INSTEEL INDUSTRIES INC
Form 10-Q
April 26, 2011

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Quarterly Period Ended April 2, 2011
OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Transition Period From ________ to ________
Commission File Number: 1-9929
Insteel Industries, Inc.
(Exact name of registrant as specified in its charter)

North Carolina	**56-0674867**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1373 Boggs Drive, Mount Airy, North Carolina	**27030**
(Address of principal executive offices)	(Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes þ No o

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

Yes o No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer þ	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

Yes o No þ

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

TABLE OF CONTENTS

PART I FINANCIAL INFORMATION

PART II OTHER INFORMATION

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

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

See accompanying notes to consolidated financial statements.

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

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

See accompanying notes to consolidated financial statements.

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

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

Cash Flows From Financing Activities:		
Proceeds from long-term debt	5,908	150
Principal payments on long-term debt	(5,908)	(150)
Cash received from exercise of stock options	13	84
Excess tax benefits from stock-based compensation	81	3
Cash dividends paid	(527)	(1,053)
Other	(97)	(1)
Net cash used for financing activities continuing operations	(530)	(967)
Net cash used for financing activities	(530)	(967)
Net increase (decrease) in cash and cash equivalents	(42,042)	17,161
Cash and cash equivalents at beginning of period	45,935	35,102
Cash and cash equivalents at end of period	$ 3,893	$ 52,263
Supplemental Disclosures of Cash Flow Information:		
Cash paid during the period for:		
Interest	$ 66	$ 46
Income taxes	760	2
Non-cash investing and financing activities:		
Purchases of property, plant and equipment in accounts payable	441	98
Declaration of cash dividends to be paid	527	
Restricted stock surrendered for withholding taxes payable	86	52
Note payable issued as consideration for business acquired	13,500	
Post-closing purchase price adjustment for business acquired	500	

See accompanying notes to consolidated financial statements.

INSTEEL INDUSTRIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY
(In thousands)
(Unaudited)

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

See accompanying notes to consolidated financial statements.

6

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

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

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

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

(2) Recent Accounting Pronouncements

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

(3) Business Combination

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

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

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

(In thousands)	
Assets acquired:	
Inventories	$ 20,585
Property, plant and equipment	37,211
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 has performed such a reassessment and has concluded that the values assigned for the Ivy Acquisition are reasonable. Consequently, the Company has recorded a $500,000 bargain purchase gain on the Ivy Acquisition.

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

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

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

	Three Months Ended		**Six Months Ended**	
(In thousands)	**April 2, 2011**	**April 3, 2010**	**April 2, 2011**	**April 3, 2010**

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

(4) Restructuring Charges and Acquisition Costs

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

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

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

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

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

(5) Fair Value Measurements

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

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

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

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

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

(In thousands)	Total	Quoted Prices in Active Markets (Level 1)	Observable Inputs (Level 2)

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

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

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

(6) Discontinued Operations

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

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

(In thousands)	**October 2, 2010**
Liabilities:	
Current liabilities:	
Accrued expenses	$ 210
Total current liabilities	210
Other liabilities	280
Total liabilities	$ 490

(7) Stock-Based Compensation

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

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

	Three Months Ended		**Six Months Ended**	
(In thousands)	**April 2, 2011**	**April 3, 2010**	**April 2, 2011**	**April 3, 2010**
Stock options:				

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

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

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

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

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

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

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

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

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

	Three Months Ended		Six Months Ended	
(In thousands)	April 2, 2011	April 3, 2010	April 2, 2011	April 3, 2010

Amortization expense	$ 50	$ 139	$ 116	$ 269

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

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

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

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

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

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

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

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

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

(8) Income Taxes

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

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

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

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

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

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

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

(9) Employee Benefit Plans

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

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

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

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

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

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

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

(10) Long-Term Debt

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

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

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

Financial Covenants

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

Negative Covenants

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

Events of Default

Under the terms of the Credit Agreement, an event of default will occur with respect to the Company upon the occurrence of, among other things: defaults or breaches under the loan documents, subject in certain cases to cure periods; defaults or breaches by the Company or any of its subsidiaries under any agreement resulting in the acceleration of amounts above certain thresholds or payment defaults above certain thresholds; certain events of bankruptcy or insolvency with respect to the Company; certain entries of judgment against the Company or any of its subsidiaries, which are not covered by insurance; or a change of control of the Company.

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

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

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

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

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

(11) Earnings (Loss) Per Share

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

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

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

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

(12) Share Repurchases

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

(13) Other Financial Data

Balance sheet information:

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