INSTEEL INDUSTRIES INC
Form 10-Q
July 28, 2011

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

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

For the Quarterly Period Ended July 2, 2011

OR

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

For the Transition Period From __________ to __________

Commission File Number: 1-9929

Insteel Industries, Inc.

(Exact name of registrant as specified in its charter)

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

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

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

Yes þ No o

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

Yes þ No o

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

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

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

Yes o No þ

The number of shares outstanding of the registrant s common stock as of July 27, 2011 was 17,615,200.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

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

	Three Months Ended		Nine Months Ended	
	July 2, 2011	July 3, 2010	July 2, 2011	July 3, 2010
Net sales	$ 98,579	$ 61,956	$ 237,818	$ 155,425
Cost of sales	86,050	54,266	213,821	137,841
Inventory write-downs				1,933
Gross profit	12,529	7,690	23,997	15,651
Selling, general and administrative expense	4,947	4,317	13,638	12,241
Restructuring charges	1,970		8,573	
Acquisition costs			3,518	
Bargain purchase gain			(500)	
Other income, net	(27)	(2)	(96)	(252)
Interest expense	260	116	664	411
Interest income	(18)	(45)	(37)	(71)
Earnings (loss) from continuing operations before income taxes	5,397	3,304	(1,763)	3,322
Income taxes	1,747	1,680	(404)	1,177
Earnings (loss) from continuing operations	3,650	1,624	(1,359)	2,145
Loss from discontinued operations net of income taxes of $- , ($12), $- and ($26)		(19)		(42)
Net earnings (loss)	$ 3,650	$ 1,605	$ (1,359)	$ 2,103
Per share amounts:				
Basic:				
Earnings (loss) from continuing operations	$ 0.21	$ 0.09	$ (0.08)	$ 0.12
Loss from discontinued operations				
Net earnings (loss)	$ 0.21	$ 0.09	$ (0.08)	$ 0.12
Diluted:				
Earnings (loss) from continuing operations	$ 0.20	$ 0.09	$ (0.08)	$ 0.12
Loss from discontinued operations				
Net earnings (loss)	$ 0.20	$ 0.09	$ (0.08)	$ 0.12

Cash dividends declared	$ 0.03	$ 0.03	$ 0.09	$ 0.09
Weighted average shares outstanding				
Basic	17,587	17,492	17,550	17,454
Diluted	17,855	17,695	17,550	17,661

See accompanying notes to consolidated financial statements.

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

	(Unaudited) July 2, 2011	October 2, 2010
Assets		
Current assets:		
Cash and cash equivalents	$ 2,009	$ 45,935
Accounts receivable, net	43,691	24,970
Inventories, net	70,454	43,919
Other current assets	5,699	3,931
Total current assets	121,853	118,755
Property, plant and equipment, net	90,018	58,653
Other assets	6,077	5,097
Total assets	$ 217,948	$ 182,505
Liabilities and shareholders equity		
Current liabilities:		
Accounts payable	$ 41,952	$ 20,689
Accrued expenses	8,267	5,929
Current portion of long-term debt	675	
Current liabilities of discontinued operations		210
Total current liabilities	50,894	26,828
Long-term debt	12,825	
Other liabilities	7,381	7,521
Long-term liabilities of discontinued operations		280
Commitments and contingencies		
Shareholders equity:		
Common stock	17,615	17,579
Additional paid-in capital	47,828	45,950
Retained earnings	83,714	86,656
Accumulated other comprehensive loss	(2,309)	(2,309)
Total shareholders equity	146,848	147,876
Total liabilities and shareholders equity	$ 217,948	$ 182,505

See accompanying notes to consolidated financial statements.

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

	Nine Months Ended July 2, 2011	Nine Months Ended July 3, 2010
Cash Flows From Operating Activities:		
Net earnings (loss)	$ (1,359)	$ 2,103
Loss from discontinued operations		42
Earnings (loss) from continuing operations	(1,359)	2,145
Adjustments to reconcile earnings (loss) from continuing operations to net cash provided by (used for) operating activities of continuing operations:		
Depreciation and amortization	7,062	5,230
Amortization of capitalized financing costs	61	342
Stock-based compensation expense	1,898	1,604
Asset impairment charges	4,135	
Inventory write-downs		1,933
Excess tax benefits from stock-based compensation	(81)	(3)
Loss (gain) on sale of property, plant and equipment	(10)	13
Deferred income taxes	(474)	(439)
Gain from life insurance proceeds	(357)	
Increase in cash surrender value of life insurance policies over premiums paid	(357)	(10)
Net changes in assets and liabilities (net of assets and liabilities acquired):		
Accounts receivable, net	(18,721)	(7,167)
Inventories	(5,950)	(5,206)
Accounts payable and accrued expenses	15,587	83
Other changes	(1,529)	14,167
Total adjustments	1,264	10,547
Net cash provided by (used for) operating activities continuing operations	(95)	12,692
Net cash used for operating activities discontinued operations		(73)
Net cash provided by (used for) operating activities	(95)	12,619
Cash Flows From Investing Activities:		
Acquisition of business	(37,308)	
Capital expenditures	(6,292)	(1,249)
Proceeds from life insurance claims	1,063	
Proceeds from sale of property, plant and equipment	164	
Increase in cash surrender value of life insurance policies	(460)	(440)
Proceeds from surrender of life insurance policies	19	
Net cash used for investing activities continuing operations	(42,814)	(1,689)

Net cash used for investing activities	(42,814)	(1,689)
Cash Flows From Financing Activities:		
Proceeds from long-term debt	12,607	231
Principal payments on long-term debt	(12,607)	(231)
Financing costs		(395)
Cash received from exercise of stock options	21	140
Excess tax benefits from stock-based compensation	81	3
Cash dividends paid	(1,055)	(1,580)
Other	(64)	(30)
Net cash used for financing activities continuing operations	(1,017)	(1,862)
Net cash used for financing activities	(1,017)	(1,862)
Net increase (decrease) in cash and cash equivalents	(43,926)	9,068
Cash and cash equivalents at beginning of period	45,935	35,102
Cash and cash equivalents at end of period	$ 2,009	$ 44,170
Supplemental Disclosures of Cash Flow Information:		
Cash paid during the period for:		
Interest	$ 439	$ 69
Income taxes, net	654	186
Non-cash investing and financing activities:		
Purchases of property, plant and equipment in accounts payable	7	197
Declaration of cash dividends to be paid	528	
Restricted stock surrendered for withholding taxes payable	86	52
Note payable issued as consideration for business acquired	13,500	
Post-closing purchase price adjustment for business acquired	500	

See accompanying notes to consolidated financial statements.

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

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders Equity
Balance at October 2, 2010	17,579	$ 17,579	$ 45,950	$ 86,656	$ (2,309)	$ 147,876
Comprehensive loss:						
Net loss				(1,359)		(1,359)
Comprehensive loss						(1,359)
Stock options exercised	13	13	8			21
Vesting of restricted stock units	30	30	(30)			
Compensation expense associated with stock-based plans			1,898			1,898
Excess tax benefits from stock-based compensation			81			81
Restricted stock surrendered for withholding taxes payable	(7)	(7)	(79)			(86)
Cash dividends declared				(1,583)		(1,583)
Balance at July 2, 2011	17,615	$ 17,615	$ 47,828	$ 83,714	$ (2,309)	$ 146,848

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, t Company or Insteel) have been prepared pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (SEC) for quarterly reports on Form 10-Q. Certain information and note disclosures normally included in the audited financial statements prepared in accordance with accounting principles generally accepted in the United States (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 2, 2010 consolidated balance sheet was derived from the audited consolidated financial statements at that date, but does not include all of the information and footnotes required by 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 2, 2010 included in the Company s Annual Report on Form 10-K filed with the SEC.

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

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

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

(2) Recent Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board (FASB) issued an update that amends the guidance provided in Accounting Standards Codification (ASC) Topic 220, *Comprehensive Income*, by requiring that all nonowner changes in shareholders equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This update will be effective for the Company s first quarter of fiscal 2013.

In May 2011, the FASB issued an update that amends the guidance provided in ASC Topic 820*, Fair Value Measurement*, by clarifying some existing concepts, eliminating wording differences between GAAP and International Financial Reporting Standards (IFRS), and in some limited cases, changing some principles to achieve convergence between GAAP and IFRS. The update results in a consistent definition of fair value, establishes common requirements for the measurement of and disclosure about fair value between GAAP and IFRS, and expands the disclosures for fair value measurements that are estimated using significant unobservable (Level 3) inputs. This update will be effective for the Company s second quarter of fiscal 2012. The Company does not expect the adoption of this update to have a material impact on its consolidated financial statements.

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

(3) Business Combination

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

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

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

(In thousands)	
Assets acquired:	
Inventories	$ 20,585
Property, plant and equipment	37,211
Total assets acquired	$ 57,796
Liabilities assumed:	
Accounts payable	$ 6,263
Accrued expenses	725
Total liabilities assumed	6,988
Net assets acquired	50,808
Purchase price	50,308
Bargain purchase gain	$ 500

Accounting standards require that when the fair value of the net assets acquired exceeds the purchase price, resulting in a bargain purchase gain, the acquirer must reassess the reasonableness of the values assigned to all of the assets acquired, liabilities assumed and consideration transferred. The Company has performed such a reassessment and has concluded that the values assigned for the Ivy Acquisition are reasonable. Consequently, the Company has recorded a $500,000 bargain purchase gain on the Ivy Acquisition.

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

Following the Ivy Acquisition, net sales for the Ivy facilities for the three- and nine-month periods ended July 2, 2011 were approximately $26.8 million and $50.2 million, respectively. The actual amount of net sales specifically attributable to the Ivy Acquisition, however, cannot be quantified due to the integration actions that have been taken by the Company involving the transfer of business between the former Ivy facilities and the Company s existing facilities. The Company has determined that the presentation of Ivy s earnings for the three- and nine-month periods ended July 2, 2011 is impractical due to the integration of Ivy s operations into the Company following the Ivy Acquisition.

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

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	Three Months Ended		Nine Months Ended	
(In thousands)	**July 2, 2011**	**July 3, 2010**	**July 2, 2011**	**July 3, 2010**
Net sales	$ 98,579	$ 91,146	$ 254,529	$ 226,524
Earnings (loss) from continuing operations before income taxes	5,397	694	(1,003)	(12,758)
Net earnings (loss)	3,650	32	(786)	(8,334)

(4) Restructuring Charges and Acquisition Costs

Restructuring charges. Subsequent to the Ivy Acquisition, the Company elected to consolidate certain of its welded wire reinforcement operations in order to reduce its operating costs, which involved the closure of facilities in Wilmington, Delaware and Houston, Texas. These actions were taken in response to the close proximity of Ivy s facilities in Hazleton, Pennsylvania and Houston, Texas to the Company s existing facilities in Wilmington, Delaware and Dayton, Texas. The Houston plant closure was completed in December 2010 and the Wilmington plant closure was completed in May 2011.

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

(In thousands)	**Severance and other employee costs**	**Asset impairment**	**Facility closure costs**	**Equipment relocation**	**Total**
Restructuring charges	$ 979	$ 2,868	$ 533	$ 10	$ 4,390
Cash payments	(310)		(75)	(10)	(395)
Non-cash charges		(2,868)			(2,868)
Liability as of January 1, 2011	$ 669	$	$ 458		