

INSTEEL INDUSTRIES INC

Form 10-Q

May 05, 2009

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**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 28, 2009**

**OR**

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

**For the Transition Period From \_\_\_\_\_ to \_\_\_\_\_**

**Commission File Number 1-9929**

**Insteel Industries, Inc.**

(Exact name of registrant as specified in its charter)

**North Carolina**

**56-0674867**

(State or other jurisdiction of  
incorporation or organization)

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

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

**27030**

(Address of principal executive offices)

(Zip Code)

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

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

Yes

No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T 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. (Check one):

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 May 4, 2009 was 17,526,315.

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

(In thousands except for per share data)

(Unaudited)

|  | <b>Three Months Ended</b> |              | <b>Six Months Ended</b> |                  |
|--|---------------------------|--------------|-------------------------|------------------|
|  | <b>March</b>              | <b>March</b> | <b>March</b>            | <b>March 29,</b> |
|  | <b>28,</b>                | <b>29,</b>   | <b>28,</b>              | <b>2008</b>      |
|  | <b>2009</b>               | <b>2008</b>  | <b>2009</b>             |                  |
| Net sales  | \$ 50,404                 | \$ 77,260    | \$ 112,203              | \$ 143,240       |
| Cost of sales  | 55,323                    | 61,473       | 114,564                 | 116,833          |
| Inventory write-downs  | 16,121                    |              | 22,955                  |                  |
| Gross profit (loss)  | (21,040)                  | 15,787       | (25,316)                | 26,407           |
| Selling, general and administrative expense  | 4,368                     | 5,165        | 9,101                   | 9,252            |
| Other income, net  | (58)                      | (57)         | (49)                    | (76)             |
| Interest expense   | 189                       | 152          | 337                     | 310              |
| Interest income  | (7)                       | (236)        | (102)                   | (443)            |
| Earnings (loss) from continuing operations before income taxes                                   | (25,532)                  | 10,763       | (34,603)                | 17,364           |
| Income taxes   | (9,150)                   | 3,871        | (12,622)                | 6,241            |
| Earnings (loss) from continuing operations   | (16,382)                  | 6,892        | (21,981)                | 11,123           |
| Earnings (loss) from discontinued operations net of income taxes of (\$8), \$16, (\$31) and \$12 | (13)                      | 26           | (49)                    | 19               |
| Net earnings (loss)  | \$ (16,395)               | \$ 6,918     | \$ (22,030)             | \$ 11,142        |
| Per share amounts:   |                           |              |                         |                  |
| Basic:   |                           |              |                         |                  |
| Earnings (loss) from continuing operations   | \$ (0.94)                 | \$ 0.40      | \$ (1.27)               | \$ 0.63          |
| Earnings (loss) from discontinued operations   |                           |              |                         |                  |
| Net earnings (loss)  | \$ (0.94)                 | \$ 0.40      | \$ (1.27)               | \$ 0.63          |
| Diluted:   |                           |              |                         |                  |
| Earnings (loss) from continuing operations   | \$ (0.94)                 | \$ 0.39      | \$ (1.27)               | \$ 0.62          |
| Earnings (loss) from discontinued operations   |                           |              |                         |                  |
| Net earnings (loss)  | \$ (0.94)                 | \$ 0.39      | \$ (1.27)               | \$ 0.62          |
| Cash dividends declared  | \$ 0.03                   | \$ 0.03      | \$ 0.06                 | \$ 0.06          |

Weighted average shares outstanding:

|         |        |        |        |        |
|---------|--------|--------|--------|--------|
| Basic   | 17,365 | 17,503 | 17,350 | 17,762 |
| Diluted | 17,365 | 17,647 | 17,350 | 17,918 |

*See accompanying notes to consolidated financial statements.*

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

|  | (Unaudited)       |                          |
|--|-------------------|--------------------------|
|  | March 28,<br>2009 | September<br>27,<br>2008 |
| <b>Assets</b>                                    |                   |                          |
| Current assets:                                  |                   |                          |
| Cash and cash equivalents                        | \$ 8              | \$ 26,493                |
| Accounts receivable, net                         | 23,353            | 49,581                   |
| Inventories                                      | 55,073            | 71,220                   |
| Prepaid expenses and other                       | 16,774            | 3,122                    |
| Total current assets                             | 95,208            | 150,416                  |
| Property, plant and equipment, net               | 67,056            | 69,105                   |
| Other assets                                     | 4,046             | 5,064                    |
| Non-current assets of discontinued operations    | 3,635             | 3,635                    |
| Total assets                                     | \$ 169,945        | \$ 228,220               |
| <b>Liabilities and shareholders equity</b>       |                   |                          |
| Current liabilities:                             |                   |                          |
| Accounts payable                                 | \$ 11,094         | \$ 23,581                |
| Accrued expenses                                 | 4,794             | 29,081                   |
| Current liabilities of discontinued operations   | 225               | 188                      |
| Total current liabilities                        | 16,113            | 52,850                   |
| Long-term debt                                   | 400               |                          |
| Other liabilities                                | 5,422             | 5,306                    |
| Long-term liabilities of discontinued operations | 200               | 217                      |
| Shareholders equity:                             |                   |                          |
| Common stock                                     | 17,526            | 17,507                   |
| Additional paid-in capital                       | 44,439            | 43,202                   |
| Deferred stock compensation                      | (1,668)           | (1,456)                  |
| Retained earnings                                | 89,398            | 112,479                  |
| Accumulated other comprehensive loss             | (1,885)           | (1,885)                  |
| Total shareholders equity                        | 147,810           | 169,847                  |
| Total liabilities and shareholders equity        | \$ 169,945        | \$ 228,220               |

*See accompanying notes to consolidated financial statements.*

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

(In thousands)

(Unaudited)

|   | <b>Six Months Ended</b>       |                           |
|---|-------------------------------|---------------------------|
|   | <b>March<br/>28,<br/>2009</b> | <b>March 29,<br/>2008</b> |
| <b>Cash Flows From Operating Activities:</b>  |                               |                           |
| Net earnings (loss)   | \$ (22,030)                   | \$ 11,142                 |
| Loss (earnings) from discontinued operations  | 49                            | (19)                      |
| Earnings (loss) from continuing operations  | (21,981)                      | 11,123                    |
| Adjustments to reconcile earnings (loss) from continuing operations to net cash provided by (used for) operating activities of continuing operations: |                               |                           |
| Depreciation and amortization   | 3,569                         | 3,473                     |
| Amortization of capitalized financing costs   | 249                           | 249                       |
| Stock-based compensation expense  | 985                           | 910                       |
| Excess tax benefits from stock-based compensation   | (2)                           | (15)                      |
| Inventory write-downs   | 22,955                        |                           |
| Loss on sale of property, plant and equipment   | 20                            | 56                        |
| Deferred income taxes   | 339                           | 653                       |
| Gain from life insurance proceeds   |                               | (661)                     |
| Net changes in assets and liabilities:  |                               |                           |
| Accounts receivable   | 26,228                        | 1,107                     |
| Inventories   | (6,808)                       | (7,907)                   |
| Accounts payable and accrued expenses   | (28,162)                      | 12,554                    |
| Other changes   | (13,883)                      | 2,512                     |
| Total adjustments   | 5,490                         | 12,931                    |
| Net cash provided by (used for) operating activities – continuing operations  | (16,491)                      | 24,054                    |
| Net cash used for operating activities – discontinued operations  | (28)                          | (65)                      |
| Net cash provided by (used for) operating activities  | (16,519)                      | 23,989                    |
| <b>Cash Flows From Investing Activities:</b>  |                               |                           |
| Capital expenditures  | (1,382)                       | (6,159)                   |
| Proceeds from sale of property, plant and equipment   | 13                            | 83                        |
| Decrease (increase) in cash surrender value of life insurance policies  | 354                           | (382)                     |
| Proceeds from surrender of life insurance policies  | 413                           |                           |
| Proceeds from life insurance claims   |                               | 1,111                     |
| Net cash used for investing activities – continuing operations  | (602)                         | (5,347)                   |
| Net cash used for investing activities  | (602)                         | (5,347)                   |

**Cash Flows From Financing Activities:**

|  |          |           |
|--|----------|-----------|
| Proceeds from long-term debt                                 | 20,474   | 772       |
| Principal payments on long-term debt                         | (20,074) | (772)     |
| Cash received from exercise of stock options                 | 66       | 38        |
| Excess tax benefits from stock-based compensation            | 2        | 15        |
| Repurchases of common stock                                  |          | (8,691)   |
| Cash dividends paid  | (9,804)  | (1,092)   |
| Other  | (28)     | 37        |
| Net cash used for financing activities continuing operations | (9,364)  | (9,693)   |
| Net cash used for financing activities                       | (9,364)  | (9,693)   |
| Net increase (decrease) in cash and cash equivalents         | (26,485) | 8,949     |
| Cash and cash equivalents at beginning of period             | 26,493   | 8,703     |
| Cash and cash equivalents at end of period                   | \$ 8     | \$ 17,652 |

**Supplemental Disclosures of Cash Flow Information:**

|  |        |       |
|--|--------|-------|
| Cash paid during the period for:                               |        |       |
| Interest   | \$ 88  | \$ 61 |
| Income taxes   | 11,333 | 2,557 |
| Non-cash investing and financing activities:                   |        |       |
| Purchases of property, plant and equipment in accounts payable | 170    | 650   |
| Issuance of restricted stock                                   |        | 733   |
| Declaration of cash dividends to be paid                       | 526    | 524   |
| Restricted stock surrendered for withholding taxes payable     | 9      | 76    |

*See accompanying notes to consolidated financial statements.*



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

(In thousands)

(Unaudited)

|   | Common Stock |           | Additional | Deferred     | Retained   | Accumulated | Total        |
|---|--------------|-----------|------------|--------------|------------|-------------|--------------|
|   | Shares       | Amount    | Paid-In    | Compensation | Earnings   | Other       | Shareholders |
|   |              |           | Capital    |              |            | Loss        | Equity       |
| Balance at<br>September 27, 2008                                    | 17,507       | \$ 17,507 | \$ 43,202  | \$ (1,456)   | \$ 112,479 | \$ (1,885)  | \$ 169,847   |
| Comprehensive<br>income:  |              |           |            |              |            |             |              |
| Net loss  |              |           |            |              | (22,030)   |             | (22,030)     |
| Comprehensive loss  |              |           |            |              |            |             | (22,030)     |
| Stock options<br>exercised  | 20           | 20        | 46         |              |            |             | 66           |
| Restricted stock<br>units granted                                   |              |           | 732        | (732)        |            |             |              |
| Compensation<br>expense associated<br>with stock-based<br>plans     |              |           | 465        | 520          |            |             | 985          |
| Excess tax benefits<br>from stock-based<br>compensation             |              |           | 2          |              |            |             | 2            |
| Restricted stock<br>surrendered for<br>withholding taxes<br>payable | (1)          | (1)       | (8)        |              |            |             | (9)          |
| Cash dividends<br>declared  |              |           |            |              | (1,051)    |             | (1,051)      |
| Balance at<br>March 28, 2009  | 17,526       | \$ 17,526 | \$ 44,439  | \$ (1,668)   | \$ 89,398  | \$ (1,885)  | \$ 147,810   |

*See accompanying notes to consolidated financial statements.*

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**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 have been condensed or omitted pursuant to such rules and regulations. These financial statements should therefore be read in conjunction with the consolidated financial statements and notes for the fiscal year ended September 27, 2008 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 28, 2009 are not necessarily indicative of the results that may be expected for the fiscal year ending October 3, 2009 or future periods.

**(2) Recent Accounting Pronouncements**

In December 2007, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standard ( SFAS ) No. 141 (revised 2007), Business Combinations ( SFAS No. 141R ). SFAS No. 141R requires the acquiring entity in a business combination to recognize all the assets acquired and liabilities assumed in the transaction; establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; and requires the acquirer to disclose all of the information required to evaluate and understand the nature and financial effect of the business combination. This statement is effective for acquisition dates on or after the beginning of the first annual reporting period beginning after December 15, 2008 and is not expected to have a material effect on the Company s consolidated financial statements to the extent that it does not enter into business combinations subsequent to adoption.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements. SFAS No. 160 amends Accounting Research Bulletin No. 51, Consolidated Financial Statements, to establish accounting and reporting standards for non-controlling interests in subsidiaries and for the deconsolidation of subsidiaries. This statement clarifies that a non-controlling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. SFAS No. 160 is effective for fiscal years beginning after December 15, 2008 and is not expected to have a material effect on the Company s consolidated financial statements to the extent that it does not obtain any minority interests in subsidiaries subsequent to adoption.

In June 2008, the FASB issued FASB Staff Position ( FSP ) Emerging Issues Task Force ( EITF ) No. 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities. FSP No. EITF 03-6-1 requires that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. This statement is effective for financial statements issued for fiscal years beginning after December 15, 2008 and interim periods within those years, and requires that all prior period earnings per share data presented (including interim financial statements, summaries of earnings and selected financial data) be adjusted retrospectively to conform with its provisions. The Company is currently evaluating the impact, if any, that the adoption of this FSP will have on its consolidated financial statements.

In December 2008, the FASB issued FSP No. FAS 132(R)-1, Employers Disclosures about Postretirement Benefit Plan Assets. FSP No. FAS 132(R)-1 requires objective disclosures about postretirement benefit plan assets which include disclosures about investment policies and strategies, categories of plan assets, fair value measurements of plan assets and significant concentrations of risk. This statement is effective, on a prospective basis, for fiscal years ending after December 15, 2009. The Company is currently evaluating the impact, if any, that the adoption of this FSP will have on its consolidated financial statements.

**(3) Fair Value Measurements**

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurement. SFAS No. 157 defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles and expands disclosures about fair value measurements. In February 2008, the FASB released FSP 157-2, Effective Date of FASB Statement No. 157, which delayed the effective date of SFAS No. 157 for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The Company adopted SFAS No. 157 for financial assets and liabilities during the first quarter of fiscal 2009.

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SFAS No. 157 establishes a three-level fair value hierarchy that prioritizes the inputs used to measure fair value. This hierarchy requires that the Company maximize the use of observable inputs and minimize the use of unobservable inputs. 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, similar assets and liabilities in markets that are not active or can be corroborated by observable market data.

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. This includes certain pricing models, discounted cash flow methodologies and similar techniques that use significant unobservable inputs.

As of March 28, 2009, the Company held assets that are required to be measured at fair value on a recurring basis. The following table presents information on these assets as well as the fair value hierarchy used to determine their fair value:

| <i>(In thousands)</i>                           | <b>Total</b> | <b>Quoted Prices<br/>in<br/>Active<br/>Markets<br/>(Level 1)</b> | <b>Observable<br/>Inputs<br/>(Level 2)</b> |
|---|--------------|--|--|
| Current assets:                                 |              |  |  |
| Cash equivalents                                | \$ 37        | \$ 37  | \$   |
| Other assets:                                   |              |  |  |
| Cash surrender value of life insurance policies | 3,170        |  | 3,170                                      |
| Total   | \$ 3,207     | \$ 37  | \$ 3,170                                   |

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 money market funds, approximates fair value due to the short maturities of these investments. Cash surrender value of life insurance policies are classified as Level 2. The value 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 March 28, 2009.

**(4) 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 is currently in the process of liquidating the remaining capital assets associated with the business.

The Company has determined that the exit from the industrial wire business meets the criteria of a discontinued operation in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. Accordingly, the results of operations and related non-recurring closure costs associated with the industrial wire business have been reported as discontinued operations for all periods presented. Additionally, the assets and liabilities of the discontinued operations have been segregated in the accompanying consolidated balance sheets.

Assets and liabilities of discontinued operations as of March 28, 2009 and September 27, 2008 are as follows:

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| <i>(In thousands)</i>     | <b>March<br/>28,<br/>2009</b> | <b>September<br/>27,<br/>2008</b> |
|---------------------------|-------------------------------|-----------------------------------|
| <b>Assets:</b>            |                               |                                   |
| Other assets              | \$ 3,635                      | \$ 3,635                          |
| Total assets              | \$ 3,635                      | \$ 3,635                          |
| <b>Liabilities:</b>       |                               |                                   |
| Current liabilities:      |                               |                                   |
| Accounts payable          | \$ 2                          | \$ 1                              |
| Accrued expenses          | 223                           | 187                               |
| Total current liabilities | 225                           | 188                               |
| Other liabilities         | 200                           | 217                               |
| Total liabilities         | \$ 425                        | \$ 405                            |

As of March 28, 2009 and September 27, 2008, there was approximately \$234,000 and \$251,000, respectively, of accrued expenses and other liabilities related to ongoing lease obligations and closure-related liabilities incurred as a result of the Company's exit from the industrial wire business, and approximately \$3.6 million of its remaining capital assets held for sale.

**(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. As of March 28, 2009 there were 850,000 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 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 March 28, 2009 and March 29, 2008, respectively, are as follows:

| <i>(In thousands)</i>              | <b>Three Months Ended</b>     |                               | <b>Six Months Ended</b>       |                               |
|------------------------------------|-------------------------------|-------------------------------|-------------------------------|-------------------------------|
|                                    | <b>March<br/>28,<br/>2009</b> | <b>March<br/>29,<br/>2008</b> | <b>March<br/>28,<br/>2009</b> | <b>March<br/>29,<br/>2008</b> |
| Stock options:                     |                               |                               |                               |                               |
| Compensation expense               | \$256                         | \$356                         | \$465                         | \$484                         |
| Excess tax deficiencies (benefits) | 43                            | (30)                          | (2)                           | (15)                          |

As of March 28, 2009, the remaining unamortized compensation cost related to unvested stock option awards was \$954,000, which is expected to be recognized over a weighted average period of 1.44 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 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 six-month periods ended March 28, 2009 and March 29, 2008 was \$4.60 and \$11.15, respectively, based on the following assumptions:

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|                          | <b>Six Months Ended</b>   |                           |
|--------------------------|---------------------------|---------------------------|
|                          | <b>March 28,<br/>2009</b> | <b>March 29,<br/>2008</b> |
| Risk-free interest rate  | 2.36%                     | 2.52%                     |
| Dividend yield           | 1.51%                     | 1.09%                     |
| Expected volatility      | 79.30%                    | 66.77%                    |
| Expected term (in years) | 4.85                      | 3.87                      |

The following table summarizes stock option activity for the six-month period ended March 28, 2009:

|  | <b>Options</b> | <b>Exercise Price Per Share</b> |                | <b>Contractual</b> | <b>Aggregate</b>      |
|--|----------------|---------------------------------|----------------|--------------------|-----------------------|
|  |                | <b>Outstanding</b>              | <b>Range</b>   | <b>Weighted</b>    | <b>Term -</b>         |
| <i>(Share amounts in thousands)</i>                        |                |                                 | <b>Average</b> | <b>Average</b>     | <b>Value</b>          |
| Outstanding at September 27, 2008                          | 531            | \$ 0.18 - \$20.27               | \$11.17        |                    | <i>(in thousands)</i> |
| Granted  | 98             | 7.55 - 7.55                     | 7.55           |                    |                       |
| Expired  | (9)            | 15.64 - 20.27                   | 18.07          |                    |                       |
| Exercised  | (20)           | 3.28 - 3.28                     | 3.28           |                    | \$ 120                |
| Outstanding at March 28, 2009                              | 600            | 0.18 - 20.27                    | 10.74          | 7.65<br>years      | 546                   |
| Vested and anticipated to vest in future at March 28, 2009 | 590            |                                 | 10.73          | 7.62<br>years      | 544                   |
| Exercisable at March 28, 2009                              | 298            |                                 | 9.46           | 6.10<br>years      | 517                   |

**Restricted stock awards.** Under the Company's equity incentive plans, employees and directors may be granted restricted stock awards 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. Restricted stock grants and amortization expense for restricted stock for the three- and six-month periods ended March 28, 2009 and March 29, 2008, respectively, is as follows:

|                          | <b>Three Months Ended</b>     |                               | <b>Six Months Ended</b>       |                               |
|--------------------------|-------------------------------|-------------------------------|-------------------------------|-------------------------------|
|                          | <b>March<br/>28,<br/>2009</b> | <b>March<br/>29,<br/>2008</b> | <b>March<br/>28,<br/>2009</b> | <b>March<br/>29,<br/>2008</b> |
| <i>(In thousands)</i>    |                               |                               |                               |                               |
| Restricted stock grants: |                               |                               |                               |                               |
| Shares                   |                               | 66                            |                               | 66                            |
| Market value             | \$                            | \$ 733                        | \$                            | \$ 733                        |
| Amortization expense     | 216                           | 226                           | 441                           | 426                           |

As of March 28, 2009, the remaining unrecognized compensation cost related to unvested restricted stock awards was \$861,000, which is expected to be recognized over a weighted average vesting period of 1.57 years.

During the three-month periods ended March 28, 2009 and March 29, 2008, 14,268 and 44,533 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 1,120 and 6,870 shares, respectively, were withheld during the three-month periods ended March 28, 2009 and March 29, 2008 to satisfy employees' minimum tax obligations.

The following table summarizes restricted stock activity during the six-month period ended March 28, 2009:

| <i>(Share amounts in thousands)</i> | <b>Restricted<br/>Stock<br/>Awards<br/>Outstanding</b> | <b>Weighted<br/>Average<br/>Grant Date<br/>Fair Value</b> |
|-------------------------------------|--|---|
| Balance, September 27, 2008         | 165  | \$15.16   |
| Granted                             |  |   |
| Released                            | (39)   | 12.77   |
| Balance, March 28, 2009             | 126  | 15.91   |



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**Restricted stock units.** On January 21, 2009, the Executive Compensation Committee of the Board of Directors approved an amendment to the Company's equity incentive plans to authorize the award of restricted stock units ( RSUs ) to employees and directors. 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 during the vesting period, which 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 March 28, 2009 and March 29, 2008, respectively, are as follows:

|                               | <b>Three Months Ended</b>     |                               | <b>Six Months Ended</b>       |                               |
|-------------------------------|-------------------------------|-------------------------------|-------------------------------|-------------------------------|
|                               | <b>March<br/>28,<br/>2009</b> | <b>March<br/>29,<br/>2008</b> | <b>March<br/>28,<br/>2009</b> | <b>March<br/>29,<br/>2008</b> |
| <i>(In thousands)</i>         |                               |                               |                               |                               |
| Restricted stock unit grants: |                               |                               |                               |                               |
| Units                         | 97                            |                               | 97                            |                               |
| Market value                  | \$732                         | \$                            | \$732                         | \$                            |
| Amortization expense          | 79                            |                               | 79                            |                               |

As of March 28, 2009, the remaining unrecognized compensation cost related to unvested RSUs was \$612,000, which is expected to be recognized over a weighted average vesting period of 1.98 years.

The following table summarizes RSU activity during the six-month period ended March 28, 2009:

|                                    | <b>Restricted<br/>Stock Units<br/>Outstanding</b> | <b>Weighted<br/>Average<br/>Grant<br/>Date<br/>Fair Value</b> |
|------------------------------------|---|---|
| <i>(Unit amounts in thousands)</i> |   |   |
| Balance, September 27, 2008        |   | \$  |
| Granted                            | 97  | 7.55  |
| Released                           |   |   |
| Balance, March 28, 2009            | 97  | \$7.55  |

**(6) Income Taxes**

The Company has recorded the following amounts for deferred income taxes and income taxes receivable on its consolidated balance sheet as of March 28, 2009: a current deferred tax asset (net of valuation allowance) of \$2.5 million in prepaid expenses and other, a non-current deferred tax liability (net of valuation allowance) of \$774,000 in other liabilities, and income taxes receivable of \$13.5 million in prepaid expenses and other. As of March 28, 2009, the Company has \$9.7 million of gross state operating loss carryforwards ( NOLs ) that begin to expire in 2013, but principally expire in 2018 - 2024.

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. Generally accepted accounting principles ( 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 March 28, 2009, the Company recorded a valuation allowance of \$602,000 pertaining to various state NOLs 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 against which an allowance had been provided or determine that such utilization is more likely than not.

In accordance with FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes ( FIN No. 48 ) as of March 28, 2009, the Company had approximately \$50,000 of gross unrecognized tax benefits classified as other liabilities on its consolidated balance sheet, of which \$47,000, if recognized, would reduce its income tax rate in future periods. The Company anticipates the remaining unrecognized tax benefit will be resolved during the fiscal

year.

The Company recognizes interest and penalties related to unrecognized tax benefits as a component of income tax expense. As of March 28, 2009, the Company has accrued interest and penalties related to unrecognized tax benefits of \$16,000.

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 tax year 2003 remain subject to examination together with certain state tax returns filed by the Company subsequent to tax year 2002.

**Table of Contents****(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 Company's funding policy is to contribute amounts at least equal to those required by law. No contributions were made to the Delaware Plan during the six-month period ended March 28, 2009 and no contributions are expected to be made during the fiscal year ending October 3, 2009. The Delaware Plan was frozen effective September 30, 2008 whereby participants will no longer earn additional benefits.

The Company adopted the measurement date provisions of SFAS No. 158, Employer's Accounting for Defined Benefit Pensions and Other Postretirement Plans, in the current fiscal year. As the Company already measured plan assets and benefit obligations as of its fiscal year-end, the adoption of the measurement date provision of SFAS No. 158 did not have an impact on its consolidated financial statements.

Net periodic pension costs and related components for the Delaware Plan for the three- and six-month periods ended March 28, 2009 and March 29, 2008, respectively, are as follows:

|                                | Three Months Ended   |                      | Six Months Ended     |                      |
|--------------------------------|----------------------|----------------------|----------------------|----------------------|
|                                | March<br>28,<br>2009 | March<br>29,<br>2008 | March<br>28,<br>2009 | March<br>29,<br>2008 |
| <i>(In thousands)</i>          |                      |                      |                      |                      |
| Service cost                   | \$                   | \$ 16                | \$                   | \$ 32                |
| Interest cost                  | 58                   | 64                   | 129                  | 128                  |
| Expected return on plan assets | (63)                 | (81)                 | (132)                | (162)                |
| Recognized net actuarial loss  | 26                   | 17                   | 61                   | 34                   |
| Net periodic pension cost      | 21                   | 16                   | 58                   | 32                   |
| Settlement loss                |                      |                      |                      | 109                  |
| Total pension cost             | \$ 21                | \$ 16                | \$ 58                | \$ 141               |

During the six-month period ended March 29, 2008, the Company incurred a settlement loss of \$109,000 for lump-sum distributions to participants in the Delaware Plan.

**Supplemental employee retirement plan.** The Company maintains supplemental employee retirement plans (each, a SERP) with certain of its employees (each, a Participant). Under the SERP, 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 28, 2009 and March 29, 2008, respectively, are as follows:

|                                    | Three Months Ended   |                      | Six Months Ended     |                      |
|------------------------------------|----------------------|----------------------|----------------------|----------------------|
|                                    | March<br>28,<br>2009 | March<br>29,<br>2008 | March<br>28,<br>2009 | March<br>29,<br>2008 |
| <i>(In thousands)</i>              |                      |                      |                      |                      |
| Service cost                       | \$ 30                | \$ 39                | \$ 60                | \$ 78                |
| Interest cost                      | 68                   | 66                   | 136                  | 132                  |
| Amortization of prior service cost | 56                   | 57                   | 112                  | 114                  |

|                               |        |        |        |        |   |
|-------------------------------|--------|--------|--------|--------|---|
| Recognized net actuarial loss |        |        | 3      |        | 6 |
| Net periodic benefit cost     | \$ 154 | \$ 165 | \$ 308 | \$ 330 |   |

**(8) Credit Facilities**

As of March 28, 2009, the Company had a \$100.0 million revolving credit facility in place to supplement its operating cash flow in funding its working capital, capital expenditures and general corporate requirements. As of March 28, 2009, \$400,000 was outstanding on the revolving credit facility, \$49.7 million of additional borrowing capacity was available and outstanding letters of credit totaled \$1.2 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 plus, upon the Company's request and subject to certain conditions, a percentage of eligible equipment and real estate. Interest rates on the revolver are based upon (1) a base rate that is established at the higher of the prime rate or 0.50% plus the federal funds rate, or (2) at the

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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 0.00% - 0.50% for the base rate and 1.25% - 2.00% for the LIBOR rate. In addition, the applicable interest rate margins would be adjusted to the highest percentage indicated for each range upon the occurrence of certain events of default provided for under the credit facility. Based on the Company's excess availability as of March 28, 2009, the applicable interest rate was 3.25% for the base rate loan of \$400,000 that was outstanding on the revolver.

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 facility require the Company to maintain a Fixed Charge Coverage Ratio (as defined in the Credit Agreement) of not less than: (1) 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 and the applicable borrowing base only includes eligible receivables and inventories; or (2) 1.15 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 and the applicable borrowing base includes eligible receivables, inventories, equipment and real estate. As of March 28, 2009, the Company was in compliance with all of the financial covenants under the credit facility.

*Negative Covenants*

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. As of March 28, 2009, the Company was in compliance with all of the negative covenants under the credit facility.

*Events of Default*

Under the terms of the credit facility, an event of default will occur with respect to the Company upon the occurrence of, among other things: a default or breach by the Company or any of its subsidiaries under any agreement resulting in the acceleration of amounts due in excess of \$500,000 under such agreement; certain payment defaults by the Company or any of its subsidiaries in excess of \$500,000; certain events of bankruptcy or insolvency with respect to the Company; an entry of judgment against the Company or any of its subsidiaries for greater than \$500,000, which amount is not covered by insurance; or a change of control of the Company.

Amortization of capitalized financing costs associated with the senior secured facility was \$124,000 and \$249,000 for the three- and six-month periods ended March 28, 2009 and March 29, 2008, respectively. Accumulated amortization of capitalized financing costs was \$3.4 million and \$2.9 million as of March 28, 2009 and March 29, 2008, respectively.

**Table of Contents****(9) Earnings (Loss) Per Share**

The reconciliation of basic and diluted earnings per share ( EPS ) for the three- and six-month periods ended March 28, 2009 and March 29, 2008 are as follows:

|   | <b>Three Months Ended</b> |              | <b>Six Months Ended</b> |              |
|---|---------------------------|--------------|-------------------------|--------------|
|   | <b>March</b>              | <b>March</b> | <b>March</b>            | <b>March</b> |
|   | <b>28,</b>                | <b>29,</b>   | <b>28,</b>              | <b>29,</b>   |
|   | <b>2009</b>               | <b>2008</b>  | <b>2009</b>             | <b>2008</b>  |
| <i>(In thousands, except per share amounts)</i> |                           |              |                         |              |
| Earnings (loss) from continuing operations      | \$ (16,382)               | \$ 6,892     | \$ (21,981)             | \$ 11,123    |
| Earnings (loss) from discontinued operations    | (13)                      | 26           | (49)                    | 19           |
| Net earnings (loss)                             | \$ (16,395)               | \$ 6,918     | \$ (22,030)             | \$ 11,142    |
| Weighted average shares outstanding:            |                           |              |                         |              |
| Weighted average shares outstanding (basic)     | 17,365                    | 17,503       | 17,350                  | 17,762       |
| Dilutive effect of stock-based compensation     |                           | 144          |                         | 156          |
| Weighted average shares outstanding (diluted)   | 17,365                    | 17,647       | 17,350                  | 17,918       |
| Per share (basic):                              |                           |              |                         |              |
| Earnings (loss) from continuing operations      | \$ (0.94)                 | \$ 0.40      | \$ (1.27)               | \$ 0.63      |
| Earnings (loss) from discontinued operations    |                           |              |                         |              |
| Net earnings (loss)                             | \$ (0.94)                 | \$ 0.40      | \$ (1.27)               | \$ 0.63      |
| Per share (diluted):                            |                           |              |                         |              |
| Earnings (loss) from continuing operations      | \$ (0.94)                 | \$ 0.39      | \$ (1.27)               | \$ 0.62      |
| Earnings (loss) from discontinued operations    |                           |              |                         |              |
| Net earnings (loss)                             | \$ (0.94)                 | \$ 0.39      | \$ (1.27)               | \$ 0.62      |

Options to purchase 428,000 shares and 205,000 shares for the three-month periods ended March 28, 2009 and March 29, 2008, respectively, were antidilutive and were not included in the diluted EPS calculation. Options to purchase 387,000 shares and 168,000 shares for the six-month periods ended March 28, 2009 and March 29, 2008, respectively, were antidilutive and were not included in the diluted EPS calculation. Options and restricted stock awards representing 140,000 shares and 144,000 shares for the three- and six-month periods ended March 28, 2009, respectively, were not included in the diluted EPS calculation due to the net loss that was incurred.

**(10) 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 replaces the previous authorization to repurchase up to \$25.0 million of the Company's common stock which was to expire on December 5, 2008. Under this previous authorization, the Company repurchased approximately \$6.2 million, or 697,813 shares of its common stock in open-market or privately negotiated transactions and \$76,000, or 6,870 shares of its common stock through restricted stock net-share settlements. During the three- and six-month periods ended March 28, 2009, the Company repurchased \$9,000 or 1,120 shares of its common stock through restricted stock net-share settlements. 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.

**Table of Contents****(11) Other Financial Data**

Balance sheet information:

| <i>(In thousands)</i>                           | <b>March 28,<br/>2009</b> | <b>September<br/>27,<br/>2008</b> |
|---|---------------------------|-----------------------------------|
| Accounts receivable, net:                       |                           |                                   |
| Accounts receivable                             | \$ 24,429                 | \$ 50,487                         |
| Less allowance for doubtful accounts            | (1,076)                   | (906)                             |
| Total   | \$ 23,353                 | \$ 49,581                         |
| Inventories:                                    |                           |                                   |
| Raw materials                                   | \$ 24,903                 | \$ 30,793                         |
| Work in process                                 | 1,709                     | 3,161                             |
| Finished goods                                  | 28,461                    | 37,266                            |
| Total   | \$ 55,073                 | \$ 71,220                         |
| Prepaid expenses and other:                     |                           |                                   |
| Income taxes receivable                         | \$ 13,455                 | \$                                |
| Current deferred tax asset                      | 2,514                     | 2,513                             |
| Other   | 805                       | 609                               |
| Total   | \$ 16,774                 | \$ 3,122                          |
| Other assets:                                   |                           |                                   |
| Cash surrender value of life insurance policies | \$ 3,170                  | \$ 3,938                          |
| Capitalized financing costs, net                | 594                       | 844                               |
| Other   | 282                       | 282                               |
| Total   | \$ 4,046                  | \$ 5,064                          |
| Property, plant and equipment, net:             |                           |                                   |
| Land and land improvements                      | \$ 5,571                  | \$ 5,631                          |
| Buildings                                       | 32,219                    | 31,819                            |
| Machinery and equipment                         | 95,905                    | 96,638                            |
| Construction in progress                        | 874                       | 2,195                             |
|   | 134,569                   | 136,283                           |
| Less accumulated depreciation                   | (67,513)                  | (67,178)                          |
| Total   | \$ 67,056                 | \$ 69,105                         |



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|                                      |    |       |           |
|--------------------------------------|----|-------|-----------|
| Accrued expenses:                    |    |       |           |
| Salaries, wages and related expenses | \$ | 1,346 | \$ 4,128  |
| Customer rebates                     |    | 647   | 840       |
| Worker s compensation                |    | 642   | 673       |
| Cash dividends                       |    | 526   | 9,279     |
| Property taxes                       |    | 321   | 794       |
| Sales allowance reserves             |    | 251   | 1,493     |
| Income taxes                         |    |       | 10,861    |
| Other                                |    | 1,061 | 1,013     |
| Total                                | \$ | 4,794 | \$ 29,081 |
| Other liabilities:                   |    |       |           |
| Deferred compensation                | \$ | 4,637 | \$ 4,476  |
| Deferred income taxes                |    | 774   | 435       |
| Deferred revenues                    |    | 11    | 395       |
| Total                                | \$ | 5,422 | \$ 5,306  |

**Table of Contents****(12) Business Segment Information**

Following the Company's exit from the industrial wire business (see Note 4 to the consolidated financial statements), the Company's operations are entirely focused on the manufacture and marketing of concrete reinforcing products for the concrete construction industry. Based on the criteria specified in SFAS No. 131, Disclosures About Segments of an Enterprise and Related Information, the Company has one reportable segment. The results of operations for the industrial wire products business have been reported as discontinued operations for all periods presented.

**(13) Contingencies**

**Legal proceedings.** On November 19, 2007, Dywidag Systems International, Inc. ( DSI ) filed a third-party lawsuit in the Ohio Court of Claims alleging that certain epoxy-coated strand sold by the Company to DSI in 2002, and supplied by DSI to the Ohio Department of Transportation ( ODOT ) for a bridge project, was defective. The third-party action seeks recovery of any damages which may be assessed against DSI in the action filed against it by ODOT, which allegedly could be in excess of \$8.3 million, plus \$2.7 million in damages allegedly incurred by DSI. The Company had previously filed a lawsuit against DSI in the North Carolina Superior Court in Surry County on July 25, 2007 seeking recovery of \$1.4 million (plus interest) owed for other products sold by the Company to DSI and a judgment declaring that it had no liability to DSI arising out of the ODOT bridge project. The Company's North Carolina lawsuit was subsequently removed by DSI to the U.S. District Court for the Middle District of North Carolina. On March 5, 2008, the Magistrate Judge in the U.S. District Court issued his recommendation that the Company's motion to remand the matter to the Surry County Court should be granted. DSI has appealed the Magistrate's recommendation to the District Judge, who has not yet ruled on DSI's appeal. On April 17, 2008, the Ohio Court of Claims reached a preliminary ruling denying the Company's motion to stay the proceedings against the Company in that court. On June 24, 2008, the Ohio Court of Claims reached a final ruling that DSI's action against the Company may proceed in that court. The Company subsequently filed a motion to dismiss the Ohio action on the grounds that it is barred by the relevant statute of limitations. On April 9, 2009, the Ohio Court issued a ruling denying the Company's motion to dismiss, apparently on the basis that it is not yet clear which state's statute of limitations applies. In any event, the Company intends to vigorously defend the claims asserted against it by DSI in addition to pursuing full recovery of the amounts owed to it by DSI. The Company has concluded that a loss is not yet probable with respect to this matter, and therefore no liability has been recorded. In the event the ultimate resolution of the case is unfavorable, the Company has estimated that the potential loss could range up to \$11.0 million.

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

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

This report contains forward-looking statements within the meaning of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, particularly under the caption "Outlook" below. When used in this report, the words believes, anticipates, expects, estimates, intends, may, should and similar expressions are intended to identify forward-looking statements. Although we believe that our plans, intentions and expectations reflected in or suggested by such forward-looking statements are reasonable, such forward-looking statements are subject to a number of risks and uncertainties, and we can provide no assurances that such plans, intentions or expectations will be implemented or achieved. All forward-looking statements are based on information that is current as of the date of this report. Many of these risks and uncertainties are discussed in detail, and where appropriate, updated in our periodic and other reports and statements, in particular under the caption "Risk Factors" in our Annual Report on Form 10-K for the year ended September 27, 2008, filed with the U.S. Securities and Exchange Commission. You should carefully review these risks and uncertainties.

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

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

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;

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credit market conditions and the impact of the measures that have been taken by the federal government on the relative availability of financing for us, our customers and the construction industry as a whole;  
the timing and magnitude of impact of the additional federal infrastructure-related funding provided for under the American Recovery and Reinvestment Act;

the anticipated reduction in spending for nonresidential construction, particularly commercial construction, and the impact on demand for our concrete reinforcing products;

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

the cyclical nature of the steel and building material industries;

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

our ability to raise selling prices in order to recover increases in wire rod costs;

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

the impact of increased imports of prestressed concrete strand ( PC strand );

unanticipated changes in customer demand, order patterns or 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;

the actual net proceeds realized and closure costs incurred in connection with our exit from the industrial wire business;

legal, environmental 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 27, 2008.

**Overview**

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

Following our exit from the industrial wire business (see Note 4 to the consolidated financial statements), our operations are entirely focused on the manufacture and marketing of concrete reinforcing products. The results of operations for the industrial wire products business have been reported as discontinued operations for all periods presented.

**Table of Contents****Results of Operations****Statements of Operations Selected Data**

(Dollars in thousands)

|  | Three Months Ended |         |                   | Six Months Ended  |         |                   |
|--|--------------------|---------|-------------------|-------------------|---------|-------------------|
|  | March 28,<br>2009  | Change  | March 29,<br>2008 | March 28,<br>2009 | Change  | March 29,<br>2008 |
| Net sales                                    | \$ 50,404          | (34.8%) | \$ 77,260         | \$ 112,203        | (21.7%) | \$ 143,240        |
| Gross profit (loss)                          | (21,040)           | N/M     | 15,787            | (25,316)          | N/M     | 26,407            |
| <i>Percentage of net sales</i>               | (41.7%)            |         | 20.4%             | (22.6%)           |         | 18.4%             |
| Selling, general and administrative expense  | \$ 4,368           | (15.4%) | \$ 5,165          | \$ 9,101          | (1.6%)  | \$ 9,252          |
| <i>Percentage of net sales</i>               | 8.7%               |         | 6.7%              | 8.1%              |         | 6.5%              |
| Interest expense                             | \$ 189             | 24.3%   | \$ 152            | \$ 337            | 8.7%    | \$ 310            |
| Interest income                              | (7)                | (97.0%) | (236)             | (102)             | (77.0%) | (443)             |
| Effective income tax rate                    | 35.8%              |         | 36.0%             | 36.5%             |         | 35.9%             |
| Earnings (loss) from continuing operations   | \$(16,382)         | N/M     | \$ 6,892          | \$(21,981)        | N/M     | \$ 11,123         |
| Earnings (loss) from discontinued operations | (13)               | N/M     | 26                | (49)              | N/M     | 19                |
| Net earnings (loss)                          | (16,395)           | N/M     | 6,918             | (22,030)          | N/M     | 11,142            |

*N/M = not meaningful***Second Quarter of Fiscal 2009 Compared to Second Quarter of Fiscal 2008****Net Sales**

Net sales for the second quarter of 2009 decreased 34.8% to \$50.4 million from \$77.3 million in the same year-ago period. Average selling prices for the quarter rose 19.7% while shipments decreased 45.5% from the prior year levels. The increase in average selling prices resulted from price increases that were implemented by us over the course of 2008 to recover the unprecedented escalation in our raw material costs. The reduction in shipments was primarily due to customer inventory destocking, the general economic downturn and the tightening in the credit markets.

**Gross Profit (Loss)**

The gross loss for the second quarter of 2009 was \$21.0 million, or (41.7%) of net sales, compared with gross profit of \$15.8 million, or 20.4% of net sales in the same year-ago period. The gross loss for the quarter reflects a pre-tax charge of \$16.1 million for inventory write-downs to reduce the carrying value of inventory to the lower of cost or market resulting from the decline in selling prices for certain products during the quarter relative to higher raw material costs under the first-in, first-out ( FIFO ) method of accounting. The gross loss for the quarter also reflects the unfavorable impact of the reduction in shipments, the consumption of higher cost inventory that was purchased prior to the recent collapse in steel prices and the escalation in unit conversion costs resulting from reduced operating schedules at our manufacturing facilities.

**Selling, General and Administrative Expense**

Selling, general and administrative expense ( SG&A expense ) for the second quarter of 2009 decreased 15.4% to \$4.4 million, or 8.7% of net sales from \$5.2 million, or 6.7% of net sales in the same year-ago period. The decrease was primarily due to reductions in employee incentive plan expense (\$1.0 million) and travel expense (\$118,000). The reduction in employee incentive plan expense was related to the decline in our financial performance during the current period. The reduction in travel expense was primarily due to the implementation of various cost reduction measures. These reductions were partially offset by an increase in bad debt expense resulting from higher estimates

for customer payment defaults (\$214,000) and the net gain on a life insurance settlement in the prior year (\$204,000).

*Interest Expense*

Interest expense for the second quarter of 2009 increased \$37,000 or 24.3% to \$189,000 from \$152,000 in the same year-ago period. The increase was primarily due to higher average outstanding balances on the revolving credit facility in the current period.

**Table of Contents***Income Taxes*

Our effective income tax rate for the second quarter of 2009 was relatively flat at 35.8% compared with 36.0% in the same year-ago period.

*Earnings (Loss) From Continuing Operations*

The loss from continuing operations for the second quarter of 2009 was \$16.4 million, or (\$0.94) per share compared with earnings from continuing operations of \$6.9 million, or \$0.39 per diluted share in the same year-ago period due to the decreases in net sales and gross profit.

*Earnings (Loss) From Discontinued Operations*

The loss from discontinued operations for the second quarter of 2009 was \$13,000, which had no effect on the loss per share compared with earnings of \$26,000 in the same year-ago period, which had no effect on diluted earnings per share. The current and prior year earnings (loss) resulted from the facility-related costs associated with the remaining assets to be sold of the discontinued industrial wire business.

*Net Earnings (Loss)*

The net loss for the second quarter of 2009 was \$16.4 million, or (\$0.94) per share compared to net earnings of \$6.9 million, or \$0.39 per diluted share in the same year-ago period primarily due to the decreases in net sales and gross profit.

***First Half of Fiscal 2009 Compared to First Half of Fiscal 2008****Net Sales*

Net sales for the first half of 2009 decreased 21.7% to \$112.2 million from \$143.2 million in the same year-ago period. Average selling prices for the year rose 34.9% while shipments decreased 41.9% from the prior year levels. The increase in average selling prices resulted from price increases that were implemented by us over the course of 2008 to recover the unprecedented escalation in our raw material costs. The reduction in shipments was primarily due to customer inventory destocking, the general economic downturn and the tightening in the credit markets.

*Gross Profit (Loss)*

The gross loss for the first half of 2009 was \$25.3 million, or (22.6%) of net sales, compared with gross profit of \$26.4 million, or 18.4% of net sales in the same year-ago period. The gross loss for the year reflects a pre-tax charge of \$23.0 million for inventory write-downs to reduce the carrying value of inventory to the lower of cost or market resulting from the decline in selling prices for certain products during the year relative to higher raw material costs under the FIFO method of accounting. The gross loss for the quarter also reflects the unfavorable impact of the reduction in shipments, the consumption of higher cost inventory that was purchased prior to the recent collapse in steel prices and the escalation in unit conversion costs resulting from reduced operating schedules at our manufacturing facilities.

*Selling, General and Administrative Expense*

SG&A expense for the first half of 2009 decreased 1.6% to \$9.1 million, or 8.1% of net sales from \$9.3 million, or 6.5% of net sales in the same year-ago period. The decrease was primarily due to reductions in employee incentive plan expense (\$1.3 million) and supplemental employee retirement plan expense (\$242,000). The reduction in employee incentive plan expense was related to the decline in our financial performance during the current period. These decreases were partially offset by the net gain on a life insurance settlement in the prior year (\$661,000) and the reduction in the cash surrender value of life insurance policies (\$605,000) in the current year resulting from the decline in the value of the underlying investments.

*Interest Expense*

Interest expense for the first half of 2009 increased \$27,000 or 8.7% to \$337,000 from \$310,000 in the same year-ago period. The increase was primarily due to higher average outstanding balances on the revolving credit facility in the current period.



**Table of Contents***Income Taxes*

Our effective income tax rate for the first half of 2009 increased to 36.5% from 35.9% in the same year-ago period due to a decrease in permanent differences resulting from reductions in nontaxable insurance settlement proceeds, an increase in non-deductible life insurance expense and a reduction in the qualified production activities deduction.

*Earnings (Loss) From Continuing Operations*

The loss from continuing operations for the first half of 2009 was \$22.0 million, or (\$1.27) per share compared with earnings from continuing operations of \$11.1 million, or \$0.62 per diluted share in the same year-ago period due to the decreases in net sales and gross profit.

*Earnings (Loss) From Discontinued Operations*

The loss from discontinued operations for the first half of 2009 was \$13,000, which had no effect on the loss per share compared with earnings of \$19,000 in the same year-ago period, which had no effect on diluted earnings per share. The current and prior year earnings (loss) resulted from the facility-related costs associated with the remaining assets to be sold of the discontinued industrial wire business.

*Net Earnings (Loss)*

The net loss for the first half of 2009 was \$22.0 million, or (\$1.27) per share compared to net earnings of \$11.1 million, or \$0.62 per diluted share in the same year-ago period primarily due to the decreases in net sales and gross profit.

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

(Dollars in thousands)

|   | <b>Six Months Ended</b>   |                           |
|---|---------------------------|---------------------------|
|   | <b>March 28,<br/>2009</b> | <b>March 29,<br/>2008</b> |
| Net cash provided by (used for) operating activities        | \$ (16,519)               | \$ 23,989                 |
| Net cash used for investing activities                      | (602)                     | (5,347)                   |
| Net cash used for financing activities                      | (9,364)                   | (9,693)                   |
| Working capital   | 79,095                    | 70,852                    |
| Total long-term debt  | 400                       |                           |
| <i>Percentage of total capital</i>                          | 0.3%                      |                           |
| Shareholders' equity  | \$ 147,810                | \$ 146,057                |
| <i>Percentage of total capital</i>                          | 99.7%                     | 100.0%                    |
| Total capital (total long-term debt + shareholders' equity) | \$ 148,210                | \$ 146,057                |

**Cash Flow Analysis**

Operating activities used \$16.5 million of cash during the first half of 2009 while providing \$24.0 million during the same period last year. The year-over-year change was primarily due to the loss that was incurred in the current year together with the cash used by the net working capital components of accounts receivable, inventories, and accounts payable and accrued expenses. The current year loss reflects the impact of the \$23.0 million (pre-tax) of inventory write-downs. Net working capital used \$8.7 million in the current year while providing \$5.8 million in the prior year. The cash used by working capital in the current year was largely due to the \$28.2 million decrease in accounts payable and accrued expenses resulting from the payment of \$10.9 million of accrued income taxes payable and lower raw material purchases. Inventories increased \$6.8 million in the current year (excluding the impact of the inventory write-downs) due to raw material receipts on previous purchase commitments. Accounts receivable decreased \$26.2 million during the current year as a result of the reductions in shipments and selling prices. In addition to these changes in working capital, the \$13.9 million of other changes in assets and liabilities in the current year reflects the impact of \$13.5 million of income taxes receivable that was recorded in prepaid expenses and other resulting from the current year loss. The cash provided by working capital in the prior year was primarily due to the

\$12.6 million increase in accounts payable and accrued expenses largely related to higher raw material purchases, which was partially offset by the \$7.9 million increase in inventories. While an economic slowdown adversely affects sales to our customers, it generally reduces our working capital requirements. We expect to significantly reduce our unit inventory levels over the remainder of the fiscal year to realign inventories more closely with the reduced level of

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demand. As the impact and duration of the current economic slowdown become clearer, we may make additional adjustments in our operating activities, which could materially impact our cash requirements.

Investing activities used \$602,000 of cash during the first half of 2009 compared to \$5.3 million during the same period last year. The decrease was primarily due to the \$4.8 million reduction in capital expenditures in the current year. Capital expenditures were \$1.4 million in the current year and are expected to total less than \$5.0 million for fiscal 2009. Current year investing activities also include a \$354,000 decrease in the cash surrender value of life insurance policies resulting from the decline in the value of underlying investments and \$413,000 of proceeds from the surrender of life insurance policies. Investing activities for the prior year include \$1.1 million of proceeds from claims on life insurance policies. Investing activities are largely discretionary and future outlays could be reduced significantly or eliminated should economic conditions warrant.

Financing activities used \$9.4 million of cash during the first half of 2009 compared to \$9.7 million during the same period last year. The year-over-year change was largely due to the \$8.7 million increase in cash dividends paid and \$400,000 of borrowings on our revolving credit facility during the current year as compared to the \$8.7 million of share repurchases during the prior year.

### **Credit Facilities**

As of March 28, 2009, we had a \$100.0 million revolving credit facility in place to supplement our operating cash flow in funding our working capital, capital expenditures and general corporate requirements. As of March 28, 2009, approximately \$400,000 was outstanding on the revolving credit facility, \$49.7 million of additional borrowing capacity was available and outstanding letters of credit totaled \$1.2 million (see Note 8 to the consolidated financial statements). During the three-month period ended March 28, 2009, ordinary course borrowings on our revolving credit facility were as high as \$10.0 million.

We believe that, in the absence of significant unanticipated cash demands, cash and cash equivalents, net cash generated by operating activities and amounts available under our revolving credit facility will be sufficient to satisfy our expected requirements for working capital, capital expenditures, dividends and share repurchases, if any. However, further deterioration in general economic conditions 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 borrow additional amounts on our revolving credit facility, 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 required 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 and capital structure as of March 28, 2009 together with the current borrowing capacity available on our revolving credit facility position us to meet our anticipated liquidity requirements.

### **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 the first half of 2009, selling prices for our products declined in response to the softening in demand and inventory destocking measures being pursued by our customers, which negatively impacted our financial results as we consumed higher cost inventory that was previously purchased. In contrast, during 2008, we implemented price increases in response to the unprecedented escalation in wire rod costs, which materially increased our net sales and earnings as we consumed lower cost inventory.

### **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.

**Table of Contents****Contractual Obligations**

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 27, 2008 other than those which occur in the ordinary course of business.

**Critical Accounting Policies**

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

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

**Revenue recognition.** We recognize revenue from product sales in accordance with Staff Accounting Bulletin ( SAB ) No. 104 when products are shipped and risk of loss and title has passed to the customer. Sales taxes collected from customers are recorded on a net basis and as such, are excluded from revenue.

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

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

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

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

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

**Litigation.** From time to time, we may be involved in claims, lawsuits and other proceedings. Such matters involve uncertainty as to the eventual outcomes and the potential losses that we may ultimately incur. We record

expenses for litigation when it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. We estimate the probability of such losses based on the advice of legal counsel, the outcome of similar litigation, the status of the lawsuits and other factors. Due to the numerous factors that enter into these judgments and assumptions, both the precision and reliability of the resulting estimates are subject to substantial uncertainties. We monitor our potential exposure to these

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contingencies on a regular basis and may adjust our estimates as additional information becomes known or developments occur.

**Assumptions for employee benefit plans.** We account for our defined employee benefit plans, the Insteel Wire Products Company Retirement Income Plan for Hourly Employees, Wilmington, Delaware (the Delaware Plan ) and the supplemental employee retirement plan ( SERPs ) in accordance with Statement of Financial Accounting Standard ( SFAS ) No. 87, *Employer s Accounting for Pensions*, as amended by SFAS No. 158 effective December 31, 2006. Under the provisions of SFAS No. 87, we recognize net periodic pension costs and value pension assets or liabilities based on certain actuarial assumptions, principally the assumed discount rate and the assumed long-term rate of return on plan assets.

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

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

For 2008, the assumed long-term rate of return utilized for plan assets of the Delaware Plan was 8%. We currently expect to use the same assumed rate for the long-term return on plan assets in 2009. In determining the appropriateness of this assumption, we considered the historical rate of return of the plan assets, the current and projected asset mix, our investment objectives and information provided by our third-party investment advisors.

The projected benefit obligations and net periodic pension cost for the Delaware Plan are based in part on expected increases in future compensation levels. Our assumption for the expected increase in future compensation levels is based upon our average historical experience and management s intentions regarding future compensation increases, which generally approximates average long-term inflation rates.

Assumed discount rates and rates of return on plan assets are reevaluated annually. Changes in these assumptions can result in the recognition of materially different pension costs over different periods and materially different asset and liability amounts in our consolidated financial statements. A reduction in the assumed discount rate generally results in an actuarial loss, as the actuarially-determined present value of estimated future benefit payments will increase. Conversely, an increase in the assumed discount rate generally results in an actuarial gain. In addition, an actual return on plan assets for a given year that is greater than the assumed return on plan assets results in an actuarial gain, while an actual return on plan assets that is less than the assumed return results in an actuarial loss. Other actual outcomes that differ from previous assumptions, such as individuals living longer or shorter lives than assumed in the mortality tables that are also used to determine the actuarially-determined present value of estimated future benefit payments, changes in such mortality tables themselves or plan amendments will also result in actuarial losses or gains. Under GAAP, actuarial gains and losses are deferred and amortized into income over future periods based upon the expected average remaining service life of the active plan participants (for plans for which benefits are still being earned by active employees) or the average remaining life expectancy of the inactive participants (for plans for which benefits are not still being earned by active employees). However, any actuarial gains generated in future periods reduce the negative amortization effect of any cumulative unamortized actuarial losses, while any actuarial losses generated in future periods reduce the favorable amortization effect of any cumulative unamortized actuarial gains.

The amounts recognized as net periodic pension cost and as pension assets or liabilities are based upon the actuarial assumptions discussed above. We believe that all of the actuarial assumptions used for determining the net periodic pension costs and pension assets or liabilities related to the Delaware Plan are reasonable and appropriate. The funding requirements for the Delaware Plan are based upon applicable regulations, and will generally differ from the amount of pension cost recognized under SFAS No. 87 for financial reporting purposes. No contributions were required to be made to the Delaware Plan in the prior year.

We currently expect to record net periodic pension costs totaling \$730,000 during 2009. However, we do not expect that any cash contributions to the Delaware Plan will be required during 2009. Contributions to the SERP plan are expected to total \$155,000, matching the required benefit payments during 2009.



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**Recent Accounting Pronouncements**

In December 2007, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 141 (revised 2007), Business Combinations ( SFAS No. 141R ). SFAS No. 141R requires the acquiring entity in a business combination to recognize all the assets acquired and liabilities assumed in the transaction; establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; and requires the acquirer to disclose all of the information required to evaluate and understand the nature and financial effect of the business combination. This statement is effective for acquisition dates on or after the beginning of the first annual reporting period beginning after December 15, 2008 and is not expected to have a material effect on our consolidated financial statements to the extent that we do not enter into business combinations subsequent to adoption.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements. SFAS No. 160 amends Accounting Research Bulletin No. 51, Consolidated Financial Statements, to establish accounting and reporting standards for non-controlling interests in subsidiaries and for the deconsolidation of subsidiaries. This statement clarifies that a non-controlling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. SFAS No. 160 is effective for fiscal years beginning after December 15, 2008 and is not expected to have a material effect on our consolidated financial statements to the extent that we do not obtain any minority interests in subsidiaries subsequent to adoption.

In June 2008, the FASB issued FASB Staff Position ( FSP ) Emerging Issues Task Force ( EITF ) No. 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities. FSP No. EITF 03-6-1 requires that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. This statement is effective for financial statements issued for fiscal years beginning after December 15, 2008 and interim periods within those years, and requires that all prior period earnings per share data presented (including interim financial statements, summaries of earnings and selected financial data) be adjusted retrospectively to conform with its provisions. We are currently evaluating the impact, if any, that the adoption of this FSP will have on our consolidated financial statements.

In December 2008, the FASB issued FSP No. FAS 132(R)-1, Employers Disclosures about Postretirement Benefit Plan Assets. FSP No. FAS 132(R)-1 requires objective disclosures about postretirement benefit plan assets which include disclosures about investment policies and strategies, categories of plan assets, fair value measurements of plan assets and significant concentrations of risk. This statement is effective, on a prospective basis, for fiscal years ending after December 15, 2009. We are currently evaluating the impact, if any, that the adoption of this FSP will have on our consolidated financial statements.

**Outlook**

Our visibility for business conditions through the remainder of fiscal 2009 is clouded by the continued uncertainty regarding future global economic conditions, the impact of the measures that have been undertaken to ease the tightening in the credit markets and the timing and magnitude of the impact of the additional federal infrastructure-related funding provided for under the American Recovery and Reinvestment Act ( ARRA ). Although we expect nonresidential construction, our primary demand driver, to decline from the levels of recent years, particularly for commercial projects which have been the most severely impacted by the economic downturn, the additional infrastructure funding provided for under ARRA should serve to at least partially mitigate this decline. We anticipate that residential construction will remain weak, which would continue to adversely affect shipments to customers that have greater exposure to the housing sector.

Prices for our primary raw material, hot-rolled steel wire rod, have continued to decline in recent months following the unprecedented escalation that we experienced during fiscal 2008 as scrap costs for steel producers have plummeted and the availability of competitively priced imports has increased. Purchasers at all levels of the supply chain have scaled back their commitments to minimize inventories in response to the heightened level of uncertainty regarding future demand and to increase their liquidity.

We expect order levels to rise during the second half of the fiscal year due to the usual seasonal factors and the anticipated completion of the inventory destocking by our customers. Although we could potentially incur additional

inventory write-downs depending upon the future trends for our selling prices, we believe that the mismatching of higher raw material costs with lower selling prices is largely behind us. We expect that margins will gradually improve as the lower replacement costs for wire rod begin to be reflected in cost of sales.

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

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productivity and effectiveness of all of our manufacturing, selling and administrative activities. We also expect gradually increasing contributions from the substantial investments we have made in our facilities in recent years in the form of reduced operating costs and additional capacity to support future growth when market conditions improve (see *Cautionary Note Regarding Forward-Looking Statements* and *Risk Factors* ). In addition to these organic growth and cost reduction initiatives, we are continually evaluating potential acquisitions in our existing businesses that further our penetration in current markets served or expand our geographic reach.

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

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

*Commodity Prices*

We are subject to significant fluctuations in the cost and availability of our primary raw material, hot-rolled steel wire rod, which we purchase from both domestic and foreign suppliers. We negotiate quantities and pricing for both domestic and foreign steel wire rod purchases for varying periods (most recently monthly for domestic suppliers), depending upon market conditions, to manage our exposure to price fluctuations and to ensure adequate availability of material consistent with our requirements. We do not use derivative commodity instruments to hedge our exposure to changes in prices as such instruments are not currently available for steel wire rod. Our ability to acquire steel wire rod from foreign sources on favorable terms is impacted by fluctuations in foreign currency exchange rates, foreign taxes, duties, tariffs and other trade actions. Although changes in wire rod costs and our selling prices may be correlated over extended periods of time, depending upon market conditions and competitive dynamics, there may be periods during which we are unable to fully recover increased wire rod costs through higher selling prices, which would reduce our gross profit and cash flow from operations. Additionally, should wire rod costs decline, our financial results may be negatively impacted if the selling prices for our products decrease to an even greater degree and to the extent that we are consuming higher cost material from inventory. Based on our shipments and average wire rod cost reflected in cost of sales for the first six months of 2009, a 10% increase in the price of steel wire rod would have resulted in a \$11.5 million increase in our pre-tax loss for the six months ended March 28, 2009 (assuming there was not a corresponding change in our selling prices).

*Interest Rates*

We have debt obligations that are sensitive to changes in interest rates under our senior secured credit facility. However, as the outstanding balance on the credit facility was \$400,000 as of March 28, 2009, we do not expect that changes in interest rates would have a material impact unless our borrowings were to materially increase.

*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 in the past. 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 28, 2009.

**Item 4. Controls and Procedures**

We have conducted an evaluation of the effectiveness of our disclosure controls and procedures as of March 28, 2009. 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 28, 2009 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents****Part II Other Information****Item 1. Legal Proceedings**

On November 19, 2007, Dywidag Systems International, Inc. ( DSI ) filed a third-party lawsuit in the Ohio Court of Claims alleging that certain epoxy-coated strand sold by us to DSI in 2002, and supplied by DSI to the Ohio Department of Transportation ( ODOT ) for a bridge project, was defective. The third-party action seeks recovery of any damages which may be assessed against DSI in the action filed against it by ODOT, which allegedly could be in excess of \$8.3 million, plus \$2.7 million in damages allegedly incurred by DSI. We had previously filed a lawsuit against DSI in the North Carolina Superior Court in Surry County on July 25, 2007 seeking recovery of \$1.4 million (plus interest) owed for other products sold by us to DSI and a judgment declaring that we had no liability to DSI arising out of the ODOT bridge project. Our North Carolina lawsuit was subsequently removed by DSI to the U.S. District Court for the Middle District of North Carolina. On March 5, 2008, the Magistrate Judge in the U.S. District Court issued his recommendation that our motion to remand the matter to the Surry County Court should be granted. DSI has appealed the Magistrate s recommendation to the District Judge, who has not yet ruled on DSI s appeal. On April 17, 2008, the Ohio Court of Claims reached a preliminary ruling denying our motion to stay the proceedings against us in that court. On June 24, 2008, the Ohio Court of Claims reached a final ruling that DSI s action against us may proceed in that court. We subsequently filed a motion to dismiss the Ohio action on the grounds that it is barred by the relevant statute of limitations. On April 9, 2009, the Ohio Court issued a ruling denying our motion to dismiss, apparently on the basis that it is not yet clear which state s statute of limitations applies. In any event, we intend to vigorously defend the claims asserted against us by DSI in addition to pursuing full recovery of the amounts owed to us by DSI. We have concluded that a loss is not yet probable with respect to this matter, and therefore no liability has been recorded. In the event the ultimate resolution of the case is unfavorable, we have estimated that the potential loss could range up to \$11.0 million.

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

**Item 1A. Risk Factors**

Except as set forth below, there are no material changes from the risk factors set forth under Part I, Item 1A.

Risk Factors in our Annual Report on Form 10-K for the fiscal year ended September 27, 2008 and in our subsequently filed Quarterly Reports on Form 10-Q. 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 27, 2008, 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 affect on our financial position, results of operations or cash flows.

***Our customers may be adversely affected by the continued negative macroeconomic conditions and tightening in the credit markets.***

Current negative macroeconomic conditions have caused many of our customers to implement inventory destocking measures, which has resulted in reduced demand for our products. In addition, the tightening in the credit markets could limit the ability of our customers to fund their financing requirements thereby further reducing their purchasing volume with us beyond the decreases resulting from their current inventory destocking measures. Further, the reduction in the availability of credit may increase the risk of customers defaulting on their payment obligations to us. The continuation or occurrence of these events could materially and adversely impact our business, financial condition and results of operations.

***Although the additional federal infrastructure-related funding provided for under the American Recovery and Reinvestment Act ( ARRA ) is expected to have a favorable impact on demand for our products, the timing and magnitude of the impact are uncertain.***

ARRA provides for significant increases in federal infrastructure-related funding, which should have a favorable impact on demand for our products. However, the timing and magnitude of the impact are uncertain, and

there can be no assurance that its impact would be sufficient to offset the reduced demand for our products resulting from the continued weakening in nonresidential construction attributable to the economic downturn and the tightening in the credit markets.

**Table of Contents****Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

On November 18, 2008, our board of directors approved a new share repurchase authorization to buy back up to \$25.0 million of our outstanding common stock in the open market or in privately negotiated transactions (the New Authorization ). The New Authorization replaces the previous authorization to repurchase up to \$25.0 million of our common stock which was to expire on December 5, 2008. Repurchases may be made from time to time in the open market or in privately negotiated transactions subject to market conditions, applicable legal requirements and other factors. We are not obligated to acquire any particular amount of common stock and the program may be commenced or suspended at any time at our discretion without prior notice. The New Authorization continues in effect until terminated by the Board of Directors.

The following table summarizes the repurchases of common stock (including shares surrendered to satisfy tax withholding obligations) during the three-month period ended March 28, 2009:

| Period   | Total<br>Number of<br>Shares<br>Purchased | Average<br>Price<br>Paid per<br>Share | Total<br>Number of<br>Shares<br>Purchased as<br>Part of<br>Publicly<br>Announced<br>Plan or<br>Program | Maximum Number (or<br>Approximate<br>Dollar Value) of<br>Shares that May Yet<br>Be Purchased Under<br>the Plan or<br>Program |
|--|---|---------------------------------------|--|--|
| <i>(In thousands except per share amounts)</i> |   |                                       |  |  |
| December 28, 2008 – January 31, 2009           |   |                                       |  | \$ 25,000  |
| February 1, 2009 – February 28, 2009           | 1,120                                     | \$ 7.87                               | 1,120  | \$ 24,991(1)   |
| March 1, 2009 – March 28, 2009                 |   |                                       |  | \$ 24,991  |
|  | 1,120                                     | \$ 7.87                               | 1,120  | \$ 24,991  |

(1) Represents 1,120 shares surrendered by employees to satisfy tax withholding obligations upon the vesting of restricted stock awards.

**Item 4. Submission of Matters to a Vote of Security Holders**

The Company held its 2009 Annual Meeting of Shareholders on February 10, 2009. The following matters were submitted to a vote of our shareholders of record at the Annual Meeting and approved by the requisite vote of our shareholders represented in person or by proxy as follows:

**Proposal 1:** Election of each of the persons named below to serve a three-year term expiring at the 2012 Annual Meeting of Shareholders or until their successors are elected and qualify.

**Number of Shares**

|                    | <b>Nominee</b> | <b>For</b> | <b>Withheld</b> |
|--------------------|----------------|------------|-----------------|
| Charles B. Newsome |                | 15,114,166 | 1,324,193       |
| H. O. Woltz III    |                | 11,540,072 | 4,898,287       |

Proposal 2: Approval of the material terms of the Insteel Industries, Inc. Return on Capital Incentive Compensation Plan.

**Number of Shares**

| <b>For</b> | <b>Against</b> | <b>Abstain</b> | <b>Broker<br/>Non-Votes</b> |
|------------|----------------|----------------|-----------------------------|
| 13,501,213 | 451,980        | 30,576         | 2,454,590                   |

Proposal 3: Ratification of the appointment of Grant Thornton LLP as the Company's independent registered public accounting firm for the fiscal year ending October 3, 2009.

**Number of Shares**

| <b>For</b> | <b>Against</b> | <b>Abstain</b> |
|------------|----------------|----------------|
| 16,166,149 | 18,598         | 253,609        |
|            | 27             |                |

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**Item 6. Exhibits**

- 10.1 Form of Notice of Grant of Restricted Stock Units and Restricted Stock Unit Agreement (incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed on January 23, 2009).
- 10.2 Insteel Industries, Inc. Return on Capital Incentive Compensation Plan (As Amended and Restated Effective August 12, 2008) (incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed on February 13, 2009).
- 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.

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**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: May 5, 2009

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

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**EXHIBIT INDEX**

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