

INSTEEL INDUSTRIES INC

Form 10-Q

January 21, 2016

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 January 2, 2016

OR

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

For the Transition Period From _____ to _____

Commission File Number: 1-9929

Insteel Industries, Inc.

(Exact name of registrant as specified in its charter)

North Carolina

(State or other jurisdiction of
incorporation or organization)

56-0674867

(I.R.S.
Employer

Identification
No.)

1373 Boggs Drive, Mount Airy, North Carolina **27030**

(Address of principal executive offices)

(Zip Code)

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

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

Yes No

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

Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer (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 January 20, 2016 was 18,600,328.

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

(In thousands except for per share data)

(Unaudited)

	Three Months Ended	
	January	December
	2,	27,
	2016	2014
Net sales	\$92,391	\$ 110,628
Cost of sales	75,968	98,585
Gross profit	16,423	12,043
Selling, general and administrative expense	6,335	5,652
Restructuring recoveries, net	(75)	-
Other income, net	(114)	(40)
Interest expense	41	94
Interest income	(18)	-
Earnings before income taxes	10,254	6,337
Income taxes	3,546	2,187
Net earnings	\$6,708	\$4,150
Net earnings per share:		
Basic	\$0.36	\$0.23
Diluted	0.36	0.22
Weighted average shares outstanding:		
Basic	18,525	18,377
Diluted	18,883	18,820
Cash dividends declared per share	\$1.03	\$0.03
Comprehensive income	\$6,708	\$4,150

See accompanying notes to consolidated financial statements.

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

(In thousands)

	(Unaudited)	
	January 2,	October
	2016	3,
		2015
Assets		
Current assets:		
Cash and cash equivalents	\$ 45,619	\$33,258
Accounts receivable, net	40,368	46,782
Inventories	69,065	66,009
Other current assets	2,547	5,309
Total current assets	157,599	151,358
Property, plant and equipment, net	83,144	84,178
Intangibles, net	9,931	10,220
Goodwill	6,965	6,965
Other assets	7,681	7,518
Total assets	\$ 265,320	\$260,239
Liabilities and shareholders' equity		
Current liabilities:		
Accounts payable	\$ 31,467	\$32,182
Accrued expenses	12,033	13,644
Dividends payable	18,600	-
Total current liabilities	62,100	45,826
Other liabilities	13,814	14,198
Commitments and contingencies		
Shareholders' equity:		
Common stock	18,600	18,466
Additional paid-in capital	62,475	60,967
Retained earnings	110,477	122,928
Accumulated other comprehensive loss	(2,146)	(2,146)
Total shareholders' equity	189,406	200,215
Total liabilities and shareholders' equity	\$ 265,320	\$260,239

See accompanying notes to consolidated financial statements.

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

(In thousands)

(Unaudited)

	Three Months Ended	
	January 2, 2016	December 27, 2014
Cash Flows From Operating Activities:		
Net earnings	\$6,708	\$4,150
Adjustments to reconcile net earnings to net cash provided by (used for) operating activities:		
Depreciation and amortization	2,742	2,869
Amortization of capitalized financing costs	16	26
Stock-based compensation expense	229	442
Deferred income taxes	1,215	935
Excess tax benefits from stock-based compensation	(253)	-
Gain on sale and disposition of property, plant and equipment	(239)	(77)
Increase in cash surrender value of life insurance policies over premiums paid	-	(136)
Net changes in assets and liabilities (net of assets and liabilities acquired):		
Accounts receivable, net	6,414	10,360
Inventories	(3,056)	(5,565)
Accounts payable and accrued expenses	(2,659)	(22,716)
Other changes	1,274	199
Total adjustments	5,683	(13,663)
Net cash provided by (used for) operating activities	12,391	(9,513)
Cash Flows From Investing Activities:		
Capital expenditures	(941)	(3,515)
Acquisition of business	-	411
Proceeds from sale of assets held for sale	180	-
Proceeds from sale of property, plant and equipment	60	89
Proceeds from surrender of life insurance policies	40	40
Increase in cash surrender value of life insurance policies	(212)	-
Net cash used for investing activities	(873)	(2,975)
Cash Flows From Financing Activities:		
Proceeds from long-term debt	65	47,757
Principal payments on long-term debt	(65)	(37,757)
Cash dividends paid	(559)	(551)
Cash received from exercise of stock options	1,492	-
Excess tax benefits from stock-based compensation	253	-

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Financing costs	(11)	-
Payment of employee tax withholdings related to net share transactions	(332)	-
Net cash provided by financing activities	843	9,449
Net increase (decrease) in cash and cash equivalents	12,361	(3,039)
Cash and cash equivalents at beginning of period	33,258	3,050
Cash and cash equivalents at end of period	\$45,619	\$ 11

Supplemental Disclosures of Cash Flow Information:

Cash paid during the period for:

Interest	\$-	\$ 16
Income taxes, net	2,194	45
Non-cash investing and financing activities:		
Purchases of property, plant and equipment in accounts payable	479	206
Declaration of cash dividends to be paid	18,600	-
Restricted stock units and stock options surrendered for withholding taxes payable	332	-
Post-closing purchase price adjustment for business acquired	-	65

See accompanying notes to consolidated financial statements.

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

(In thousands)

(Unaudited)

	Common Stock		Additional	Retained	Accumulated	Total	
	Shares	Amount	Paid-In	Earnings	Other	Shareholders'	
			Capital		Comprehensive	Equity	
					Loss		
Balance at October 3, 2015	18,466	\$18,466	\$ 60,967	\$122,928	\$ (2,146	) \$ 200,215
Net earnings				6,708		6,708	
Stock options exercised, net	134	134	1,358			1,492	
Compensation expense associated with stock-based plans			229			229	
Excess tax benefits from stock-based compensation			253			253	
Restricted stock units and stock options surrendered for withholding taxes payable			(332)		(332)
Cash dividends declared				(19,159)	(19,159)
Balance at January 2, 2016	18,600	\$18,600	\$ 62,475	\$110,477	\$ (2,146	) \$ 189,406

See accompanying notes to consolidated financial statements.

INSTEEL INDUSTRIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(1) Basis of Presentation

The accompanying unaudited interim consolidated financial statements of Insteel Industries, Inc. (“we,” “us,” “our,” “the Company” or “Insteel”) have been prepared pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (“SEC”) for quarterly reports on Form 10-Q. Certain information and note disclosures normally included in the audited financial statements prepared in accordance with accounting principles generally accepted in the United States (“GAAP”) have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures made are adequate to make the information not misleading. The October 3, 2015 consolidated balance sheet was derived from the audited consolidated financial statements at that date, but does not include all of the information and footnotes required by GAAP for complete financial statements. These financial statements should therefore be read in conjunction with the consolidated financial statements and notes for the fiscal year ended October 3, 2015 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 three-month period ended January 2, 2016 are not necessarily indicative of the results that may be expected for the fiscal year ending October 1, 2016 or future periods.

On August 15, 2014, the Company through its wholly-owned subsidiary, Insteel Wire Products Company (“IWP”), purchased substantially all of the assets associated with the prestressed concrete strand (“PC strand”) business of American Spring Wire Corporation (“ASW”) (see Note 3 to the consolidated financial statements).

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

(2) Recent Accounting Pronouncements

In November 2015, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2015-17 “Income Taxes (Topic 740) - Balance Sheet Classification of Deferred Taxes” to simplify the presentation of deferred income taxes. Under this update, all deferred tax assets and liabilities, along with any related valuation allowance, are required to be classified as noncurrent on the balance sheet. Effective January 2, 2016, the Company early adopted ASU No. 2015-17 on a prospective basis, which resulted in the reclassification of the Company’s current deferred tax asset as a non-current deferred tax liability on its consolidated balance sheet. No prior periods were retrospectively adjusted.

In July 2015, the FASB issued ASU No. 2015-11 “Simplifying the Measurement of Inventory,” which requires that an entity measure inventory at the lower of cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business less reasonably predictable costs of completion, disposal and transportation. ASU No. 2015-11 will become effective for the Company in the first quarter of fiscal 2018. The Company does not expect the adoption of this update will have a material effect on its consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09 “Revenue from Contracts with Customers,” which will supersede nearly all existing revenue recognition guidance under GAAP. ASU No. 2014-09 provides that an entity recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This update also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments, and assets recognized from costs incurred to obtain or fulfill a contract. ASU No. 2014-09 allows for either full retrospective or modified retrospective adoption and will become effective for the Company in the first quarter of fiscal 2019. The Company is evaluating the alternative transition methods and the potential effects of the adoption of this update on its consolidated financial statements.

(3) Business Combination

On August 15, 2014, the Company purchased substantially all of the assets associated with the PC strand business of ASW for a final adjusted purchase price of \$33.5 million, net of post-closing adjustments of \$480,000 (the “ASW Acquisition”).

ASW manufactured PC strand at facilities located in Houston, Texas and Newnan, Georgia. The Company acquired, among other assets, the accounts receivable and inventories related to ASW’s PC strand business, the production equipment at its facility in Houston and its production equipment and facility in Newnan. Pursuant to an agreement with ASW, the Company is leasing the Houston facility from ASW with an option to purchase it in the future. In addition, the Company assumed certain of ASW’s accounts payable and accrued liabilities related to its PC strand business.

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

(In thousands)

Assets acquired:	
Accounts receivable	\$7,854
Inventories	6,292
Other current assets	786
Property, plant and equipment	8,638
Intangibles	8,530
Total assets acquired	\$32,100
Liabilities assumed:	
Accounts payable	\$3,240
Accrued expenses	2,362
Total liabilities assumed	5,602
Net assets acquired	26,498
Purchase price	33,463
Goodwill	\$6,965

In connection with the ASW Acquisition, the Company acquired intangible assets consisting of customer relationships, developed technology and know-how, and a non-competition agreement. The ASW Acquisition was accounted for as a business purchase pursuant to Accounting Standards Codification (“ASC”) Topic 805, *Business Combinations*. Acquisition and integration costs are not included as components of consideration transferred, but are recorded as expenses in the period in which such costs are incurred.

Restructuring charges. Subsequent to the ASW Acquisition, in fiscal 2014, the Company incurred employee separation costs for staffing reductions associated with the acquisition. In February 2015, the Company elected to consolidate its PC strand operations with the closure of the Newnan, Georgia facility that had been acquired through the ASW Acquisition, which was completed in March 2015.

Following is a summary of the restructuring activities and associated costs that were incurred during the three-month periods ended January 2, 2016 and December 27, 2014:

<i>(In thousands)</i>	Equipment Relocation Costs	Severance and Other Employee Separation Costs	Facility Closure Costs	Gain on Sale of Equipment	Total
2016					
Liability as of October 3, 2015	\$ -	\$ 735	\$ -	\$ -	\$735
Restructuring charges (recoveries)	75	-	30	(180)	(75)
Cash payments/receipts	(75)	(72)	(30)	180	3
Liability as of January 2, 2016	\$ -	\$ 663	\$ -	\$ -	\$663
2015					
Liability as of September 27, 2014	\$ -	\$ 1,208	\$ -	\$ -	\$1,208
Cash payments	-	(53)	-	-	(53)
Liability as of December 27, 2014	\$ -	\$ 1,155	\$ -	\$ -	\$1,155

The Company recorded restructuring liabilities of \$0.7 million on its consolidated balance sheet as of January 2, 2016 and October 3, 2015, including \$0.5 million in accrued expenses and \$0.2 million in other liabilities. The Company does not currently expect to incur any significant restructuring charges during the remainder of fiscal 2016.

(4) Fair Value Measurements

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

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

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

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

As of January 2, 2016 and October 3, 2015, the Company held financial assets that are required to be measured at fair value on a recurring basis. The financial assets held by the Company and the fair value hierarchy used to determine their fair values are as follows:

<i>(In thousands)</i>	Total at January 2, 2016	Quoted Prices in Active Markets (Level 1)	Observable Inputs (Level 2)
Current assets:			
Cash equivalents	\$45,566	\$45,566	\$ -
Other assets:			
Cash surrender value of life insurance policies	7,366	-	7,366
Total	\$52,932	\$45,566	\$ 7,366

<i>(In thousands)</i>	Total at October 3, 2015	Quoted Prices in Active Markets (Level 1)	Observable Inputs (Level 2)
Current assets:			
Cash equivalents	\$32,843	\$ 32,843	\$ -
Other assets:			
Cash surrender value of life insurance policies	7,194	-	7,194
Total	\$40,037	\$ 32,843	\$ 7,194

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

As of January 2, 2016 and October 3, 2015, the Company did not have any nonfinancial assets that were required to be measured at fair value on a nonrecurring basis other than the assets and liabilities that were acquired from ASW at fair value (see Note 3 to the consolidated financial statements). The carrying amounts of accounts receivable, accounts payable and accrued expenses approximates fair value due to the short-term maturities of these financial instruments.

(5) Intangible Assets

The primary components of the Company's intangible assets and the related accumulated amortization are as follows:

<i>(In thousands)</i>	Gross Amount	Accumulated Amortization	Net Book Value
As of January 2, 2016:			
Customer relationships	\$ 6,500	\$ (450)	) \$6,050
Developed technology and know-how	1,800	(125)	) 1,675
Non-competition agreements	3,577	(1,371)	) 2,206
	\$ 11,877	\$ (1,946)	) \$9,931

<i>(In thousands)</i>	Gross Amount	Accumulated Amortization	Net Book Value
As of October 3, 2015:			
Customer relationships	\$ 6,500	\$ (369	) \$6,131
Developed technology and know-how	1,800	(102	) 1,698
Non-competition agreements	3,577	(1,186	) 2,391
	\$ 11,877	\$ (1,657	) \$10,220

Amortization expense for intangibles was \$289,000 and \$216,000 for the three-month periods ended January 2, 2016 and December 27, 2014, respectively.

(6) Stock-Based Compensation

Under the Company's equity incentive plans, employees and directors may be granted stock options, restricted stock, restricted stock units and performance awards. Effective February 17, 2015, the shareholders of the Company approved the 2015 Equity Incentive Plan of Insteel Industries, Inc. (the "2015 Plan"), which authorizes up to 900,000 shares of Company common stock for future grants under the plan. The 2015 Plan, which expires on February 17, 2025, replaces the 2005 Equity Incentive Plan of Insteel Industries, Inc., which expired on February 15, 2015. As of January 2, 2016, there were 711,000 shares of Company common stock available for future grants under the 2015 Plan, which is the Company's only active equity incentive plan.

Stock options. Under the Company's equity incentive plans, employees and directors may be granted options to purchase shares of the Company's common stock at the fair market value on the date of the grant. Options granted under these plans generally vest over three years and expire ten years from the date of the grant. Compensation expense associated with stock options for the three-month periods ended January 2, 2016 and December 27, 2014 is as follows:

	Three Months Ended	
	January 2,	December 27,
<i>(In thousands)</i>	2016	2014
Stock options:		
Compensation expense	\$83	\$ 173

As of January 2, 2016, the remaining unamortized compensation cost related to unvested stock option awards was \$280,000, which is expected to be recognized over a weighted average period of 1.36 years.

The following table summarizes stock option activity for the three-month period ended January 2, 2016:

	Options Outstanding	Exercise Price Per Share	Weighted Average	Contractual Term - Weighted Average	Aggregate Intrinsic Value
	<i>(in thousands)</i>	Range	Average	(years)	<i>(in thousands)</i>
Outstanding at October 3, 2015	923	\$ 7.55-\$ 21.96	\$ 15.14		
Exercised	(176)	7.55 -20.50	12.32		\$ 2,016
Outstanding at January 2, 2016	747	7.55 -21.96	15.80	6.31	3,882
Vested and anticipated to vest in the future at January 2, 2016	741		15.78	6.30	3,872
Exercisable at January 2, 2016	491		13.95	5.05	3,421

Stock option exercises include "net exercises," pursuant to which the optionee received shares of common stock equal to the intrinsic value of the options (fair market value of common stock on the date of exercise less exercise price) reduced by any applicable withholding taxes.

Restricted stock units. Restricted stock units (“RSUs”) granted under the Company’s equity incentive plans are valued based upon the fair market value on the date of the grant and provide for a dividend equivalent payment which is included in compensation expense. The vesting period for RSUs is generally one year from the date of the grant for RSUs granted to directors and three years from the date of the grant for RSUs granted to employees. RSUs do not have voting rights. RSU compensation expense for the three-month periods ended January 2, 2016 and December 27, 2014 is as follows:

	Three Months Ended	
	January 2, 2016	December 27, 2014
<i>(In thousands)</i>		
Compensation expense	\$ 146	\$ 269

As of January 2, 2016, the remaining unrecognized compensation cost related to unvested RSUs was \$444,000, which is expected to be recognized over a weighted average vesting period of 1.58 years.

The following table summarizes RSU activity during the three-month period ended January 2, 2016:

	Restricted Stock Units Outstanding	Weighted Average Grant Date Fair Value
<i>(Unit amounts in thousands)</i>		
Balance, October 3, 2015	157	\$ 18.96
Granted	-	-
Released	-	-
Balance, January 2, 2016	157	18.96

(7) Income Taxes

Effective income tax rate. The Company's effective income tax rate was 34.6% for the three-month period ended January 2, 2016 compared with 34.5% for the three-month period ended December 27, 2014. The effective income tax rates for both periods were based upon the estimated rate applicable for the entire fiscal year adjusted to reflect any significant items related specifically to interim periods.

Deferred income taxes. In November 2015, the FASB issued ASU No. 2015-17 "Income Taxes (Topic 740) - Balance Sheet Classification of Deferred Taxes" to simplify the presentation of deferred income taxes. Under this update, all deferred tax assets and liabilities, along with any related valuation allowance, are required to be classified as noncurrent on the balance sheet. Effective January 2, 2016, the Company early adopted ASU No. 2015-17 on a prospective basis, which resulted in the reclassification of the Company's current deferred tax asset as a non-current deferred tax liability on its consolidated balance sheet. No prior periods were retrospectively adjusted.

As of January 2, 2016, the Company recorded a non-current deferred tax liability (net of valuation allowance) of \$5.8 million in other liabilities on its consolidated balance sheet. The Company has \$9.3 million of state net operating loss carryforwards ("NOLs") that begin to expire in 2017, but principally expire between 2017 and 2031. The Company has also recorded \$178,000 of gross deferred tax assets for various state tax credits that begin to expire in 2016, but principally expire between 2016 and 2020.

The realization of the Company's deferred tax assets is entirely dependent upon the Company's ability to generate future taxable income in applicable jurisdictions. GAAP requires that the Company periodically assess the need to establish a reserve against its deferred tax assets to the extent the Company no longer believes it is more likely than not that they will be fully realized. As of January 2, 2016 and October 3, 2015, the Company recorded a valuation allowance of \$492,000 pertaining to various state NOLs and tax credits that were not expected to be utilized. The valuation allowance established by the Company is subject to periodic review and adjustment based on changes in facts and circumstances and would be reduced should the Company utilize the state NOLs and tax credits against which an allowance had previously been provided or determine that such utilization was more likely than not.

Uncertainty in income taxes. As of January 2, 2016, the Company has no material, known tax exposures that require the establishment of contingency reserves for uncertain tax positions.

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 2010 remain subject to examination.

(8) Employee Benefit Plans

Retirement plans. The Company has one defined benefit pension plan, the Insteel Wire Products Company Retirement Income Plan for Hourly Employees, Wilmington, Delaware (the “Delaware Plan”). The Delaware Plan provides benefits for eligible employees based primarily upon years of service and compensation levels. The Company’s funding policy is to contribute amounts at least equal to those required by law. The Delaware Plan was frozen effective September 30, 2008 whereby participants no longer earn additional service benefits. The Company made contributions totaling \$49,000 to the Delaware Plan during the three-month period ended January 2, 2016 and expects to contribute an additional \$143,000 during the remainder of the current fiscal year.

Net periodic pension costs for the Delaware Plan for the three-month periods ended January 2, 2016 and December 27, 2014 include the following components:

	Three Months Ended	
	January 2, 2016	December 27, 2014
<i>(In thousands)</i>		
Interest cost	\$37	\$ 33
Expected return on plan assets	(44)	(45)
Recognized net actuarial loss	19	13
Net periodic pension cost	\$12	\$ 1

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

Net periodic pension costs for the SERPs for the three-month periods ended January 2, 2016 and December 27, 2014 include the following components:

	Three Months Ended	
	January 2, 2016	December 27, 2014
<i>(In thousands)</i>		
Service cost	\$66	\$ 72
Interest cost	81	81
Recognized net actuarial loss	21	29
Net periodic pension cost	\$168	\$ 182

(9) Long-Term Debt

Revolving Credit Facility. The Company has a \$100.0 million revolving credit facility (the “Credit Facility”) that is used to supplement its operating cash flow and fund its working capital, capital expenditure, general corporate and growth requirements. In May 2015, the Company amended the Credit Facility to, among other changes, extend the maturity date of the Credit Facility from June 2, 2016 to May 13, 2020. Advances under the Credit Facility are limited to the lesser of the revolving loan commitment amount (currently \$100.0 million) or a borrowing base amount that is calculated based upon a percentage of eligible receivables and inventories. As of January 2, 2016, no borrowings were outstanding on the Credit Facility, \$75.2 million of borrowing capacity was available and outstanding letters of credit totaled \$1.6 million.

Interest rates on the Credit Facility are based upon (1) an index rate that is established at the highest of the prime rate, 0.50% plus the federal funds rate or the LIBOR rate plus the excess of the then-applicable margin for LIBOR loans over the then-applicable margin for index rate loans, or (2) at the election of the Company, a LIBOR rate, plus in either case, an applicable interest rate margin. The applicable interest rate margins are adjusted on a quarterly basis based upon the amount of excess availability on the Credit Facility within the range of 0.25% to 0.75% for index rate loans and 1.25% to 1.75% for LIBOR loans. In addition, the applicable interest rate margins would be increased by 2.00% upon the occurrence of certain events of default provided for under the terms of the Credit Facility. Based on the Company’s excess availability as of January 2, 2016, the applicable interest rate margins on the Credit Facility were 0.25% for index rate loans and 1.25% for LIBOR loans.

The Company’s ability to borrow available amounts under the Credit Facility will be restricted or eliminated in the event of certain covenant breaches, events of default or if the Company is unable to make certain representations and warranties provided for under the terms of the Credit Facility. The Company is required to maintain a fixed charge coverage ratio of not less than 1.10 at the end of each fiscal quarter for the twelve-month period then ended when the amount of liquidity on the Credit Facility is less than \$12.5 million. In addition, the terms of the Credit Facility restrict

the Company's ability to, among other things: engage in certain business combinations or divestitures; make investments in or loans to third parties, unless certain conditions are met with respect to such investments or loans; pay cash dividends or repurchase shares of the Company's stock subject to certain minimum borrowing availability requirements; incur or assume indebtedness; issue securities; enter into certain transactions with affiliates of the Company; or permit liens to encumber the Company's property and assets. The terms of the Credit Facility also provide that an event of default will occur with respect to the Company upon the occurrence of, among other things: defaults or breaches under the loan documents, subject in certain cases to cure periods; defaults or breaches by the Company or any of its subsidiaries under any agreement resulting in the acceleration of amounts above certain thresholds or payment defaults above certain thresholds; certain events of bankruptcy or insolvency with respect to the Company; certain entries of judgment against the Company or any of its subsidiaries, which are not covered by insurance; or a change of control of the Company. As of January 2, 2016, the Company was in compliance with all of the financial and negative covenants under the Credit Facility and there have not been any events of default.

Amortization of capitalized financing costs associated with the Credit Facility was \$16,000 and \$26,000 for the three-month periods ended January 2, 2016 and December 27, 2014, respectively. Accumulated amortization of capitalized financing costs was \$4.5 million as of January 2, 2016 and October 3, 2015.

(10) Earnings Per Share

The computations of basic and diluted earnings per share attributable to common shareholders for the three-month periods ended January 2, 2016 and December 27, 2014 are as follows:

	Three Months Ended	
	January 2, 2016	December 27, 2014
<i>(In thousands except per share amounts)</i>		
Net earnings available to common shareholders	\$6,708	\$ 4,150
Basic weighted average shares outstanding	18,525	18,377
Dilutive effect of stock-based compensation	358	443
Diluted weighted average shares outstanding	18,883	18,820
Net earnings per share:		
Basic	\$0.36	\$ 0.23
Diluted	\$0.36	\$ 0.22

Options representing 86,000 and 25,000 shares for the three-month periods ended January 2, 2016 and December 27, 2014, respectively, were antidilutive and not included in the diluted earnings per share calculation.

(11) Share Repurchases

On November 18, 2008, the Company's board of directors approved a share repurchase authorization to buy back up to \$25.0 million of the Company's outstanding common stock (the "Authorization"). Under the Authorization, repurchases may be made from time to time in the open market or in privately negotiated transactions subject to market conditions, applicable legal requirements and other factors. The Company is not obligated to acquire any particular amount of common stock and the program may be commenced or suspended at any time at the Company's discretion without prior notice. The Authorization continues in effect until terminated by the Board of Directors. As of January 2, 2016, there was \$24.8 million remaining available for future share repurchases under this authorization. No repurchases of common stock were made during the three-month periods ended January 2, 2016 and December 27, 2014.

(12) Other Financial Data

Balance sheet information:

<i>(In thousands)</i>	January 2, 2016	October 3, 2015
Accounts receivable, net:		
Accounts receivable	\$40,945	\$47,420
Less allowance for doubtful accounts	(577)	(638)
Total	\$40,368	\$46,782
Inventories:		
Raw materials	\$38,344	\$38,457
Work in process	2,636	2,968
Finished goods	28,085	24,584
Total	\$69,065	\$66,009
Other current assets:		
Prepaid insurance	\$1,186	\$2,519
Current deferred tax asset	-	1,492
Other	1,361	1,298
Total	\$2,547	\$5,309
Other assets:		
Cash surrender value of life insurance policies	\$7,366	\$7,194
Capitalized financing costs, net	219	227
Other	96	97
Total	\$7,681	\$7,518
Property, plant and equipment, net:		
Land and land improvements	\$9,424	\$9,279
Buildings	43,032	43,016
Machinery and equipment	142,900	142,662
Construction in progress	2,454	1,715
	197,810	196,672
Less accumulated depreciation	(114,666)	(112,494)
Total	\$83,144	\$84,178
Accrued expenses:		
Salaries, wages and related expenses	\$3,122	\$5,455
Income taxes	2,072	2,187
Customer rebates	1,973	1,760
Property taxes	1,460	1,507

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Pension plan	1,222	1,263
Customer advances	665	71
Restructuring liabilities	505	505
Workers' compensation	293	294
Other	721	602
Total	\$12,033	\$13,644

Other liabilities:

Deferred compensation	\$7,853	\$7,765
Deferred income taxes	5,780	6,057
Other	181	376
Total	\$13,814	\$14,198

(13) Business Segment Information

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

(14) Contingencies

Insurance recoveries. On January 21, 2014, a fire occurred at the Company's Gallatin, Tennessee PC strand manufacturing facility, damaging a portion of the facility and requiring the temporary curtailment of operations until the necessary repairs were completed. The Company reassigned a portion of its production requirements to its PC strand facility located in Sanderson, Florida, which was operating at a reduced utilization level. During the first quarter of fiscal 2015, the Company completed the remainder of the repairs and the Gallatin facility was fully operational.

The Company maintained general liability, business interruption and replacement cost property insurance coverage on its facilities that was sufficient to cover the losses incurred from the fire. During the three months ended December 27, 2014, the Company recorded a \$257,000 receivable for the anticipated insurance proceeds related to the costs that were incurred during the period related to the fire which were recorded in cost of sales (\$244,000) and selling, general and administrative expense ("SG&A expense") (\$13,000) on the consolidated statement of operations and comprehensive income. The insurance proceeds attributable to the property and equipment damaged in the fire were reported in cash flows from investing activities and all other insurance proceeds received were reported in cash flows from operating activities on the consolidated statement of cash flows. The Company reached a final settlement with its insurance carrier on this claim during the third quarter of fiscal 2015.

Legal proceedings. The Company is involved in 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,” “appears,” “plans,” “intends,” “may,” “should,” “could” 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, they 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. Many of these risks and uncertainties are discussed in detail, and where appropriate, updated in our periodic and other reports and statements, in particular under the caption “Risk Factors” in our Annual Report on Form 10-K for the year ended October 3, 2015, filed with the U.S. Securities and Exchange Commission (“SEC”). You should carefully review these risks and uncertainties.

All forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by these cautionary statements. All forward-looking statements speak only to the respective dates on which such statements are made and we do not undertake and specifically decline any obligation to publicly release the results of any revisions to these forward-looking statements that may be made to reflect any future events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events, except as may be required by law.

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

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

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

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

the cyclical nature of the steel and building material industries;

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

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

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

changes in United States or foreign trade policy affecting imports or exports of steel wire rod or our products;

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

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

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

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

unanticipated plant outages, equipment failures or labor difficulties;

continued escalation in certain of our operating costs; and

the “Risk Factors” discussed in our Annual Report on Form 10-K for the year ended October 3, 2015 and in other filings that we make with the SEC.

Overview

Insteel Industries, Inc. (“we”, “us”, “our”, “the Company” or “Insteel”) is the nation’s largest manufacturer of steel wire reinforcing products for concrete construction applications. We manufacture and market prestressed concrete strand (“PC strand”) and welded wire reinforcement, including ESM, concrete pipe reinforcement and standard welded wire reinforcement. Our products are sold primarily to manufacturers of concrete products that are used in nonresidential construction. We market our products through sales representatives who are our employees. Our products are sold

nationwide as well as into Canada, Mexico, and Central and South America, and delivered primarily by truck, using common or contract carriers. Our business strategy is focused on: (1) achieving leadership positions in our markets; (2) operating as the lowest cost producer; and (3) pursuing growth opportunities within our core businesses that further our penetration of the markets we currently serve or expand our geographic footprint.

On August 15, 2014, we, through our wholly-owned subsidiary, Insteel Wire Products Company (“IWP”), purchased substantially all of the assets associated with the PC strand business of American Spring Wire Corporation (“ASW”) for a final adjusted purchase price of \$33.5 million (the “ASW Acquisition”). ASW manufactured PC strand at facilities located in Houston, Texas and Newnan, Georgia (see Note 3 to the consolidated financial statements). We acquired, among other assets, the accounts receivable and inventories related to ASW’s PC strand business, the production equipment at its facility in Houston and its production equipment and facility in Newnan. We also entered into an agreement to lease the Houston facility from ASW with an option to purchase it in the future. Subsequent to the acquisition, we elected to consolidate our PC strand operations with the closure of the Newnan facility, which was completed in March 2015.

Results of Operations**Statements of Operations – Selected Data**

(Dollars in thousands)

	Three Months Ended			December	
	January	Change		27,	
	2016		2014		
Net sales	\$92,391	(16.5 %)	\$ 110,628		
Gross profit	16,423	36.4 %	12,043		
<i>Percentage of net sales</i>	<i>17.8 %</i>		<i>10.9 %</i>		
Selling, general and administrative expense	\$6,335	12.1 %	\$ 5,652		
<i>Percentage of net sales</i>	<i>6.9 %</i>		<i>5.1 %</i>		
Restructuring recoveries, net	\$(75)	100.0 %	\$ -		
Other income, net	(114)	N/M	(40)		
Interest expense	41	(56.4 %)	94		
Interest income	(18)	100.0 %	-		
Effective income tax rate	34.6 %		34.5 %		
Net earnings	\$6,708	61.6 %	\$ 4,150		

*"N/M" = not meaningful****First Quarter of Fiscal 2016 Compared to First Quarter of Fiscal 2015****Net Sales*

Net sales for the first quarter of 2016 decreased 16.5% to \$92.4 million from \$110.6 million in the prior year quarter on a 9.0% decrease in shipments and an 8.3% decrease in average selling prices. The reduction in shipments was primarily due to a more pronounced seasonal downturn in the current year quarter partially related to the Company's fiscal calendar. Sales for both periods reflect reduced volumes relative to prerecession levels in our construction end-markets.

Gross Profit

Gross profit for the first quarter of 2016 increased 36.4% to \$16.4 million, or 17.8% of net sales, from \$12.0 million, or 10.9% of net sales, in the prior year quarter. The year-over-year increase was primarily due to higher spreads between average selling prices and raw material costs (\$5.1 million) and, to a much lesser extent, lower unit conversion costs (\$0.1 million) partially offset by the decrease in shipments (\$1.2 million). The increase in spreads was driven by lower raw material (\$13.1 million) and freight costs (\$0.4 million) partially offset by lower average selling prices (\$8.4 million). Gross profit for both periods was unfavorably impacted by reduced shipment volumes and elevated unit conversion costs relative to prerecession levels largely due to reduced operating schedules.

Selling, General and Administrative Expense

Selling, general and administrative expense (“SG&A expense”) for the first quarter of 2016 increased 12.1% to \$6.3 million, or 6.9% of net sales, from \$5.7 million, or 5.1% of net sales, in the same year-ago period as higher compensation expense (\$0.7 million) was partially offset by lower employee benefit costs (\$0.2 million). The increase in compensation expense was largely driven by higher incentive plan expense due to our improved financial results in the current year quarter. The decrease in employee benefit costs was primarily related to lower employee health insurance expense.

Restructuring Recoveries, Net

Net restructuring recoveries of \$75,000 were realized in the first quarter of 2016 related to the consolidation of our PC strand facilities, reflecting a gain on the sale of equipment previously associated with the Newnan, Georgia PC strand facility (\$180,000) partially offset by equipment relocation (\$75,000) and facility closure costs (\$30,000).

Interest Expense

Interest expense for the first quarter of 2016 decreased 56.4% to \$41,000 from \$94,000 in the prior year quarter primarily due to the borrowings on our revolving credit facility during the year-ago period.

Income Taxes

Our effective income tax rate for the first quarter of 2016 was essentially unchanged at 34.6% compared with 34.5% for the prior year quarter.

Net Earnings

Net earnings for the first quarter of 2016 increased to \$6.7 million (\$0.36 per share) from \$4.2 million (\$0.22 per diluted share) in the prior year quarter primarily due to an increase in gross profit partially offset by an increase in SG&A expense.

Liquidity and Capital Resources**Selected Financial Data**

(Dollars in thousands)

	Three Months Ended	
	January	December
	2,	27,
	2016	2014
Net cash provided by (used for) operating activities	\$ 12,391	\$ (9,513)
Net cash used for investing activities	(873)	(2,975)
Net cash provided by financing activities	843	9,449
Net working capital	95,499	92,977
Total debt	-	10,000
<i>Percentage of total capital</i>	-	5.2 %
Shareholders' equity	\$ 189,406	\$ 182,924
<i>Percentage of total capital</i>	100.0 %	94.8 %
Total capital (total debt + shareholders' equity)	\$ 189,406	\$ 192,924

Operating Activities

Operating activities provided \$12.4 million of cash during the first quarter of 2016 primarily from net earnings adjusted for non-cash items and a reduction in the net working capital components of accounts receivable, inventories, and accounts payable and accrued expenses. Net working capital provided \$0.7 million of cash due to a \$6.4 million decrease in accounts receivable partially offset by a \$3.0 million increase in inventories and a \$2.7 million decrease in accounts payable and accrued expenses. The decrease in accounts receivable was primarily related to the seasonal downturn in sales and lower selling prices. The increase in inventory was largely due to the seasonal downturn in sales and a higher proportion of import purchases during the quarter. The decrease in accounts payable and accrued expenses was principally due to lower accrued salaries and wages.

Operating activities used \$9.5 million of cash during the first quarter of 2015 primarily due to an increase in the net working capital components of accounts receivable, inventories, and accounts payable and accrued expenses partially offset by net earnings adjusted for non-cash items. Net working capital used \$17.9 million of cash due to a \$22.7 million decrease in accounts payable and accrued expenses and a \$5.6 million increase in inventories partially offset by a \$10.4 million decrease in accounts receivable. The decrease in accounts payable and accrued expenses was largely due to lower raw material purchases during the latter portion of the quarter and changes in the mix of vendors and payment terms. The increase in inventories was primarily driven by higher raw material purchases. The decrease in accounts receivable was principally due to the usual seasonal downturn in sales.

We may elect to make adjustments in our operating activities as there are changes in the conditions in our construction end-markets, which could materially impact our cash requirements. While a downturn in the level of construction activity adversely affects sales to our customers, it generally reduces our working capital requirements.

Investing Activities

Investing activities used \$0.9 million of cash during the first quarter of 2016 compared to \$3.0 million during the prior year quarter. Capital expenditures for the first quarter of 2016 were \$0.9 million compared with \$3.5 million in the prior year period and are expected to total approximately \$20.0 million for fiscal 2016, including \$9.0 million of outlays related to expansion of our Houston PC strand facility. Our investing activities are largely discretionary, providing us with the ability to significantly curtail outlays should business conditions warrant that such actions be taken.

Financing Activities

Financing activities provided \$0.8 million of cash during the first quarter of 2016 compared to \$9.4 million during the prior year quarter. Stock option exercises provided \$1.5 million of cash during the current quarter, which was partially offset by the payment of \$0.6 million of cash dividends. Additionally, in December 2015 we declared a special cash dividend totaling \$18.6 million, or \$1.00 per share, that was paid in the second quarter of fiscal 2016. In the prior year quarter, net borrowings on our revolving credit facility provided \$10.0 million of cash, which was partially offset by the payment of \$0.6 million of cash dividends.

Cash Management

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

Credit Facility

We have a \$100.0 million revolving credit facility (the "Credit Facility") that is used to supplement our operating cash flow and fund our working capital, capital expenditure, general corporate and growth requirements. In May 2015, we amended the Credit Facility to, among other changes, extend the maturity date from June 2, 2016 to May 13, 2020. As of January 2, 2016, no borrowings were outstanding on the Credit Facility, \$75.2 million of borrowing capacity was available and outstanding letters of credit totaled \$1.6 million.

We believe that, in the absence of significant unanticipated cash demands, cash and cash equivalents, net cash generated by operating activities, and the borrowing availability provided under the Credit Facility will be sufficient to satisfy our expected requirements for working capital, capital expenditures, dividends and share repurchases, if any. We expect to have access to the amounts available under the Credit Facility as required. However, deterioration in our construction end-markets could result in reduced demand from our customers, which would likely reduce our operating cash flows. Under such circumstances, we may need to curtail capital and operating expenditures, delay or restrict share repurchases, cease dividend payments and/or realign our working capital requirements.

Should we determine, at any time, that we required additional short-term liquidity, we would evaluate the alternative sources of financing that were potentially available to provide such funding. There can be no assurance that any such financing, if pursued, would be obtained, or if obtained, would be adequate or on terms acceptable to us. However, we believe that our strong balance sheet, flexible capital structure and borrowing capacity available to us under the Credit

Facility position us to meet our anticipated liquidity requirements for the foreseeable future.

Seasonality and Cyclical

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

Impact of Inflation

We are subject to inflationary risks arising from fluctuations in the market prices for our primary raw material, hot-rolled steel wire rod, and, to a much lesser extent, freight, energy and other consumables that are used in our manufacturing processes. We have generally been able to adjust our selling prices to pass through increases in these costs or offset them through various cost reduction and productivity improvement initiatives. However, our ability to raise our selling prices depends on market conditions and competitive dynamics, and there may be periods during which we are unable to fully recover increases in our costs. Inflation did not have a material impact on our sales or earnings during the first fiscal quarter of 2016. The timing and magnitude of any future increases or decreases in the prices for wire rod and the impact on selling prices for our products is uncertain at this time.

