assets: | | | |
| Cash surrender value of life insurance policies | 5,813 | - | 5,813 |
| Total | \$ 13,188 | \$ 7,375 | \$ 5,813 |

| (In thousands) | Total at September 29, 2012 | Quoted Prices in Active Markets (Level 1) | Observable Inputs (Level 2) |
|---|-----------------------------------|--|-----------------------------------|
| Other assets: | | | |
| Cash surrender value of life insurance policies | \$ 5,146 | \$ - | \$ 5,146 |
| Total | \$ 5,146 | \$ - | \$ 5,146 |

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

As of March 30, 2013 and September 29, 2012, the Company had no nonfinancial assets that are required to be measured at fair value on a nonrecurring basis. The carrying amounts of accounts receivable, accounts payable and accrued expenses approximates fair value due to the short-term maturities of these financial instruments. As of September 29, 2012, the carrying amount of long-term debt outstanding under the Company's revolving credit facility approximated its estimated fair value. The estimated fair value of long-term debt is primarily based upon quoted market prices as well as borrowing rates currently available to the Company for bank loans with similar terms and maturities.

(5) 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 March 30, 2013, there were 683,000 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 benefits associated with stock options for the three- and six-month periods ended March 30, 2013 and March 31, 2012 are as follows:

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| (In thousands) | Three Months Ended | | Six Months Ended | |
|-----------------------|--------------------|-------------------|-------------------|-------------------|
| | March 30, 2013 | March 31, 2012 | March 30, 2013 | March 31, 2012 |
| Stock options: | | | | |
| Compensation expense | \$ 347 | \$ 319 | \$ 486 | \$ 448 |
| Excess tax benefits | (295) | (126) | (331) | (131) |

As of March 30, 2013, the remaining unamortized compensation cost related to unvested stock option awards was \$623,000, which is expected to be recognized over a weighted average period of 1.39 years.

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

The estimated fair value of stock options granted during the three- and six-month periods ended March 30, 2013 and March 31, 2012 was \$7.17 and \$6.06, respectively, based on the following assumptions:

| | Six Months Ended | | | |
|--------------------------|-------------------|---|-------------------|---|
| | March 30, 2013 | | March 31, 2012 | |
| Risk-free interest rate | 1.25 | % | 1.18 | % |
| Dividend yield | 0.74 | % | 0.92 | % |
| Expected volatility | 48.15 | % | 54.67 | % |
| Expected term (in years) | 6.47 | | 5.75 | |

The following table summarizes stock option activity for the six-month period ended March 30, 2013:

| | Options Outstanding (in thousands) | Exercise Price Per Share Range | Weighted Average | Contractual Term - Weighted Average (years) | Aggregate Intrinsic Value (in thousands) |
|---|---|-----------------------------------|---------------------|---|--|
| Outstanding at September 29, 2012 | 1,160 | \$ 0.36 - \$ 20.27 | \$ 11.09 | | |
| Granted | 65 | 16.45 - 16.45 | 16.45 | | |
| Exercised | (254) | 0.36 - 12.43 | 8.89 | | \$ 1,799 |
| Outstanding at March 30, 2013 | 971 | 5.43 - 20.27 | 12.02 | 6.76 | 4,446 |
| Vested and anticipated to vest in the future at March 30, 2013 | 965 | | 12.01 | 6.75 | 4,422 |
| Exercisable at March 30, 2013 | 632 | | 12.03 | 5.61 | 2,970 |

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 compensation expense for the three- and six-month periods ended March 30, 2013 and March 31, 2012 are as follows:

| (In thousands) | Three Months Ended | | Six Months Ended | |
|----------------|--------------------|-------------------|-------------------|-------------------|
| | March 30, 2013 | March 31, 2012 | March 30, 2013 | March 31, 2012 |

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Restricted stock unit grants:

| | | | | |
|----------------------|--------|--------|--------|--------|
| Units | 43 | 54 | 43 | 54 |
| Market value | \$ 703 | \$ 703 | \$ 703 | \$ 703 |
| Compensation expense | 433 | 438 | 607 | 678 |

As of March 30, 2013, the remaining unrecognized compensation cost related to unvested RSUs was \$1.1 million, which is expected to be recognized over a weighted average vesting period of 1.55 years.

The following table summarizes RSU activity during the six-month period ended March 30, 2013:

| (Unit amounts in thousands) | Restricted Stock Units Outstanding | Weighted Average Grant Date Fair Value |
|-----------------------------|--|---|
| Balance, September 29, 2012 | 293 | \$ 10.74 |
| Granted | 43 | 16.45 |
| Forfeited | (5) | 10.72 |
| Released | (67) | 10.40 |
| Balance, March 30, 2013 | 264 | 11.75 |

(6) Income Taxes

Effective income tax rate. The Company's effective income tax rate was 35.7% for the six-month period ended March 30, 2013 compared with 32.8% for the six-month period ended March 31, 2012. The year-over-year increase in the effective rate was primarily due to changes in permanent book versus tax differences. 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 March 30, 2013, the Company has recorded a current deferred tax asset (net of valuation allowance) of \$2.1 million in other current assets and a non-current deferred tax liability of \$5.2 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 \$27.5 million of state net operating loss carryforwards ("NOLs") that begin to expire in 2016, but principally expire between 2016 and 2032, and \$5.3 million of federal NOLs that expire in 2031 and 2032. The Company has also recorded \$262,000 of gross deferred tax assets for various state tax credits that begin to expire in 2014, but principally expire between 2014 and 2019.

In accordance with Accounting Standards Codification ("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. The Company recorded a valuation allowance of \$679,000 as of March 30, 2013 and September 29, 2012 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 based on management's judgment as to the estimated liabilities that would be incurred in connection with the resolution of these matters. As of March 30, 2013, the Company had approximately \$29,000 of gross unrecognized tax benefits classified in accrued expenses, of which \$28,000, if recognized, would reduce its income tax expense in future periods. The Company anticipates the gross unrecognized tax benefits of \$28,000 will be resolved during the next twelve months and otherwise does not expect its unrecognized tax benefits to change significantly over that time.

The Company recognizes interest and penalties related to unrecognized tax benefits as a component of income tax expense. As of March 30, 2013, the Company had \$38,000 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. The Company's 2011 fiscal year federal income tax return is currently under examination by the U.S. Internal Revenue Service ("IRS").

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(7) 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 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 \$49,000 and \$91,000 to the Delaware Plan during the three- and six-month periods ended March 30, 2013, respectively, and expects to contribute an additional \$216,000 during the remainder of the current fiscal year.

Net periodic pension costs and related components for the Delaware Plan for the three- and six-month periods ended March 30, 2013 and March 31, 2012 are as follows:

| (In thousands) | Three Months Ended | | Six Months Ended | |
|--------------------------------|--------------------|-------------------|-------------------|-------------------|
| | March 30, 2013 | March 31, 2012 | March 30, 2013 | March 31, 2012 |
| Interest cost | \$ 32 | \$ 37 | \$ 64 | \$ 74 |
| Expected return on plan assets | (36) | (34) | (72) | (68) |
| Recognized net actuarial loss | 14 | 14 | 28 | 28 |
| Net periodic pension cost | \$ 10 | \$ 17 | \$ 20 | \$ 34 |

Supplemental employee retirement plan. The Company maintains supplemental employee retirement plans (each, a “SERP”) with certain of its employees (each, a “Participant”). Under the SERPs, if the Participant remains in continuous service with the Company for a period of at least 30 years, the Company will pay to the Participant a supplemental retirement benefit for the 15-year period following the Participant’s retirement equal to 50% of the Participant’s highest average annual base salary for five consecutive years in the 10-year period preceding the Participant’s retirement. If the Participant retires prior to the later of age 65 or the completion of 30 years of continuous service with the Company, but has completed at least 10 years of continuous service with the Company, the amount of the supplemental retirement benefit will be reduced by 1/360th for each month short of 30 years that the Participant was employed by the Company.

Net periodic benefit costs and related components for the SERPs for the three- and six-month periods ended March 30, 2013 and March 31, 2012 are as follows:

| (In thousands) | Three Months Ended | | Six Months Ended | |
|------------------------------------|--------------------|-------------------|-------------------|-------------------|
| | March 30, 2013 | March 31, 2012 | March 30, 2013 | March 31, 2012 |
| Service cost | \$ 60 | \$ 50 | \$ 120 | \$ 100 |
| Interest cost | 72 | 71 | 144 | 142 |
| Amortization of prior service cost | 57 | 57 | 114 | 114 |
| Recognized net actuarial loss | 34 | 15 | 68 | 30 |
| Net periodic benefit cost | \$ 223 | \$ 193 | \$ 446 | \$ 386 |

(8) 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 March 30, 2013, no borrowings were outstanding on the Credit Facility, \$72.0 million of borrowing capacity was available and outstanding letters of credit totaled \$1.4 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 March 30, 2013, 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 March 30, 2013, 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 \$24,000 for the three-month periods ended March 30, 2013 and March 31, 2012, respectively, and \$51,000 and \$45,000 for the six-month periods ended March 30, 2013 and March 31, 2012, respectively. Accumulated amortization of capitalized financing costs was \$4.2 million as of March 30, 2013 and September 29, 2012.

Subordinated Note. As part of the consideration for the Ivy Acquisition, on November 19, 2010 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 statements of operations and comprehensive income for the six-month period ended March 31, 2012.

(9) Earnings Per Share

The computations of basic and diluted earnings per share attributable to common shareholders for the three- and six-month periods ended March 30, 2013 and March 31, 2012 are as follows:

| (In thousands except per share amounts) | Three Months Ended | | Six Months Ended | |
|---|--------------------|----------------|------------------|----------------|
| | March 30, 2013 | March 31, 2012 | March 30, 2013 | March 31, 2012 |
| Net earnings available to common shareholders | \$ 3,714 | \$ 262 | \$ 6,116 | \$ 82 |
| Basic weighted average shares outstanding | 17,846 | 17,649 | 17,785 | 17,630 |
| Dilutive effect of stock-based compensation | 440 | 389 | 402 | 356 |
| | 18,286 | 18,038 | 18,187 | 17,986 |

Diluted weighted average shares
outstanding

Per share basic:

| | | | | |
|--------------|---------|---------|---------|------|
| Net earnings | \$ 0.21 | \$ 0.01 | \$ 0.34 | \$ - |
|--------------|---------|---------|---------|------|

Per share diluted:

| | | | | |
|--------------|---------|---------|---------|------|
| Net earnings | \$ 0.20 | \$ 0.01 | \$ 0.34 | \$ - |
|--------------|---------|---------|---------|------|

Options and RSUs representing 283,000 and 340,000 shares for the three-month periods ended March 30, 2013 and March 31, 2012, respectively, were antidilutive and were not included in the diluted earnings per share calculation. Options and RSUs representing 351,000 and 481,000 shares for the six-month periods ended March 30, 2013 and March 31, 2012, respectively, were antidilutive and were not included in the diluted earnings per share calculation.

(10) Share Repurchases

On November 18, 2008, the Company's board of directors approved a share repurchase authorization to buy back up to \$25.0 million of the Company's outstanding common stock (the "New Authorization"). Under 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 March 30, 2013, 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 six-month periods ended March 30, 2013 and March 31, 2012.

(11) Other Financial Data

Balance sheet information:

| (In thousands) | March 30, 2013 | September 29, 2012 |
|---|-------------------|-----------------------|
| Accounts receivable, net: | | |
| Accounts receivable | \$ 34,432 | \$ 43,261 |
| Less allowance for doubtful accounts | (846) | (1,123) |
| Total | \$ 33,586 | \$ 42,138 |
| Inventories, net: | | |
| Raw materials | \$ 32,047 | \$ 38,911 |
| Work in process | 3,226 | 3,634 |
| Finished goods | 30,942 | 23,229 |
| Total | \$ 66,215 | \$ 65,774 |
| Other current assets: | | |
| Current deferred tax asset | \$ 2,139 | \$ 3,958 |
| Prepaid insurance | 1,461 | 1,755 |
| Other | 1,306 | 1,433 |
| Total | \$ 4,906 | \$ 7,146 |
| Other assets: | | |
| Cash surrender value of life insurance policies, net of loans of \$30 and \$486 | \$ 5,813 | \$ 5,146 |
| Capitalized financing costs, net | 223 | 274 |
| Other | 349 | 348 |
| Total | \$ 6,385 | \$ 5,768 |
| Property, plant and equipment, net: | | |
| Land and land improvements | \$ 9,175 | \$ 9,131 |
| Buildings | 41,985 | 41,585 |
| Machinery and equipment | 125,959 | 121,321 |
| Construction in progress | 3,527 | 5,270 |
| | 180,646 | 177,307 |
| Less accumulated depreciation | (93,702) | (89,591) |
| Total | \$ 86,944 | \$ 87,716 |
| Accrued expenses: | | |
| Salaries, wages and related expenses | \$ 2,231 | \$ 1,342 |
| Pension plan | 1,371 | 1,442 |
| Customer rebates | 652 | 716 |
| Property taxes | 392 | 1,233 |
| Workers' compensation | 308 | 327 |
| Interest | 34 | 29 |
| Other | 721 | 788 |
| Total | \$ 5,709 | \$ 5,877 |

| | | | |
|---------------------------|----|--------|-----------|
| Other liabilities: | | | |
| Deferred compensation | \$ | 7,801 | \$ 7,487 |
| Deferred income taxes | | 5,181 | 4,087 |
| Total | \$ | 12,982 | \$ 11,574 |

(12) Business Segment Information

The Company's operations are entirely focused on the manufacture and marketing of concrete reinforcing products for the concrete construction industry. The Company's concrete reinforcing products consist of welded wire reinforcement and prestressed concrete strand. Based on the criteria specified in ASC Topic 280, Segment Reporting, the Company has one reportable segment.

(13) Contingencies

Legal proceedings. The Company is involved in legal proceedings, 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 September 29, 2012, 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:

- 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 and residential construction and the impact on demand for our products;
-

changes in the amount and duration of transportation funding provided by federal, state and local governments and the impact on spending for infrastructure construction and demand for our products;

- 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 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 September 29, 2012 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 footprint.

On November 19, 2010, we, through our wholly-owned subsidiary, Insteel Wire Products Company, purchased certain of the assets and assumed certain of the liabilities of Ivy Steel and Wire, Inc. (“Ivy”) for a final adjusted purchase price of \$50.3 million (the “Ivy Acquisition”). Ivy was one of the nation’s largest producers of welded wire reinforcement and wire products for concrete construction applications. Among other assets, we acquired certain of Ivy’s inventories and its production facilities located in Arizona, Florida, Missouri and Pennsylvania, 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 | | | | Six Months Ended | | | |
|---|--------------------|---------|-------------------|-------------------|------------------|-------------------|--|--|
| | March 30, 2013 | Change | March 31, 2012 | March 30, 2013 | Change | March 31, 2012 | | |
| Net sales | \$ 82,873 | (4.8 %) | \$ 87,029 | \$ 168,760 | (1.8 %) | \$ 171,840 | | |
| Gross profit | 11,051 | 101.1 % | 5,494 | 19,644 | 93.5 % | 10,153 | | |
| Percentage of net sales | 13.3 % | | 6.3 % | 11.6 % | | 5.9 % | | |
| Selling, general and administrative expense | \$ 5,245 | 6.9 % | \$ 4,906 | \$ 10,087 | 6.2 % | \$ 9,498 | | |
| | 6.3 % | | 5.6 % | 6.0 % | | 5.5 % | | |

| | | | | | | |
|--------------------------------------|----------|-----------|--------|----------|-----------|-----------|
| Percentage of net sales | | | | | | |
| Gain on early extinguishment of debt | \$ - | - | \$ - | \$ - | N/M | \$ (425) |
| Restructuring charges, net | - | (100.0 %) | 203 | - | (100.0 %) | 802 |
| Interest expense | 53 | (55.5 %) | 119 | 125 | (66.4 %) | 372 |
| Interest income | (2) | - | (2) | (2) | - | (2) |
| Effective income tax rate | 36.4 % | | 36.4 % | 35.7 % | | 32.8 % |
| Net earnings | \$ 3,714 | N/M | \$ 262 | \$ 6,116 | N/M | \$ 82 |

"N/M" = not meaningful

Second Quarter of Fiscal 2013 Compared to Second Quarter of Fiscal 2012

Net Sales

Net sales for the second quarter of 2013 decreased 4.8% to \$82.9 million from \$87.0 million in the same year-ago period. Shipments for the quarter decreased 1.5% while average selling prices declined 3.4% from the prior year levels. The decrease in shipments was primarily due to adverse weather conditions in most of our markets during the current year quarter. The decrease in average selling prices was driven by competitive pricing pressures. 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 second quarter of 2013 increased 101.1% to \$11.1 million, or 13.3% of net sales, from \$5.5 million, or 6.3% of net sales, in the same year-ago period. The year-over-year increase was primarily due to wider spreads between average selling prices and raw material costs relative to the prior year quarter. 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 (“SG&A”) expense for the second quarter of 2013 increased 6.9% to \$5.2 million, or 6.3% of net sales, from \$4.9 million, or 5.6% of net sales, in the same year-ago period primarily due to higher compensation expense (\$618,000) partially offset by lower bad debt expense (\$267,000). The increase in compensation expense was primarily driven by higher incentive plan expense due to our improved financial results in the current year.

Restructuring Charges, Net

Net restructuring charges for the second quarter of 2012 were \$203,000 which related to equipment relocation costs.

Interest Expense

Interest expense for the second quarter of 2013 decreased 55.5% to \$53,000 from \$119,000 in the same year-ago period primarily due to the reduction in debt outstanding.

Income Taxes

The effective income tax rate for the second quarter of 2013 was unchanged from the same year-ago period at 36.4%.

Net Earnings

Net earnings for the second quarter of 2013 were \$3.7 million, or \$0.20 per diluted share, compared to \$262,000, or \$0.01 per share, in the same year-ago period primarily due to the increase in gross profit partially offset by the increase in SG&A expense.

First Half of Fiscal 2013 Compared to First Half of Fiscal 2012

Net Sales

Net sales for the first half of 2013 decreased 1.8% to \$168.8 million from \$171.8 million in the same year-ago period. Shipments for the period increased 2.0% and average selling prices for the period decreased 3.7% from the prior year levels. The increase in shipments was primarily due to modest improvement in construction activity and demand for our products during the period. The decrease in average selling prices was driven by competitive pricing pressures. 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 half of 2013 was \$19.6 million, or 11.6% of net sales, compared to \$10.2 million, or 5.9% of net sales, in the same year-ago period. The year-over-year increase was primarily due to wider spreads between average selling prices and raw material costs relative to the prior year period together with higher shipments and lower 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

SG&A expense for the first half of 2013 increased 6.2% to \$10.1 million, or 6.0% of net sales, from \$9.5 million, or 5.5% of net sales, in the same year-ago period primarily due to increases in compensation expense (\$785,000) and employee benefit costs (\$117,000) together with the relative year-over-year change in the cash surrender value of life insurance policies (\$405,000), partially offset by lower bad debt expense (\$420,000). The increase in compensation expense was primarily driven by higher incentive plan expense due to our improved financial results in the current year. The cash surrender value of life insurance policies increased \$291,000 in the current year period compared to \$696,000 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 half 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 half of 2012 were \$802,000 which included \$714,000 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. 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 first half of 2013 decreased 66.4% to \$125,000 from \$372,000 in the same year-ago period primarily due to the reduction in debt outstanding and 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 period prior to its prepayment in December 2011.

Income Taxes

Our effective income tax rate for the first half of 2013 increased to 35.7% from 32.8% in the prior year period due to changes in permanent book versus tax differences.

Net Earnings

Net earnings for the first half of 2013 were \$6.1 million, or \$0.34 per share, compared to \$82,000, or essentially breakeven on a per share basis, in the same year-ago period primarily due to the increase in gross profit partially offset by the increase in SG&A expense.

Liquidity and Capital Resources

Selected Financial Data
(Dollars in thousands)

| | Six Months Ended | |
|---|-------------------|-------------------|
| | March 30, 2013 | March 31, 2012 |
| Net cash provided by operating activities | \$ 26,079 | \$ 11,584 |
| Net cash used for investing activities | (3,142) | (4,320) |
| Net cash used for financing activities | (15,044) | (7,041) |
| Net working capital | 73,173 | 71,829 |
| Total debt | - | 8,000 |
| Percentage of total capital | - | 5.1 % |
| Shareholders' equity | \$ 153,520 | \$ 148,493 |
| Percentage of total capital | 100.0 % | 94.9 % |
| Total capital (total debt + shareholders' equity) | \$ 153,520 | \$ 156,493 |

Operating Activities

Operating activities provided \$26.1 million of cash during the first half of 2013 primarily from net earnings adjusted for non-cash items and a reduction in the net working capital components of accounts receivable, inventories, and accounts payable and accrued expenses. Net working capital provided \$11.9 million of cash due to a \$8.5 million decrease in accounts receivable and a \$3.8 million increase in accounts payable and accrued expenses partially offset by a \$0.4 million increase in inventories. The decrease in accounts receivable was primarily related to the usual seasonal downturn in sales. The increase in accounts payable and accrued expenses was due to higher raw material purchases and changes in the mix of vendor payments and related terms.

Operating activities provided \$11.6 million during the same period last year primarily due to an increase in net working capital together with net earnings adjusted for non-cash items. Net working capital provided \$5.8 million of cash due to a \$5.4 million decrease in accounts receivable related to the usual seasonal downturn in sales and a \$7.1 million decrease in inventories resulting from lower raw material purchases, which was partially offset by a \$6.8 million decrease in accounts payable and accrued expenses also related to lower raw material purchases.

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

Investing activities used \$3.1 million of cash during the first half of 2013 compared to \$4.3 million during the same period last year. Capital expenditures for the first half of 2013 were \$3.7 million compared to \$4.0 million in the same year-ago period and are not expected to exceed \$12.0 million during fiscal 2013. Our investing activities are largely discretionary, providing us with the ability to significantly curtail future outlays should future business conditions warrant that such actions be taken.

Financing Activities

Financing activities used \$15.0 million of cash during the first half of 2013 compared to \$7.0 million during the same period last year. Net repayments of borrowings on our revolving credit facility used \$11.5 million of cash during the current year and cash dividends totaling \$5.5 million were paid, including a special cash dividend of \$4.5 million (\$0.25 per share) and regular cash dividends totaling \$1.0 million (\$0.06 per share). These uses of cash were partially offset by \$2.3 million of proceeds from the exercise of stock options during the current year period. While we intend to pay regular quarterly cash dividends for the foreseeable future, the declaration and payment of future dividends, if any, are discretionary and will be subject to determination by the board of directors each quarter after taking into account various factors.

Cash Management

Our cash is concentrated primarily at one financial institution, which at times exceeds federally insured limits. We invest excess cash primarily in money market funds, which are highly liquid securities that bear minimal risk.

Credit Facility

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 March 30, 2013, no borrowings were outstanding on the Credit Facility, \$72.0 million of borrowing capacity was available and outstanding letters of credit totaled \$1.4 million.

As part of the consideration for the Ivy Acquisition, 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 statements of operations and comprehensive income for the first half of fiscal 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 2012, our ability to fully recover higher wire rod costs was mitigated by competitive pricing pressures resulting from the ongoing weakness in demand. Inflation did not have a material impact on our sales or earnings during the second fiscal quarter of 2013. 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 a decrease in borrowings on the revolving credit facility (See Note 8 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 September 29, 2012 other than those which occur in the ordinary course of business.

Critical Accounting Policies

Our Management's Discussion and Analysis of Financial Condition and Results of Operations is based on our unaudited financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial information. 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. Please refer to "Management's Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies" included in our Annual Report on Form 10-K for the year ended September 29, 2012 for further information regarding our critical accounting policies and estimates. As of March 30, 2013, there were no changes in the nature of our significant accounting policies or the application of those policies from those reported in our Annual Report on Form 10-K for the year ended September 29, 2012.

Recent Accounting Pronouncements

Refer to Note 2 of the Notes to Consolidated Financial Statements in Item 1 of this Quarterly Report for recently adopted and issued accounting pronouncements since the filing of our Form 10-K for the year ended September 29, 2012, including the expected dates of adoption and estimated effects, if any, on our consolidated financial statements.

Outlook

As we look ahead to the remainder of 2013, our visibility remains limited due to the continued uncertainty regarding the prospects for a recovery in the economy and employment market, the availability of financing in the credit markets and the volatility in raw material costs. Conditions in our construction end-markets appear to be improving following the steep decline in demand that we have experienced in recent years. We believe, however, that construction activity is likely to continue trending at depressed levels pending a more substantive upturn in the economy.

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 during the remainder of the year through the realization of additional operational synergies and the anticipated benefits from the reconfiguration of our combined welded wire reinforcement operations, which was completed last year. 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 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 wire rod. Our ability to acquire wire rod from foreign sources on favorable terms is impacted by fluctuations in foreign currency exchange rates, foreign taxes, duties, tariffs and other trade actions. Although changes in wire rod costs and our selling prices may be correlated over extended periods of time, depending upon market conditions and competitive dynamics, there may be periods during which we are unable to fully recover increased wire rod costs through higher selling prices, which would reduce our gross profit and cash flow from operations. Additionally, should wire rod costs decline, our financial results may be negatively impacted if the selling prices for our products decrease to an even greater degree and to the extent that we are consuming higher cost material from inventory. Based on our shipments and average wire rod cost reflected in cost of sales for the first six months of 2013, a 10% increase in the price of steel wire rod would have resulted in a \$11.0 million decrease in our pre-tax earnings for the six months ended March 30, 2013 (assuming there was not a corresponding change in our selling prices).

Interest Rates

Although we did not have any balances outstanding on our revolving credit facility as of March 30, 2013, future borrowings under the facility are subject to a variable rate of interest and are sensitive to changes in interest rates.

Foreign Exchange Exposure

We have not typically hedged foreign currency exposures related to transactions denominated in currencies other than U.S. dollars, as such transactions have not been material historically. We will occasionally hedge firm commitments for certain equipment purchases that are denominated in foreign currencies. The decision to hedge any such transactions is made by us on a case-by-case basis. There were no forward contracts outstanding as of March 30, 2013.

Item 4. Controls and Procedures

We have conducted an evaluation of the effectiveness of our disclosure controls and procedures as of March 30, 2013. 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 March 30, 2013 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

During the quarter ended March 30, 2013, there were 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 September 29, 2012. 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 September 29, 2012, as well as other reports and statements that we file with the SEC, are not the only risks and uncertainties facing us. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial may also have a material adverse effect on our financial position, results of operations or cash flows.

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

On November 18, 2008, our Board of Directors approved a share repurchase authorization to buy back up to \$25.0 million of our outstanding common stock (the “New Authorization”). Under 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. 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 March 30, 2013, 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 six-month periods ended March 30, 2013 and March 31, 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 March 30, 2013, formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Statements of Operations and Comprehensive Income for the three and six months ended March 30, 2013 and March 31, 2012, (ii) the Consolidated Balance Sheets as of March 30, 2013 and September 29, 2012, (iii) the Consolidated Statements of Cash Flows for the six months ended March 30, 2013 and March 31, 2012, (iv) the Consolidated Statements of Shareholders’ Equity as of March 30, 2013 and September 29, 2012, 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: April 18, 2013

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

EXHIBIT INDEX

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